

National Public Finance Guarantee Corp.

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Rationale

Financial Strength Rating

Local Currency

AA-/Stable/--

- Strong competitive position reflecting an ability to add value to the market and boost premiums written
- Satisfactory management and corporate strategy
- Low insurance industry and country risk assessment

- Capital adequacy ratio greater than 1.0x
- Low-risk investment portfolio
- Largest obligor violation
- Strong operating performance based on a prospective view of favorable operating metrics as its business grows
- Financial flexibility neutral to the rating

Other Assessments

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

Factors Specific To The Holding Company

- Our rating on MBIA Inc. reflects its structural subordination to its regulated operating subsidiaries

Outlook

The outlook on National Public Finance Guarantee Corp. is stable reflecting its very strong capital adequacy and prospective strong competitive position. S&P Global Ratings expects National will write business gradually at first and at increasing rates once it gains more visibility in the insured U.S. municipal market.

Downside scenario

We may lower our ratings if the company does not demonstrate sustainable and consistent growth, its capital adequacy deteriorates as a result of earnings or claims volatility, or its municipal risk-adjusted pricing (RAP) ratio is consistently below that of peers.

Upside scenario

We may raise our ratings if National shows successful execution and seasoning 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 RAP ratio above 4.0% by year-end 2017
- Combined ratio less than 100% by year-end 2017
- An increase in par insured year-over-year

Company Description

National is a wholly owned subsidiary of MBIA Inc. and provides financial guarantees to U.S. public finance issuers, with the majority of new business in the general obligation, tax-backed, and revenue bond sectors. In February 2009, 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 industry risk is '2', leading to a business risk profile score of '2'.

Insurance industry and country risk

We believe National faces low industry and country risk since it operates only in the U.S. Our view of National's very low country risk stems from the U.S. market's higher-income nature, its relatively effective and stable political institutions, sophisticated financial systems, and strong payment culture. We believe its 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.

Table 1

National Public Finance Guarantee Corp. -- Business Statistics

(Mil. \$)	--Year ended Dec. 31, 2015--
Net par exposure	156,634
Net protection and indemnity exposure	259,436
Adjusted gross premiums written*	
U.S. public finance	17
U.S. asset-backed and other	-
U.S. total	17
International public finance	
International asset-backed and other	
International total	-
Total adjusted gross premiums written	17
Net premiums written	
Gross par written	
U.S. public finance	597
U.S. asset-backed and other	-
U.S. total	597
International public finance	
International asset-backed and other	
International total	-
Total gross par written	597
Net par written	597

*Includes upfront and present value of installment premiums.

Competitive position

We view National's competitive position as strong, and believe it will continue to grow its premiums written and provide added value to the U.S. public finance market. Its flexibility in writing a variety of sectors allows it to take advantage of arising opportunities. Its new business writings in 2015 showed a positive momentum in total par insured, as well as the number of transactions insured; the trend continues into 2016. National began expanding into the secondary market in the second half of 2015. Its business written was relatively small compared with peers, but we expect National to boost its market share as it continues to expand its writings and gains visibility.

National's substantial existing book of business provides further visibility as legacy insured bond trade in the market.

The insured portfolio is well diversified by sector and geography, and we expect the company to have a more granular portfolio given its single-risk limits. Since National reentered the market in 2015, management has made some key new hires and has put together targeted marketing and new business plans to win more bids and reintroduce the firm to market participants.

Table 2

National Public Finance Guarantee Corp. -- Portfolio Statistics						
--Year ended Dec. 31--						
(Mil \$)	% of par 2015	Net par 2015	Net par 2014	Net par 2013	Net par 2012	Net par 2010
Public Finance						
General obligation	43.32	67,857	96,501	122,240	149,864	216,768
Utility	17.35	27,177	38,555	49,157	60,019	82,901
Tax-backed	12.40	19,419	26,654	33,793	42,841	59,122
Hospitals	2.55	3,990	4,990	5,673	7,259	12,775
Transportation	9.43	14,778	20,133	24,131	29,014	46,156
Colleges and universities	5.47	8,567	12,568	15,157	18,577	25,235
Investor-owned utilities	1.05	1,650	1,812	2,147	2,688	6,829
Housing	5.41	8,470	10,088	10,935	12,310	14,626
Special revenue	1.87	2,922	3,996	5,684	5,710	2,144
Other	1.15	1,803	1,952	2,188	2,563	1,999
Total	100	156,634	217,248	271,105	330,845	468,555

Management and corporate strategy

We view National's management and corporate strategy as satisfactory. The management team has successfully resolved all litigation, allowing the company to reenter the market. National made all claims payments and successfully remediated distressed credits while inactive. We believe management has significant knowledge of the municipal market with 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.

We have not identified any governance deficiencies in our assessment.

Financial Risk Profile

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

Capital adequacy

National's capital adequacy is extremely strong, with a capital adequacy ratio above 1.0x. As a result of elevated refunding and ordinary amortizations, combined with minimal new business written, National is deleveraging its risk exposure at an accelerated rate.

We have analyzed the effect of losses related to exposure to issuers in Puerto Rico. The initial scenario assumed all issuers defaulted on 100% of their debt service in the next four years with National required to make claim payments

equal to 100% of debt service. Our analysis also assumed payments of 15%, 25%, 35%, and 45% on total debt service. The analysis indicated that, without accounting for any other factors, with the exception of the 45% claim scenario, National had sufficient capital to absorb the losses at the different claim payment rates and there would be no change in the capital adequacy score. We continue to monitor events in Puerto Rico and their impact on the company.

As of Dec. 31, 2015, National did not comply with the largest obligor test, which weakened the capital adequacy score.

Table 3

National Public Finance Guarantee Corp. -- Capital Statistics						
(Mil \$)	--Year ended Dec. 31--					
	2015	2014	2013	2012	2011	2010
Portfolio risk						
Municipal insurance weighted average capital charge (% of average annual debt service)	18.7	17.35	15.88	16.37	16.04	16.05
Model capital inputs						
Statutory capital	3,388	3,266	3,257	3,248	2,809	2,381
Unearned premiums	1,042	1,375	1,678	2,041	2,485	2,873
Loss reserves	(30)	(13)	(87)	(109)	(3)	96
Present value of instalment premiums	197	216	225	217	239	282
Capital adequacy*						
Capital adequacy ratio (x)	>1.00	>1.00	>1.00	>1.00	0.65-0.80	0.65-0.80
Reliance on soft capital (%)	1.6	1.5	2.0	2.5	3.5	1.5

*Capital adequacy results for 2012 and 2011 are based on the release of updated bond insurance criteria on Aug. 25, 2011.

Investment risk modifier

We believe National's investment portfolio presents low risk to its financial risk profile. The portfolio is well diversified, highly liquid, and of high credit quality. The company focuses on fixed income and taxable investments comprising 'AA' average credit quality municipals (32%), corporates (25%), and agency mortgages (24%).

National participates in an asset-swap facility with MBIA Inc., but significantly reduced it to \$133 million as of March 31, 2016, from a high of \$1.8 billion as of Dec. 31, 2009.

Operating performance

We view National's operating performance as strong stemming from our prospective view that, as the company writes more business in the primary and secondary markets, it will demonstrate favorable operating and risk-adjusted pricing metrics in line with peers. In 2015, National insured \$597 million of primary and secondary par after reentering the insured municipal market in third-quarter 2014. While its market share in 2015 is relatively small, National has recently shown positive momentum--in first-quarter 2016, it insured \$158 million of par in 19 transactions versus \$38.2 million in 2015 with four transactions.

Because National has had a limited amount of net premiums written in recent years, its expense ratio has resulted in a combined ratio that provides minimal analytical value. But when evaluating the expense ratio in terms of net premiums earned, the combined ratio has been well under 100% for the past five years. National typically collects

premiums associated with the U.S. public finance business up front and earns them over the life of the underlying transaction, 20 years on average. So evaluating operating performance based on net premiums earned provides better analytical insight for a company like National with a large legacy book of business. We expect its net earned premiums (excluding refundings) to continue declining due to the run-off of the insured portfolio and low new business writings.

If the ultimate losses related to issuers in Puerto Rico are greater than reserves already taken, operating performance may suffer. We believe that, if this occurs, it would be a single-year event since there does not appear to be any other large exposures in the insured portfolio that are experiencing the same stress levels as Puerto Rico. The annual accretion of discounted reserves would not be enough to materially hurt operating performance.

Table 4

National Public Finance Guarantee Corp. -- Operating Performance						
	--Year ended Dec. 31--					
(%)	2015	2014	2013	2012	2011	2010
Operating return on equity (GAAP)	4.90	5.10	4.40	7.60	9.00	10.90
Statutory combined ratio	N.M.	N.M.	N.M.	N.M.	N.M.	70.91
Statutory loss ratio	(2.80)	27.90	18.30	5.53	1.33	14.46
Statutory expense ratio	N.M.	N.M.	N.M.	N.M.	N.M.	56.45
Statutory return on revenue	89.00	68.20	71.20	75.87	88.75	80.44
Insured portfolio speculative-grade exposure	4.00	2.60	1.66	0.85	0.69	0.57

N.M.--Not meaningful.

Financial flexibility

We view financial flexibility as neutral to the rating due to 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 2015, National paid a \$114 million dividend to MBIA Inc.; \$228 million was released to MBIA Inc. from the group's tax escrow account, to which National contributes. 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 about 83% of gross par outstanding at the 'AA' and 'A' level as of Dec. 31, 2015. We believe National has adequate liquidity to cover any near-term claims payments while pursuing remediation.

Table 5

National Public Finance Guarantee Corp. Financial Statistics						
	--Year ended Dec. 31--					
(Mil. \$)	2015	2014	2013	2012	2011	2010
Total assets	4,676.6	5,142.4	5,340.4	5,726.2	6,656.1	7,290.0
Cash and invested assets	4,635.8	5,087.3	5,266.4	5,646.1	6,594.8	7,221.4
Net premiums earned	349.7	316.4	374.8	439.3	365.8	362.5
Losses and loss adjustment expense	(9.9)	88.2	66.7	24.3	4.9	52.4
Underwriting expense	61.1	49.9	76.2	133.8	60.3	75.2
Investment income including gains/(losses)	113.6	129.9	162.0	286.5	304.8	257.0
Net income	283.8	238.1	256.0	415.5	477.9	408.8

Other Assessments

Enterprise risk management

We view National's ERM framework as adequate with strong risk controls, which has a limiting effect on the adjusted indicative rating on the company. 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.

National has risk limits in place for single obligor, sector, and geographic exposure that guide underwriting along with identified emerging risks and feedback from the remediation and surveillance groups. It uses its centralized exposure testing application that integrates internal risk and regulatory limits in monitoring and decision-making with regards to selecting and approving new transactions. It also uses its economic capital model to stress capital under various sector-specific default and severity assumptions.

Management has a new business growth, marketing, and underwriting strategy in place, and we look for evidence of execution of its strategic risk management program and optimization of risk-adjusted returns as it writes new business.

Liquidity

We view National's liquidity as strong, reflecting its highly liquid assets, full coverage of short-term liquidity needs, and lack of any credit-sensitive liabilities or collateral-posting requirements. As of Dec. 31, 2015, it held \$379 million in cash and short-term investments. We expect that, as the company writes more business, its cash flow ratios will improve.

Table 6

National Public Finance Guarantee Corp. -- Liquidity Statistics						
	--Year ended Dec. 31--					
(%)	2015	2014	2013	2012	2011	2010
Underwriting cash flow ratio	N.M.	N.M.	N.M.	N.M.	N.M.	95.92
Liquid assets	97.4	98.7	94.1	94.0	75.0	100.0
Cash and short-term assets to loss payable ratio	496.5	3,014.0	2,188.1	897.4	858.0	260.9

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 its 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 7

MBIA Inc. -- Financial Statistics						
GAAP basis						
	--Year ended Dec. 31--					
	2015	2014	2013	2012	2011	2010
Fixed-charge coverage (x)	1.9	1.4	N.M.	N.M.	N.M.	N.M.
Financial leverage (%)	30.7	28.5	30.0	30.8	31.7	32.7

N.M.--Not meaningful.

Accounting

We view National's accounting policies as consistent with industry standards and 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 credit default swap. 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. We don't consider gains taken from the deterioration in MBIA Inc.'s own creditworthiness are economic or real for the purposes of our ratings analysis. We do not factor in any market-based gyrations 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
- Methodology: 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 July 27, 2016)

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-/Stable/--

Related Entities

MBIA Inc.

Issuer Credit Rating

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. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' 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.

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