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National Public Finance Guarantee Corp.

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National Public Finance Guarantee Corp.

Rationale

Financial Strength Rating
Local Currency
AA-/Stable/--

Business Risk Profile

- Strong competitive position, reflecting the company's ability to add value to the market and grow its market share
- Satisfactory management and corporate strategy given its knowledgeable management team and targeted marketing and new business strategy
- Low insurance industry and country risk assessment

Financial Risk Profile

- Capital adequacy ratio greater than 1.0X
- Investment portfolio presents low risk to the financial risk profile
- Largest obligor violation
- Strong operating performance because of a prospective view it will demonstrate favorable operating metrics as it continues writing new business
- Financial flexibility is neutral to the rating

Factors Specific to the Holding Company

- MBIA Inc.'s rating reflects its structural subordination to its regulated operating subsidiaries, specifically National Public Finance Guarantee Corp.

Other Assessments

- Adequate enterprise risk management (ERM) with strong risk controls
- Strong liquidity, reflecting highly liquid assets and full coverage of liquidity needs in the short term
- Rating adjusted up one notch based on expectation of adding value to the industry and its risk-adjusted pricing ratio and operating performance will be in line with peers

Outlook

The outlook is stable reflecting National's very strong capital adequacy and prospective strong competitive position. Standard & Poor's Rating Services expects National will continue gaining market share, gradually at first and at increasing rates once it gains more visibility in the primary market. We also expect the company will effectively manage its expenses as it grows its premiums and expands its team.

Downside scenario

We may lower our ratings if the company does not demonstrate sustainable growth in market share, its capital adequacy deteriorates as a result of earnings or claims volatility, or if the municipal risk-adjusted pricing (RAP) ratio deteriorates.

Upside scenario

We may raise our ratings if the company demonstrates successful execution of its strategic risk management program and optimization of risk-adjusted returns, as well as a sustainable competitive position relative to peers.

Base-Case Scenario

Company-Specific Assumptions

- Capital adequacy ratio greater than 1.0x
- Municipal risk adjusted pricing ratio greater than 4.0%
- Prospective combined ratio less than 100%

Company Description

National Public Finance Guarantee Corp. is a wholly owned subsidiary of MBIA Inc. and provides financial guarantees to U.S. public finance issuances, with the majority of new business expected in the general obligation, tax-backed, and revenue bond sectors.

In February 2009, MBIA Inc. announced a restructuring plan whereby separate legal entities were created within MBIA Inc., and National (formerly MBIA Illinois) became a sister company of other MBIA Inc. entities. National had assumed the U.S. public finance book of business previously part of MBIA Insurance Corp. (MBIA Corp.) on a reinsurance cut through basis.

Business Risk Profile

The score for the company's adjusted competitive position is '3' and the industry risk is '2', leading to a business risk profile score of '2'.

Insurance industry and country risk: Operating in stable markets

We believe National faces low industry and country risk. Our view of National's very low country risk stems from the potentially higher-income nature of the markets in which National operates and their relatively effective and stable political institutions, sophisticated financial systems, and strong payment culture (especially in the U.S.). We believe National's financial guarantee operations are exposed to low industry risks because of high barriers to entry and moderate product risk. The U.S. financial guarantee market's growth prospects and overall institutional framework further support the low industry risk assessment.

Competitive position: Strong, well-diversified U.S. public finance underwriting strategy

We continue to view National's competitive position as strong, with a prospective view that the company will continue to grow its market share and have the ability to provide added value to the U.S. public finance market. Its flexibility in writing a variety of exposures will allow it to take advantage of additional opportunities. Although the company did not write a meaningful amount of new business in 2014, it has demonstrated favorable trading values of its bonds as compared with those that went uninsured. It has also demonstrated increasing market share and visibility in the market in first-quarter 2015.

Table 1

National Public Finance Guarantee Corp. -- Portfolio Statistics*

		--Year ended Dec. 31--			
(Mil. $)	**% of par 2014**	**Net Par 2014**	**Net Par 2013**	**Net Par 2012**	**Net Par 2011**
Public finance					
General obligation	44.42	96,501	122,240	149,864	184,475
Utility	17.75	38,555	49,157	60,019	70,888
Tax-backed	12.27	26,654	33,793	42,841	46,737
Hospitals	2.30	4,990	5,673	7,259	9,932
Transportation	9.27	20,133	24,131	29,014	37,535
Colleges and universities	5.78	12,568	15,157	18,577	22,047
Investor-owned utilities	0.83	1,812	2,147	2,688	5,902
Housing	4.64	10,088	10,935	12,310	13,573
Special revenue	1.84	3,996	5,684	5,710	6,248
Other	0.90	1,952	2,188	2,563	1,264
Total	100.00	217,248	271,105	330,845	398,602

*U.S. statutory basis

National wrote $343 million of gross par during the year. During the three months ending March 31, 2015, National insured an additional $38 million. The company's existing book of business, at $205 billion net par outstanding, also provides additional visibility as it trades insured bonds in the marketplace. The company's insured portfolio is also well diversified by sector and geography, and we expect the company to have a more granular portfolio going forward given its single risk limits in place.

Since National reentered the market last year, management has made some key new hires, is looking to expand the team further, and has put together targeted marketing and new business plans based on the market research.

Management and corporate strategy: Significant knowledge of the U.S. municipal market and a history of writing profitable U.S. public finance business

We view National's management and corporate strategy as satisfactory. The management team has successfully resolved all litigation, and the company was able to reenter the market last year. The company made all claims payments and successfully remediated distressed credits while inactive. We believe National's management team has significant knowledge of the municipal market and has a history of writing profitable U.S. public finance business. The team has incorporated lessons learned as part of its underwriting guidelines as well as new business selection.

Management is focused on increasing new business activity where there are opportunities for appropriate returns as well as having developed a targeted marketing and new business strategy. The company is also looking to expand the team, and management has added key new hires in business development.

We have not identified any governance deficiencies in our assessment.

Financial Risk Profile

The company's final capital adequacy score is '2' and the operating performance score is '3', leading to a financial risk profile score of '2'.

Capital adequacy: Very strong

National's capital adequacy is extremely strong, with a capital adequacy ratio in excess of 1.0x. The capital adequacy ratio expresses the relationship between losses the capital adequacy model generates and capital remaining at the end of a theoretical economic depression.

Table 2

National Public Finance Guarantee Corp. -- Capital Statistics*					
	--Year ended Dec. 31--				
(Mil. $)	**2014**	**2013**	**2012**	**2011**	**2010**
Portfolio risk					
Municipal insurance weighted average capital charge (% of average annual debt service)	17.35	15.88	16.37	16.04	16.05
Model capital inputs					
Statutory capital	3,266	3,257	3,248	2,809	2,381
Unearned premiums	1,375	1,678	2,041	2,485	2,873
Loss reserves	(13)	(87)	(109)	(3)	96
Present value of instalment premiums	216	225	217	239	282
Capital adequacy					
Capital adequacy ratio (x)	>1.00	>1.00	>1.00	0.65-0.80	0.65-0.80
Reliance on soft capital (%)	1.5	2.0	2.5	3.5	1.5
*U.S. statutory basis. Capital adequacy results for 2012 and 2011 are based on the release of updated bond insurance criteria on Aug. 25, 2011.					

The capital adequacy results include the downgrades of various issuers within Puerto Rico that occurred after year-end 2014. Further analysis indicates that there would be no change in National's capital adequacy score if there were a default by multiple issuers over a one, two, or three year time period without accounting for any other factors. Although the reported exposure to issuers within Puerto Rico may be large relative to statutory capital, claim payments are made over time based on the payment schedule of the insured issue. We will continue monitoring the situation as it develops in Puerto Rico and the impact it has on National. Additionally, National's repurchase of MBIA Inc.'s common stock from Warburg Pincus in May 2015 does not result in a change to the company's capital adequacy score.

As a result of elevated refunding activity and ordinary amortizations, National continues to deleverage its insured portfolio. As new business is gradually placed, we expect National to maintain capital adequacy ratio at greater than 1.0x.

As of Dec. 31, 2014, National had a number of largest obligors test violations, which weakened the capital adequacy score.

Investment risk modifier: Neutral to the financial risk profile

We believe National's investment portfolio continues to present low risk to its capital. The investment portfolio is well diversified, highly liquid, and of high credit quality. The company maintains its focus on fixed income and taxable investments consisting of 'AA' average credit quality corporates (31%), municipals (29%), and agency mortgages (25%).

As of March 31, 2015, the company's fixed-income investment portfolio totaled $4.5 billion, consisting of 2% tax-exempt, 89% taxable, and 9% short-term. The long-term fixed-income portfolio continues to be of high credit quality as evidenced by 43% of investments in the 'AAA' category as of March 31, 2015 (33% in 'AA').

The company continues to participate in the asset-swap facility with MBIA Inc., but has significantly reduced it to $385 million as of March 31, 2015 from a high of $1.8 billion as of Dec. 31, 2009.

Operating performance: Expected favorable operating metrics in writing new business

We view National's operating performance as strong given our prospective view that as the company writes more meaningful amounts of business, it will demonstrate favorable operating metrics in line with peers' and maintain prudent underwriting and a U.S. public finance RAP of at least 4.0%.

Table 3

National Public Finance Guarantee Corp. Operating Performance*

	--Year ended Dec. 31--				
(%)	**2014**	**2013**	**2012**	**2011**	**2010**
Operating return on equity (National, GAAP)	5.1	4.31	7.60	9.00	10.90
Statutory combined ratio	N.M.	N.M.	N.M.	N.M.	70.91
Statutory loss ratio	27.9	18.30	5.53	1.33	14.46
Statutory expense ratio	N.M.	N.M.	N.M.	N.M.	56.45
Statutory return on revenue	68.2	71.20	75.87	88.75	80.44
Insured portfolio speculative grade exposure	2.5	1.66	0.85	0.69	0.57

*U.S. statutory basis. N.M. -- Not meaningful

National reentered the market in third-quarter 2014 and wrote $343 million of gross par during the year. During the three months ending March 31, 2015, National insured an additional $38 million. Additionally, the company continues to earn premium from its book of business, albeit at reduced amounts as the book amortizes at an accelerated rate as a result of refunding activity in addition to scheduled amortization. We expect earned premiums from the existing book will continue supporting earnings as new business writings gradually grow. The company also reported reduced net investment income as a result of a lower investment yield year-over-year as the higher-yielding intercompany loan was repaid.

Table 4

National Public Finance Guarantee Corp. -- Financial Statistics*					
	--Year ended Dec. 31--				
(Mil. $)	**2014**	**2013**	**2012**	**2011**	**2010**
Total assets	5,142.4	5,340.4	5,726.2	6,656.1	7,290.0
Cash and invested assets	5,087.3	5,266.4	5,646.1	6,594.8	7,221.4
Net premiums earned	316.4	374.8	439.3	365.8	362.5
Losses and loss adjustment expense	88.2	66.7	24.3	4.9	52.4
Underwriting expense	49.9	76.2	133.8	60.3	75.2
Investment income incl. gains/(losses)	129.9	162.0	286.5	304.8	257.0
Net income	238.1	256.0	415.5	477.9	408.8

*U.S. statutory basis

As National grows its premiums and expands its team, we expect it will be able to effectively manage expenses and demonstrate and sustain a combined ratio of less than 100%.

Financial flexibility: Neutral to the financial risk profile

We view financial flexibility as neutral to the rating, driven by our favorable view of MBIA Inc.'s access to capital and liquidity. We believe the market will look to National as the group's main contributor of funds. In 2014, National contributed a $220 million dividend to MBIA Inc., as well as $79 million to the Tax Escrow Account. MBIA Inc. is targeting significant improvements in leverage with annual takedowns.

We do not expect National to face any significant immediate claims payments given its overall high quality book of business, with approximately 85% of gross par outstanding in the 'AA' and 'A' range as of March 31, 2014. Any claim payments will also be made over time, and we believe National has adequate liquidity to cover them in the near term while pursuing remediation.

Other Assessments

Enterprise risk management: Adequate with strong risk controls

We view National's ERM framework as in line with our view of the group's overall ERM score, as our analysis examines risk management practices across the overall enterprise. Our view reflects a positive assessment of the company's underwriting, surveillance, and loss mitigation risk controls, which we believe are the material risks. These are partially offset by our neutral view of strategic risk management. The company has put in place risk limits for single obligor, sector, and geographic exposure that guide underwriting along with identified emerging risks and feedback from the remediation and surveillance groups. The company aims to have early involvement in deteriorating credits, has a dedicated workout unit for this purpose, and has successfully remediated stressed credits even while it was not writing new business. Although management has a new business growth and underwriting strategy in place, we look for evidence of execution of its strategic risk management program and optimization of risk-adjusted returns as the company writes new business.

Liquidity

We view National's liquidity as strong, reflecting its highly liquid assets, full coverage of liquidity needs in the short term, and lack of any credit-sensitive liabilities or collateral-posting requirements. As of Dec. 31, 2014, National held $528 million of cash and highly liquid short-term investments. We also expect as the company begins to write more meaningful amounts of business, its underwriting cash flow ratio will improve.

Table 5

National Public Finance Guarantee Corp. -- Liquidity Statistics*

	--Year ended Dec. 31--				
(%)	**2014**	**2013**	**2012**	**2011**	**2010**
Underwriting cash flow ratio	N.M.	N.M.	N.M.	N.M.	95.92
Liquid assets	98.7	94.1	94.0	75.0	100.0
High-risk assets and below A-	4.2	1.4	3.1	6.0	2.0
Cash and short-term assets to loss payable ratio	3,014.0	2,188.1	897.4	858.0	260.9

*U.S. statutory basis. N.M. -- Not meaningful

Factors Specific To The Holding Company

Our rating on MBIA Inc. reflects its structural subordination to its regulated operating subsidiaries, specifically National. We view National as the principal source of debt-servicing and holding-company expense needs. In addition to National's dividend payments, the continued estimated tax escrow releases related to the tax-sharing agreement also support MBIA Inc.'s liquidity.

Table 6

MBIA Inc.-- Financial Statistics (GAAP)

	--Year ended Dec. 31--				
(x)	**2014**	**2013**	**2012**	**2011**	**2010**
Fixed-charge coverage	1.4	N.M.	N.M.	N.M.	N.M.
Financial leverage (%)	28.5	30.0	30.8	31.7	32.7

N.M. -- Not meaningful

Accounting Considerations

National's accounting policies are consistent with industry standards and are neutral to the rating. The company files financial statements under both generally accepted accounting principles (GAAP) and statutory accounting principles.

MBIA Inc. files consolidated statements according to U.S. GAAP.

The Financial Accounting Standards Board Accounting Standards Codification (ASC) 810 "Consolidation" addresses whether certain legal entities often used in securitization and other structured finance transactions should be included in consolidated financial statements of any particular interested party. The remediation rights MBIA Corp. may gain once an insured structured-finance transaction experiences stress may give MBIA Corp. power over the most significant activities of the special-purpose entity (SPE). As a result, assets and liabilities of the insured transaction may be consolidated on MBIA Inc.'s balance sheet. We do not view consolidation of transactions as indicating different or incremental risk relative to the company's nonconsolidated insurance exposure. From a risk perspective, we assess the guaranteed transactions a capital charge for capital adequacy modeling purposes. Because of this, we do not include the debt associated with SPEs in any leverage calculations or fixed-charge coverage ratios.

ASC 944 "Financial Services-Insurance" prescribes loss-reserve practices for financial guarantors. Under that accounting, loss reserves are booked on an expected loss basis to the extent that losses exceed the unearned premium return. We evaluate the strength of the financial guarantors using the financial statements prepared under statutory accounting principles, when reserves are booked when a loss is incurred. In addition, we estimate theoretical losses in a severe economic environment, which may be greater than current losses, to evaluate the adequacy of the bond insurer's claims-paying resources.

ASC 820 "Fair Value Measurements and Disclosures," the valuation of MBIA Inc.'s derivative liabilities, must take into account the market's perception of MBIA Corp.'s nonperformance risk by incorporating the spreads of MBIA Corp.'s CDS. From a ratings perspective, the market's perception of MBIA Corp.'s ability to settle its obligations does not relieve it of its requirement to pay, and MBIA Corp. cannot transfer the obligation at the market value. Any gains taken from the deterioration in MBIA Inc.'s own creditworthiness are not considered economic or real for the purposes of our ratings analysis. We do not factor in any market-based gyration unrelated to fundamental credit deterioration when considering capital and earnings.

We adjusted the leverage and return ratios we used for MBIA Inc. for the impact of ASC 810 and 820. The theoretical losses mentioned in the discussion of ASC 944 are included in the capital adequacy analysis in the capital adequacy section.

Related Criteria And Research

- Group Rating Methodology, Nov. 19, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Bond Insurance Rating Methodology And Assumptions, Aug. 25, 2011
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings Detail (As Of June 29, 2015)	
National Public Finance Guarantee Corp.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Counterparty Credit Rating	
Local Currency	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/--/--
Related Entities	
MBIA Inc.	
Issuer Credit Rating	
Local Currency	A-/Stable/--
Senior Unsecured	A-
Municipal Bond Insurance Assn.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Holding Company	MBIA Inc.
Domicile	New York

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.