

# THE BOND BUYER

## BAM 'may perform better in a stressful economic situation,' S&P says

By [Aaron Weitzman](#)  
July 09, 2020, 11:42 a.m.

As some experts and analysts [predicted](#), COVID-19 has hit state and local municipalities hard but the bond insurers are making the most of the opportunity.

S&P Global Ratings issued its [annual report](#) on Build America Mutual, affirming its AA rating along with a stable outlook.

"The combination of a very strong business risk profile and very strong financial risk profile leads to a split anchor of 'AA/AA-'," a release said. "We chose the higher anchor due to redundancy of capital at the current rating level."

"BAM has a strong market position, excellent capital and earnings with a meaningful capital adequacy buffer at its current rating," wrote primary credit analyst David Veno. "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."

S&P specifically conducted a stress test in the context of the COVID pandemic, which concluded that "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."

"S&P's analysis recognizes BAM's 'excellent capital and earnings' and low-risk insured portfolio that consists exclusively of bonds from the safest sectors of the U.S. municipal market," said Seán W. McCarthy, BAM's chief executive officer. "As a mutual insurer, those strengths translate into a strong, durable guaranty for municipal bond investors and our issuer members."

Just as Municipal Market Analytics predicted in March, bond insurance has since expanded its primary and secondary market presence.

"The rolling four week insurance rate is now 9.2%, up from 6.0% at this time last year," wrote Matt Fabian, partner at MMA. "For the municipal sector at large, this is a very modest credit spread tightener; apparent investor value in the monolines' AAs comes at the expense of reliance on insured credits' underlying ratings."

He also noted that for the insured sector in particular, outperformance is possible if current trends are sustained and wraps begin to provide a more durable improvement to secondary market liquidity.

"That seems at least possible, noting how the insurers' rising market share has come amid steady growth in the weekly primary calendar, suggesting related demand is both real and distributed," he said.

S&P said that the stable outlook reflects their 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.

However, S&P could lower its 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.

But on the flip side, it could raise the ratings if S&P doesn't believe BAM's competitive position or earnings will dramatically change. S&P doesn't expect to raise its ratings in the next two years.

"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," Veno wrote. "The severe market dislocation forced many municipal issuers to delay, not abandon, their transactions until market volatility falls and market access is much better."

The report, also noted that 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,” the report said. “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.”

**Aaron Weitzman**

Markets Reporter , The Bond Buyer