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Market Disruption Provides Pricing Opportunity For Some Bond Insurers

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The risk-adjusted pricing indices associated with bond insurers that underwrote at least a billion dollars of par in the first half of 2008 illustrate the effects of a financial guarantee market in flux. While insured new-issue volume is significantly lower in all business lines, it appears insured secondary market transaction volume and pricing are the strongest they have ever been. The risk-adjusted pricing index is a measure that shows how much premium has been charged per unit of risk.

Standard & Poor's Ratings Services believes that new business prospects for existing insurers as well as new entrants are uncertain given that, while the U.S. public finance new-issue market was active in the first half of the year, the insured penetration rate was significantly reduced -- and is likely to remain so for the next several years -- and the structured finance business for the insurers is dormant. We expect that disciplined underwriting will be key for the bond insurers going forward as they develop a book of business that has strong risk/reward characteristics that may generate earnings well into the future.

The risk-adjusted pricing indices are calculated by Standard & Poor's for financial guarantees written in a given period (usually one year) for each of the four broad financial guaranty business lines: U.S. public finance, U.S. structured finance, international public finance, and international structured finance. A book of businesses' weighted average premium rate is divided by its weighted average capital charge, to produce the risk-adjusted pricing index. Capital charges are assigned to all insured transactions and are used to determine theoretical losses in Standard & Poor's capital adequacy model.

Risk-Adjusted Pricing Trends

The insured volume trends in each of the three business lines for which there was a meaningful amount of business underwritten highlight a refocus of strategies by bond insurers toward the lower-risk public finance market and away from the higher-risk structured finance market. In the U.S. public finance segment, pricing was strong due in large part to the lack of competition. While Financial Security Assurance Inc. (FSA) and Assured Guaranty Corp. (AGC) have garnered the lion's shares of the new-issue market, FSA, AGC, and Berkshire Hathaway Assurance Corp. have insured a significant amount of secondary transactions. All three companies have also insured transactions that were already wrapped by a lower-rated bond insurer. Although pricing has been strong, a shrinking municipal market, combined with the possible entry of new competitors, will likely pressure pricing in our view.

Reflecting the current disruption for most sectors in the U.S. structured finance market, first-half 2008 insured volume was down substantially. Those sectors experiencing the greatest decline in volume included pooled debt and mortgage-backed and home equity line of credit. What little business was written occurred in the consumer receivables sector that includes auto loan and credit-card receivables. With little competition and insurers being very selective in what they underwrite, pricing was very robust and the quality of underwriting, as measured by Standard & Poor's capital charges, was sound. For this business line, we believe that pricing may remain strong and underwriting quality sound because of the limited number of participants as most insurers have restricted underwriting in this line.

In the international structured finance business line, most of the production in the first half of 2008 was in the mortgage-backed and home equity sector, compared with a concentration in the corporate collateralized debt obligation (CDO) sector for the same period in 2007. Insured par production has long been dominated by private placement corporate CDOs due to what appears to be limited acceptance in capital markets of the financial guaranty product, as illustrated by historically low insured par volume. The global capital markets' wariness of the financial guarantors, combined with a pullback by the insurers in insuring CDOs, may all but close them out of this market in our view. Proposed insurance regulation may also limit, if not prohibit, activity in CDO sector.

The insured international public finance market has been slow to develop for the financial guarantors, with volume production in the first half of 2008 being nearly nonexistent, and for that reason the risk-adjusted pricing data for this business line is not included in the tables below.

In the past, Standard & Poor's has published comprehensive reports on risk-adjusted pricing for each business line commenting on each company's performance and strategy, and trend and prospects for the industry. In 2008, the limited number of active financial guarantors and low business production make indentifying and commenting on trends very difficult. What can be said is that, in our view, the bond insurance industry has been significantly impaired by the impact of actual losses paid and reserves set aside for bond insurers' exposure to 2005-2007 vintage direct and indirect residential mortgage-based securities transactions.

We believe there may be increased demand for bond insurance in the future but that it will take time and will depend on the insurers' capital strength and ability to achieve a sustainable business and operating profile, which then may lead to stable, high investment-grade ratings.

Table 1

U.S. Public Finance Premium Rate And Economic Trends							
(Mil \$)	Six months ended						
	June 30, 2008	June 30, 2008	2007	2006	2005	2004	2003
Ambac Assurance Corp.							
Gross P&I written	2,370	59,072	125,802	85,427	100,521	82,473	81,287
Adjusted gross premium written	14	301	653	442	613	566	750
Implied premium rate (%)	0.58	0.51	0.52	0.52	0.61	0.69	0.92
Gross per period capital charge (%)	11.03	10.50	10.15	11.17	10.55	10.94	11.83
Profitability index (%)	5.26	4.86	5.11	4.64	5.78	6.28	7.80
Assured Guaranty Corp. (Direct only)							
Gross P&I written	37,448	2,631	8,142	3,440	2,054	353	N.A.
Adjusted gross premium written (307	24	60	36	24	6	N.A.
Implied premium rate (%)	0.82	0.92	0.74	1.04	1.17	1.61	N.A.
Gross per period capital charge (%)	11.18	15.96	13.32	18.21	21.51	28.72	N.A.
Profitability index (%)	7.32	5.77	5.54	5.69	5.43	5.62	N.A.
Berkshire Hathaway Assurance Corp.							
Gross P&I written	16,475	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Adjusted gross premium written	202	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Implied premium rate (%)	1.22	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Gross per period capital charge (%)	8.57	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Profitability index (%)	14.28	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

Table 1

U.S. Public Finance Premium Rate And Economic Trends(cont.)							
Financial Security Assurance Inc.							
Gross P&I written	71,552	46,780	104,857	83,618	109,440	82,856	89,711
Adjusted gross premium written	470	151	393	310	485	434	483
Implied premium rate (%)	0.66	0.32	0.37	0.37	0.44	0.52	0.54
Gross per period capital charge (%)	6.81	6.34	7.41	6.70	7.48	7.42	7.08
Profitability index (%)	9.63	5.10	5.06	5.53	5.92	7.05	7.60
MBIA Insurance Corp.							
Gross P&I written	7,237	40,797	98,471	80,509	108,534	94,252	107,967
Adjusted gross premium written	50	147	404	319	486	457	626
Implied premium rate (%)	0.69	0.36	0.41	0.40	0.45	0.48	0.58
Gross per period capital charge (%)	11.02	8.45	9.67	8.79	8.83	7.38	8.10
Profitability index (%)	6.26	4.26	4.24	4.51	5.07	6.57	7.16
'AAA' Primary Insurers' Average							
Gross P&I written	135,271	204,474	450,285	360,872	432,345	345,581	362,963
Adjusted gross premium written	1,044	823	1,918	1,728	2,187	1,913	2,310
Implied premium rate (%)	0.77	0.40	0.43	0.48	0.51	0.55	0.64
Gross per period capital charge (%)	7.61	8.55	9.15	9.82	9.07	8.44	8.39
Profitability index (%)	10.14	4.71	4.66	4.87	5.57	6.56	7.59
N.A.--Not available							

Table 2

U.S. Structured Finance Premium Rate And Economic Trends							
(Mil \$)	Six months ended						
	June 30, 2008	June 30, 2007	2007	2006	2005	2004	2003
Ambac Assurance Corp.							
Gross domestic asset-backed par written	447	28,244	37,808	52,228	52,305	52,628	46,474
Weighted-average premium rate for the period (%)	0.60	0.15	0.20	0.17	0.23	0.28	0.25
Gross per-period capital charge (%)	5.34	1.28	1.64	2.07	2.74	2.66	2.07
Profitability index (%)	11.32	11.72	12.25	8.23	8.39	10.34	12.27
Assured Guaranty Corp. (Direct Only)							
Gross domestic asset-backed par written	8,140	13,499	31,346	26,843	12,740	10,964	5,286
Weighted-average premium rate for the period (%)	0.38	0.12	0.18	0.10	0.12	0.12	0.25
Gross per-period capital charge (%)	0.75	0.48	0.59	0.34	0.75	0.93	1.00
Profitability index (%)	50.44	25.22	31.07	28.99	16.53	12.88	25.30
Financial Security Assurance Inc.							
Gross domestic asset-backed par written	3,611	22,277	41,210	28,699	28,087	48,755	15,639
Weighted-average premium rate for the period (%)	0.38	0.16	0.21	0.13	0.19	0.18	0.51
Gross per-period capital charge (%)	1.35	1.61	1.27	1.79	1.71	0.97	2.63
Profitability index (%)	27.89	9.94	16.49	7.38	11.23	18.23	19.20
MBIA Insurance Corp.							
Gross domestic asset-backed par written	47	50,766	87,745	45,767	35,443	32,508	26,162

Table 2

U.S. Structured Finance Premium Rate And Economic Trends(cont.)							
Weighted-average premium rate for the period (%)	6.34	0.15	0.24	0.15	0.22	0.19	0.29
Gross per-period capital charge (%)	2.59	1.36	1.30	2.12	3.34	2.51	2.90
Profitability index (%)	245.34	11.03	18.63	7.08	6.65	7.48	10.00
Industry Average							
Gross domestic asset-backed par written	12,245	156,003	260,290	230,283	182,101	194,797	118,694
Weighted-average premium rate for the period (%)	0.41	0.15	0.20	0.14	0.19	0.20	0.29
Gross per-period capital charge (%)	1.10	1.34	1.29	1.65	2.29	1.93	2.27
Profitability index (%)	37.13	11.42	15.73	8.41	8.33	10.27	12.82

Table 3

International Structured Finance Premium Rate And Economic Trends							
(Mil \$)	Six months ended						
	June 30, 2008	June 30, 2007	2007	2006	2005	2004	2003
Ambac Assurance Corp.							
Gross par written	N.A.	5,234	12,556	11,628	6,953	15,541	18,444
Weighted average per-period premium rate (%)	N.A.	0.31	0.31	0.27	0.40	0.28	0.24
Gross per-period weighted average capital charge (%)	N.A.	2.56	3.17	2.04	3.55	2.46	1.50
Risk-adjusted pricing index (%)	N.A.	11.97	9.86	13.28	11.27	11.33	15.67
Assured Guaranty Corp.							
Gross par written	3,964	3,155	8,431	6,663	2,800	N.A.	N.A.
Weighted average per-period premium rate (%)	0.39	0.12	0.15	0.12	0.17	N.A.	N.A.
Gross per-period weighted average capital charge (%)	0.10	0.62	0.30	0.79	1.82	N.A.	N.A.
Risk-adjusted pricing index (%)	398.52	19.19	49.61	15.67	9.62	N.A.	N.A.
Financial Security Assurance Inc.							
Gross par written	520	4,575	9,562	9,089	6,894	7,495	6,044
Weighted average per-period premium rate (%)	0.35	0.12	0.18	0.15	0.17	0.11	0.11
Gross per-period weighted average capital charge (%)	0.10	0.33	0.47	0.87	0.51	0.17	0.20
Risk-adjusted pricing index (%)	348.76	35.71	38.21	16.84	33.33	69.29	56.00
MBIA Insurance Corp.							
Gross par written	1,175	12,112	18,596	21,955	24,014	18,326	20,953
Weighted average per-period premium rate (%)	0.40	0.20	0.25	0.14	0.14	0.13	0.30
Gross per-period weighted average capital charge (%)	5.45	1.33	1.22	0.98	1.19	1.09	1.87
Risk-adjusted pricing index (%)	7.34	14.67	20.72	14.06	12.18	11.96	16.04
Industry Trends							
Gross par written	5,659	31,647	59,139	63,734	54,043	45,596	48,278
Weighted average per-period premium rate (%)	0.39	0.20	0.23	0.18	0.21	0.20	0.26
Gross per-period weighted average capital charge (%)	1.21	1.27	1.56	1.14	1.70	1.48	1.53
Risk-adjusted pricing index (%)	32.35	15.73	14.93	15.46	12.25	13.47	16.76

N.A.--Not available

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