

BOND INSURANCE - PART 1

JANNEY FIXED INCOME STRATEGY

OCTOBER 11, 2011



In this first of a three part report we provide an overview of the municipal bond insurance industry.

Insurance does not replace a rating, but rather enhances bondholder security.

THE EVOLUTION OF BOND INSURANCE

- Three years after the financial crisis and a troubled mortgage market lead to downgrades for most bond insurers, market share of new issuance has fallen from near 50% to 6%.
- Remaining insurers are segmented with two still viable, three trading water and two defunct.
- Assured Guaranty and BHAC retain high ratings, although only one is actively writing new business.
- National/MBIA, Ambac and Radian continue to provide investor value, which is not reflected in yields.

Five years ago, about half of municipal new issue volume was backed by insurance from one of the multiple AAA rated insurers. Although these companies focused initially on municipal debt, most eventually diversified into other business lines, and as the real estate market continued to thrive, much of the exposure of these insurers migrated to mortgage backed securities (MBS), collateralized debt obligations (CDO) and other types of derivative and structured products, to which they provided their guarantee. The financial crisis of 2007 - 2008 brought the birds home to roost, and as the real estate market crumbled, it became evident that the credit quality of many of the insurers' liabilities was well below initial assessments. Expanding beyond their municipal bond roots, to the more risky MBS and CDO products, proved disastrous for most of these companies.

Beginning with a few downgrades in January 2008, the rating agencies ended the reign of AAA insurance, with ratings for several insurers below investment grade by year end. CIFG, for example, which carried a AAA rating from all three rating agencies dating to May 2002, was downgraded to the A category in March 2008, and by year end was rated B3/B/NR. The only insurer to buck the trend was a startup, Berkshire Hathaway's BHAC, which received AAA ratings from both Moody's and S&P in April 2008, but even BHAC's rating subsequently fell below AAA. Three insurers retain investment grade ratings today, but only one, Assured Guaranty, is writing new business, insuring about 6% of total new issuance in the past twelve months.

Prior to the downgrades, it was not uncommon for bond issuers to seek ratings based only on insurance, skipping the additional payment rating agencies require for an underlying rating. Underlying ratings are based on the creditworthiness of the issuer, rather than the insurer. When several insurers lost their ratings altogether, many investors were left with nonrated bonds. In the today's environment, few borrowers would consider offering bonds with only an insurance rating since most investors consider the underlying rating to be an important credit factor. Insurance does not replace a rating, but rather enhances bondholder security. The question remains whether insurance from a low rated or non rated insurer provides value for investors in the secondary market.

Bond insurers are generally structured as subsidiaries of holding companies. For example Assured Guaranty Ltd is the parent company, traded on the NYSE and other exchanges under the symbol AGO. Its bond insurance subsidiaries are Assured Guaranty Corp, Assured Guaranty Municipal Corp and Assured Guaranty Re Ltd. Each subsidiary maintains and reports separate financial information, although this information is often presented on a consolidated basis. These companies are regulated by state insurance departments, in most cases the New York Insurance Department although Wisconsin is Ambac's regulator while ACA is regulated by Maryland.

ALAN SCHANKEL
Managing Director
215 665 6088
aschankel@janney.com

See page 4 for important information and disclaimers.

JANNEY MONTGOMERY SCOTT
www.janney.com
© 2011 Janney Montgomery Scott LLC
Member: NYSE, FINRA, SIPC

See Appendix on page 4 for explanation of bond insurers' resources and obligations.

Investors demand 7 to 25 more basis points for an uninsured bond compared to the same bond backed by Assured.

Five Municipal Bond Insurers Continue to Pay Claims

Amounts in millions	BHAC (1)	Assured	National	Ambac	Radian
Ratings	Aa1/AA+	Aa3/AA+	Baa1/BBB	NR/NR	Ba1/BB-
Par Insured	\$20,808	\$587,196	\$449,805	\$299,683	\$74,688
US Muni Percent of Total Par	100%	70%	100%	63%	48%
Net Debt Service Outstanding (P&I)	\$30,000	\$870,856	\$715,720	\$476,948	\$95,108
Claims Paying Resources (2)	\$1,694	\$13,139	\$5,659	\$7,939	\$2,155
Claims Paying Ratio (3)	17.71	66.28	126.47	60.07	44.13

(1) BHAC net debt service and ratio is estimate

(2) Claims Paying Resources includes Statutory Capital, Unearned Premiums and PV of Future Installment Payments

(3) Claims Paying Ratio is Debt Service Outstanding divided by Claims Paying Resources

Financial information is as of 6-30-11 except BHAC which is as of 12-31-10

Source: Moody's, S&P, Company Reports and Janney Fixed Income Strategy.

THE VALUE OF BOND INSURANCE

The tumultuous decline of the bond insurance industry indelibly changed investor perceptions about the value of bond insurance. There was a period of time in late 2008 and early 2009 when insurance from MBIA or Ambac was actually regarded by many as a negative factor. When considering an investment, some investors were willing to accept a lower yield for an uninsured bond than for the same bond with insurance. Of course this was an irrational reaction born of extreme uncertainty.

Assured and BHAC

To some extent, the value of Assured Guaranty insurance can be quantified. Occasionally, larger issuers, seeking to market to a wide range of investors, will split up maturities between insured and uninsured bonds. The table lists several issues and maturities which were marketed since July 1, 2010. By comparing the offering yield of insured and uninsured bonds within the same maturity, a spread or yield differential between insured and uninsured can be identified. This spread can vary depending on underlying rating, maturity and timing. Based on this data we can posit that investors demand 7 to 25 more basis points for an uninsured bond compared to the same bond backed by Assured. BHAC insurance is likely at least as valuable to investors as that of Assured. It's more challenging to quantify the value of insurance for the rest of the field.

Up to 25 Basis Point Yield Difference Between Assured Guaranty and Uninsured

Date	Issuer	Underlying Rating	Maturity	Insured Yield %	Uninsured Yield %	Spread %
6/27/2011	Citizens Property - FL	A2/A+/A+	2015	2.83	3.08	0.25
6/27/2011			2020	4.50	4.75	0.25
5/9/2011	Illinois Fin Auth - Carle	NR/A+/AA-	2041	6.03	6.15	0.12
3/28/2011	Sunshine Govt Comm - FL	Aa3/A+	2021	4.80	4.98	0.18
2/7/2011	Puerto Rico GO	A3/BBB-/BBB+	2034	6.05	6.30	0.25
10/25/2010	Phila Airport	A2/A+/A	2014	1.79	1.86	0.07
10/25/2010			2022	3.75	3.92	0.17
7/19/2010	Miami Dade Co Aviation	A2/A-/A	2024	4.36	4.49	0.13
7/19/2010			2030	4.83	5.00	0.17
7/5/2010	Delaware River Port Auth	A3/A-	2040	4.89	5.09	0.20

Source: Bloomberg and Janney Fixed Income Strategy

Insurance from National, Ambac and Radian does add value to investor holdings, especially in the case of otherwise low rated and non rated issues.

Insurance will continue as a useful niche product, adding security to otherwise well rated credits, but it is no longer the panacea it was viewed to be in the past.

National

Intrinsically there is an identifiable benefit to having National Insurance, with its investment grade rating, \$5.6 billion of claims paying resources and well functioning management. National's surveillance and remediation capabilities are a tangible benefit for bondholders, but quantifying this value is challenging. Anecdotal observations of offerings and trades show little if any yield differential for a bond with National insurance compared to similar uninsured bonds, and in some cases, investors shy away from a bond with an underlying rating of A, but also carrying the Baa1/BBB rating of National as if the BBB range ratings taint the otherwise A rated issue. On lower rated or non rated issues, in particular, we believe the intrinsic investor benefit to be in the 5 basis point range, and in a few cases, as much as 10 basis points. If, as we expect, National emerges as an A or higher rated insurer down the road, the benefit will be more evident and reflected in market prices.

Ambac

Ambac is not in the same league as National, with much more uncertainty in the future, including the evolving bankruptcy of its parent, but like National, Ambac has a significant and proven surveillance and remediation capability as well as nearly \$8 billion of claims paying resources. If National insurance has 5 to 10 basis points of value when associated with lower rated issues, then Ambac is in the 2 to 5 basis point range – again a theoretical assessment.

Radian

Although rated as junk, we'd put the value of Radian insurance about on par with Ambac in the 2 to 5 basis point range. Radian's resources are more limited, with only \$2.1 billion in claims paying resources, but its obligations are also well below National's and Ambac's.

Syncora and AGC

We see no value in these two defunct insurers.

CONCLUSION

Although only about 6% of new municipal issuance carries insurance, much of the secondary market supply is guaranteed by insurers covered in this report. Assured Guaranty and BHAC are both high quality insurers, with high investment grade ratings and the ability to continue writing new business, although BHAC chooses not to do so – at least for now. Contrary to an overwhelming market perception in the aftermath of the financial crisis and resultant insurer downgrades, insurance from National, Ambac and Radian does add value to investor holdings, especially in the case of otherwise low rated and non rated issues.

The future for the bond insurance industry remains uncertain, but as the most serious issues recede, and as insurer obligations become more seasoned with time, the situation is slowly improving. Risks remain, including potential credit issues if the national economy deteriorates rapidly. Ambac and National face unresolved legal hurdles which will take time to work through. As the market stands now, it will be surprising to see any new insurers enter the market, although National could re-start if their legal process is finalized favorably. Going forward, we will not see anything near the 50% market penetration of years past. Although bond insurance has largely accomplished its primary function, protecting bondholders from missed debt service payments, investors are much more cautious about insurance today. Insurance will continue as a useful niche product, adding security to otherwise well rated credits, but it is no longer the panacea it was viewed to be in the past.

Note: This report is Part 1 of a three part report on municipal bond insurance. Part 2 reviews Assured Guaranty and BHAC in more depth. Part 3 is a review of National/MBIA, Ambac, Radian, Syncors and ACA. Contact your Janney Financial Consultant for further information.

APPENDIX - COMPANY RESOURCES AND OBLIGATIONS

Like other insurance companies, bond insurers identify an amount of capital to back insurance obligations, the amount a fraction of the actual liabilities. A measure of this capital is claims paying resources, whose primary components are:

- Policyholders’ surplus – the difference between assets and liabilities on the balance sheet.
- Contingency reserves – amounts required by regulation to be accumulated as premiums are earned.
- Unearned premiums – this is the insurance premium paid by issuers. Although usually received immediately when a new issue is settled, this revenue is booked as income over time, depending on the duration of the insurance obligation.

An insurer’s obligations under its guarantee are listed in two ways:

- Par insured is self evident, being the total par value of the bonds and securities the company guarantees.
- Total debt service is more encompassing, including both par insured and all future interest payments associated with the insured obligations.

There is a time element to these obligations, which is less evident without digging into financial data. Bond insurers guarantee principal and interest payments over time, so if a municipal bond maturing in 20 years stops making debt service payments today, the insurer is obligated to pay interest when due over the next 20 years and then the principal amount when due at maturity, stretching out the obligation.

The claims paying ratio is the amount of total debt service divided by claims paying resources. Ratios such as this are useful, but limited since there are many underlying factors to be considered. For example if obligations are relatively low risk – high quality municipal bonds compared to derivatives based on subprime mortgages – a higher ratio might be acceptable. Another consideration is the quality of the investments in the portfolio underlying a company’s capital. The bond insurers are restricted by regulators in their ability to drain capital through upstream dividends or loans to the parent organization, with minimum capital levels required by the state insurance departments which regulate them.

ANALYST CERTIFICATION

I, Alan Schankel, the Primarily Responsible Analyst for this report, hereby certify that all of the views expressed in this report accurately reflect my personal views about any and all of the subject sectors, industries, securities, and issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Disclaimer

This Firm, its officers, directors, employees, or members of their families may have positions in the securities mentioned and may make purchases or sales of such securities from time to time in the open market or otherwise and may sell to or buy from customers such securities on a principal basis.

Unless otherwise noted, market data is from Bloomberg, Barclays, and Janney Fixed Income Strategy & Research (Janney FIS). This report is the intellectual property of Janney Montgomery Scott LLC (Janney) and may not be reproduced, distributed, or published by any person for any purpose without Janney’s express prior written consent. This report has been prepared by Janney and is to be used for informational purposes only. In no event should it be construed as a solicitation or offer to purchase or sell a security. The information presented herein is taken from sources believed to be reliable, but is not guaranteed by Janney as to accuracy or completeness. Any issue named or rates mentioned are used for illustrative purposes only, and may not represent the specific features or securities available at a given time. Preliminary Official Statements, Final Official Statements, or Prospectuses for any new issues mentioned herein are available upon request. The value of and income from investments may vary because of changes in interest rates, foreign exchange rates, securities prices, market indexes, as well as operational or financial conditions of issuers or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. We have no obligation to tell you when opinions or information contained in Janney FIS publications change. Janney Fixed Income Strategy does not provide individually tailored investment advice and this document has been prepared without regard to the circumstances and objectives of those who receive it. The appropriateness of an investment or strategy will depend on an investor’s circumstances and objectives. For investment advice specific to your individual situation, or for additional information on this or other topics, please contact your Janney Financial Advisor and/or your tax or legal advisor.

The bond insurers are restricted by regulators in their ability to drain capital, with minimum capital levels required by the state insurance departments which regulate them.

BOND INSURANCE - PART 2

JANNEY FIXED INCOME STRATEGY

OCTOBER 12, 2011



Assured Guaranty and BHAC are no longer AAA rated, but they provide significant, measurable value to investors.

In January 2009, AGC acquired the investment grade portion of now defunct CIFG's municipal exposure through a reinsurance agreement.

ASSURED GUARANTY AND BHAC REMAIN STRONG

- Assured Guaranty, the "last man standing" in municipal insurance, has 100% market share, but the market has shrunk from 50% of new issues to 6%.
- BHAC with Berkshire Hathaway's implicit backing is the strongest of bond insurers, but is writing no new business - at least for now.
- An S&P review, following the release of a revised rating methodology, should leave both insurers in the AA category.

Two insurers retain strong ratings, with Assured Guaranty continuing to actively seek new business, while BHAC only infrequently adds to its insured portfolio. We believe that the creditworthiness and business capabilities of Assured and BHAC are strong, adding value to investors, especially in the case of smaller bond issuers, which are less frequently reviewed by rating agencies, and generally provide less timely and comprehensive financial disclosure.

ASSURED GUARANTY

Moody's Aa3 (Negative Outlook)

S&P AA+ (Negative Watch)

Assured Guaranty is in some ways the last man standing in the bond insurance landscape, responsible for virtually all new issue municipal insurance underwriting in the past two years. Assured Guaranty Municipal Corp and Assured Guaranty Corp, both of which insure municipal bonds, are the primary subsidiaries of Bermuda domiciled Assured Guaranty Ltd.

Assured Guaranty Municipal Corp (AGM) – This subsidiary, originally Financial Security Assurance (FSA), was purchased from French/Belgian bank Dexia in July 2009. AGM is the larger entity, with \$341 billion of par value insurance in force, about 72% of which is US municipal. Although this subsidiary has legacy exposure to structured finance and non-US public finance, its new business underwriting is all US municipal.

Assured Guaranty Corp (AGC) – This is the smaller of the two main subsidiaries, with \$111 million of par value insurance in force, about 57% of which is US municipal. The majority of its new business is US municipal related, but AGC continues to write policies insuring structured finance and non-US public finance transactions. In 2010, this portion of new business totaled below 10% of par insured. In January 2009, AGC acquired the investment grade portion of now defunct CIFG's municipal exposure through a reinsurance agreement. The process of transferring policies, called novation, is ongoing, with most formerly CIFG bonds now carrying the Aa3/AA+ ratings of AGC.

Assured Backs 16% of All Muni Debt

Assured Guaranty Resources and Obligations	
Ratings	Aa3/AA+
Claims Paying Resources (1)	\$13,139
Claims Paying Ratio (2)	66.28
Par Insured	\$587,196
US Muni Percent of Total Par	70%
Net Debt Service Outstanding (P&I)	\$870,856

(1) Claims Paying Resources includes Statutory Capital, Unearned Premiums and PV of Future Installment Payments
(2) Claims Paying Ratio is Debt Service Outstanding divided by Claims Paying Resources
Data is as of 6-30-11 with dollar amounts in millions.

Source: Moody's, S&P, Company Reports and Janney FIS

ALAN SCHANKEL
Managing Director
215 665 6088
aschankel@janney.com

See page 4 for important information and disclaimers.

JANNEY MONTGOMERY SCOTT
www.janney.com
© 2011 Janney Montgomery Scott LLC
Member: NYSE, FINRA, SIPC

Although some company financials break out results by individual unit, for the most part the company presents information on a consolidated basis. Moody's notes that "the credit profiles of the operating companies are differentiated, but intertwined due to the group's flexibility in managing capital among these entities." S&P says "we view AGM and AGC as core to [Assured], and we rate them as a consolidated group." We believe there are meaningful differences between the two subsidiaries in terms of financial profile as well as composition of insured exposure, but given the ability and willingness of the parent to move capital between subsidiaries, within regulatory constraints, they should be viewed as like credits.

Assured's consolidated investment portfolio totals \$11.1 billion, about half of which is invested in municipal bonds (32% AAA, 43% AA, 16% A), with the balance primarily in U S Treasury and Agency securities, corporate bonds and mortgage backed securities.

In a June 2011 report, S&P noted the following about Assured Guaranty:

- US municipal exposure is a predominantly investment grade book of business with minimal history of adverse loss development
- Experienced management team demonstrates a solid understanding of the various risks the company faces

- A conservative investment and liquidity strategy has protected Assured's financial position

The structured finance portion of Assured's consolidated exposure was hit with significant claims in recent years, as the real estate market deteriorated, but on a percentage basis their exposure was not as large as other insurers such as MBIA and Ambac, leading to fewer claims and allowing AGM and AGC to retain their high investment grade ratings. The addition of the insured book of CIFG has and will increase the percentage of exposure accounted for by municipal bonds.

In January 2011, S&P began revising its rating criteria for municipal bond insurers, with initial indications that AGC and AGM could see ratings drop to the A range based on stronger capital requirements. After considering industry comments and results of their own internal review, S&P released final criteria which seemed to spare Assured downgrades based on capital. Revised concentration requirements however, may present a further issue. In September, S&P placed the AA+ rating for AGC and AGM on review for possible downgrade, but both Assured and S&P said the insurer would likely be able to address large exposures to single issuers through reinsurance agreements, which would transfer some of the concentrated exposure to other insurers. S&P expects to complete its review by the end of November 2011. We expect the S&P ratings to remain in the AA category.

BERKSHIRE HATHAWAY

Moody's Aa1 (Stable Outlook) S&P AA+ (Negative Outlook)

As the bond insurance industry began to crumble in 2007, Warren Buffet and Berkshire Hathaway (BRK) saw opportunity. Berkshire Hathaway Assurance Corporation (BHAC) was formed in late 2007, starting business by insuring a few municipal lots in the secondary market. In April 2008, BHAC received AAA ratings from both Moody's and S&P, and extended its reach to the new issue market. With the demise of most AAA insurers, BHAC was able to combine very selective underwriting standards with higher premium levels, reflecting the lack of competition. A year later, with about \$20 billion of insured par value, BHAC effectively exited the bond insurance business. BHAC had seized the opportunity and written high quality business for a year, but as stability came back to credit markets, it became difficult for BHAC to attract new business at the relatively high premium levels it had been able to charge in the depths of the liquidity crisis, so it chose to stop writing new business rather than compete for market share with lower premiums. The decision was also based on Warren Buffet's professed concerns about the municipal market in general. BHAC occasionally insures secondary bond positions, but as a practical matter operates in runoff mode.

80% of Assured Portfolio is AA and AAA

Assured - Investments in millions (June 30, 2011)

US Treasuries and Agencies	\$975
Munis	\$5,184
Corps	\$1,066
RMBS, CMBS and ABS	\$2,371
Foreign Government Securities	\$345
Short Term Investments	\$1,230
Total	\$11,170

Source: Company Reports and Janney FIS

A conservative investment and liquidity strategy has protected Assured's financial position.

Unlike the other bond insurers, which are subsidiaries of financial guaranty companies, BHAC is a very small part of a large diversified company, with \$372 billion in assets and \$136 billion in annual revenue. BHAC does not release the depth of financial detail that other insurers offer, since most BRK information is presented on a consolidated basis, but its basic financial position is very strong, with the lowest claims paying ratio of the companies included in this report. More important is a guarantee of insured policies from Columbia Insurance, majority owner of BHAC and a subsidiary of Berkshire Hathaway.

In a July 2011 report Moody's notes BHAC's Aa1 rating "reflects the company's very strong capital position and high quality insured portfolio of US public finance credits, as well as the explicit support coming from Columbia Insurance Company and implicit support from Berkshire, its ultimate parent." More than 60% of BHAC's exposure is to issues previously insured by other bond insurers and subsequently "wrapped" through reinsurance by BHAC. BHAC was downgraded by Moody's to Aa1 from Aaa in April 2009, along with the parent and other insurance subsidiaries, based on the steep decline in equity markets, which put pressure on valuations in Berkshire Hathaway's substantial investment portfolio. S&P followed suit in February 2010, dropping the rating to AA+ from AAA due to Berkshire's \$26 billion purchase of Burlington Northern Santa Fe.

We would not rule out the possibility of BHAC's reentry into the primary market insurance business should underlying conditions change. Unlike other potential insurers, BHAC has no legacy issues with its business, such as ongoing exposure to mortgage backed securities, and would not face the start up time and costs or other barriers to entry that would challenge new entrants. BHAC remains the strongest of the insurers, and the only one with backing from a huge, diversified corporation. Unfortunately investors will find few offerings of BHAC insured bonds in the market. Perhaps that will change in the future.

Note: This report is Part 2 of a three part report on municipal bond insurance. Part 1 provided an overview of municipal bond insurance while Part 3 is a review of National/MBIA, Ambac, Radian, Syncora and ACA. Contact your Janney Financial Consultant for further information.

BHAC Has Lowest Claims Paying Ratio

BHAC Resources and Obligations	
Ratings	Aa1/AA+
Claims Paying Resources (1)	\$1,019
Claims Paying Ratio (2) (Est.)	30.63
Par Insured	\$20,806
US Muni Percent of Total Par	100%
Net Debt Service Outstanding (P&I) (est)	\$31,209
<small>(1) - Claims Paying Resources includes qualified statutory capital, unearned premium reserves and PV of future installment payments. (2) - Claims paying ratio is debt service outstanding divided by claims paying resources Data as of 12-31-10 with dollar amounts in millions.</small>	

Source: Moody's, S&P, Company Reports and Janney FIS

BHAC remains the strongest of the insurers, and the only one with backing from a huge, diversified corporation.

ANALYST CERTIFICATION

I, Alan Schankel, the Primarily Responsible Analyst for this report, hereby certify that all of the views expressed in this report accurately reflect my personal views about any and all of the subject sectors, industries, securities, and issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Disclaimer

This Firm, its officers, directors, employees, or members of their families may have positions in the securities mentioned and may make purchases or sales of such securities from time to time in the open market or otherwise and may sell to or buy from customers such securities on a principal basis.

Unless otherwise noted, market data is from Bloomberg, Barclays, and Janney Fixed Income Strategy & Research (Janney FIS). This report is the intellectual property of Janney Montgomery Scott LLC (Janney) and may not be reproduced, distributed, or published by any person for any purpose without Janney's express prior written consent. This report has been prepared by Janney and is to be used for informational purposes only. In no event should it be construed as a solicitation or offer to purchase or sell a security. The information presented herein is taken from sources believed to be reliable, but is not guaranteed by Janney as to accuracy or completeness. Any issue named or rates mentioned are used for illustrative purposes only, and may not represent the specific features or securities available at a given time. Preliminary Official Statements, Final Official Statements, or Prospectuses for any new issues mentioned herein are available upon request. The value of and income from investments may vary because of changes in interest rates, foreign exchange rates, securities prices, market indexes, as well as operational or financial conditions of issuers or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. We have no obligation to tell you when opinions or information contained in Janney FIS publications change. Janney Fixed Income Strategy does not provide individually tailored investment advice and this document has been prepared without regard to the circumstances and objectives of those who receive it. The appropriateness of an investment or strategy will depend on an investor's circumstances and objectives. For investment advice specific to your individual situation, or for additional information on this or other topics, please contact your Janney Financial Advisor and/or your tax or legal advisor.

BOND INSURANCE - PART 3

JANNEY FIXED INCOME STRATEGY

OCTOBER 21, 2011



Although unable to write new business, three bond insurers retain significant assets to back obligations.

National (MBIA) and Ambac in combination insure more than \$600 billion of municipal bonds, about 16% of the total outstanding.

INSURANCE FROM NATIONAL, AMBAC AND RADIAN ADDS VALUE

- Baa1/BBB rated National (MBIA) may yet return as a viable insurer.
- Ambac retains significant capital resources, but is struggling with parent bankruptcy and legal challenges to the regulator ordered segregation of toxic liabilities.
- Radian is in rundown mode, but is pursuing a partnership to form a new bond insurance entity.

GOOD COMPANY/BAD COMPANY – SEGREGATING THE RISK

In the third and final part of our report on municipal bond insurers, we look at five insurers that are no longer able to write new business, the two biggest being National (MBIA) and Ambac, which in combination insure more than \$600 billion of municipal bonds, about 16% of the total outstanding. These two insurers dominated the market for AAA bond insurance for many years, along with now defunct FGIC. Their business expansion into non-municipal areas, especially exposures to mortgage backed securities, led to significant claims, capital erosion and rating downgrades, ending their ability to write new business. In early 2009, MBIA began the process of separating its financial guarantee business into two separate units, with National retaining most municipal obligations. Ambac's separation plan was implemented by the Wisconsin Office of the Commissioner of Insurance, with the establishment of a segregated account for most non-municipal obligations. Both plans are being challenged in the courts. National is treated as a separate company in MBIA's financial releases, with distinct capital and obligations. Ambac, on the other hand, still reports as a consolidated unit.

MBIA/NATIONAL

Moody's Baa1 (Developing Outlook)

S&P BBB (Developing Outlook)

With a history dating to 1974, MBIA retained AAA ratings from all three rating agencies until April 2008, when Fitch lowered its rating, followed two months later by Moody's and S&P. Like most other insurers, MBIA stopped writing new policies in 2008. In early 2009, faced with growing claims on its non-public finance exposure, primarily mortgage related securities, MBIA restructured into a version of good company/bad company, creating a separate entity within MBIA, named National Public Finance Guarantee Corp (National), with its own capital base. This effectively walled off the municipal business from the more volatile and risky exposure of structured finance and mortgage related liabilities, which were retained in the MBIA Insurance subsidiary. Although the New York Department of Insurance approved the creation of National, several lawsuits seek to reverse or otherwise unwind the restructuring.

National's Entire Exposure is Muni

National Resources and Obligations	
Ratings	Baa1/BBB
Claims Paying Resources (1)	\$5,659
Claims Paying Ratio (2)	126.47
Par Insured	\$449,805
US Muni Percent of Total Par	100%
Net Debt Service Outstanding (P&I)	\$715,720
(1) Claims Paying Resources includes Statutory Capital, Unearned Premiums and PV of Future Installment Payments	
(2) Claims Paying Ratio is Debt Service Outstanding divided by Claims Paying Resources	
Data is as of 6-30-11 with dollar amounts in millions	

Source: Moody's, S&P, Company Reports and Janney FIS

ALAN SCHANKEL
Managing Director
215 665 6088
aschankel@janney.com

See page 4 for important information and disclaimers.

JANNEY MONTGOMERY SCOTT
www.janney.com
© 2011 Janney Montgomery Scott LLC
Member: NYSE, FINRA, SIPC

Rather than separating into two companies, as was the case with MBIA/National, Ambac's path was established by its regulator.

In a June 2011 report, S&P notes that National would have a standalone rating of A+, and based on capital adequacy alone, National meets S&P's AA standard.

Resolution of legal issues is unlikely before 2012. If the company prevails with its restructuring plan, it's likely that National will be upgraded, potentially able to write new business. If the plan is reversed, claims on the structured finance portfolio exposure will likely weigh down the overall enterprise, putting the operation in runoff mode, and potentially placing MBIA's longer term ability to meet municipal liabilities in jeopardy. Almost certainly, a re-combined entity would be rated below investment grade. A middle ground settlement is also possible with, for example, allowance for a separate National entity, but a requirement that some capital be moved from National to legacy MBIA. S&P says that it "regards National's corporate strategy, management and municipal underwriting staff favorably" further noting that "once litigation is resolved, National will be able to expand or contract its book to achieve strong earnings."

In August 2008, MBIA announced that it would reinsure the investment grade municipal bonds initially insured by FGIC. The transaction was effective January 1, 2009, for a total of \$166 billion of par value. In exchange for the reinsurance, FGIC paid MBIA approximately \$639 million of unearned premiums. As a result of this transaction, the vast majority of FGIC insured bonds now carry the insurance and rating of National. The reinsurance is provided on a "cut-through" basis, meaning that FGIC policyholders can present any claims directly to National. FGIC filed for bankruptcy in August 2010.

AMBAC

No Ratings

Ambac Assurance is a subsidiary of Ambac Financial, which filed for bankruptcy relief in November 2010. Like other insurers, Ambac experienced dramatic credit deterioration amidst the mortgage and financial market crisis of 2007-2008. The company stopped writing new business after losing its AAA ratings in June 2008, and was rated Caa2/CC, before its ratings were withdrawn by S&P in November 2010, and Moody's in April 2011.

Rather than separating into two companies, as was the case with MBIA/National, Ambac's path was established by its regulator, the Wisconsin Insurance Commissioner. In March 2010, the Insurance Commissioner established an account to segregate "certain liabilities that presented serious financial hazards to the company and all of its policyholders." This consists primarily of various Residential Mortgage Securities (RMBS) and Credit Default Swaps (CDS) Ambac had insured, but notably it also includes Ambac insured municipal bonds issued for the now bankrupt Las Vegas Monorail. The segregation is a component of a rehabilitation plan that was confirmed by a Wisconsin court in January 2011. Claims against securities in the segregated account are to be settled by payment of 25% of the claim in cash, and 75% in Ambac notes maturing in 2020.

As of June 30, 2011 Ambac had \$300 billion of par value exposure with claims paying resources of \$7.9 billion, with about \$50 billion in the segregated account. The combination of the parent bankruptcy filing and uncertainty about finality of the insurance commissioner's rehabilitation plan make future stability questionable and timing for ultimate resolution unknown. Late last month, Ambac filed a revised bankruptcy reorganization plan, which reportedly was approved by representatives of all stakeholders, including the Wisconsin regulator. A best case would have the rehabilitation plan play out, with the general account (non segregated), consisting mostly of municipal bond obligations, backed by sufficient capital to allow an orderly rundown of exposure, but it will take time – perhaps many years – before the final outcome is evident.

National's Investments Average AA

National - Investments in millions (December 31, 2010)	
US Treasuries and Agencies	\$247
Munis	\$3,187
Corps	\$405
RMBS, CMBS and ABS	\$1,487
Foreign Government Securities	\$1
Short Term Investments	\$96
Total	\$5,423

Source: Company Reports and Janney FIS

Ambac Resources Total \$8 Billion

Ambac Resources and Obligations	
Ratings	NR/NR
Claims Paying Resources (1)	\$7,939
Claims Paying Ratio (2)	60.07
Par Insured	\$299,683
US Muni Percent of Total Par	63%
Net Debt Service Outstanding (P&I)	\$476,948
<small>(1) Claims Paying Resources includes Statutory Capital, Unearned Premiums and PV of Future Installment Payments</small>	
<small>(2) Claims Paying Ratio is Debt Service Outstanding divided by Claims Paying Resources</small>	
<small>Data as of 6-30-11 with dollar amounts in millions</small>	

Source: Company Reports and Janney FIS

It seems unlikely that Ambac will recover enough to re-enter the bond insurance arena. Much of the value of Ambac resides in the company's demonstrated ability to monitor and address problems within its insured portfolio. With the exception of Las Vegas Monorail and certain student loan securities in the segregated account, claims against municipal bonds have been paid in full as presented. Although \$8 billion of claims paying resources is a significant amount, it is uncertain how resolution of the rehabilitation plan and reorganization plan will affect capital available to pay claims. The Wisconsin Insurance Commissioner's approach is certainly positive for holders of most Ambac insured municipal bonds, but Ambac's future remains uncertain.

Ambac Investments Average AA

Ambac - Investments in millions (December 31, 2010)	
US Treasuries and Agencies	\$361
Munis	\$2,204
Corps	\$918
RMBS, CMBS and ABS	\$2,543
Foreign Government Securities	\$118
Short Term Investments	\$709
Total	\$6,853

Source: Company Reports and Janney FIS

RADIAN - IN RUNDOWN MODE

Moody's Ba1 (Stable Outlook)

S&P BB- (Negative Outlook)

Radian Asset Assurance is a subsidiary of Radian Group, whose primary business is providing private mortgage insurance. Radian never carried the AAA ratings of most of its competitors, but was rated Aa3/AA before downgrades began in June 2008, forcing Radian to cease writing new business. Currently in rundown mode, Radian insured \$35.6 billion in municipal debt and \$39 billion in structured debt on June 30, 2011, down about 14% from levels of eighteen months earlier. Supporting these insurance liabilities is about \$2 billion of claims paying resources. The parent's announced plan is to bolster its mortgage insurance business by using the bond insurer subsidiary as a capital source, withdrawing capital in excess of amounts needed to meet regulatory requirements. As the insured portfolio runs off, regulatory capital requirements decline in line with reduced liabilities. Radian Assurance pays this excess capital as dividends to the parent, including \$69 million in 2010 and \$53 million in June 2011. Although this policy supports growth of the mortgage insurance business, it limits increases in capital ratios at the bond insurance subsidiary level.

Half of Radian Exposure is Non-Muni

Radian Resources and Obligations	
Ratings	Ba1/BB-
Claims Paying Resources (1)	\$2,155
Claims Paying Ratio (2)	44.13
Par Insured	\$74,688
US Muni Percent of Total Par	48%
Net Debt Service Outstanding (P&I)	\$95,108
<small>(1) Claims Paying Resources includes Statutory Capital, Unearned Premiums and PV of Future Installment Payments</small>	
<small>(2) Claims Paying Ratio is Debt Service Outstanding divided by Claims Paying Resources</small>	
<small>Data is as of 6-30-11 with dollar amounts in millions</small>	

Source: Moody's, S&P, Company Reports and Janney FIS

In June, Radian completed the purchase of MIAC, a New York financial guaranty company, which had planned to enter the bond insurance business, but wrote no policies. Radian noted in the December 2010 annual report that the purchase would provide the flexibility to "pursue strategic alternatives in the public finance market." In late September, Radian announced a partnership with the National League of Cities to create a mutual municipal bond insurance company. Such an entity would be challenged to attract the necessary investment, limited by the mutual structure.

Although Radian Asset Assurance is rated below investment grade and retains exposure to structured debt such as CDO's, the company has adequate capital to support the rundown of its insured portfolio, barring unforeseen problems or a hard downturn in the US economy. The Radian moniker on a municipal bond adds some amount of investor value in both the capital support it provides and the support of its professional staff, which monitors and where needed, negotiates resolution of problems with impaired securities. A bond insured by Radian is stronger than the same bond with no insurance.

In late September, Radian announced a partnership with the National League of Cities to create a mutual municipal bond insurance company.

Syncora and ACA are effectively defunct.

SYNCORA (XLCA)

Moody's Ca (Developing Outlook)

S&P No Rating

Syncora, formerly XLCA, began operations as a AAA rated bond insurer in 2001. Like other insurers, its exposure to the mortgage market eroded its capital base, and threatened solvency. In early 2008 Syncora was downgraded from AAA and by year end was rated Caa1/B. In April 2009, the New York Insurance Department (NYID) ordered the company to cease paying claims and prohibited Syncora from writing any new business until it restored policyholders surplus to \$65 million, the minimum state requirement. Syncora undertook a restructuring plan which, among other things, sought to negotiate commutation or remediation of much of its CDS, CDO and RMBS exposure. At year end 2009, policyholders' surplus, at \$100 million, was barely above the state requirements. In June 2010, Syncora received authorization from NYID to resume paying claims, but its ability to meet future claims is questionable.

ACA

No Ratings

The company began operations in 1997, focusing on the higher yielding, more risky areas of the municipal market, insuring issuers rated in the BB and BBB range, with concentrations in the higher education and healthcare sectors. Like most other insurers, ACA expanded into structured products, backing collateralized debt obligations, including those with exposure to mortgage backed securities. Targeting a lower quality, but higher premium range of the municipal credit spectrum, ACA operated as the only A rated insurer in a world of AAA guarantors. Fitch dropped its rating to BBB in May 2004 and removed the rating before the end of that year. S&P dropped from A to CCC in 2007 and removed the rating in 2008. As the financial markets imploded, in August 2008, the company completed a restructuring that essentially settled most non-municipal claims at a discount, and left the company as an undercapitalized municipal insurer, operating in rundown mode.

Note: This report is Part 3 of a three part report on municipal bond insurance. Part 1 provided an overview of municipal bond insurance while Part 2 is a review of Assured Guaranty and BHAC. Contact your Janney Financial Consultant for further information.

ANALYST CERTIFICATION

I, Alan Schankel, the Primarily Responsible Analyst for this report, hereby certify that all of the views expressed in this report accurately reflect my personal views about any and all of the subject sectors, industries, securities, and issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Disclaimer

This Firm, its officers, directors, employees, or members of their families may have positions in the securities mentioned and may make purchases or sales of such securities from time to time in the open market or otherwise and may sell to or buy from customers such securities on a principal basis.

Unless otherwise noted, market data is from Bloomberg, Barclays, and Janney Fixed Income Strategy & Research (Janney FIS). This report is the intellectual property of Janney Montgomery Scott LLC (Janney) and may not be reproduced, distributed, or published by any person for any purpose without Janney's express prior written consent. This report has been prepared by Janney and is to be used for informational purposes only. In no event should it be construed as a solicitation or offer to purchase or sell a security. The information presented herein is taken from sources believed to be reliable, but is not guaranteed by Janney as to accuracy or completeness. Any issue named or rates mentioned are used for illustrative purposes only, and may not represent the specific features or securities available at a given time. Preliminary Official Statements, Final Official Statements, or Prospectuses for any new issues mentioned herein are available upon request. The value of and income from investments may vary because of changes in interest rates, foreign exchange rates, securities prices, market indexes, as well as operational or financial conditions of issuers or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. We have no obligation to tell you when opinions or information contained in Janney FIS publications change. Janney Fixed Income Strategy does not provide individually tailored investment advice and this document has been prepared without regard to the circumstances and objectives of those who receive it. The appropriateness of an investment or strategy will depend on an investor's circumstances and objectives. For investment advice specific to your individual situation, or for additional information on this or other topics, please contact your Janney Financial Advisor and/or your tax or legal advisor.