

# **Changing Roles and Responsibilities of Debt Issuers**

What's changed and why?

CDIAC Debt Basics – February 1, 2011

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## What's Changed and Why?

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- Bond Insurance and Reserve Fund Sureties are nearly things of the past
- Fewer commercial banks offering credit and those that do are more selective and are charging higher fees
- SEC attempting to expand its reach into the municipal bond market
- Significant outflows from municipal bond funds in recent months

## Municipal Bond Insurance

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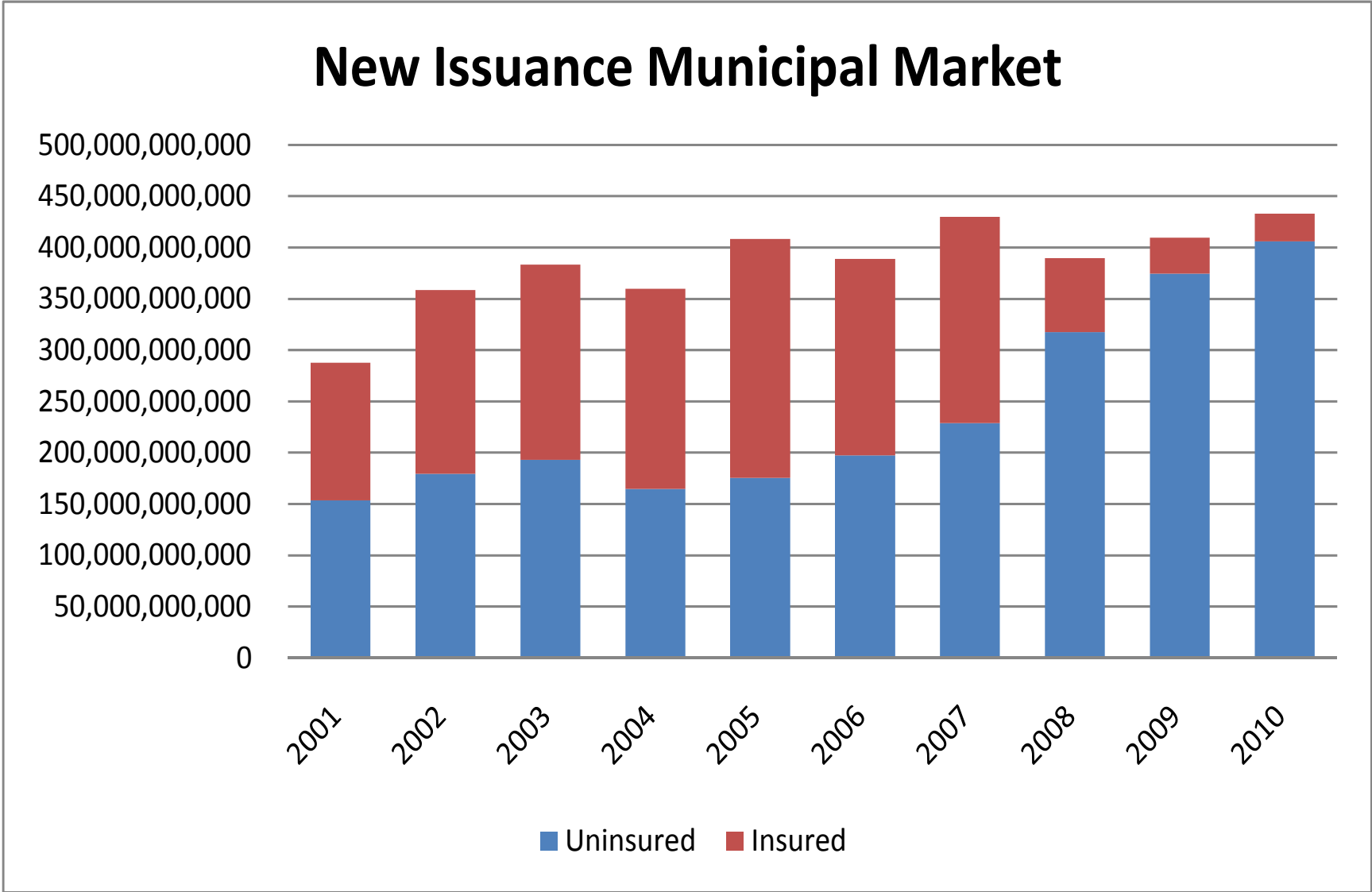
- Municipal Bond Insurance started in the early 1970s
- In 1980, roughly 2.5% of all new issuance municipal bonds were insured
- By 1990, over 50% of all new issuance municipal bonds were insured
- Rule of thumb: If it was 'A' rated or better, it qualified for insurance
- Municipal Bonds began to be priced and traded almost like a commodity

## **What was the practical effect of Municipal Bond Insurance?**

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- Investors didn't need to look beyond the 'AAA' rating of the bond insurer to value the security
- The underlying security of the bond, while important, was seen as secondary
- Continuing Disclosure was treated as nearly perfunctory
- The relationship with your bond insurer seemed more important than the relationship with your investors

# Insured vs. Uninsured Market Volume

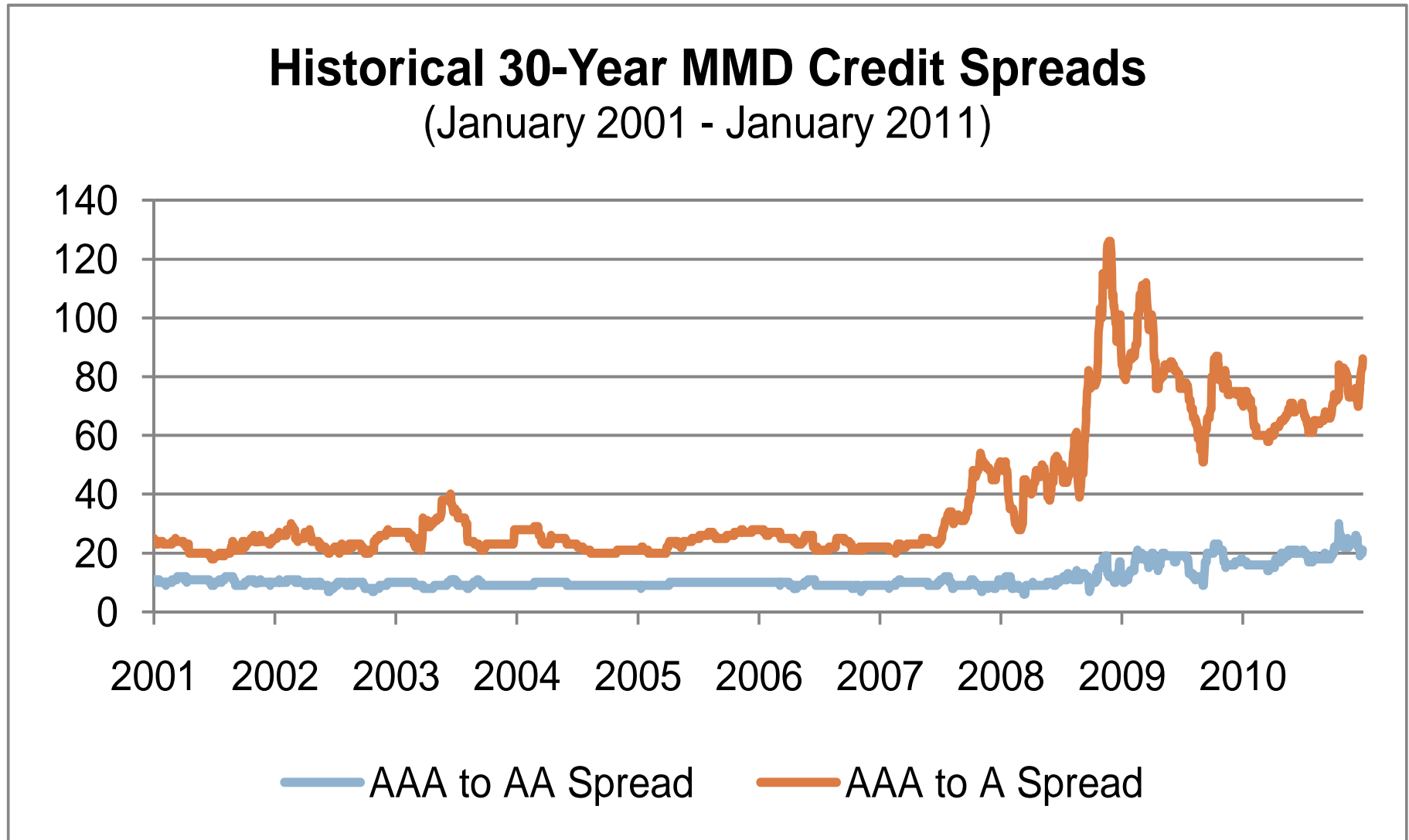


## **The collapse of the mono-line insurers impacted the market**

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- Following the financial crisis, only 2 viable bond insurers remained and one of those has since left the market
- In 2010, only 6% of new issues came with bond insurance
- Municipal bonds no longer price or trade as commodities
- Reserve Fund Sureties are rarely available and revenue bond issuers now need to bond/cash fund DSRFs
- Credit quality is more highly scrutinized
- Investors want to know your credit

## Widening Credit Spreads Suggest Greater Credit Scrutiny



## Commercial Banks and Credit

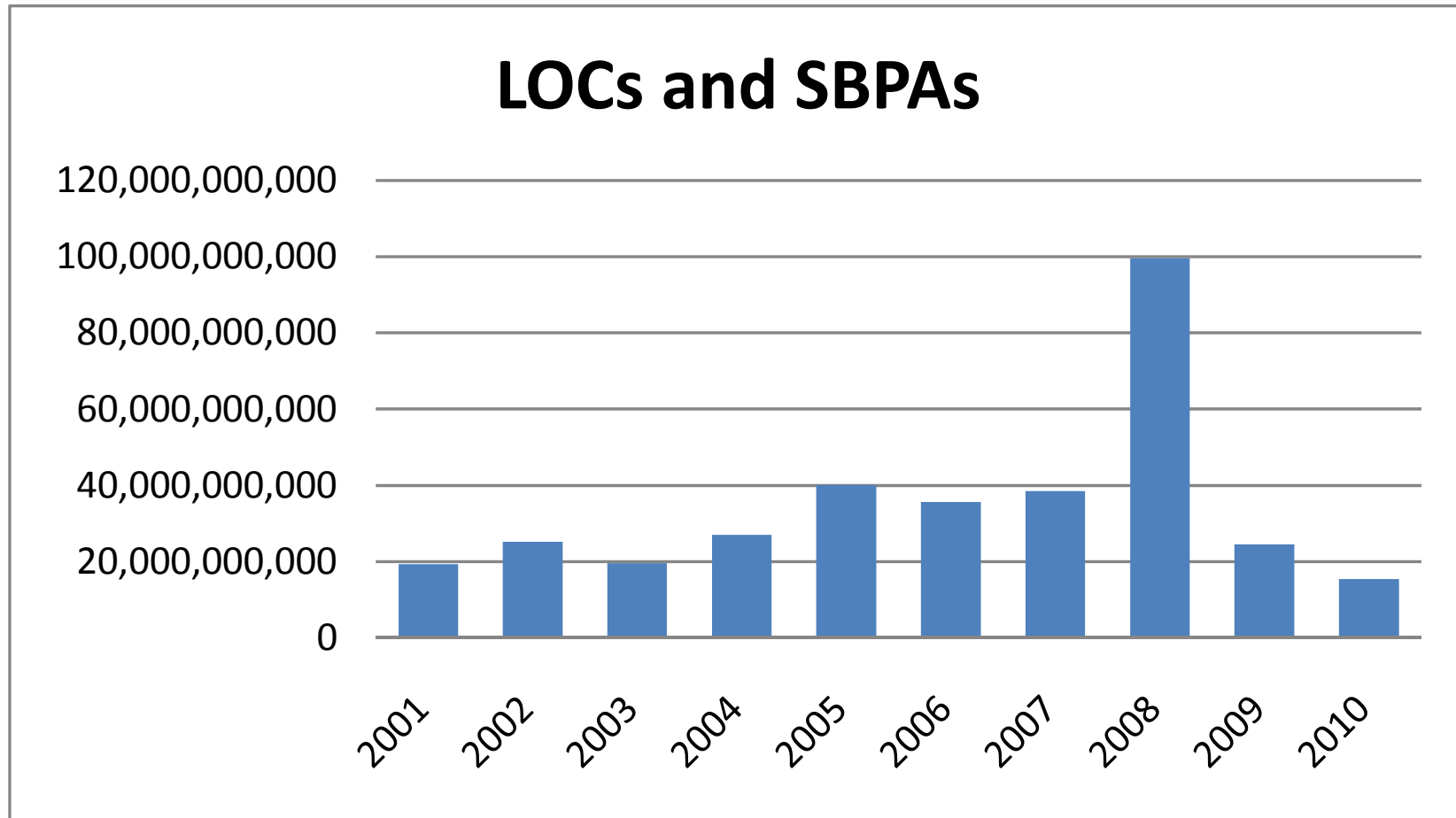
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- Financial crisis altered credit landscape
  - Highly rated credits impacted on price
  - Lower rated credits shut out of market
- Fewer commercial banks and only a handful are offering credit
  - Issuers have less flexibility
  - Likely to change as sector becomes more lucrative and more banks enter the space
- Price of credit has increased
- Regulatory changes will further impact credit availability
  - Basel III will drive up the cost of credit



## Availability of Credit

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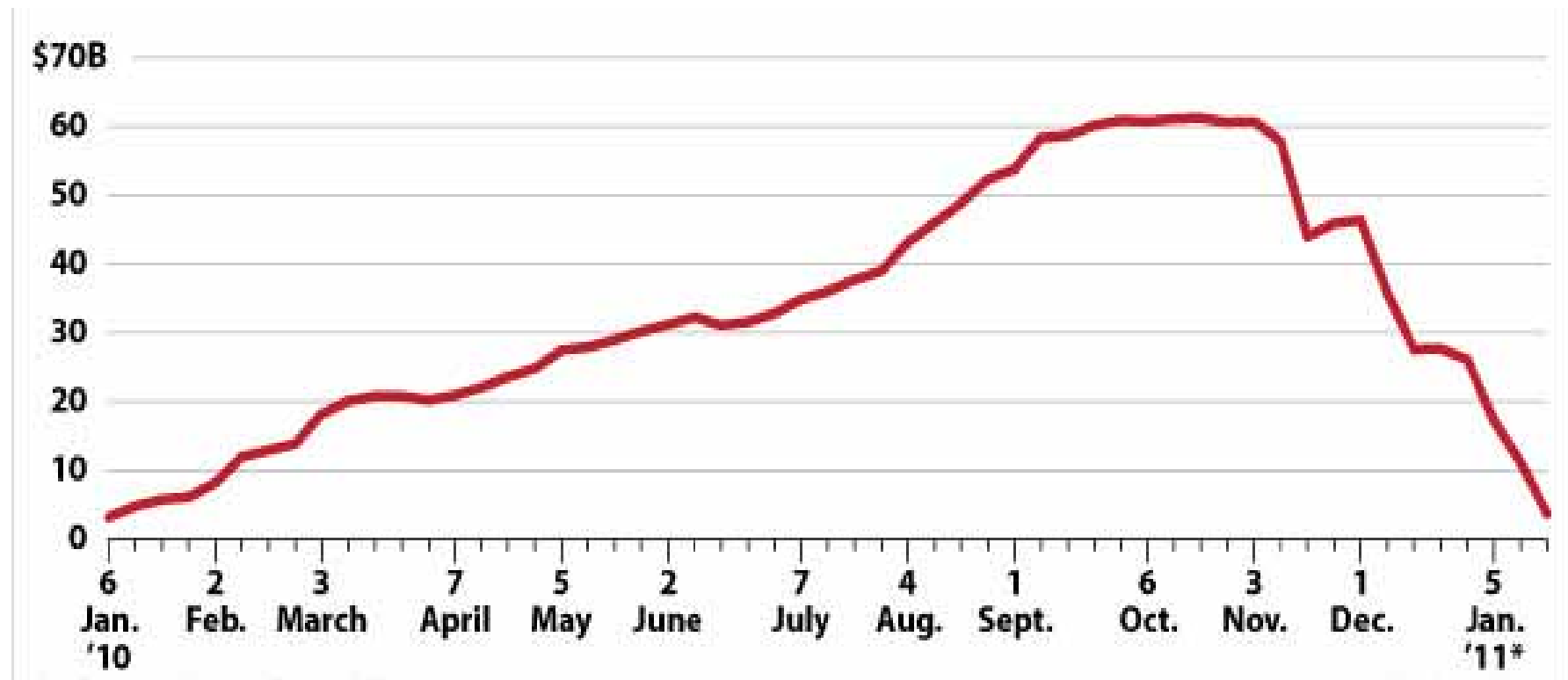
## SEC Attempting to Expand Its Reach Further into the Market

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- Despite no discernable wide-spread increase in defaults, the SEC wants tighter regulatory control over the municipal bond market
- Recent changes to the types, timing and reporting of significant events
- Investors seeking more frequent, timely and thorough continuing disclosure
  - Shorten filing of financials from 270 days to 150 days
  - Post on EMMA interim (quarterly) financial reports
- Does better secondary market disclosure result in better prices?
- “Headlines” driving policy decisions

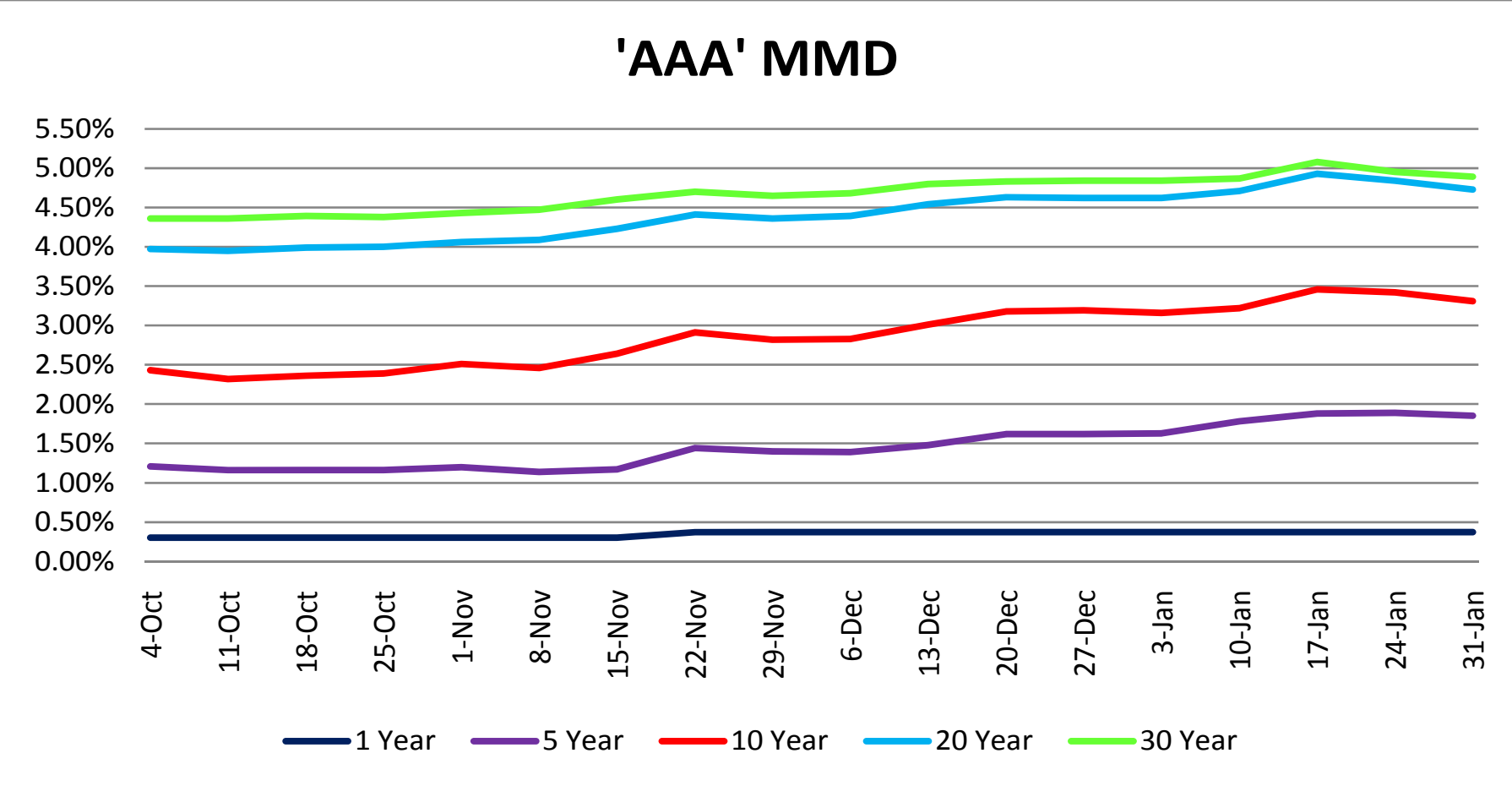
## Municipal Bond Fund Outflows

- Issuers have no control over this but its impact is felt in the cost of debt
- The amount of recent outflows has been historic in size...
  - \$31.19 billion since November



# Municipal Bond Fund Outflows

- ...and has resulted in a 75-100 basis point increase in long-term rates



## Summary

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- The municipal bond market is changing
- There are greater pressures on municipal issuers
- The market has become more complicated
- The number of stakeholders has grown
- What's an issuer to do?