KBRA Rating: AA+
Outlook: Stable

Municipal Assurance Corp. (MAC)

Analytical Contacts:

Peter Giacone, Senior Director
pgiacone@kbra.com, (646) 731-2407

Jack Morrison, Associate Director
jmorrison@kbra.com, (646) 731-2410

Karen Daly, Senior Managing Director
kdaly@kbra.com, (646) 731-2347

Paul Kwiatkoski, Managing Director
pkwiatkoski@kbra.com, (646) 731-2387

Josh Deligdish, Analyst
jdeligdish@kbra.com, (646) 731-2437

July 14, 2017

Table of Contents

KBRA KROLL BOND RATING AGENCY

Executive Summary

Kroll Bond Rating Agency (KBRA) has affirmed the insurance financial strength rating of **AA+** with a **Stable Outlook** for Municipal Assurance Corp. (MAC or "the Company").

Key aspects of KBRA's rating assessment are MAC's strong claims-paying resources and the Company's diverse insured portfolio, which consists of lower-risk, predominantly investment-grade U.S. municipal exposures. MAC has no exposure to Puerto Rico, which, in light of the Commonwealth's severely stressed financial position and current debtor behavior, KBRA views as a credit positive. As a major part of our analysis, KBRA used a Monte Carlo simulation analysis to determine a level of stress losses to be applied to MAC's insured portfolio. KBRA tested MAC's ability to pay this stress level of claims, and other expenses, in a run-off scenario. Under KBRA's Bond Insurer Financial model, MAC satisfied all projected claims due with a comfortable balance remaining.

Since the Company's capitalization in 2013, new business origination has fallen short of management projections and has not kept pace with the steady amortization of MAC's legacy exposures. Despite the reduction in claims-paying resources resulting from MAC's repayment of $400 million of surplus notes in June 2016, the decline in the insured portfolio combined with MAC's large and stable balance sheet has continued to drive leverage ratios lower than historical levels.

KBRA also conducted a detailed review of MAC's governance, credit, and risk management protocols, and found them to be strong and reflecting best practices. MAC has a proven management team and a well-developed governance framework.

KBRA views the surplus note repayment as equivalent to an extraordinary dividend. Prior to the surplus note repayment, MAC had not paid any dividends. KBRA notes that MAC paid an ordinary dividend of $12 million in the first quarter of 2017. Management has stated its intention to pay out the remaining maximum allowable dividend of $37 million over the balance of 2017. Management views MAC as overcapitalized and may explore additional actions, including possibly seeking regulatory approval, to return assets to the parent company as part of its overall capital management strategy. This pattern is consistent with recent financial guaranty industry trends of increased capital extraction. MAC's financial model results from KBRA's stress test remain above the AA+ rating level and reflect the impact of additional capital extraction in the form of regular dividends projected to occur over the next twelve months based on KBRA's discussions with management. KBRA notes that increased capital extraction in the future at a pace that outstrips the risk profile of the insured portfolio could put downward pressure on MAC's ratings.

This rating is based on KBRA's **Financial Guaranty Rating Methodology** dated December 18, 2015.

Key Rating Strengths
• Strong claims-paying resources that can withstand KBRA stress losses in a run-off scenario with a comfortable balance remaining.
• Diverse, high quality insured portfolio; no exposure to Puerto Rico.
• Skilled and disciplined management and staff with deep expertise and market experience.
• A mature and high-functioning operating platform supported by strong governance and risk management systems.
Key Rating Concerns
• General industry risks characterized by narrow credit spreads, low interest rates, and uncertain direction of the industry.
• Increased loss profile manifesting itself in the public finance market among distressed municipal issuers.
• Lack of company charter provision that restricts the Company to its current mandate of insuring only lower-risk municipal bonds.

Rating Summary

A key element of KBRA's analysis of MAC is testing the Company's ability to provide for all claims under conservative stress case assumptions. These stress case losses have been developed to reflect KBRA's best estimate of the level of losses that an entity rated AA+ should be able to cover so that an investor holding a bond insured by MAC would not suffer losses under these assumed conditions. These stress case losses are not meant to represent KBRA's actual expectation of losses.

The primary method used by KBRA to develop stress case losses is a Monte Carlo simulation model. The Monte Carlo model runs a series of 100,000 paths, where each path assesses the probability of future defaults for each credit in each year of its remaining life. If a credit defaults in a particular path, a severity assumption based upon its sector is applied against the amount of debt outstanding at that point in time to calculate a loss amount. The model runs 100,000 paths to produce a broad distribution of results. In KBRA's analysis of MAC's insured portfolio, we focus on the tail of this distribution to construct a stress case loss scenario, in particular the 99.9% confidence level, the level that is associated with a AAA rating.

KBRA developed projected stress case claim payments from the loss distribution of the Monte Carlo simulation model. In addition, based on our review of some of the lower rated credits in MAC's insured portfolio, KBRA excluded certain exposures from the Monte Carlo simulation and developed discrete stress case losses for these credits. The Monte Carlo annual losses and the discrete stress case amounts for distressed credits total $229 million on a future value basis.

We assessed MAC's ability to meet these losses in the KBRA Bond Insurer financial model. The financial model begins with an asset base equal to MAC's claims paying resources according to KBRA's definition, which is $1.1 billion, at March 31, 2017. These resources, plus a conservative estimate of interest earnings, must be sufficient to provide for the stress level claims and all other expenses. Based upon KBRA's model assumptions, MAC was projected to be able to pay all claims and expenses in full and on time under this scenario with a comfortable balance remaining.

Outlook: Stable

MAC's declining portfolio risk and improving leverage ratios provide a stable framework for the AA+ rating.

In KBRA's view, the following factors may contribute to a rating upgrade:

- Market factors that support consistent growth in claims-paying resources that include, for example, a more favorable interest rate environment, firmer pricing conditions, and consistent profitability.
- Broader market acceptance of MAC.
- Further development of a low-risk insured portfolio with limited losses relative to claims-paying resources when subjected to KBRA's loss simulation and financial stress model.

In KBRA's view, the following factors may contribute to a rating downgrade:

- Further significant transfers of capital or other management actions which materially reduce the Company's ability to cover KBRA stress scenario losses or which outpace the decrease in portfolio risk.
- Market-wide increases in municipal default and severity rates which are incorporated into the default and severity rates expected by KBRA within MAC's insured portfolio.
- Significant changes in MAC's senior management team or strategy.
- Expansion of MAC's risk appetite beyond the parameters stated in the current business plan.

Key Rating Determinants

Rating Determinant 1: Corporate Assessment

Background

MAC's ultimate parent is Assured Guaranty Ltd., (AGL). AGL is a Bermuda-based holding company incorporated in 2003 that provides financial guaranty products, through its subsidiaries (taken together, Assured), to the U.S. and international public finance, infrastructure, and structured finance markets.

MAC was established in mid-2013 with $800 million of capital from AGM and AGC. AGM and AGC ceded a total portfolio of $103 billion of insured par to MAC. The portfolio was solely investment-grade municipal risk, specifically excluding any exposure to Puerto Rico or other severely distressed credits. MAC received ceded premium of $709 million for the portfolio and paid no ceding commission, further supporting MAC's financial strength.

Corporate Governance

The board of directors of AGL oversees the governance framework of all AGL subsidiaries, including MAC. The AGL board consists of 10 members and, except for the chief executive officer who is a board member, considers all of the other directors to be independent according to the listing standards of the New York Stock Exchange. KBRA notes that all directors have extensive professional backgrounds and appropriate qualifications for the oversight of a financial guaranty insurer.

The board carries out its responsibilities through the operation of six committees: Audit, Compensation, Finance, Nominating and Governance, Risk Oversight, and Executive. The CEO sits only on the Executive Committee, which meets in between board meetings only if time-sensitive matters arise that require board deliberation and authority prior to the next scheduled meeting of the full Board. In 2016, all of the committees met at least four times, except for the Executive Committee, which met once.

In KBRA's view, a board-level committee that focuses exclusively on risk, such as AGL's Risk Oversight Committee, better positions a company to maintain a high level of focus on this area, one that is critically important for a financial guaranty insurance company.

The Board is responsible for defining the business strategy for the overall group of companies, meets quarterly to review progress towards operational objectives and conducts separate sessions to discuss current or emerging issues that might impact the business.

The roles of chairman and CEO are separate. The board members meet regularly without the presence of the CEO which, in KBRA's view, contributes to the board's independence.

MAC's board of directors comprises 10 members, consisting of persons who are also officers of MAC.

Risk Management

Assured has established a risk management framework under the supervision of the board's Risk Oversight Committee (ROC). The risk management department is responsible for the oversight of the framework under the supervision of the chief risk officer (CRO) and the Portfolio Risk Management Committee (PRMC). The PRMC is a management level committee that consists of the CEO, CRO, chief surveillance officer, chief credit officer, general counsel, CFO, the president of AG Re, the CEO of AGE, and the executive officer.

The risk-management department is responsible for providing the PRMC with research and data used to establish, monitor, and reassess policies and procedures on a regular basis. The risk management department is also responsible for the execution of policies established by the PRMC. The PRMC meets at least four times a year to review the insured portfolio and market trends. All decisions made by the PRMC are reported to the ROC. This ensures that representatives of AGL's board are adequately informed about risk positions and industry trends. These reporting mechanisms add discipline to the risk management process and enhance the ability of the board and senior management to effectively execute company strategy.

The risk-management department prepares the annual corporate-wide risk appetite statement, which incorporates MAC, and is also responsible for enterprise risk management across Assured.

Surveillance

MAC's surveillance of its insured risk is integrated with the surveillance process for all of Assured. Surveillance follows a set of priorities that determines how frequently credits are reviewed. Upon review each credit is assigned to one of six surveillance categories ranging from 1 to 6 that also determines the level of ongoing review. Category 1 and 2 credits are considered to be performing in accordance with expectations and are generally reviewed on an annual or semi-annual basis. Category 3 generally requires quarterly reviews. At Category 4 the intensity of review increases further and generally requires the creation of a team that includes legal resources. Categories 5 and 6 are considered impaired and require the establishment of loss reserves. These exposures are also monitored by the Workout Committees.

Written credit reports document the surveillance review. KBRA reviewed the surveillance reports for the majority of MAC credits in surveillance category 4; MAC currently has no category 5 or 6 exposures.

KBRA views the surveillance reporting process as comprehensive and as providing a sufficient mechanism to inform senior management about the condition of the insured portfolio.

Business Strategy

MAC insures U.S. municipal bonds in lower risk sectors and focuses on bank qualified, midsize, and smaller transactions. In the sectors MAC serves, municipal issuers or their advisors may request an insurance policy from either MAC or AGM and, according to management, in many cases they will be offered a policy from both companies. Assured management continues its current business practice of generally utilizing the MAC platform for new issues with a par amount of $5 million or less.

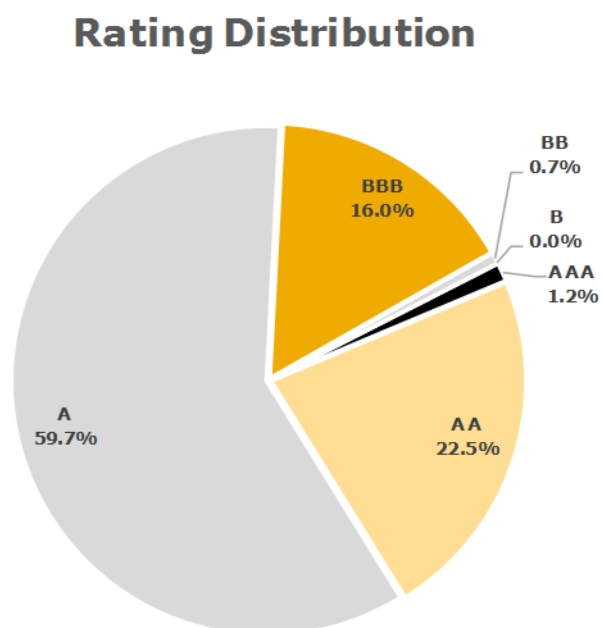
Rating Determinant 2: Insured Portfolio and Modeling Analysis

Insured Portfolio

For MAC's purposes, gross par is equivalent to net par as MAC does not utilize any reinsurance. As of March 31, 2017, MAC's insured portfolio has $38.8 billion of gross statutory par outstanding, comprised of over 6,000 individual risks. The insured portfolio consists mainly of general obligation, utility revenue, and tax-backed credits. As a whole, the portfolio continues to represent credit characteristics similar to those at the last portfolio review, however, the portfolio continues to run off at a rapid pace. Since last year's review, gross par outstanding has decreased by approximately 33% as a result of scheduled debt maturities and bond refunding activity. Over the same time period, MAC has written approximately $1.0 billion of new business, well below the rate of portfolio run-off. As previously stated, MAC does not have any exposure to the Commonwealth of Puerto Rico or any of its bond issuing entities.

Rating Distribution

The portfolio continues to exhibit above-average credit quality: 83.3% of insured par is rated in the single-A category or above (based on internal MAC ratings). As of March 31, 2017, 99.3% of MAC's exposures are rated investment grade. The portfolio's weighted average rating remains single-A. Below-investment-grade par remains less than 1% of total exposures, despite the significant portfolio run-off across the entire portfolio.



Note: Reflects MAC's internal ratings.

Sector Distribution

In KBRA's opinion, MAC's insured portfolio represents a diverse and generally stable group of U.S. public finance sectors. The majority of the insured portfolio, or nearly 59% of gross par, falls within the general obligation sector. The municipal utility revenue and the tax-supported sectors account for 16% and 14% of gross par, respectively. Despite the reduction in total par, the distribution has changed little compared to the prior year, highlighting consistent rates of amortization across all sectors.

MAC Insured Portfolio Sectors ($ millions)						
	3/31/2017			3/31/2016		
Sector Type	Gross Par			Gross Par		
General Obligation	$	22,852	58.9%	$	32,924	57.2%
Municipal Utility Revenue		6,188	16.0%		9,801	17.0%
Tax-supported		5,418	14.0%		8,262	14.3%
Transportation Revenue		2,243	5.8%		2,852	5.0%
Education/University		1,488	3.8%		2,695	4.7%
Other Public Finance		402	1.0%		755	1.3%
Housing Revenue		176	0.5%		319	0.6%
	$	38,767	100.0%	$	57,608	100.0%

State and Single Risk Distribution

Aggregate exposure to credits located in the top five states total $20.6 billion and represent 53.3% of gross par outstanding. The largest geographic exposure is to the state of California, which constitutes 18.6% of gross par. Texas, Pennsylvania, Illinois, and New York make up the remaining top five geographic exposures by state, representing 10.3%, 8.8%, 8.5%, and 7.1% of total par, respectively.

The 50 largest individual exposures in MAC's portfolio total $4.4 billion and represent 11.2% of total insured statutory gross par. Further, the 10 largest exposures total $1.2 billion and represent 3.2% of insured par. Compared to last year, the slight increase in the state and single risk distribution percentages is a characteristic of a portfolio experiencing run-off.

Monte Carlo Simulation Model

KBRA uses a Monte Carlo simulation model to quantify the amount of stress claims within the MAC insured portfolio. KBRA views this as the most appropriate approach for modeling loss scenarios for large, diverse portfolios typical of the financial guaranty industry.

The model uses the assigned rating and sector of each insured credit to simulate default and severity over the remaining life of the portfolio. KBRA generally used MAC's internal ratings but before doing so, KBRA reviewed the ratings for a select number of credits and found them to be generally consistent with our assessment. KBRA ratings were used for all credits that are independently rated by KBRA or have been internally assessed in some other manner.

As stated in KBRA's Financial Guaranty Rating Methodology, the default probabilities applied by KBRA are scaled off of historical corporate default data. In scaling down municipal default rates from corporate default rates, KBRA is reflecting its view that municipal defaults across most sectors are likely to be higher than historic municipal experience, but unlikely to reach corporate levels over the foreseeable future.

The Monte Carlo model runs a series of 100,000 paths, where each path assesses the probability of future defaults for each credit in each year of its remaining life. If a credit defaults, a severity assumption based upon its sector is applied against the amount of debt outstanding at that point in time to calculate a loss amount. The model aggregates losses to produce a broad distribution of results. KBRA focuses on the tail of this distribution to construct a view of stress case losses. The total of all annual loss payments at the 99.9% confidence level, or that level associated with a AAA, was $197 million on a future value basis.

The total loss amounts produced by the Monte Carlo model also incorporates KBRA's conservative assumptions for MAC's future insured portfolio refunding experience.

KBRA reviewed the majority of Category 4 credits (see "Surveillance" section above) and estimated approximately $32 million of stress case losses on a deterministic basis from this pool of exposures, even though MAC does not expect any losses nor has it established any loss reserves. These losses were added to the annual claims stream generated by the Monte Carlo simulation at the AAA level and used in the Financial Model discussed below.

Financial Model

KBRA assesses the ability of a financial guarantor to pay forecasted claims in a stress case scenario. The model uses MAC's claims-paying resources (defined in the "Claims-Paying Resources" section below) as the beginning base of assets. The assets earn interest at rates adjusted downward by KBRA from the Company's current yield levels.

The model assesses the ability of the Company to pay annual stress losses and other expected operating expenses through the 35-year forecast period. Administrative expenses are estimated based on management projections and KBRA analysis of the Company's operational profile. The Company is assumed by KBRA to go into run-off immediately and expenses begin to decline after the fifth year. For MAC, the total stress losses of $229 million represent the sum of the aggregate annual losses generated from the tail of the distribution calculated in the Monte Carlo model plus the deterministic losses described earlier.

MAC is able to pay all claims and other expenses in this analysis with a comfortable amount of assets remaining at the end of the 35 year forecast period. In KBRA's opinion, this result is consistent with a rating of AA+.

Rating Determinant 3: Claims-Paying Resources and Financial Profile

KBRA focuses its analysis of financial resources on statutory results as it is our opinion that statutory accounting principles provide the most appropriate benchmark for assessing an insurer's ability to meet policyholder obligations. Unless otherwise noted, all amounts are based on statutory reports as filed or reported by the Company.

Claims-Paying Resources

KBRA defines claims paying resources (CPR) as the sum of policyholder surplus, contingency reserves, loss and loss adjustment reserves and unearned premium reserves. As of March 31, 2017, MAC had CPR of $1.1 billion. The decrease in CPR from a year prior reflects MAC's repayment of its $400 million of surplus notes in June 2016. Prior to the capital extraction in 2016, MAC's CPR was essentially unchanged from prior periods, reflecting the relatively low level of new business since the Company's inception as well as the absence of dividends. Despite the reduction in CPR, MAC's leverage ratio continues to decrease, as the portfolio continues to amortize. Management initiated the payment of ordinary dividends in the first quarter of 2017 and management estimates MAC will pay out a total of $49 million of ordinary dividends over 2017.

Select MAC Statutory Balance Sheet Data					
$ Thousands	**3/31/2017**	**12/31/2016**	**12/31/2015**	**12/31/2014**	**12/31/2013**
Claims paying resources:					
Unearned premium reserves	$309,840	$332,918	$468,965	$591,806	$670,694
Loss & LAE reserves	-	-	-	-	-
Contingency reserve	267,233	260,497	282,193	300,067	319,432
Policyholder surplus	486,221	486,946	729,508	611,534	514,392
Adjustments	-	-	-	-	-
Total claims paying resources (KBRA definition)	**$1,063,294**	**$1,080,362**	**$1,480,666**	**$1,503,407**	**$1,504,518**
Net statutory par outstanding (NPO)	$38,767,000	$41,951,000	$61,805,000	$82,322,000	$96,141,000
Net statutory debt service outstanding (NDSO)	$57,154,000	$61,829,000	$92,048,000	$123,198,000	$144,672,000
Leverage: NPO/Claims paying resources (X)	**36x**	**39x**	**42x**	**55x**	**64x**
Leverage: NDSO/Claims paying resources (X)	**54x**	**57x**	**62x**	**82x**	**96x**

Source: MAC Statutory Statements and Financial Supplements

Balance Sheet

The balance sheet figures presented below are through the period ending on March 31, 2017. Low new business origination, conservative invested asset management and continued insured portfolio amortization resulted in minimal changes in balance sheet composition beyond the release of unearned premium reserves into policyholder surplus in the past year. As of March 31, 2017, the decrease in net assets reflected MAC's repayment of its surplus notes, as stated above. MAC continues to report no loss reserves which reflects positively on the credit quality of the insured portfolio. Nevertheless, KBRA recognizes the inherent risk that MAC will likely need to establish some loss reserves over the medium to long term.

MAC Statutory Balance Sheet					
$ Thousands	**3/31/2017**	**12/31/2016**	**12/31/2015**	**12/31/2014**	**12/31/2013**
Bonds	$1,034,336	$1,041,140	$1,463,402	$1,440,227	$1,452,181
Stocks (includes Investments in Affiliates)	-	-	-	-	-
Cash & short term investments	12,777	19,184	4,339	28,752	24,076
Derivatives, receivables, other invested assets	25,577	25,577	15,000	15,000	15,000
Total cash and invested assets, net admitted	**$1,072,690**	**$1,085,901**	**$1,482,740**	**$1,483,979**	**$1,491,258**
Investment income due and accrued	13,895	12,792	17,746	17,014	17,093
Other assets	4,638	6,127	8,821	18,762	7,859
Total Assets, net admitted	**$1,091,222**	**$1,104,819**	**$1,509,307**	**$1,519,755**	**$1,516,210**
Loss and LAE Reserves	-	-	-	-	-
Unearned Premium Reserve	309,840	332,918	468,965	591,806	670,694
Contingency reserve	267,233	260,497	282,193	300,067	319,432
Other liabilities	27,928	24,458	28,641	16,348	11,692
Total Liabilities	**$605,001**	**$617,873**	**$779,799**	**$908,220**	**$1,001,818**
Common capital stock	15,000	15,000	15,000	15,000	15,000
Surplus Notes	-	-	400,000	400,000	400,000
Gross paid-in and contributed surplus	373,670	373,670	373,670	373,670	361,695
Unassigned Funds	97,551	98,276	(59,163)	(177,136)	(262,303)
Policyholder Surplus	**$486,221**	**$486,946**	**$729,508**	**$611,534**	**$514,392**
Total Liabilities and Policyholder Surplus	**$1,091,222**	**$1,104,819**	**$1,509,307**	**$1,519,755**	**$1,516,210**
Cash & short term assets/Total assets (%)	1.2%	1.7%	0.3%	1.9%	1.6%
Bonds/Total assets (%)	94.8%	94.2%	97.0%	94.8%	95.8%

Source: MAC Statutory Statements

Income Statement

Gross premiums written continue to be well below management forecasts and reflect weak new business activity. However, they are trending upwards. Because of the challenging market environment, MAC's low gross premium written generates a reported expense ratio far above industry and historical benchmarks, although the trend continues to be marginally favorable. KBRA does not view MAC's expense ratio as a significant issue in the near term and also acknowledges the inherent lag between expense recognition and revenue generation. We will continue to monitor the Company's efforts to manage its revenue/cost profile since KBRA views the current expense ratio as very high.

Net premiums earned increased in 2016 relative to the prior year, reflecting the continued surge in refunding activity in the context of a persistent and historically low interest rate environment; this trend has continued in the first quarter of 2017. MAC reported net income of $141.6 million in 2016, 39% higher than 2015, primarily due to continued increased premium earnings from refundings. If the general level of interest rates in the municipal market begins to rise, KBRA expects the level of refunding activity will moderate over time as the insured portfolio runs-off and the pool of bonds eligible for refunding continues to shrink.

Select MAC Statutory Income Data					
$ Thousands	**3/31/2017**	**12/31/2016**	**12/31/2015**	**12/31/2014**	**12/31/2013**
Gross Premiums Written (GPW)	$1,150	$4,404	$3,315	$3,098	$709,935
Net Premiums Written	(2,081)	1,173	(4,783)	(5,001)	709,935
Net premiums Earned (NPE)	20,997	137,220	118,057	73,887	39,241
Loss & loss adjustment expenses (L&LAE)	4	6	-	-	-
Other underwriting expenses	4,762	18,661	16,738	19,038	12,448
Total losses & operating expenses	4,767	18,667	16,738	19,038	12,448
Net underwriting gain (loss)	16,231	118,552	101,320	54,849	26,792
Net investment gain	7,570	40,691	33,194	30,768	17,910
Other income, net gain (loss)	-	-	-	12	1
Earnings Before Taxes	23,801	159,243	134,514	85,629	44,704
Net Income	$18,699	$141,597	$101,919	$74,762	$25,745
Dividends Paid	$12,000	$0	$0	$0	$0
Expense ratio (Underwriting exp. / GPW)	414.0%	423.8%	504.9%	614.6%	1.8%
Loss ratio (L&LAE / NPE)	0.0%	0.0%	0.0%	0.0%	0.0%
Combined ratio	414.0%	423.8%	504.9%	614.6%	1.8%
Return on Surplus (ROS) Pre-tax basis *	19.6%	26.2%	20.1%	15.2%	8.7%
Return on Surplus (ROS) After-tax basis *	15.4%	23.3%	15.2%	13.3%	5.0%

Source: MAC statutory statements
** ROS annualized for the 1Q 2017 by multiplying the earnings by 4.*

In the first quarter of 2017, MAC's indirect parent, Assured Guaranty US Holdings Inc., formed and capitalized AG US Group Services Inc., a Delaware corporation, to act as the payroll company and employer for all U.S. personnel and the central, dedicated service provider within Assured Guaranty. Until this change, Assured had operated under its Group Service Agreement whereby AGC was the employer of all U.S. employees and service provider. As such, expenses under the agreement were allocated directly based upon employee time. The amended Group Service Agreement is nearly identical except for a few changes primarily related to operational matters, including pre-funding by affiliates who are the largest consumers of group services and inter-company allocation of expenses.

Investments

MAC's asset base is conservatively managed, with over 75% of the portfolio invested in municipal bonds. The portfolio's credit quality remains strong with an average rating of AA. The overall duration has continued to decline and is 3.7 years as of March 31, 2017, although investment performance is marginally higher than prior periods despite the reduction in the portfolio's tenor. The reduction in MAC's investment portfolio largely reflects last year's repayments of the outstanding surplus notes.

MAC Investment Portfolio Composition (3/31/2017)				
$ Millions			**---Book Yields---**	
Sector	**Fair Value**	**% of portfolio**	**Pre-tax**	**After-tax**
State and Political Subdivisions	$833	77%	2.97%	2.79%
Insured State and Political Subdivision	113	10%	3.48%	3.29%
U.S Treasury Securities	16	1%	2.63%	1.71%
U.S Agency Obligations	6	1%	1.25%	0.81%
Corporate Securities	65	6%	2.84%	1.84%
RMBS	11	1%	2.80%	1.82%
CMBS	20	2%	3.46%	2.25%
Total Fixed Maturities	**$1,064**	**99%**	**3.01%**	**2.74%**
Short term investments and cash	13	1%	0.26%	0.17%
Grand Total	**$1,077**	**100%**	**2.97%**	**2.71%**

Source: MAC financial supplement

Dividends

New York Insurance Law regulates the payment of dividends by MAC and it requires that companies may not declare or distribute dividends except out of statutory earned surplus. In addition, the sum of the amount of dividends declared may not exceed the lesser of: i) 10% of policyholders' surplus, as reported in the latest statutory financial statements, or ii) 100% of adjusted net investment income for the prior 12-month period.

MAC paid an ordinary dividend to its parent of $12 million in March 2017, its first since MAC's capitalization in 2013. Management estimates that MAC can pay total ordinary dividends of approximately $49 million in 2017. Therefore, MAC is expected to dividend approximately $37 million over the remaining three quarters of 2017. As previously noted, management views MAC as overcapitalized and may explore actions, including possibly seeking regulatory approval, to return assets to the parent company as part of its overall capital management strategy. KBRA will continue to monitor and evaluate MAC's current and projected dividends in relation to the risk profile of the Company's insured portfolio.

Reinsurance

MAC, jointly with AGM and AGC, benefits from an aggregate excess of loss reinsurance facility with a number of reinsurers rated no lower than AA- or who have posted collateral. The current facility attaches when the group's aggregate combined net losses exceed $1.25 billion on investment grade U.S. public finance exposures as of September 30, 2015. The reinsurers cover $360 million of the next $400 million of losses in excess of the attachment point with MAC, AGM and AGC jointly retaining the remaining $40 million. The reinsurance agreement terminates on January 1, 2018 unless the Assured subsidiaries decide to extend it. Because of its joint nature and the potential for losses at AGM or AGC to limit the support available for MAC, this facility is not incorporated in KBRA's rating assessment of MAC.

MAC HoldCo

Municipal Assurance Holdings Inc., is an intermediate holding company owned by AGM and AGC. MAC HoldCo was capitalized entirely from common shares issued to AGM (60.7%) and AGC (39.3%). MAC HoldCo in turn, capitalized MAC by purchasing a $300 million surplus note issued by MAC and $400 million of MAC's common shares. These two investments in MAC are the only assets owned by MAC HoldCo. Although the operating expenses of MAC HoldCo are fairly limited, the funding of these expenses is dependent upon the support of AGM and AGC. As of December 31, 2016, MAC Holdco consolidated shareholder's equity was reported at $752 million, down 24% from $990 million as of March 31, 2016, due to the decrease in retained earnings resulting from MAC's full repayment of the surplus notes.

KBRA has affirmed an issuer rating of **AA/Stable** for MAC HoldCo. This is one notch below the regulated operating company rating level, which reflects the structural subordination of cash flows to MAC HoldCo. MAC HoldCo currently has no debt outstanding and management has indicated there are no plans for this entity to issue debt in the near term. KBRA notes that AGL recently filed a shelf registration statement to issue equity and debt securities at other companies in the group. KBRA would consider any changes to the capital structure or business profile of MAC HoldCo as a factor that could affect the rating.

Conclusion

KBRA has affirmed MAC's the insurance financial strength rating of **AA+/Stable**, which reflects the Company's strong level of claims paying resources to support potential stress case losses in a run-off scenario. MAC's stated business plan is focused exclusively on writing financial guarantees within the U.S. Public Finance market, which should limit long-term losses. MAC benefits from a well-established underwriting platform, a seasoned staff of experienced professionals, strong risk management frameworks, and a high-quality insured portfolio with no exposure to Puerto Rico or other significant distressed credits. Any material shift in the risk profile of MAC's business or significant change in dividend strategy that affects the sufficiency of claims-paying resources could result in an adjustment to KBRA's rating assessment.

KBRA has also affirmed an issuer rating of **AA/Stable** for MAC HoldCo. This is one notch below the operating company rating level, which reflects the structural subordination of cash flows to MAC HoldCo.

KBRA INSURANCE FINANCIAL STRENGTH RATING: AA+
OUTLOOK: Stable

Key Takeaways:

- KBRA developed stress losses for MAC's insured portfolio based upon assumptions that are consistent with a AA+ insurance financial strength rating
  - KBRA's total stress losses were $229 million (future value) over a 35-year period.
  - MAC satisfied all claims in full and on time in the KBRA stress case scenario with a comfortable capital balance remaining.
- Key aspects of KBRA's rating assessment are MAC's strong claims-paying resources and the company's diverse insured portfolio which consists of lower risk, predominantly investment grade U.S. municipal exposures.
  - MAC has no exposure to Puerto Rico.
- KBRA also conducted a detailed review of MAC's governance, credit and risk management protocols and found them to be strong and reflecting best practices. MAC has a proven management team and a well-developed governance framework.

Key Rating Strengths
▪ Strong claims-paying resources that can withstand KBRA stress losses in a run-off scenario with a comfortable balance remaining.
▪ Diverse, high quality insured portfolio; no exposure to Puerto Rico.
▪ Skilled and disciplined management and staff with deep expertise and market experience.
▪ A mature and high-functioning operating platform supported by strong governance and risk management systems.

Key Rating Concerns
▪ General industry risks characterized by narrow credit spreads, low interest rates, and uncertain direction of the industry.
▪ Increased loss profile manifesting itself in the public finance market among distressed municipal issuers.
▪ Lack of company charter provision that restricts the Company to its current mandate of insuring only lower-risk municipal bonds.

KBRA's Financial Guaranty Rating Methodology incorporates lessons learned from the collapse of the financial industry and utilizes an objective, rigorous rating approach. KBRA's assessment of a financial guarantor considers:

I. A company's ownership, management, competitive position, strategy, organization and operations;
II. The composition of the insured portfolio in terms of credit sectors, geography and underlying ratings, portfolio losses generated through KBRA's simulation modeling and the company's ability to weather portfolio losses while paying operating expenses and claims in runoff; and
III. The guarantor's financial profile.

Related Publications:

Municipal Assurance Corp. Surveillance Report
Rating Risk and the Financial Guarantors: Déjà Vu All Over Again
Bond Insurance Capital: Can You Ever Have Too Much?
Financial Guaranty Rating Methodology

Analytical Contacts:

Peter Giacone, Senior Director
pgiacone@kbra.com, (646) 731-2407

Paul Kwiatkoski, Managing Director
pkwiatkoski@kbra.com, (646) 731-2387

Jack Morrison, Associate Director
jmorrison@kbra.com, (646) 731-2410

Josh Deligdish, Analyst
jdeligdish@kbra.com, (646) 731-2437

Karen Daly, Senior Managing Director
kdaly@kbra.com, (646) 731-2347