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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	Risks
Very strong competitive position driven by a focus on the U.S. public finance market and stable market share	Concentration risk in the insured portfolio as measured by the largest obligor test (LOT)
Capital adequacy ratio historically above 1.0x and management focus on maintaining this level of capital adequacy	Potential rating migration of some insured exposures as a result of the economic effects of the COVID-19 pandemic

BAM has a strong market position. Build America Mutual Assurance Co.'s (BAM) management has a proven record of credit discipline and growth in terms of par insured and premiums written, which fosters market acceptance of its financial guarantees. BAM writes in the U.S. public finance market only and has a broad presence across the U.S. It is structured as a mutual company owned by the issuers it insures.

BAM has excellent capital and earnings with a meaningful capital adequacy buffer at its current rating. The application of our LOT, however, highlights potential concentration risks of the insured portfolio, which weigh on our assessment of the financial risk profile. S&P Global Ratings thinks the strength of BAM's capital adequacy allows it to withstand potential rating migration within its insured portfolio as a result of the economic effects of the COVID-19 pandemic on underlying insured issuers.

The combination of a very strong business risk profile (BRP) and very strong financial risk profile (FRP) leads to a split anchor of 'aa/aa-'. We chose the higher anchor due to redundancy of capital at the current rating level.

Outlook: Stable

The stable outlook reflects our view that BAM's competitive position will remain very strong while its share of par written and transactions insured will not materially change. We also expect operating performance to improve and become less of a limit on capital growth. 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 operating performance has a significant negative effect on its capital adequacy, limiting the growth of qualified statutory surplus plus the assets in the collateral trusts, or demand for its offered financial guarantees declines as shown by a substantially lower amount of par insured.

Upside scenario

Based on our view of the insurable new-issue U.S. public finance markets, 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 U.S. GDP year-over-year contraction of 5.2% in 2020 and growth of 6.2% in 2021
- 10-year Treasury rate near 1.3% in 2020 and 1.8% in 2021
- Consumer Price Index (CPI) at 0.9% in 2020 and 2.7% in 2021
- Unemployment rate at about 8.8% in 2020 and 6.7% in 2021

Key Metrics

	2019	2018	2017	2016	2015
S&P Global Ratings capital adequacy	AAA	AAA	AAA	AAA	AAA
Claims paying resources (mil. $)	938	871	808	644	602
Gross premium written (mil. $)	108	110	104	77	55
Operating return on equity (%)	7.3	4.6	2.8	1.2	N.M.
Statutory return on revenue (%)	40.8	33.4	25.9	10.8	N.M.
Net combined ratio (%)	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 BRP is shaped by its strong market presence in the U.S. public finance market, prudent underwriting discipline, and stable share of par insured and premiums written in the U.S. public finance market. 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.

As BAM's business volume has risen and insured portfolio has grown, its operating performance and profitability have improved. 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 in which it was collected.

Uncertainty in the U.S. public finance market stemming from the pandemic led to many municipal issuers generally delaying new issue transactions, which limits the bond insurers' underwriting opportunities. The severe market dislocation forced many municipal issuers to delay, not abandon, their transactions until market volatility falls and market access is much better.

A flight to safety by investors pushed U.S. Treasury bond yields much lower/faster than the municipal bond market as investors focus on credit risk and credit concerns, creating wider spreads between differently rated municipal issuers. The outflows in mutual funds that forced massive selling have contributed to widening spreads. Wider credit spreads and investor uncertainty provide BAM underwriting opportunities.

We expect BAM to continue seeing strong demand in the secondary market because the economics of bond insurance are appealing to institutional investors as a tool for risk mitigation. Once market volatility ebbs and market access is reestablished, BAM should see an increase in underwriting opportunities.

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 took 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 the supplemental trust holds 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 Fidus Re Ltd. and members' surplus contributions that are assessed with the issuance of each policy.

While the COVID-19 pandemic is causing significant volatility in U.S. financial markets and presents fiscal challenges ahead for all U.S. public finance sectors, we view the potential impact on BAM as somewhat low at this time. Notwithstanding the current macroeconomic environment, we do not expect defaults of issues insured by BAM to be widespread, but there is potential for rating changes for some insured issues. We also do not expect these possible rating changes to put excessive stress on capital adequacy due to BAM's capital adequacy redundancy and our expectation that rating changes within the insured portfolio will be low--limited to a notch. BAM's underwriting and risk-management guidelines result in an insured portfolio that does not reflect the overall U.S. municipal market and may perform better in a stressful economic scenario.

We have performed a sensitivity stress test for sectors we view as having the greatest potential for rating changes. The sensitivity stress tests include following sectors within BAM's insured portfolio:

- Tax-supported debt--sales, gas, excise, and hotel/motel;
- Transportation--airports, ports, toll roads, and parking facilities; and
- Special revenue--public universities and community colleges.

The sensitivity assumed a one-category downward rating change (three notches) of insured exposure in these sectors. Our analysis indicated that the incremental increase in loss assumption would still result in an excellent capital adequacy assessment.

BAM's moderately high risk exposure reflects the application of our LOT, which highlights potential concentration risks of the insured portfolio and that weigh on our assessment of BAM's FRP. The investment portfolio presents low risk and is entirely fixed income investments 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 transaction 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. It runs stress and scenario tests, including an assessment of potentially correlated revenue streams and sensitivities to a variety of concerns at least quarterly. We view the well-seasoned management team--with more than 25 years on average in the municipal bond insurance industry--as a strong factor in our assessment.

Liquidity

We view BAM's liquidity as exceptional based on the lack of any credit-sensitive liabilities or collateral-posting requirements, as well as a high-quality investment portfolio. As of Dec. 31, 2019, BAM had $206 million in cash and short-term investments. Additionally, BAM is a member of the Federal Home Loan Bank of New York, which expands its financial flexibility by providing access to reliable liquidity at a low cost.

Environmental, social, and governance(ESG)

We assess BAM's ESG risks as in line with those of the insurance industry. The most-predominant of these risks are the sector's exposure to natural catastrophe events and the effect this has on lease and revenue streams backing insured issues, as well as lower assessed property values due to weather-related property damage. But the insurer's underwriting, surveillance, and insured portfolio management strategies mitigate risk concentration and potential losses due to the macroenvironment. When we assess the risk of the underlying insured issue to a bond insurer, ESG is part of the analysis of each insured issue. BAM's investment guidelines incorporate ESG considerations by prohibiting investment in coal and other fossil fuels, as well as clear limits by individual obligor, sector, credit ratings, and speculative-grade securities. Through BAM GreenStar, it is instructing targeted issuers about the benefits of green bonds as a tool to satisfy investor demand for social investing. We also think both social and governance credit factors are not material to our opinion of BAM's creditworthiness. While we continue to view BAM's governance practices as a strength, our governance assessment does not provide any uplift to the ratings.

Enterprise risk management(ERM)

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 a bond insurer'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 confidence-sensitive nature of bond insurance industry lead us to view ERM functions as an important factor to the ratings.

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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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 June 29, 2020)*

Build America Mutual Assurance Company	
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.