S&P Global Ratings

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Build America Mutual Assurance Co.

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Build America Mutual Assurance Co.

Anchor	aa
Business Risk	**Very Strong**
Competitive position	Very strong
IICRA	Low
Financial Risk	**Very Strong**
Capital and earnings	Excellent
Risk exposure	Moderately high
Funding structure	Neutral

+

Modifiers	0
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0

=

SACP	aa

+

Support	**0**
Group support	0
Government support	0

=

AA/Stable/--
Financial strength rating

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

Credit Highlights

Overview

Strengths	**Risk**
A very strong competitive position, supported by conservative underwriting, with a focus on insuring low-risk U.S. public finance issues.	Concentration risk in the insured portfolio, as measured by the largest obligor test (LOT).
An excellent capital adequacy ratio, which management is committed to maintaining.	Continued low interest rates could pressure risk adjusted pricing.

Build America Mutual Assurance Co. (BAM) has a strong market position and a proven record of credit discipline. BAM has maintained a stable share of the new-issue U.S. public finance market while its capital market strategy has led to strong growth in insured secondary market transactions. Although the company only writes business in the U.S. public finance market, it has a broad presence across the U.S. and its insured exposure represents the lowest risk sectors, as measured by S&P Global ratings' capital charges.

BAM has excellent capital adequacy and has historically maintained a strong buffer above its current rating. The strength of the company's capital position is supported by excess of loss coverage from Fidus Re Ltd. through two note issues, as well as a members' surplus contribution that is assessed with the issuance of each policy. The application of our LOT, however, highlights potential concentration risks in the insured portfolio, which weigh on our financial risk assessment.

The combination of a very strong business risk profile and very strong financial risk profile leads to a split anchor of 'aa/aa-'. We selected the higher anchor due to the company's redundancy of capital at the current rating level and management's commitment to maintaining this level of capital adequacy.

Outlook

The stable outlook reflects our view that BAM's competitive position will remain very strong, with no material change in its share of par written and transactions insured in the U.S. public finance market. Our assessment of the outlook is also formed by the company's conservative underwriting strategy. We view the maintenance of a capital adequacy ratio at more than 1.0x as essential for rating stability.

Downside scenario

We could lower our ratings if BAM's qualified statutory surplus plus the assets in the collateral trusts decline and its capital adequacy falls below 1.0x and we believe BAM will not be able to improve its capital position, or if its share of the U.S. public finance market declines substantially for a prolonged period of time.

Upside scenario

Based on our view of the insurable new-issue U.S. public finance market, we don't believe BAM's competitive position or earnings will dramatically change, so we don't expect to raise our ratings in the next two years.

Key Assumptions

- Real GDP growth of about 6.7% in 2021 and 3.7% in 2022
- A 10-year Treasury yield of about 1.7% in 2021 and 2.3% in 2022
- The Consumer Price Index at about 3.6% in 2021 and 2.3% in 2022
- An unemployment rate of 5.6% in 2021 and 4.5% in 2022
- A stable sector outlook

Source: Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes, June 24, 2021

Build America Mutual--Key Metrics

	2020	2019	2018	2017	2016	2015
S&P Global Ratings capital adequacy	AAA	AAA	AAA	AAA	AAA	AAA
Claims paying resources (mil. $)	1,137	938	871	808	644	602
Gross premium written (mil. $)	133	108	110	104	77	55
Operating return on equity (%)	9.6	9.3	4.6	2.8	1.2	N.M.
Statutory return on revenue (%)	43.1	46.9	33.4	25.9	10.8	N.M.
Net combined ratio (%)	58.9	59.0	63.2	75.1	82.2	104.3

N.M.--Not meaningful

Business Risk Profile: Very Strong

Our view of BAM's competitive position is shaped by its strong market presence in the U.S. public finance market, prudent underwriting discipline, and stable share of par and transactions insured, as well as premiums written. BAM is a mutual bond insurer writing business solely in the U.S. public finance market with a broad, well-diversified presence across the U.S.; its insured portfolio comprises primarily general obligation bonds for school districts and municipalities, which somewhat lessens the volatility of its insured portfolio.

BAM has a unique pricing structure with the "premium" charged comprising a member's surplus contribution (MSC) and an upfront risk premium. In evaluating BAM's profitability metrics, we include the MSC as a component of revenue in the year it was collected. As BAM's business volume has risen and the insured portfolio has grown, its operating performance and profitability have improved and the MSC has benefited the company's consolidated capital growth.

After a period of uncertainty in the U.S. public finance market, insured new-issue business volume in the second half of 2020 reflected investors' return to the municipal market with a heightened focus on credit quality, trading value stability, and market liquidity. These factors drive the demand for bonds insured by BAM. In 2021, business volume, in terms of par written and premiums written, may not be at the same level as 2020 due to the year's market dynamics. Insured business volume, however, is likely to be above what we saw before the pandemic as a result of investors realizing the benefits of the financial guarantee product during market uncertainty. Additionally, we expect BAM to continue seeing strong demand in the insured secondary market, because the economics of bond insurance are appealing to institutional investors as a tool for risk mitigation, combined with BAM's marketing efforts in this sector of the U.S. public finance market.

Financial Risk Profile: Very Strong

We assess BAM's capital and earnings as excellent, with a capital adequacy ratio above 1.0x. Our analysis includes the consolidation of the assets in the collateralized trusts securing the first-loss reinsurance obligations of HG Re Ltd. We take this approach because BAM is the sole beneficiary of the trusts and has significant control rights to the investments and distribution of assets from the trusts. The BAM surplus notes held by the supplemental trust are considered an intercompany loan and we don't give them value as assets to meet HG Re's reinsurance obligations. Our capital adequacy analysis also includes the excess of loss coverage from two Fidus Re note issues and MSCs that are assessed with the issuance of each policy.

While the pandemic has led to fiscal challenges for all U.S. public finance sectors, we view the potential impact on BAM as somewhat low at this time. There have been a limited number of ratings downgrades on insured issues, and these downgrades have been limited to a notch or two, with an immaterial effect on BAM's capital adequacy. Further downward migration of ratings on some insured issues is still a possibility. We do not expect, however, these possible rating changes to put excessive stress on capital adequacy given the level of BAM's capital adequacy redundancy.

BAM's moderately high risk exposure reflects the application of our LOT, which highlights potential concentration risks of the insured portfolio that weigh on our our financial risk assessment. This test captures the possible volatility in capital and earnings from rating changes on the underlying insured issues and does not necessarily assume these exposures will default. The investment portfolio of entirely fixed-income investments is low risk, with an average credit quality of 'AA'.

As a mutual insurer, BAM collects member capital contributions with each policy issuance. Its surplus notes are owned by HG Re, but permanently pledged to the collateral trust. The Fidus Re transactions demonstrates BAM's access to capital to fund growth.

Other Key Credit Considerations

Governance

Management effectively enhances its risk management, continuing to address the changing risk dynamics of the U.S. public finance market. Governance and structural limits define the risk categories and underlying risk exposures, which BAM monitors closely for validation. Stress and scenario tests, including an assessment of potentially correlated revenue streams and sensitivities to a variety of concerns are run at least quarterly. We view the well-seasoned management team as a strong factor in our assessment.

Liquidity

We view BAM's liquidity as exceptional based on the high-quality investment portfolio and lack of any credit-sensitive liabilities or collateral-posting requirements. Additionally, BAM is a member of the Federal Home Loan Bank of New York, which expands its access to reliable liquidity at a low cost.

Enterprise risk management

The combination of high leverage (net par exposure relative to capital) and potential increased correlation between individual issuers in stress scenarios is a significant risk to BAM's creditworthiness. The increased correlation between issuers in times of stress can result in substantial losses or rating migration of insured exposure with the high leverage employed magnifying the impact on capital. This leverage and the confidence-sensitive nature of the bond insurance industry lead us to view enterprise risk management functions as important to the rating.

Related Criteria

- Criteria | Insurance | Bond: Methodology And Assumptions For Analyzing Bond Insurance Capital Adequacy, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	**Very Strong**	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	**aa/aa-**	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of July 28, 2021)*

Build America Mutual Assurance Co.	
Financial Strength Rating	
Local Currency	AA/Stable/--
Issuer Credit Rating	
Local Currency	AA/Stable/--
Financial Enhancement Rating	
Local Currency	AA/Stable/--
Holding Company	None
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.