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# Conditions Improve For Bond Insurers In U.S. Asset-Backed Market

**Primary Credit Analyst:**

Robert E Green, New York (1) 212-438-2013; robert\_green@standardandpoors.com

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# Conditions Improve For Bond Insurers In U.S. Asset-Backed Market

Greater demand and wider spreads in some sectors, notably mortgages and CDOs, led to pricing and structuring opportunities in the first half of 2007 that were generally better for bond insurers. Likewise, investor demand waned for alternative executions, such as senior subordinated structured bonds in the mortgage sector.

Gross par written volume for 'AAA' rated bond insurers in the U.S. asset-backed market was \$156.4 billion in the first half of 2007, a 40.4% increase from the first half of 2006. However, all seven 'AAA' rated bond insurers did not share the gain; four saw a decrease in par volume while three recorded sizable increases in par written. More importantly, five insurers reported gains in their risk-adjusted pricing index in the first half of 2007, compared with only two declines. For the industry on average, the risk-adjusted pricing index was 11.4% for the first half of 2007, compared with 10.1% for the first half of 2006. The risk-adjusted pricing index is the relationship between weighted average premium rates and weighted average capital charges for a given book of business. Since capital charges are risk factors used to determine losses in the Standard & Poor's capital adequacy model, this ratio indicates how much premium is received per unit of risk, providing a basis for analysis of economic and risk trends and company comparisons.

Since 2003, when the industry reported its best-ever risk-adjusted pricing index of 12.8%, the combination of tight spreads and increased competition have lowered the index. From 2004-2006, the weighted average risk-adjusted pricing index was about 9%. If the current six-month risk-adjusted pricing index holds, it will be the industry's best result since 2003.

Driving the improvement, the book of business for the first half of 2007 has the lowest risk profile since at least 2000. Given current credit volatility, especially in the mortgage and CDO sectors, the industry is proactively reducing risk on insured business. Increased demand in the sectors in which the industry participated also allowed bond insurers to conservatively structure their transactions, resulting in a weighted average capital charge of 1.35% for the first half of 2007, down from 1.75% for the first six months of 2006. The weighted average premium rate also declined to 0.15% from 0.18%, reflecting the assumption of lower risk business; that decline, however, was proportionately less than the capital charge decline.

## Individual Company Results

### Ambac

Ambac's volume in the U.S. structured finance market was \$28.2 billion in the first half of 2007, down 17.3% from the first half of 2006. Indicative of a business shift, both the weighted average premium rate and weighted average capital charge were down by 42.3% and 40.7%, respectively, in the first half of 2007. In contrast to 2006, Ambac targeted more lower risk, lower capital charge CDO business and less commercial asset-backed and auto business. However, while the current risk-adjusted pricing ratio of 11.7% substantially exceeded results for the 2005 and 2006 books of business (which were about 8.3%), we note that recent internal downgrades of several underlying ratings in the CDO sector by Ambac suggest that the economics of those transactions have weakened.

### **Assured Guaranty Corp.**

Assured Guaranty Corp.'s volume in the first half of 2007 was \$13.9 billion, down 9.7% from the first half of 2006. Most volume came from the CDO and mortgage sectors, although there was also progress in more traditional flow business, such as consumer receivables. The reduced volume was partly due to management's focus on further enhancing the profitability of the 2007 book of business. The risk-adjusted pricing index for the first half of 2007 was 29.3%, up from 26.5% for the first half of 2006. Supporting this gain was an improved pricing environment, which also helped the weighted average premium rate increase to 0.17% for the first half of 2007, up from 0.09% for the first half of 2006. Capital charges also increased, but to a lesser degree.

### **CIFG**

Volume for CIFG for the first half of 2007 was \$3.7 billion, the lowest among the 'AAA' primary companies and a decline from the \$7.4 billion recorded in the first half of 2006. The company attributes the year-to-year decline to an unusually strong year in 2006 and to overall issuance declines in several of its business sectors. The business written in the first half of 2007 reflected a 19.6% increase in the weighted average capital charge. However, a 50% increase in the weighted average premium rate for the same time periods resulted in a risk-adjusted pricing index of 19% for the first half of 2007. The risk-adjusted pricing index for the first half of 2006 was 15.15%.

### **FGIC**

Volume for FGIC declined modestly to \$15.9 billion for the first half of 2007, down from \$16.4 billion for the first half of 2006. Volume in 2007 came from a mix of the commercial and consumer asset-backed sectors. While the company's weighted average premium rate remained the same between periods, at 0.18%, the weighted average capital charge increased to 2.45% for business written in the first half of 2007, up from 2.25% for business written in the first half of 2006. The resulting risk-adjusted pricing index is 7.22%, slightly above the 6.90% index for the full year of 2006.

### **FSA**

FSA's volume in the U.S. asset-backed market was \$22.3 billion in the first half of 2007, a 71% increase from the first half of 2006. Unlike in 2006, when unattractive pricing and structures limited the company's participation in the mortgage-backed security sector, widening spreads and a better pricing environment supported the volume increase, which was mostly in the mortgage-backed security and corporate CDO sectors. The risk-adjusted pricing index for the first half of 2007 was 9.9%, better than 6.4% in the first half of 2006 and 7.38% for the full year of 2006. While the weighted average premium rate increased by one basis point to 0.16% from the first half of 2007's book of business, most of the risk-adjusted pricing index gain was attributable to a lower weighted average capital charge. Much of the CDO business had super senior underlying ratings. For the first half of 2007's book of asset-backed business, the weighted average capital charge was 1.61%, down from 2.35% for the first half of 2006. For credit reasons, FSA does not underwrite the CDO of ABS, EETC, and franchise transactions, a factor that contributed to the company's underperformance compared with the industry average.

### **MBIA**

MBIA had a very strong six-month result in both volume and economics for the U.S. asset-backed sector. Volume in the first half of 2007 was \$50.8 billion of gross par written, compared with \$13.6 billion of gross par written in the first half of 2006. This was the most U.S. asset-backed par written in the industry for the first half of 2007. It was also greater than any full year level of volume for MBIA since 2002. Sectors contributing to this production were CDOs (no CDOs were closed in the first quarter of 2006), aircraft securitization, and residential mortgages. MBIA's risk-adjusted pricing index of 11% was also the best in its history, compared with any previous year result. Stronger

demand and widening spreads in some sectors contributed to the gain. In particular, the weighted average capital charge for the June 30, 2007, book of business fell to 1.4% from 2.0% for the June 30, 2006, book of business.

## XLCA

Volume was up sharply for XLCA in the first half of 2007, rising by 90.3% compared with the first half of 2006 and reaching \$21.6 billion. The increase was mostly due to activity in the CDO and consumer asset-backed sectors. Reflecting the activity in the CDO sector, where underlying ratings are generally 'AAA', the weighted average capital charge fell to 0.94% for the first half of 2007, compared with 1.30% for the first half of 2006. On the premium side, the weighted average premium rate increased by two basis points to 0.14% in the first half of 2007. This was driven by improvement in consumer ABS pricing due to improved opportunities in the mortgage sector. The resulting risk-adjusted pricing index for the first half of 2007 was 14.7%, better than both the industry average of 11.4% and XLCA's full-year 2006 index of 10.2%.

**Table 1**

	--Six months ending June 30--		--Fiscal year ending Dec. 31--				
	2007	2006	2006	2005	2004	2003	2002
<b>Ambac</b>							
Gross domestic asset-backed par written (Mil. \$)	28,244	34,171	52,228	52,305	52,628	46,474	44,770
Weighted-average premium rate for the period (%)	0.15	0.26	0.17	0.23	0.28	0.25	0.22
Gross per-period capital charge (%)	1.28	2.16	2.07	2.74	2.66	2.07	2.45
Risk-adjusted pricing index (%)	11.72	12.04	8.23	8.39	10.34	12.27	9.13
<b>Assured Guaranty Corp.</b>							
Gross domestic asset-backed par written (Mil. \$)	13,917	15,389	26,843	12,740	10,964	5,286	4,706
Weighted-average premium rate for the period (%)	0.17	0.09	0.10	0.12	0.12	0.25	0.34
Gross per-period capital charge (%)	0.58	0.34	0.34	0.75	0.93	1.00	0.68
Risk-adjusted pricing index (%)	29.31	26.47	28.99	16.53	12.88	25.30	50.00
<b>CIFG</b>							
Gross domestic asset-backed par written (Mil. \$)	3,686	7,470	17,849	7,732	5,218	5,361	1,161
Weighted-average premium rate for the period (%)	0.15	0.10	0.10	0.10	0.20	0.24	0.39
Gross per-period capital charge (%)	0.79	0.66	0.64	0.41	1.40	1.22	0.10
Risk-adjusted pricing index (%)	18.99	15.15	15.83	23.67	14.24	19.35	386.00
<b>FGIC</b>							
Gross domestic asset-backed par written (Mil. \$)	15,944	16,401	33,186	36,045	26,229	8,894	9,007
Weighted-average premium rate for the period (%)	0.18	0.18	0.17	0.16	0.15	0.13	0.21
Gross per-period capital charge (%)	2.45	2.25	2.39	2.12	2.38	2.10	2.20
Risk-adjusted pricing index (%)	7.22	8.00	6.93	7.41	6.37	6.29	9.60
<b>FSA</b>							
Gross domestic asset-backed par written (Mil. \$)	22,277	13,032	28,699	28,087	48,755	15,639	38,351
Weighted-average premium rate for the period (%)	0.16	0.15	0.13	0.19	0.18	0.51	0.19
Gross per-period capital charge (%)	1.61	2.35	1.79	1.71	0.97	2.63	1.31
Risk-adjusted pricing index (%)	9.94	6.38	7.38	11.23	18.23	19.20	14.77

**Table 1**

<b>U.S. Structured Finance Premium Rate and Economic Trends(cont.)</b>							
<b>MBIA</b>							
Gross domestic asset-backed par written (Mil. \$)	50,766	13,632	45,767	35,443	32,508	26,162	55,603
Weighted-average premium rate for the period (%)	0.15	0.17	0.15	0.22	0.19	0.29	0.18
Gross per-period capital charge (%)	1.36	2.04	2.12	3.34	2.51	2.90	1.88
Risk-adjusted pricing index (%)	11.03	8.33	7.07	6.65	7.48	10.00	9.57
<b>XLCA</b>							
Gross domestic asset-backed par written (Mil. \$)	21,587	11,323	25,710	9,749	18,495	10,878	9,575
Weighted-average premium rate for the period (%)	0.14	0.12	0.09	0.15	0.17	0.32	0.28
Gross per-period capital charge (%)	0.94	1.30	0.90	1.88	1.50	2.38	2.76
Risk-adjusted pricing index (%)	14.68	9.23	10.22	7.93	11.33	13.49	10.11
<b>Industry Average</b>							
Gross domestic asset-backed par written (Mil. \$)	156,421	111,418	230,283	182,101	194,797	118,694	163,174
Weighted-average premium rate for the period (%)	0.15	0.18	0.14	0.19	0.20	0.29	0.21
Gross per-period capital charge (%)	1.35	1.74	1.65	2.29	1.93	2.27	1.92
Risk-adjusted pricing index (%)	11.42	10.10	8.40	8.33	10.27	12.82	10.79

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