Syncora Holdings Ltd.

Moderator: Michael Corbally
April 30, 2015
8:30 a.m. ET

Operator: Good morning, and welcome to Syncora Holdings, Limited, earnings call for year-end December 31st, 2014. Please note that all participants are in listen-only mode for the duration of the call. A replay together with a transcript of the call, will be posted on the investor relations section of the company's website.

It is now my pleasure to introduce Michael Corbally of Syncora Holdings, Limited.

Michael Corbally: Good morning, and thanks for joining the call today. I'm Michael Corbally, Syncora's chief administrative officer. With me today are Susan Comparato, Syncora's chief executive officer; and Claude LeBlanc, Syncora's chief financial officer and chief restructuring officer.

Before I hand over to Susan, I do have some brief opening comments.

During our call, reference is going to be made, to slides within the presentation that has been posted to the investor relations section of our website, www.syncora.com, specifically on the investor events page.

We also hope you've had an opportunity to review the Syncora Holdings, Limited, consolidated GAAP financial statements for the year ended

December 31st, 2014 and the associated press release we issued after market close yesterday. The financial statements are available on our website, specifically in the company reports and financial information sections. The press release is available on the news section.

As the moderator indicated, this call is listen-only mode. We will not be holding a Q&A session after our remarks. The replay of this call, together with a transcript, will be posted to the investor relations section of our website.

Turning to slide one of the presentation, I'm obligated to provide you with some disclosure language. Please note that the following discussion contains statements about future results, plans and events that may constitute forward-looking statements. We caution that these statements are not a guarantee of future events, and that actual events may differ materially from those set forth in these statements.

Forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond the company's control. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as "may, plan, seek, comfortable with, will, expect, intend, estimate, anticipate, believe or continue," or the negative thereof or variations thereon or similar terminology.

Forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond the company's control. These risks and uncertainties include, but are not limited to, the factors described in the company's historical filings with the New York Department of Financial Services and in Syncora Holdings, Limited, Syncora Guarantee, Inc., and Syncora Capital Assurance, Inc.'s GAAP and statutory financial statements as posted on our website.

You are cautioned not to place undue reliance on forward-looking statements which speak only as of the date they are made. The company does not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the date that forward-looking statements are made.

Finally, references throughout the call to SHL, SGI, and SCAI refer to Syncora Holdings, Limited, Syncora Guarantee, Inc., and Syncora Capital Assurance, Inc., respectively.

With that, let me now introduce Syncora Holdings, Limited's, CEO Susan Comparato.

Susan Comparato: Thank you, Mike. And I want to thank everyone for joining the call.

Let me briefly highlight what we'll be covering today. If you turn to the agenda on slide two of the presentation, we will be discussing 2014 financial and operating results. But please note that we will not be discussing our first quarter statutory results on this call. We anticipate filing the Q1 2015 statutory financial statements for SGI and SCAI on or before May 15th, 2015.

In addition, following our discussion of the financial results, we will also be reviewing the claims-paying resources, liquidity estimates, and portfolio composition for both SGI and SCAI. We also want to update you on our progress to advance the company's strategic goals as highlighted during our investor update call in November.

As Mike mentioned, we will not be holding a Q&A session after our remarks today. However, throughout our presentation, we will be addressing questions we have received since our November investor update and our discussion today takes into consideration those various questions from analysts and other stakeholders.

So, with that as background, I would now like to hand it over to Claude who is going to provide you with a summary of the company's financial results and other operating highlights for 2014.

Claude LeBlanc: Thank you, Susan.

And welcome to everyone joining today's earnings call.

I am pleased to report that Syncora continued to make substantial progress in the remediation of key risk exposures during 2014. For the 12 months ended December 31st, 2014, Syncora achieved materially favorable results with respect to the remediation of its Detroit pension obligation and general obligation bonds, Puerto Rico exposures, as well as the commutation and remediation of various global infrastructure, power and utility, and RMBS swap exposures.

Overall during 2014, Syncora reduced its net par exposure by approximately 19 percent to $42 billion, and its flag list exposure by 16 percent to $6.8 billion. I will discuss this in more detail later.

As part of the strategic goals outlined during our November ‘14 investor call, Syncora has made material progress in achieving financial stability for the insurance platform through risk remediations and asset recoveries during 2014. Still, significant challenges remain in addressing the ongoing risks of liquidity at SGI and surplus at SCAI, which will be a continued focus of the company's strategic initiatives in 2015, along with other priorities outlined in our November investor call.

Turning to slide three, the key financial developments for 2014 include the results from the Detroit remediations and settlements, offset by reserve developments in our Puerto Rico exposures and certain U.S. distressed structured single-risk credits. In February 2014, the company also settled its RMBS litigation with J.P. Morgan, which was previously recognized in our 2013 income statement, resulting in material improvements in SGI's liquidity by approximately $400 million.

Touching on these and other key developments, we now turn to slide four. First, an update on Detroit, which likely had the most significant effect on our financial results. There were two large bond purchases made during the year where the company bought back $120 million of its insured City of Detroit pension obligation bonds. These purchases combined with continued adverse developments resulted in an approximate $125 million reduction to earnings on our insurance cash flow certificates, once reclassified into a variable interest entity, or VIE, in the third quarter of 2014.

This reclassification was the primary cause of the net loss of $165.4 million recorded for insurance cash flow certificates during the year.

Prior to the City of Detroit's emergence from bankruptcy in December, 2014, we had successfully remediated 100 percent of our exposures to these pension obligation bonds. Upon the city's emergence, the company released approximately $184 million in reserves related to the Detroit exposures. This net recovery was primarily offset by adverse development in Puerto Rico and structured single-risk exposures resulting in a net 2014 recovery of $18.2 million.

The 2013 net recoveries of $397 million reflected the recognition of the JPMorgan litigation settlement, as well as the Jefferson County settlement.

The company continues to be exposed to the City of Detroit interest rate swap exposures. However, the company is in dispute as to whether and to what extent it continues to be obligated under these policies, guaranteeing the City of Detroit interest rate swap exposures.

Turning now to Puerto Rico -- as of December 31st, 2014, Syncora's total insured exposure to Puerto Rico included approximately $229 million of Puerto Rico general obligation bonds, $200 million of Puerto Rico Electric Power Authority, or PREPA, and $41 million of other mixed state and revenue bonds.

These exposures include inbound re-insurance guarantees of approximately $145 million.

As part of our remediation activities, Syncora purchased approximately $42 million of its insured PREPA and other Puerto Rico bond exposures as of December 31st, 2014.

In 2014, we also established reserves of $56.7 million on our PREPA exposures. This reserve represents a greater than 20 percent weighted average loss given default on our total pre-remediated PREPA exposures.

In June, 2014, Puerto Rico passed a law that purported to establish a formal debt modification and recovery program process, as well as a bankruptcy-like debt enforcement process for quasi government agencies like PREPA and the Puerto Rico Aqueduct and Sewer Authority, PRASA.

In February, 2015, the law was ruled unconstitutional by the U.S. District Court for Puerto Rico. And this ruling has been appealed by Puerto Rico to the 1st Circuit. And oral argument is scheduled for May 6th, 2015.

In addition, bills have also been proposed in the U.S. Congress to allow Puerto Rican agencies like PREPA and PRASA to be eligible to file Chapter 9 under the U.S. bankruptcy laws.

The passage of these bills remains highly uncertain.

Last year, to provide a potential path to a consensual restructuring of PREPA, Syncora joined other monolines and significant creditors in entering into a forbearance agreement. The forbearance agreement and restructuring negotiations are ongoing.

Certain PREPA creditors have made a restructuring proposal that involves $2 billion of new capital. PREPA's advisers have, however, publicly stated that the proposal understates certain costs, and is, therefore, impractical.

I would also like to highlight that PREPA has a large scheduled bond payment due July 1st, 2015. This payment remains uncertain. Syncora's portion of such payment is approximately $21 million.

During the year, Syncora recognized $128 million of adverse development on certain SGI distressed U.S. structure single risk exposures.

There is significant variability with respect to the anticipated salvage recoveries, given the long-dated nature of these assets and the variable nature of potential outcomes.

The established reserves reflect estimated losses for the majority of the credits where we expect material claim payments in the 2017 to 2029 period, which I will discuss later.

As previously disclosed in our financial statements, the company noted the potential risks of material adverse developments on such credits, including those credits exposed to re-insurance.

The company remains subject to other exposures with similar attributes, which we continue to actively monitor and seek to remediate where possible.

I would now like to turn to premium earnings and operating expenses.

As you can see, SHL earned net premiums of $69.8 million in 2014, as compared to $132.7 million in 2013.

The year-over-year decline resulted primarily from accelerated earned premium in 2013 as a result of certain commutations, foreign exchange movements, and re-insurance premium adjustments.

In addition, the orderly runoff of the insured portfolio reflected a lower earned premium during 2014. And we expect this trend to continue into 2015, excluding the effects of future remediations and refundings.

Operating and interest expenses were $150.9 million in 2014, as compared to $124.3 million in 2013. This increase was primarily due to higher interest rate expenses on SGI surplus notes and the inclusion of a full year of Pike Pointe Holdings, which includes American Roads, in 2014, as compared to only four months in 2013.

For further information on the 2014 income statement and balance sheet accounts, please see Syncora's earnings release dated April 29th, 2015 and the company's 2014 GAAP financial statements.

Turning now to slide 5 -- before we walk through the company's adjusted book value, ABV calculation, we thought it would be helpful to provide you with an overview of the company's capital structure and outstanding securities.

Set out on this slide, we show growth and net outstanding securities reflecting the results of our prior remediations.

I would like to draw your attention to the $85 million reduction in the SHL series A preferred shares. For illustrative purposes, this table reflects the $85 million preferred shares on a pro-forma basis, reflecting a reduction to the gross outstanding shares.

These shares were received by SGI in connection with a settlement with Bank of America Countrywide, and remain outstanding for voting and all other purposes.

As disclosed in our statutory financial statements we will reflect the receipt of such shares during our first quarter financial results in 2015.

Please see our notes to our consolidated financial statements for further information.

Turning to slide 6, this slide and our press release contain information on the adjusted book value calculation, a financial measure that is not calculated in accordance with GAAP.

While the company does not manage its business or measure its performance using non-GAAP measures, such as ABV, we have included the measure because the company believes it provides investors with important additional information to compare the company to other financial guarantors.

A full description of the limitations in using the ABV for comparative purposes and the adjustments made to the calculation of our ABV is included in the press release. Please refer to the detailed footnotes in the press release for further information.

I would now like to turn to slide 7 to discuss SGI and SCI's claim-paying resources. SGI's claim-paying resources declined to $1.45 billion at December 31, 2014, compared to $1.54 billion at year end 2013. This decline was primarily driven by a reduction in the Net Present Value of Future Installation Premiums, or NPVFIP of $81.9 million.

The reduction in NPVFIP was primarily the result of certain commutations, foreign exchange movements on long dated forward payment streams and re-insurance premium adjustments.

Associated portfolio leverage continued to decline in 2014 to 7.3 times from 8.3 times in 2013.

SCAI’s claim-paying resources declined to $638.4 million at December 31, 2014, compared to $736.2 million at year end 2013. This decline was primarily driven by remediation purchases for the Detroit Pension Obligation Bonds which were subsequently written off in the amount of $77.1 million and a reduction in Net Present Value of Future Installment Premiums resulting from the remediation of transactions and foreign exchange movements, partially offset by SGI's $30 million capital contribution.

As you will note, the benefits from liability to remediations are removed from the calculation of claim-paying resources. Notwithstanding the decline in claim-paying resources, SCAI’s leverage ratio continue to decline in 2014 to 49 times from 52.3 times in 2013.

Slide 8 sets forth updated information that was discussed during the November investor call. SGI continues to face a potential liquidity mismatch between expected future medium to long-term claim payments and related recoveries.

Again and in particular, first, SGI anticipates that it will be obligated to make substantial claim payments on certain loss credits in 2017 to 2029 of approximately $587 million.

Secondly, SGI is further exposed to one refinancing risk with heightened risk of material claim payments with an aggregate par outstanding of $921 million and other credits with exposure to refinancing and risk of material principal repayments with an aggregate par of $3.8 billion.

Additionally, as we noted above, the company recorded reserves in 2014 related to certain distressed U.S. structured single risk exposures on our flag list with existing or anticipated claim payments that are also expected to contribute to this potential liquidity mismatch.

With respect to SCAI, SCAI has significant exposure to public finance transactions which pose a risk of material adverse developments to its short to medium-term liquidity position.

As previously discussed, SCAI could also face future adverse developments on its Puerto Rico exposure, which includes re-insurance and direct investments by the company that could have material adverse effect on SCAI surplus, liquidity and financial position.

Now moving to slide 9 and the respective portfolios of the operating insurance companies. As of December 31, 2014, SGI's portfolio consisted of 93 credits, totaling $10.3 billion in net par exposure. This compares to 105 credits and $12.8 billion in net par exposure as of year end 2013.

The average internal rating of SGI's portfolio was BBB minus for both 2014 and 2013. In addition, as of December 31, 2014, 30 percent or $3.1 billion of SGI's portfolio was internally rated below investment grade, as compared to $3.7 billion or 29 percent, at year end 2013.

For SCAI, as of year end 2014, SCAI's portfolio consisted of 1,650 credits totalling $31.3 billion of net par exposure. This compares to 1,896 credits and $38.5 billion in net par exposure at year end 2013. The average internal rating for SCAI's portfolio was a minus and a, as of December 31, 2014 and '13 respectively.

In addition, as of year end 2014, 6 percent or $1.8 billion of SCAI's portfolio was internally rated below investment grade, compared to 3 percent or 1.2 billion as of year end '13. The primary drivers for the increase in below-investment grade credits relates to Puerto Rico.

Turning now to slide 10, the reduction in consolidated net par exposure was approximately $9.8 billion or 19 percent from year end 2013 to year end 2014. This was driven largely by the $3.8 billion in refunding activities, 2.9 billion in amortizations and 3.2 billion in terminations, foreign exchange adjustments and commutations.

Likewise, the number of insured credits reduced from a total of 2,001 to 1,743 during the year. Ninety-two percent of the 2014 credits are public finance by number, versus 56 percent, as measured by net par outstanding. The structured single-risk portfolio makes up our next-largest net outstanding par exposure category at 33 percent. CDO’s comprised 8 percent of the portfolio and ABS the remaining 3 percent.

Turning now to slide 11, our flag list exposure reduced from $8.2 billion to $6.8 billion during the period, driven largely by commutations, amortizations and terminations. The flag list is largely comprised of structured single-risk credits, which includes global finance infrastructure credits, which make up 40 percent of the flag list and public finance transactions, which make up close to 34 percent.

CDOs and ABS transactions make up the remaining 26 percent. With respect to the Loss List exposures, structured single risk credits make up 47 percent of the Loss List and ABS 36 percent. Public finance make up the remaining 17 percent.

With that, let me turn the call back to Susan to update you on some of our activities since our November investor call.

Susan Comparato: Thank you, Claude. As indicated on slide 12 and as we noted during our investor call, held in November 2014, Syncora's three strategic goals are: one, to achieve financial stability for the insurance platforms; two, to enhance financial and operating flexibility for the Syncora entities as a whole; and three, to initiate new businesses with sustainable sources of economic and strategic value.

The company continues to progress each of these three strategic goals.

First, and in particular, as Claude described, management remains very focused on risk reduction and remediation in order to stabilize the insurance platforms.

Second, we continue to actively explore options designed to enhance the operating and financial flexibility of the company and simplify the company's capital structure which include all of the actions we discussed during our investor update call in November, which are described in greater detail in footnote two to the GAAP financial statements available in the company reports and financial information sections of our Web site.

And third, with respect to business initiatives, we continue to enhance the American roads platform. For example, we have now executed a 20-year lease extension for the Detroit Windsor tunnel and have executed other agreements in principle that we discussed on our November call.

We have also made modest investments where these can provide sustainable sources of future liquidity matching for longer term liabilities. Before we conclude the call, I'd also like to provide you with an update on the appointments of the two directors to SHL's board, Alan Carr and Spencer Wells.

They were elected to the board last September by a vote of the Series A Preferred Shareholders and the NYDFS continues to review their applications.

Michael Corbally: Thank you, Susan. Ladies and gentlemen, this concludes today's call. We'll post the transcript to our Web site. And a replay of the call will be available later today. Thank you all for listening.

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