

# MOODY'S

## INVESTORS SERVICE

### **Rating Action: Moody's affirms MBIA Inc. (senior at Ba1) and National Public Finance Guarantee Corp. (IFS at A3); downgrades MBIA Insurance Corp. to Caa1**

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Global Credit Research - 20 May 2016

New York, May 20, 2016 -- Moody's Investors Service, ("Moody's") has affirmed the Ba1 senior debt rating of MBIA Inc. (MBIA) and the A3 insurance financial strength (IFS) rating of its principal operating subsidiary, National Public Finance Guarantee Corporation (National). In the same rating action, Moody's downgraded the IFS rating of MBIA Insurance Corporation (MBIA Corp.) to Caa1 from B3, concluding a review for downgrade that was initiated on 19 January 2016. The outlook for these ratings is negative.

Moody's also affirmed the Ba2 IFS rating of MBIA UK Insurance Limited (MBIA UK), with a stable outlook.

These rating actions also have implications for the various transactions wrapped by MBIA Corp. as discussed later in this press release.

MBIA Mexico S.A. de C.V. (MBIA Mexico) was not part of today's rating action. MBIA Mexico's IFS rating is currently B3, on review for downgrade.

#### RATINGS RATIONALE -- MBIA INSURANCE CORPORATION

Moody's stated that today's rating downgrade of MBIA Corp.'s IFS rating to Caa1, from B3, reflects the insurer's very weak liquidity and capital position, and increasing risk of default on insurance obligations, in light of continued uncertainties and material risks associated with the Zohar II CLO transaction it insures.

The default of Zohar I in November 2015 resulted in MBIA Corp. making a \$149 million claims payment to insured noteholders, which meaningfully reduced its liquidity position. Given the correlation between the Zohar I and Zohar II deals, Moody's believes that it is likely that Zohar II will also default upon maturity, in January 2017, triggering a claim of up to \$776 million on MBIA Corp. Moody's notes that a claim of this size would exhaust MBIA Corp.'s current liquidity that consisted of approximately \$278 million of liquid assets as of 31 March 2016. MBIA Corp., however, believes that it can access sufficient liquidity to satisfy any Zohar claim through a combination of collateralized loans and sale of subsidiaries.

While MBIA Corp. has been able to install a new collateral manager for the Zohar transactions, there is significant uncertainty with respect to the market value of the collateral backing these transactions and the related recovery that MBIA Corp. can expect on the insured bonds.

Recent commutations of insured exposures, and the settlement of RMBS put-back claims have improved the firm's capital adequacy profile, but liquidity remains tight as much of the firm's statutory capital stems from expected contingent claims on excess spread recoveries on RMBS transactions and additional RMBS put-back settlement recoveries. The majority of MBIA Corp.'s structured finance book is expected to run off within the next five years, freeing up capital resources. However, MBIA Corp. remains exposed to a number of large structured transactions that could cause significant stress, including insolvency, in the event of default with a large liquidity call and/or a high severity of loss.

Moody's added that the ratings of MBIA Corp.'s preferred stock (C (hyb)) and surplus notes (Ca (hyb)) reflect their high expected loss content given the company's still weak capital profile and the deeply subordinated nature of these securities.

According to Moody's, credit deterioration at MBIA Corp. has only a limited impact on the broader MBIA group given the substantial delinking following the removal of the cross-default provision with MBIA Inc.'s debt, and MBIA Corp.'s repayment of a loan from affiliate National. However, MBIA Corp.'s very weak credit profile could still adversely impact MBIA Inc., and to a lesser extent, National, through reputational damage caused by their affiliation with MBIA Corp.

#### RATINGS RATIONALE -- NATIONAL PUBLIC FINANCE GUARANTEE CORP.

National's A3 IFS rating, with negative outlook, reflects the insurer's substantial stand-alone capital resources, the meaningful delinking from its weaker affiliates, steady amortization of its legacy book, and its ongoing efforts to reestablish its franchise in the primary and secondary US municipal debt markets. Moderating these strengths is National's substantial exposure to below investment grade credits, which represented approximately 4.2% of its insured book and 185% of qualified statutory capital at 1Q2016. In addition, Moody's notes that National, like its peers, continues to face challenging fundamentals in the sector, including low financial guaranty insurance penetration, weak pricing and low interest rates. National's market share of new business is a fraction of the one achieved by its two main competitors.

As of 31 March 2016, National had approximately \$4.3 billion of gross par exposure to the debt securities of Puerto Rico issuers (including accreted interest on capital appreciation bonds). While the situation in Puerto Rico remains fluid, there remains a high likelihood that much of Puerto Rico's debt will eventually need to be restructured, with the potential for substantial loss claims under National's insurance policies. However, Moody's notes that Puerto Rico Electric Power Authority (PREPA -- Caa3/negative), which represents nearly \$1.4 billion, or 32%, of National's total Puerto Rico exposure, has entered into a consensual restructuring agreement with its creditors that would not result in a principal impairment on insured bonds. Such planned restructuring has, however, not yet occurred.

Beyond PREPA, the majority of National's remaining Puerto Rico exposure is to the Commonwealth's general obligation bonds (Caa3/negative) and to senior lien bonds issued by Puerto Rico Sales Tax Financing Corporation (Caa3/negative). The absence of a clear legal framework for a broad debt restructuring in Puerto Rico, as well as the number of stakeholders involved, suggests that it may be some time before the ultimate losses on these exposures is known. The negative outlook on National's IFS rating reflects the uncertainties and downside risks that could emerge during the restructuring process.

#### RATINGS RATIONALE -- MBIA UK

According to Moody's, MBIA UK's Ba2 insurance financial strength rating reflects its meaningful stand-alone capital resources relative to its insured exposures. This strength is tempered by the company's limited stand-alone business profile as a company in run-off, its ownership by MBIA Corp. that may be able to access its financial resources, and by its highly concentrated portfolio of European infrastructure finance exposures that includes a number of very large single risks, which exposes the company to heightened idiosyncratic risk.

#### RATINGS RATIONALE -- MBIA INC.

The Ba1 senior unsecured debt rating and negative outlook of MBIA Inc. reflects the credit profiles of its subsidiaries and its adequate liquidity profile stemming from the resumption of dividend payments from National and release of funds from tax escrow. However, the firm's high debt burden and meaningful asset risks, a large share of which linger at its wind-down operations, remain a distinct weakness. The notching between MBIA Inc.'s senior debt rating and the IFS rating of its lead insurance subsidiary, National, is four notches, reflecting the group's high financial leverage and the significantly weaker credit profile of MBIA Corp., its other substantial subsidiary.

#### WHAT COULD CHANGE THE RATINGS UP OR DOWN

The ratings of MBIA Corp. could be raised if its financial profile, including capital adequacy and liquidity, improved materially. The rating could be lowered in the event the firm's plans to improve liquidity for potential default claims on the Zohar II transaction are unsuccessful and it defaults on its insurance obligations.

National's rating could return to a stable outlook once there is visibility that qualified statutory capital will not decrease by more than 10% following a restructuring of its Puerto Rico exposures (over a twelve month period). Conversely, National's rating could be downgraded if developments in Puerto Rico result in losses that reduce the firm's qualified statutory capital by more than 15% over a twelve month period. Additionally, the rating could be lowered if capital were to be up-streamed to its parent without an associated reduction of risk, or if National provided material capital support to MBIA Corp.

For MBIA UK, given its ownership by MBIA Corp., the slow expected amortization in its insured portfolio and the company's run-off status, there is limited potential for upward rating movement over the near to medium term. Conversely, the following factors could lead to a downgrade of MBIA UK's rating: 1) Significant incurred losses or credit deterioration among large single risk exposures; and 2) Capital extraction by MBIA Corp. that significantly diminishes the firm's risk adjusted capital adequacy.

The following factors could lead to an upgrade of MBIA Inc.'s debt rating: 1) an upgrade of National; and/or 2)

a significant reduction in adjusted financial leverage. Conversely, the following factors could result in a downgrade: 1) a downgrade of National; and/or 2) constrained liquidity at the holding company.

#### RATING LIST

The following ratings have been affirmed with a negative outlook:

MBIA Inc. -- Senior unsecured debt at Ba1;

National Public Finance Guarantee Corporation -- insurance financial strength at A3;

The following rating has been affirmed with a stable outlook:

MBIA UK Insurance Limited -- insurance financial strength at Ba2;

The following rating has been downgraded and assigned a negative outlook:

MBIA Insurance Corporation -- insurance financial strength to Caa1 from B3;

The following ratings have been affirmed:

MBIA Insurance Corporation -- surplus notes at Ca(hyb), preferred stock at C(hyb).

#### TREATMENT OF WRAPPED TRANSACTIONS

Moody's ratings on securities that are guaranteed or "wrapped" by a financial guarantor are generally maintained at a level equal to the higher of the following: a) the rating of the guarantor (if rated at the investment grade level); or b) the published underlying rating (and for structured securities, the published or unpublished underlying rating). Moody's approach to rating wrapped transactions is outlined in Moody's methodology "Rating Transactions Based on the Credit Substitution Approach: Letter of Credit-backed, Insured and Guaranteed Debts" (December 2015).

MBIA Insurance Corporation and National Public Finance Guarantee Corporation are financial guaranty insurance companies domiciled in New York State and are wholly owned subsidiaries of MBIA Inc. [NYSE: MBI]. As of March 31, 2016, MBIA Inc. had consolidated net par outstanding of approximately \$183 billion and qualified statutory capital at its subsidiaries of approximately of \$4.3 billion.

The principal methodology used in these ratings was Financial Guarantors published in April 2016. Please see the Ratings Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

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