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Thought For the Month

“What Municipal Bond Insurance Means To You”

When you look over the portfolio of any of the municipal bond funds in the Aquilasm Group of Funds, you will come across the notation “MBIA,” “AMBAC,” or “FGIC” insured. You might well wonder what this information means for you as a shareholder.

Sometimes when a municipal bond issuer wishes to market a specific bond more advantageously, it seeks to gain a credit rating higher than that which might normally be assigned. The way this might be accomplished is for the issuer to have the specific bond insured through a specialized insurance company such as Municipal Bond Investors Assurance Corporation (“MBIA”), American Municipal Bond Assurance Corp. (“AMBAC”) or Financial Guarantee Insurance Company (“FGIC”). These insurance companies are themselves AAA rated by nationally-recognized credit services.

The issuer pays the insurance company a premium in order to provide shareholders with a further assurance that the interest and bond principal amount will be paid to bondholders when due. For a bondholder, it is a line of defense in the possible event of default by the issuer.

Besides being a line of defense in case of a default, the insuring process itself also serves another purpose. In addition to the analysis undertaken by each Aquila fund’s portfolio manager, the company providing the insurance policy carefully reviews the cash flow coverage of the issuer to make sure, to the maximum extent possible, that there won’t be a default on the bond. The insurance company wants to lessen the chance of having to actually pay out on the policy by making payments to bondholders itself.

With the premiums being charged to insure bonds being relatively low, many more bonds than the historical norm are being insured. Some of the bonds chosen for the portfolios of the Aquilasm Group of Funds may have insurance coverage, while various others may not. While insurance is an added level of protection, the primary criteria used in our bond selection is the underlying soundness and payment prospect of the municipal project for which the bond is issued.

Insurance on an obligation is intended to mitigate credit risk; it does not insure the market price of the obligation. A change in a bond insurer’s rating can adversely affect the bond or bonds for which coverage is provided.

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