

SECTOR COMMENT

BAM's launch is a mixed blessing for the financial guaranty industry

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On 23 July, White Mountains Insurance Group, Ltd. (WTM, unrated)¹ announced it has capitalized HG Global Ltd. (HG Global, unrated) with approximately \$600 million to fund and provide reinsurance support to Build America Mutual Assurance Company (BAM, unrated), a startup mutual financial guarantor focused on enhancing US municipal debt. The entry of a new financial guarantor is positive for the financial guaranty industry in that it may help to validate the product after most bond insurers were sidelined by losses in 2008 and 2009. At the same time, BAM's entry into the market and its distinct organizational structure may serve to challenge the incumbents.

BAM, a mutual focusing on insuring US essential public purpose municipal bonds, is planning to start writing business in September 2012. The firm has been capitalized through a \$500 million surplus notes investment from HG Global and will receive first loss reinsurance support from HG Re (unrated), a subsidiary of HG Global. WTM indicated that it expects to syndicate \$110 million of its approximately \$600 million investment in HG Global in the near future.

Moody's noted that BAM's co-founders, Robert Cochran and Sean McCarthy, were previously executives at Financial Security Assurance (now Assured Guaranty Municipal Corporation, Aa3 under review for downgrade), a financial guarantor once partially owned by WTM.

BAM's entry could help revitalize the financial guaranty insurance sector by increasing the supply of insurance, and broadening the appeal of the product through greater insurance penetration. In recent years, Assured Guaranty has been the only active bond insurance group. Berkshire Hathaway Insurance Corp (Aa1 insurance financial strength, stable outlook) briefly entered the market during the financial crisis, but has since stopped writing new business. Bond insurance penetration of new-issue municipal debt in the US has been on a downward trend and below 10% since 2009.

The actual effect of BAM's entry on the bond insurance market is, nevertheless, hard to predict. The firm will face the typical challenges of startups and looks to enter a sector that is still showing signs of dislocation following a number of business failures and amid an unprecedented low interest rate environment. At the same time, BAM, with its narrower business focus, mutual structure and no legacy exposure, could gain traction as an attractive alternative to Assured Guaranty, pressuring its competitive position.

¹ Moody's rates WTM's subsidiaries, OneBeacon Insurance Group, Ltd. (A2 insurance financial strength, stable outlook) and Sirius International Group, Ltd. (A3 insurance financial strength, stable outlook). The ratings were unaffected by the announcement.

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