MOODY'S
INVESTORS SERVICE

CREDIT OPINION
25 May 2016

Update

Rate this Research

RATINGS

National Public Finance Guarantee Corp

Domicile	ILLINOIS, United States
Long Term Rating	A3
Type	Insurance Financial Strength
Outlook	Negative

Please see the ratings section at the end of this report for more information.The ratings and outlook shown reflect information as of the publication date.

Contacts

James Eck 212-553-4438
VP-Sr Credit Officer
james.eck@moodys.com

Stanislas Rouyer 212-553-3684
Associate Managing Director
stanislas.rouyer@moodys.com

Roman Harutyunyan 212-553-4853
Associate Analyst
roman.harutyunyan@moodys.com

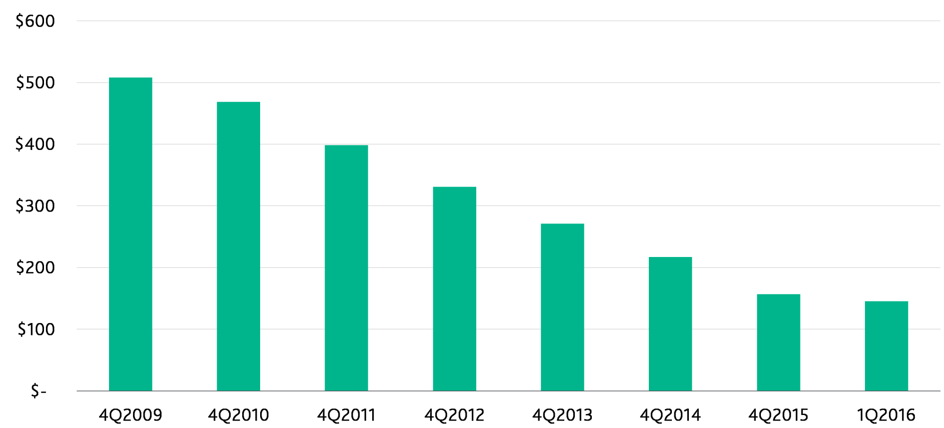
National Public Finance Guarantee Corp.

Update following rating affirmation at A3

Summary Rating Rationale

National Public Finance Guarantee Corporation's (National) A3 insurance financial strength (IFS) rating (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. National has substantial exposure to below investment grade (BIG) credits, which represent approximately 4.2% of its insured book and 185% of qualified statutory capital at 1Q2016. Included in its BIG exposures are approximately $4.3 billion gross par plus accreted interest exposure to debt issued by Puerto Rico and its public enterprises. In addition, National, like its peers, faces significant headwinds from weak fundamentals in the financial guaranty insurance sector, including low levels of product utilization, moderate prospective profitability and meaningful legacy risk. Moody's also notes that National remains a distant third competitor in the US financial guaranty insurance sector behind market leaders Assured Guaranty and Build America Mutual.

Exhibit 1
National Public Finance Guarantee Corporation
Net Par Outstanding ($ Bil.)



Source: Company Reports

National is a direct writer of financial guaranty insurance on US municipal bonds. National is one of three main operating companies of its ultimate parent, MBIA Inc. (MBIA – Senior debt Ba1/negative) Affiliated companies include MBIA Insurance Corporation (MBIA Corp. - IFS rating at Caa1/negative), which provides insurance primarily on structured finance transactions and is currently in run-off. MBIA Corp. subsidiary MBIA UK Insurance Limited (MBIA UK – IFS Rating Ba2/stable) provides insurance primarily on non-US public finance and infrastructure transactions and is also currently in run-off.

The rating differentiation among MBIA's operating companies is based primarily on Moody's view of the respective firms' strategic role within the MBIA group of companies as well as the composition and risk of their insured portfolio relative to their liquidity and capital resources.

Credit Strengths

» Generally high quality and well-diversified US municipal insurance portfolio

» Substantial claims-paying resources

» The group's experienced management team

Credit Challenges

» Difficult market environment characterized by low interest rates and limited demand for bond insurance

» Large single risk exposures, including high risk Puerto Rico related obligations that represent more than 100% of qualified statutory capital

» Part of a group comprising significantly weaker affiliates

Rating Outlook

On 20 May 2016, Moody's affirmed the A3 IFS rating of National with a negative outlook. The negative outlook reflects the heightened risk of losses on National's Puerto Rico-related exposures, the size of these exposures relative to capital and claims paying resources and the meaningful level of uncertainty about the possible losses in the event of a default or restructuring.

What to Watch For:

» Growth in new business production

» Further details on potential defaults and restructuring among Puerto Rico exposures, with a near-term focus on the Puerto Rico Electric Power Authority (Caa3/negative) which has reached a restructuring agreement with creditors, but has yet to complete its contemplated restructuring.

Factors that Could Lead to an Upgrade

A substantial reduction in National's exposure to Puerto Rico, or of the range of possible losses relative to National's statutory capital and claims paying resources could lead to a return to a stable outlook. Over the longer term, the following factors could lead to an upgrade of National's rating:

» The successful, long-term resolution of Puerto Rico's funding and solvency issues

» The reestablishment of National's financial guaranty franchise in the US municipal market

Factors that Could Lead to a Downgrade

» Substantial credit erosion of insured risks, including meaningful impairments of its Puerto Rico exposure that result in 15%+ reduction in qualified statutory capital over a twelve month period

» A meaningful withdrawal of capital absent a significant reduction in the uncertainty around its Puerto Rico exposures

» Provision of material support to weaker affiliates

» A material decrease in profitability

» Significant diversification into higher risk businesses

Key Indicators

National Public Finance Guarantee Corporation

National Public Finance Guarantee Corporation[1][2]	2015	2014	2013	2012	2011
As Reported (U.S. Dollar Millions)					
Gross Par Written	597	343	-	-	-
Present Value Premiums (PVP)	5	3	-	-	-
Net Income	284	238	256	416	478
Gross Premiums Written	17	14	12	(5)	22
Net Par Outstanding [1]	156,634	217,248	271,105	330,845	398,602
Regulatory Capital [2]	3,388	3,266	3,258	3,248	2,809
Portfolio Leverage of Regulatory Capital [2]	46.2x	66.5x	83.2x	101.9x	141.9x
Claims Paying Resources	4,699	4,950	5,252	5,659	5,691
Portfolio Leverage of Claims Paying Resources	33.3x	43.9x	51.6x	58.5x	70.0x
Coverage of Moody's Capital Charge at the A3 Level	1.42x	1.23x	1.29x	--	--
PV Premiums divided by gross par written (bps)	130	118	--	--	--
% Of Industry Gross Par Written	2.1%	1.6%	0.0%	0.0%	0.0%
% Par Reinsured	2.7%	2.3%	2.1%	1.9%	2.9%
Underwriting Margin (1 yr)	85%	56%	61%	64%	82%
Return on Capital (1 yr)	8.5%	7.3%	7.9%	13.7%	18.4%
Sharpe Ratio of ROC (5 yr avg)	261%	269%	--	--	--
Financial Leverage [3]	39.2%	38.7%	41.9%	41.5%	43.2%
Total Leverage [3]	44.2%	42.9%	45.9%	44.9%	46.3%
Cashflow Coverage (1 yr) [4]	3.5x	4.4x	2.7x	1.5x	0.0x
Earnings Coverage (1 yr) [4]	1.9x	2.8x	-2.6x	-3.7x	-1.7x

[1] Net Par Outstanding is based on GAAP reported amounts
[2] Regulatory capital defined as U.S. Statutory Qualified Statutory Capital for U.S. guarantors
[3] Based on MBIA Inc. consolidated financial statements
[4] Based on holding company data excluding Surplus Notes accrued interest; Cashflow coverage includes tax escrow release
Source: Moody's Investors Service, Company Reports

Notching Considerations

MBIA Inc.'s Ba1/negative senior unsecured debt rating is four notches lower than the IFS rating of its lead insurance subsidiary, National. This is wider than the typical three notches for insurance groups domiciled in the United States, reflecting MBIA's high leverage and the significantly weaker credit profile of affiliate MBIA Corp. The negative outlook on MBIA Inc.'s rating, reflects the heightened risk of losses on National's Puerto Rico exposures, and the adverse effect it could have on its liquidity, given its reliance on the future release of tax escrow funds and dividends from National to pay debt service. In addition, the firm's high debt burden and meaningful asset risks, a large share of which reside in its wind-down operations, remain a distinct weakness.

Detailed Rating Considerations

Moody's rates National A3 for insurance financial strength, which is in line with the A3 rating produced by Moody's unadjusted rating scorecard.

Insurance Financial Strength Rating

The key factors currently influencing the ratings and outlook are:

MARKET ENVIRONMENT AND PRODUCT STRATEGY: Baa - EFFORTS TO GROW PRODUCTION FACE HEADWINDS FROM DEPRESSED INSURANCE USAGE AND LEGACY EXPOSURES

The Baa score reflects National's ongoing efforts to reestablish its franchise in the primary and secondary US municipal debt markets, having resolved litigation related to MBIA's "transformation" transactions and significantly reduced inter-company linkages within the MBIA group. In addition, market prices on National wrapped debt indicate investors are attributing value for the wrap. However, National has yet to gain significant traction in the market, and the firm's market share remains in the low single digit percentage range. Like its peers, National faces significant headwinds from weak fundamentals in the financial guaranty insurance sector, including a dramatic reduction in insurance usage, moderate prospective profitability and still-meaningful legacy risk. We also believe that National will have to contend with risk-concentration overhang including, notably, its exposure to Puerto Rico, in achieving broad market acceptance of its insurance. In addition, persistent low interest rates exacerbate an already challenging business environment. It remains to be seen whether the company will successfully establish a durable market presence, marked by its ability to underwrite policies at attractive risk-adjusted pricing.

PORTFOLIO CHARACTERISTICS AND CAPITAL ADEQUACY: A – LARGE PUERTO RICO EXPOSURE IS A DISTINCT WEAKNESS

National's single-A range capital adequacy score reflects its substantial capital resources relative to its predominately low-risk, US municipal-focused portfolio. At 1Q2016, National reported qualified statutory capital (QSC) of $3.4 billion and total claims paying resources of $4.7 billion. While its statutory capital and claims paying resources are substantial and the public finance portfolio is, for the most part, of high credit quality, National's capital adequacy score is negatively impacted by its exposure to certain large below investment grade (BIG) credits.

The average credit quality of National's insured portfolio is strong, with the majority of the insured risks rated double-A or single-A. However, single risk concentrations and relatively large BIG exposures are notable weaknesses. At 1Q2016, National reported BIG exposure of approximately 4.2% of its insured book and 185% of QSC. National's BIG exposure includes approximately $4.3 billion of total gross par plus accreted interest exposure to the Commonwealth of Puerto Rico and its public enterprises. Other high profile exposures to weaker municipal credits include the City of Chicago ($1.3 billion City GO/$1.6 billion Board of Education GO, both adjusted for accreted interest on capital appreciation bonds).

Partially offsetting the credit deterioration of certain large single risk exposures to some extent, is the rapid amortization of National's insured portfolio over the past several years, which frees up capital.

PROFITABILITY: A - STRONG EMBEDDED EARNINGS MODERATED BY VULNERABILITY TO CREDIT IMPAIRMENTS

During 2015, National reported gross par written of approximately $597 million, an increase from $343 million written during 2014, a year which marked the firm's return to the US public finance market after a long hiatus. Despite the very low new business premiums associated with this business, National continues to earn substantial revenues from its existing insurance portfolio through recognition in earnings of the unearned premium reserve and investment income.

This ability to generate earnings absent significant new business flow is a powerful characteristic of the financial guaranty insurance business model, and affords National some leeway as it works to reestablish its business. That said, refunding premiums earned are expected to decline, as the refinancing wave tapers off, and there is a meaningful degree of uncertainty as to the level of new business National will be able to generate. Without a significant increase in new business flow, National's earned premiums will continue to exhibit a structural decline as the company's legacy exposures amortize. In addition, National's large exposure to BIG municipal credits, Puerto Rico in particular, could result in substantial earnings volatility.

FINANCIAL FLEXIBILITY: Ba - NO CAPITAL ACCESS SINCE EARLY 2008

The group has not demonstrated access to capital markets since 2008, however, in our view, MBIA's financial flexibility has improved over the past few years, as it has redeemed debt and has the ability to upstream dividends from National. The group's adjusted financial leverage was approximately 39.2% at YE2015, a slight improvement relative to a couple of years ago (41.9% at YE2013). Excluding the principal and accrued interest on the surplus notes of MBIA Corp., MBIA Inc.'s adjusted financial leverage was approximately 30% at YE2015. The group's cashflow coverage of interest expense (excluding accrued interest on MBIA Corp.'s surplus notes that is not currently being paid) was approximately 3.5x during 2015.

Liquidity Analysis

MBIA Inc.'s liquidity profile strengthened with the resumption of dividend payments from National in October 2013, and the steady release of funds from the National tax escrow account. At 1Q2016, the holding company had unencumbered cash and liquid investments of $371 million, which has trended downward in recent quarters due to $330 million in share repurchases since January 2015. We expect the group's financial flexibility and MBIA Inc.'s liquidity to be adequate absent extraordinarily high losses at National that erode the firm's earned surplus and impair its ability to upstream dividends without regulatory approval and reduce future levels of tax escrow funds that can be released.

While liquidity has strengthened, the holding company remains dependent on dividends from National and funds from the tax escrow account to service its obligations. At 1Q2016, the holding company reported debt (including investment agreements, long-term debt and medium-term note liabilities) of approximately $2.2 billion, and cash and invested assets of approximately $1.4 billion. The company expects to address the shortfall in cash and invested assets over time, through distributions from National and releases from the tax escrow.

MBIA Inc. is required to meet collateral posting requirements under terms of its derivatives and investment agreements. In order to secure access to eligible assets to post as collateral, MBIA Inc. entered into simultaneous repurchase and reverse repurchase agreements (Asset Swap) with National, whereby MBIA Inc. borrows government securities from National, in-turn, collateralized with investment grade assets, from MBIA Inc. A haircut, which varies according to mark-to-market adjustments, is applied to the assets posted by MBIA Inc. While the Asset Swap facility is limited to a notional value of $2 billion, as of 1Q2016, $130 million was outstanding under the facility.

Rating Methodology and Scorecard Factors

National Public Finance Guarantee Corporation

Financial Strength Rating Scorecard	Aa	A	Baa	Ba	B	Caa	Score	Adjusted Score
Business Profile								
Market Environment and Product Strategy (25%)							**Ba**	**Baa**
Industry Environment				x				
Market Position and Product Strategy				x				
Financial Profile								
Portfolio Characteristics and Capital Adequacy (40%)							**Aa**	**A**
Risk Adjusted Capital Coverage	x							
Profitability (20%)							**Aa**	**A**
Underwriting Margin (5 yr average)	69.9%							
Return on Capital (5 yr average)	11.2%							
Sharpe Ratio of ROC (5 yr)		260.6%						
Financial Flexibility (15%)							**Baa**	**Ba**
Financial Policy			x					
Ease of Access to Capital				x				
Operating Environment							Aaa - A	Aaa - A
Aggregate Profile							**A3**	**A3**

[1] Information based on SAP financial statements as of Fiscal YE December 31
[2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis
Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
NATIONAL PUBLIC FINANCE GUARANTEE CORP	
Rating Outlook	NEG
Insurance Financial Strength	A3
MBIA INC.	
Rating Outlook	NEG
Senior Unsecured	Ba1

Source: Moody's Investors Service

REPORT NUMBER 1029207

MOODY'S
INVESTORS SERVICE