MBIA INC
Form 10-Q
November 09, 2011

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarter ended September 30, 2011

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 1-9583

MBIA INC.

(Exact name of registrant as specified in its charter)

Connecticut	**06-1185706**
(State of incorporation)	**(I.R.S. Employer**
	Identification No.)
113 King Street, Armonk, New York	**10504**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (914) 273-4545

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the Registrant is shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

As of November 3, 2011, 193,167,893 shares of Common Stock, par value $1 per share, were outstanding.

Table of Contents

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions except share and per share amounts)

	00000000 **September 30, 2011**	00000000 **December 31, 2010**
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $7,874 and $9,679)	$ 7,818	$ 9,092
Fixed-maturity securities at fair value	286	25
Investments pledged as collateral, at fair value (amortized cost $666 and $548)	591	552
Short-term investments held as available-for-sale, at fair value (amortized cost $1,486 and $2,073)	1,487	2,070
Other investments (includes investments at fair value of $139 and $186)	151	188
Total	10,333	11,927
Cash and cash equivalents	659	366
Accrued investment income	91	95
Premiums receivable	1,399	1,589
Deferred acquisition costs	364	412
Prepaid reinsurance premiums	91	97
Insurance loss recoverable	2,770	2,531
Reinsurance recoverable on paid and unpaid losses	18	15
Goodwill	31	31
Property and equipment, at cost (less accumulated depreciation of $138 and $135)	69	71
Receivable for investments sold	46	8
Derivative assets	2	4
Current income taxes	-	41
Deferred income taxes, net	1,298	908
Other assets	55	46
Assets of consolidated variable interest entities:		
Cash	580	764
Investments held-to-maturity, at amortized cost (fair value $3,492 and $3,760)	3,886	4,039
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $574 and $338)	532	339
Fixed-maturity securities at fair value	3,276	5,241
Loans receivable at fair value	2,218	2,183
Loan repurchase commitments	938	835
Derivative assets	713	699
Other assets	1	38
Total assets	**$ 29,370**	**$ 32,279**

Liabilities and Equity		
Liabilities:		
Unearned premium revenue	$ 3,648	$ 4,145
Loss and loss adjustment expense reserves	932	1,129
Reinsurance premiums payable	64	71
Investment agreements	1,635	2,005
Medium-term notes (includes financial instruments carried at fair value $128 and $116)	1,636	1,740
Securities sold under agreements to repurchase	387	471
Short-term debt	-	65
Long-term debt	1,841	1,851
Current income taxes	37	-
Deferred fee revenue	8	10
Payable for investments purchased	54	2
Derivative liabilities	5,266	4,617
Other liabilities	205	272
Liabilities of consolidated variable interest entities:		
Variable interest entity notes (includes financial instruments carried at fair value $5,123 and $6,680)	9,033	10,590
Long-term debt	360	360
Derivative liabilities	1,888	2,104
Other liabilities	1	1
Total liabilities	**26,995**	**29,433**
Commitments and contingencies (See Note 13)		
Equity:		
Preferred stock, par value $1 per share; authorized shares 10,000,000; issued and outstanding none	-	-
Common stock, par value $1 per share; authorized shares 400,000,000; issued shares 274,913,262 and 274,719,578	275	275
Additional paid-in capital	3,070	3,064
Retained earnings	1,431	2,124
Accumulated other comprehensive loss, net of deferred tax of $94 and $229	(148)	(406)
Treasury stock, at cost 81,755,455 and 74,973,978 shares	(2,276)	(2,225)
Total shareholders equity of MBIA Inc.	2,352	2,832
Preferred stock of subsidiary and noncontrolling interest	23	14
Total equity	**2,375**	**2,846**
Total liabilities and equity	**$ 29,370**	**$ 32,279**

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In millions except share and per share amounts)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenues:				
Premiums earned:				
Scheduled premiums earned	$ 111	$ 123	$ 354	$ 386
Refunding premiums earned	65	14	108	64
Premiums earned (net of ceded premiums of $3, $4, $9 and $24)	176	137	462	450
Net investment income	92	113	299	342
Fees and reimbursements	16	15	41	148
Change in fair value of insured derivatives:				
Realized gains (losses) and other settlements on insured derivatives	(53)	552	(599)	454
Unrealized gains (losses) on insured derivatives	776	(1,044)	(531)	(1,717)
Net change in fair value of insured derivatives	723	(492)	(1,130)	(1,263)
Net gains (losses) on financial instruments at fair value and foreign exchange	13	12	(114)	(36)
Investment losses related to other-than-temporary impairments:				
Investment losses related to other-than-temporary impairments	(12)	-	(25)	(187)
Other-than-temporary impairments recognized in accumulated other comprehensive loss	1	-	(19)	144
Net investment losses related to other-than-temporary impairments	(11)	-	(44)	(43)
Net gains (losses) on extinguishment of debt	-	10	26	28
Other net realized gains (losses)	1	(1)	6	18
Revenues of consolidated variable interest entities:				
Net investment income	17	20	53	48
Net gains (losses) on financial instruments at fair value and foreign exchange	88	(19)	3	394
Net gains (losses) on extinguishment of debt	-	14	-	18
Other net realized gains (losses)	5	-	8	(74)
Total revenues	1,120	(191)	(390)	30
Expenses:				
Losses and loss adjustment	190	(20)	204	122
Amortization of deferred acquisition costs	12	6	51	42
Operating	76	78	226	209
Interest	75	81	225	246
Expenses of consolidated variable interest entities:				
Operating	7	4	24	14
Interest	15	16	45	44
Total expenses	375	165	775	677
Income (loss) before income taxes	745	(356)	(1,165)	(647)
Provision (benefit) for income taxes	301	(143)	(472)	(249)
Net income (loss)	**$ 444**	**$ (213)**	**$ (693)**	**$ (398)**

Net income (loss) per common share:								
Basic	$	2.27	$	(1.06)	$	(3.50)	$	(1.96)
Diluted	$	2.26	$	(1.06)	$	(3.50)	$	(1.96)
Weighted average number of common shares outstanding:								
Basic		195,612,615		200,529,483		198,262,715		203,239,935
Diluted		196,347,502		200,529,483		198,262,715		203,239,935

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

For The Nine Months Ended September 30, 2011

(In millions except share amounts)

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total Shareholders Equity of MBIA Inc.	Preferred Stock of Subsidiary and Noncontrolling Interest	
	Shares	Amount	Capital	Earnings		Shares	Amount		Shares	Amount
Balance, December 31, 2010	**274,719,578**	**$ 275**	**$ 3,064**	**$ 2,124**	**$ (406)**	**(74,973,978)**	**$ (2,225)**	**$ 2,832**	**1,426**	**$ 14**
Comprehensive income (loss):										
Net income (loss)	-	-	-	(693)	-	-	-	(693)	-	-
Other comprehensive income (loss):										
Change in unrealized gains and losses on investments, net of tax of $117	-	-	-	-	257	-	-	257	-	-
Portion of other-than-temporary impairment losses recognized in other comprehensive loss, net of tax of $15	-	-	-	-	29	-	-	29	-	-
Change in fair value of derivative instruments, net of tax of $3	-	-	-	-	5	-	-	5	-	-
Change in foreign currency translation, net of tax of $0	-	-	-	-	(33)	-	-	(33)	-	-
Other comprehensive income (loss)								258		
Total comprehensive income (loss)								(435)		
Share-based compensation, net of tax of $4	193,684	-	6	-	-	(240,401)	(1)	5	-	-
Treasury shares acquired under share repurchase program	-	-	-	-	-	(6,541,076)	(50)	(50)	-	-
Preferred shares of subsidiary acquired	-	-	-	-	-	-	-	-	(111)	(2)
Change in noncontrolling interest in subsidiary	-	-	-	-	-	-	-	-	-	11
Balance, September 30, 2011	**274,913,262**	**$ 275**	**$ 3,070**	**$ 1,431**	**$ (148)**	**(81,755,455)**	**$ (2,276)**	**$ 2,352**	**1,315**	**$ 23**

	2011
Disclosure of reclassification amount:	
Change in unrealized gains and losses and other-than-temporary impairments on investments arising during the period, net of taxes	$ 321
Reclassification adjustment, net of taxes	(35)

Change in net unrealized gains and losses, net of taxes	$ 286

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In millions)

	Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net income (loss)	$ (693)	$ (398)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Change in:		
Accrued investment income	4	(9)
Premiums receivable	182	180
Deferred acquisition costs	48	45
Unearned premium revenue	(495)	(466)
Prepaid reinsurance premiums	6	72
Reinsurance premiums payable	(7)	(39)
Loss and loss adjustment expense reserves	(198)	(273)
Reinsurance recoverable on paid and unpaid losses	(3)	(15)
Insurance loss recoverable	(239)	(438)
Payable to reinsurers on recoveries	7	(72)
Accrued interest payable	(29)	(16)
Accounts receivable	(6)	3
Accrued expenses	3	6
Deferred fee revenue	(1)	(1)
Current income taxes	74	512
Amortization of bond (premiums) discounts, net	(13)	(27)
Depreciation	6	6
Amortization of medium-term notes (premiums) discounts, net	(9)	5
Net investment losses related to other-than-temporary impairments	44	43
Realized (gains) losses and other settlements on insured derivatives	-	(607)
Unrealized (gains) losses on insured derivatives	531	1,717
Net (gains) losses on financial instruments at fair value and foreign exchange	111	(358)
Other net realized (gains) losses	(14)	56
Deferred income tax benefit	(497)	(324)
(Gains) losses on extinguishment of debt	(26)	(46)
Share-based compensation	11	1
Other operating	3	21
Total adjustments to net income (loss)	(507)	(24)
Net cash provided (used) by operating activities	(1,200)	(422)
Cash flows from investing activities:		
Purchase of fixed-maturity securities	(5,590)	(7,792)
Sale and redemption of fixed-maturity securities	7,096	9,539
Decrease in loans receivable	223	778
Purchase of held-to-maturity investments	-	(71)
Redemptions of held-to-maturity investments	153	632
Sale (purchase) of short-term investments, net	968	(8)
Sale of other investments, net	26	9
Purchase of controlling interest in an affiliate, net of cash received	-	(27)

Consolidation/deconsolidation of variable interest entities, net		(16)		531
(Payments) proceeds for derivative settlements		(66)		19
Capital expenditures		(3)		(3)
Disposals of capital assets		-		1
Net cash provided (used) by investing activities		2,791		3,608
Cash flows from financing activities:				
Proceeds from issuance of investment agreements		89		75
Payments for drawdowns of investment agreements		(453)		(480)
Issuance of medium-term notes		17		18
Principal paydown of medium-term notes		(107)		(416)
Principal paydown of variable interest entity notes		(829)		(1,530)
Securities sold under agreements to repurchase		(84)		(31)
Dividends paid		-		(1)
Repayments for retirement of debt		(72)		(315)
Purchase of treasury stock		(50)		(31)
Contribution from noncontrolling interest and redemption of subsidiary preferred stock, net		9		(29)
Restricted stock awards settlements		(2)		3
Collateral from swap counterparty		-		164
Net cash provided (used) by financing activities		(1,482)		(2,573)
Net increase in cash and cash equivalents		109		613
Cash and cash equivalents - beginning of period		1,130		803
Cash and cash equivalents - end of period	$	1,239	$	1,416
Supplemental cash flow disclosures:				
Income taxes refunded	$	(54)	$	(422)
Interest paid:				
Investment agreements	$	25	$	29
Medium-term notes		27		28
Variable interest entity notes		202		267
Securities sold under agreements to repurchase		1		1
Other borrowings and deposits		3		3
Long-term debt		173		178
Non cash items:				
Share-based compensation	$	11	$	1

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Businesses, Developments, Risks and Uncertainties

Summary

MBIA Inc., together with its consolidated subsidiaries, (collectively, MBIA or the Company) operates the largest financial guarantee insurance business in the industry and is a provider of asset management advisory services. These activities are managed through three business segments: United States (U.S.) public finance insurance, structured finance and international insurance, and advisory services. The Company s U.S. public finance insurance business is primarily operated through National Public Finance Guarantee Corporation and subsidiaries (National), its structured finance and international insurance business is primarily operated through MBIA Insurance Corporation and its subsidiaries (MBIA Corp.), and its asset management advisory services business is primarily operated through Cutwater Holdings, LLC and its subsidiaries (Cutwater). MBIA also manages certain business activities through its corporate, asset/liability products, and conduit segments. The corporate segment includes revenues and expenses that arise from general corporate activities. Funding programs managed through the asset/liability products and conduit segments are in wind-down. Refer to Note 11: Business Segments for further information about the Company s business segments.

Business Developments

The Company has been unable to write meaningful amounts of new insurance business since 2008 and does not expect to write significant new insurance business prior to an upgrade of the credit ratings of its insurance subsidiaries. As of September 30, 2011, National was rated BBB with a developing outlook by Standard & Poor s Financial Services LLC (S&P) and Baa1 with a developing outlook by Moody s Investors Service, Inc. (Moody s). As of September 30, 2011, MBIA Insurance Corporation was rated B with a negative outlook by S&P and B3 with a negative outlook by Moody s.

In August 2011, S&P issued new guidelines that reflect significant changes to its rating methodology for financial guarantee insurers. These new guidelines are effective immediately. S&P expects to publish any changes to the ratings of the Company s insurance subsidiaries by November 30, 2011, after its review of the Company s third quarter 2011 financial statements. The changes to S&P s rating methodology substantially increase the amount of capital required to achieve its highest ratings, implement a new Largest Obligors Test, which is punitive in the rating assessment, and incorporate additional qualitative considerations into the ratings process. However, the effect on the ratings of the Company s insurance subsidiaries is uncertain. The absence of S&P s highest ratings could adversely impact the Company s ability to write new insurance business and the premiums the Company can charge, and could diminish the future acceptance of its financial guarantee insurance products.

During the third quarter of 2011, the Company continued to seek to reduce both the absolute amount and the volatility of its liabilities and potential liabilities through purchases of securities issued and commutations of insurance policies. Additionally, during 2011, the Company undertook actions to mitigate declines in the liquidity of MBIA Insurance Corporation and the asset/liability products segment through inter-company lending arrangements and the monetization of illiquid assets. MBIA Insurance Corporation had statutory capital of $2.6 billion and $2.7 billion as of September 30, 2011 and December 31, 2010, respectively. MBIA Insurance Corporation ended the third quarter of 2011 with $824 million in cash and highly liquid assets, after claim payments and commutations of insured derivatives, compared with $1.2 billion as of December 31, 2010. A decline in the pace at which delinquencies increased in troubled real estate sectors and improvements in asset values have also benefited capital and liquidity in these businesses during the nine months ended September 30, 2011, even though during the third quarter of 2011, the asset/liability products segment experienced deterioration in the market values of its assets as a result of market disruption due to S&P s downgrade of the U.S. triple-A rating, fears surrounding the Eurozone debt crisis and the risk of a double dip recession in the U.S., as described further below.

In the first nine months of 2011, MBIA Corp. commuted $12.2 billion of gross insured exposure comprising commercial mortgage-backed securities (CMBS) pools, investment grade corporate collateralized debt obligations (CDOs), asset-backed collateralized debt obligations (ABS CDOs), a government supported entity, and a municipal gas facility. Subsequent to September 30, 2011, MBIA Corp. agreed to commute transactions with additional counterparties. These transactions, comprising primarily commercial real estate, totaled $10.6 billion in gross insured exposure. The total amount the Company agreed to pay to commute the above transactions was within its aggregate statutory loss reserves for such transactions. In consideration for the commutation of insured transactions, including the transactions described above, the Company has made and may in the future make payments to the counterparties the amounts of which, if any, may be less than or greater than any statutory loss reserves established for the respective transactions.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Businesses, Developments, Risks and Uncertainties (continued)

Risks and Uncertainties

The Company s financial statements include estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The outcome of certain significant risks and uncertainties could cause the Company to revise its estimates and assumptions or could cause actual results to differ from the Company s estimates. Significant risks and uncertainties that could affect amounts reported in the Company s financial statements in future periods include, but are not limited to, the following:

If the U.S. economy weakens, commercial real estate values decline and commercial real estate servicer behavior does not continue to mitigate potential or actual credit losses in line with current trends, MBIA could incur substantial additional losses in that sector. As of September 30, 2011, MBIA Corp. had CMBS pool and commercial real estate (CRE) CDO insured par exposure of approximately $33.4 billion and $6.9 billion, respectively, excluding approximately $3.6 billion of CRE loan pools, primarily comprising European assets. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about the Company s estimate of CMBS credit impairments.

Incurred losses from insured residential mortgage-backed securities (RMBS) have declined from their peaks. However, performance remains difficult to predict and losses could ultimately be in excess of the Company s current estimated loss reserves. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about the Company s RMBS loss reserves.

While the Company has settled a substantial portion of its insured ABS CDO exposure at levels within MBIA Corp. s statutory loss reserves related to those exposures, further economic stress might cause increases in the Company s loss estimates. As of September 30, 2011, the Company s ABS CDO gross par outstanding was approximately $6.9 billion, and has decreased approximately $29.0 billion since 2007.

MBIA Corp. s efforts to recover losses from the second-lien securitization originators could be delayed, settled at amounts below its contractual claims or potentially settled at amounts below those recorded on its balance sheets prepared under statutory accounting principles (U.S. STAT) and accounting principles generally accepted in the United States of America (GAAP). Contractual claims could become subject to a bankruptcy proceeding of the originators. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about the Company s second-lien RMBS loss recoveries.

The Company s asset/liability products segment may not have sufficient liquidity to make all payments due on its liabilities and to meet other financial requirements, such as posting collateral, as a result of a deficit of invested assets at amortized cost to debt issued to third parties and affiliates at amortized cost. Furthermore, during the third quarter of 2011, the Company s asset/liability products segment experienced deterioration in the market values of its assets. If the segment is required to sell invested assets at their current market values in order to settle liabilities, the liquidity position of the segment will experience additional stress. Resolving the deficit will depend on the Company s ability to successfully implement strategies, such as raising capital and/or receiving further liquidity support from the corporate segment, and there can be no assurance that the Company will be successful in implementing these strategies or that such strategies will provide adequate liquidity. Refer to the following Liquidity section for additional information about the Company s asset/liability products segment s liquidity position.

The Company s recent financial results have been volatile, which has impacted management s ability to accurately project future taxable income. Insurance losses incurred beyond those currently projected may cause the Company to record allowances against some or all of its deferred tax assets. Refer to Note 10: Income Taxes for information about the Company s deferred tax assets.

Litigation over the New York Department of Financial Services (NYDFS), previously referred to as the New York State Insurance Department or NYSID, approval of National s creation or additional hurdles to achieving high stable ratings may impede National s ability to resume writing municipal bond insurance for some time, reducing its long-term ability to generate capital and cash from operations. Also, municipal and state fiscal distress could adversely affect the Company s operations if they result in larger-than-expected incurred insurance losses.

In the event the economy and the markets to which MBIA is exposed do not improve, or decline, the unrealized losses on insured credit derivatives could increase, causing additional stress in the Company s reported financial results. In addition, volatility in the relationship between MBIA s credit spreads and those on underlying collateral assets of insured credit derivatives can create significant unrealized gains and losses in the Company s reported results of operations. Refer to Note 6: Fair Value of Financial Instruments for information about the Company s valuation of insured credit derivatives.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Businesses, Developments, Risks and Uncertainties (continued)

While the Company believes it continues to have sufficient capital and liquidity to meet all of its expected obligations, if one or more possible adverse outcomes were to be realized, its statutory capital, financial position, results of operations and cash flows could be materially and adversely affected. Statutory capital, defined under U.S. STAT as policyholders surplus and contingency reserves, is a key measure of an insurance company s financial condition under insurance laws and regulations. Failure to maintain adequate levels of statutory surplus and total statutory capital could lead to intervention by the Company s insurance regulators in its operations and constitute an event of default under certain of the Company s contracts, thereby materially and adversely affecting the Company s financial condition and results of operations.

Under New York s financial guarantee statutes, MBIA Insurance Corporation is also required to establish a contingency reserve to provide protection to policyholders in the event of extreme losses in adverse economic events. The amount of the reserve is based on the percentage of principal insured or premiums earned, depending on the type of obligation (net of collateral, reinsurance, refunding, refinancings and certain insured securities). Under the New York Insurance Law, MBIA Insurance Corporation is required to invest its minimum surplus and contingency reserve, and 50% of its loss reserves and unearned premium reserves, in certain qualifying assets. Reductions in the contingency reserve may be recognized based on excess reserves and under certain stipulated conditions, subject to the approval of the Superintendent of the NYDFS. Pursuant to approval granted by the NYDFS in accordance with the New York Insurance Law, as of September 30, 2011, MBIA Insurance Corporation released to surplus an aggregate of $318 million of its contingency reserve. Absent this approval, MBIA Insurance Corporation would have had a short-fall of qualifying assets required to support its contingency reserves.

The reference herein to ineligible mortgage loans refers to those mortgage loans that the Company believes failed to comply with the representations and warranties made by the sellers/servicers of the securitizations to which those mortgage loans were sold with respect to such mortgage loans, including failure to comply with the related underwriting criteria, based on the Company s assessment, which included information provided by third-party review firms, of such mortgage loans compliance with such representations and warranties. The Company s assessment of the ineligibility of individual mortgage loans could be challenged by the sellers/servicers of the securitizations in litigation and there is no assurance that the Company s determinations will prevail.

Liquidity

As a financial services company, MBIA has been materially adversely affected by conditions in global financial markets. Current conditions and events in these markets, in addition to losses incurred due to ineligble loans in securitizations the Company has insured, have created substantial liquidity risk for the Company. MBIA continues to satisfy all of its payment obligations and the Company believes that it has adequate resources to meet its expected liquidity needs in both the short-term and the long-term.

In order to manage liquidity risk, the Company maintains a liquidity risk management framework with the primary objective of monitoring potential liquidity constraints in its asset and liability portfolios and guiding the proactive matching of liquidity resources to needs. The Company s liquidity risk management framework seeks to monitor the Company s cash and liquid asset resources using stress-scenario testing. Members of MBIA s senior management meet regularly to review liquidity metrics, discuss contingency plans and establish target liquidity cushions on an enterprise-wide basis.

As part of MBIA s liquidity risk management framework, the Company seeks to evaluate and manage liquidity on both a legal entity basis and a segment basis. Legal entity liquidity is an important consideration as there are legal, regulatory and other limitations on the Company s ability to utilize the liquidity resources within the overall enterprise. Unexpected loss payments arising from ineligible mortgage loans in securitizations that the Company has insured, dislocation in the global financial markets, the loss of MBIA Corp. s triple-A insurance financial strength ratings in 2008, the overall economic downturn in the U.S. and credit spreads widening during the third quarter of 2011 significantly increased the liquidity needs and decreased the financial flexibility in the Company s legal entities and segments. The Company could face additional liquidity pressure in all of its operations and businesses through increased liquidity demands or a decrease in its liquidity supply if (i) the Company is unable to collect or is delayed in collecting on its contract claim recoveries related to ineligible mortgage loans in securitizations, (ii) loss payments on the Company s insured transactions were to rise significantly, including due to ineligible mortgage loans in securitizations that it has insured, (iii) adverse market or economic conditions persist for an extended period of time or worsen, (iv) the value of the assets in the asset/liability products segment portfolio decline due to market conditions similar to those experienced in 2009, which will increase the collateralization requirements for that portfolio, (v) the Company is unable to sell assets at values necessary to satisfy payment obligations or is unable to access new capital through the issuance of equity or debt, or (vi) the Company experiences an unexpected acceleration of payments required to settle liabilities, including as a result of payment or other defaults. These pressures could arise from exposures beyond residential mortgage-related stress, which to date has been the main cause of stress.

As of September 30, 2011, National paid $194 million to MBIA Inc. related to its 2010 tax liability and 2011 estimated tax liability pursuant to the Company s tax sharing agreement. Consistent with the tax sharing agreement, these funds were placed in an escrow account in the second and third quarters of 2011 and will remain in escrow until the expiration of National s two-year net operating loss (NOL) carry-back period under U.S. tax rules. At the expiration of National s carry-back period, any funds remaining after any reimbursement to National in respect of any NOL carry-backs will be available for general corporate purposes, including to satisfy any other obligations under the tax sharing agreement.

As of September 30, 2011, the Company s asset/liability products segment had a deficit of invested assets at amortized cost to debt issued to third parties and affiliates at amortized cost of $610 million. Additionally, during the third quarter of 2011, the asset/liability products segment experienced deterioration in the market values of its assets, resulting in increased collateral requirements, as a consequence of market volatility caused by S&P s downgrade of the U.S. triple-A rating, fears surrounding the Eurozone debt crisis and the risk of a double dip recession in the U.S. As a result, subsequent to the third quarter of 2011, the Company received approval from the NYDFS to extend the maturity of an intercompany secured loan from November 2011 to May 2012 for a maximum outstanding amount of $450 million. The outstanding principal balance on the loan was $600 million as of September 30, 2011. Also subsequent to the third quarter of 2011, the Company s corporate segment contributed $50 million of capital to the asset/liability products segment.

To the extent the Company s asset/liability products segment experiences further asset impairments, asset or liability cash flow variability or reductions in the market value or rating eligibility of assets pledged as collateral, among other factors, it may have insufficient resources to meet its payment obligations and any increase in collateral margin requirements. In such events, the Company may sell invested assets, potentially with substantial losses, or use free cash within the asset/liability products segment or the corporate segment. There can be no assurance that the asset/liability products segment will be able to draw on these additional sources of liquidity or that its resources will be adequate to meet its obligations. In the event that the asset/liability products segment s additional liquidity resources are insufficient to make all payments on obligations as they come due, MBIA Corp., as guarantor of the investment agreements and MBIA Global Funding, LLC (GFL) medium-term notes (MTNs), may be called upon to satisfy those obligations.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 2: Significant Accounting Policies

The Company has disclosed its significant accounting policies in Note 2: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. The following significant accounting policies provide an update to those included in the Company s Annual Report on Form 10-K.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, do not include all of the information and disclosures required by GAAP for annual periods. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2010. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the Company s consolidated financial position and results of operations.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. As additional information becomes available or actual amounts become determinable, the recorded estimates are revised and reflected in operating results. The results of operations for the three and nine months ended September 30, 2011 may not be indicative of the results that may be expected for the year ending December 31, 2011. The December 31, 2010 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. Certain amounts have been reclassified in prior years financial statements to conform to the current presentation. This includes the reclassification of certain investments from the previously reported line Investments held-to-maturity, at amortized cost to Fixed-maturity securities held as available-for-sale, at fair value reported under Assets of consolidated variable interest entities and certain investments from the previously reported line Other investments to Fixed-maturity securities held as available-for-sale, at fair value on the Company s consolidated balance sheets. These reclassifications had no impact on total revenues, expenses, assets, liabilities, or stockholders equity for all periods presented.

Consolidation

The consolidated financial statements include the accounts of MBIA Inc., its wholly owned subsidiaries and all other entities in which the Company has a controlling financial interest. All material intercompany balances and transactions have been eliminated. The Company determines whether it has a controlling financial interest in an entity by first evaluating whether an entity is a voting interest entity or a variable interest entity (VIE).

Voting interest entities are entities in which (i) the total equity investment at risk is sufficient to enable an entity to finance its activities independently and (ii) the equity holders have the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity s activities. Voting interest entities are consolidated when the Company has a majority voting interest.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 2: Significant Accounting Policies (continued)

VIEs are entities that lack one or more of the characteristics of a voting interest entity. The consolidation of a VIE is required if an entity has a variable interest (such as an equity or debt investment, a beneficial interest, a guarantee, a written put option or a similar obligation) and that variable interest or interests give it a controlling financial interest in the VIE. A controlling financial interest is present when an enterprise has both (a) the power to direct the activities of a VIE that most significantly impact the entity s economic performance and (b) the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. The enterprise with the controlling financial interest, known as the primary beneficiary, is required to consolidate the VIE. The Company consolidates all VIEs in which it is the primary beneficiary. Refer to Note 4: Variable Interest Entities for additional information.

Note 3: Recent Accounting Pronouncements

Recently Adopted Accounting Standards

Improving Disclosures about Fair Value Measurements (Accounting Standards Update 2010-06)

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements, to require additional disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. The standard also clarifies existing disclosures about the level of disaggregation, valuation techniques and inputs to fair value measurements. The Company adopted this standard as of the first quarter of 2010 except for the requirement to provide the Level 3 activity of purchases, sales, issuances and settlements on a gross basis, which was adopted in the first quarter of 2011. As this standard only affects disclosures related to fair value, the adoption of this standard did not affect the Company s consolidated balance sheet, results of operations, or cash flows. Refer to Note 6: Fair Value of Financial Instruments for these disclosures.

Refer to the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010 for further information regarding the effects of recently adopted accounting standards on prior year financials.

Recent Accounting Developments

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (ASU 2010-26)

In October 2010, the FASB issued ASU 2010-26, Financial Services Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. This amendment specifies which costs incurred in the acquisition of new and renewal insurance contracts should be capitalized. The new guidance is effective for the Company beginning January 1, 2012 with early adoption as of January 1, 2011 permitted. The Company did not early adopt the guidance as of January 1, 2011. The adoption of this standard will not have a material effect on the Company s consolidated balance sheet, results of operations, or cash flows.

Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04)

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This amendment results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between GAAP and International Financial Reporting Standards. The new guidance is effective for the Company beginning January 1, 2012. This standard is expected to only affect the Company s disclosures related to fair value, therefore, the adoption of this standard is not expected to affect the Company s consolidated balance sheet, results of operations, or cash flows.

Presentation of Comprehensive Income (ASU 2011-05)

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This amendment eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. The amendment does not change what currently constitutes net income and other comprehensive income. The new guidance is effective for the Company beginning January 1, 2012. This standard will only affect the Company s presentation of comprehensive income and will not affect the Company s consolidated balance sheets, results of operations, or cash flows.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 3: Recent Accounting Pronouncements (continued)

Testing Goodwill for Impairment (ASU 2011-08)

In September 2011, the FASB issued ASU 2011-08, Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment. Under the revised guidance, an entity has an option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The new guidance is effective for the Company beginning January 1, 2012 with early adoption permitted. The Company did not early adopt the guidance. The adoption of this standard will not have a material effect on the Company s consolidated balance sheet, results of operations, or cash flows.

Note 4: Variable Interest Entities

Structured Finance and International Insurance

Through MBIA s structured finance and international insurance segment, the Company provides credit protection to issuers of obligations that may involve issuer-sponsored special purpose entities (SPEs). An SPE may be considered a VIE to the extent the SPE s total equity at risk is not sufficient to permit the SPE to finance its activities without additional subordinated financial support or its equity investors lack any one of the following characteristics (i) the power to direct the activities of the SPE that most significantly impact the entity s economic performance or (ii) the obligation to absorb the expected losses of the entity or the right to receive the expected residual returns of the entity. A holder of a variable interest or interests in a VIE is required to assess whether it has a controlling financial interest, and thus is required to consolidate the entity as primary beneficiary. An assessment of a controlling financial interest identifies the primary beneficiary as the variable interest holder that has both of the following characteristics (i) the power to direct the activities of the VIE that most significantly impact the entity s economic performance and (ii) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. The primary beneficiary is required to consolidate the VIE. An ongoing reassessment of controlling financial interest is required to be performed based on any substantive changes in facts and circumstances involving the VIE and its variable interests.

The Company evaluates issuer-sponsored SPEs initially to determine if an entity is a VIE, and is required to reconsider its initial determination if certain events occur. For all entities determined to be VIEs, MBIA performs an ongoing reassessment to determine whether its guarantee to provide credit protection on obligations issued by VIEs provides the Company with a controlling financial interest. Based on its ongoing reassessment of controlling financial interest, the Company determines whether a VIE is required to be consolidated or deconsolidated.

The Company makes its determination for consolidation based on a qualitative assessment of the purpose and design of a VIE, the terms and characteristics of variable interests of an entity, and the risks a VIE is designed to create and pass through to holders of variable interests. The Company generally provides credit protection on obligations issued by VIEs, and holds certain contractual rights according to the purpose and design of a VIE. The Company may have the ability to direct certain activities of a VIE depending on facts and circumstances, including the occurrence of certain contingent events, and these activities may be considered the activities of a VIE that most significantly impact the entity s economic performance. The Company generally considers its guarantee of principal and interest payments of insured obligations, given nonperformance by a VIE, to be an obligation to absorb losses of the entity that could potentially be significant to the VIE. At the time the Company determines it has the ability to direct the activities of a VIE that most significantly impact the economic performance of the entity based on facts and circumstances, MBIA is deemed to have a controlling financial interest in the VIE and is required to consolidate the entity as primary beneficiary. The Company performs an ongoing reassessment of controlling financial interest that may result in consolidation or deconsolidation of any VIE.

Wind-down Operations

In its asset/liability products segment, the Company invests in obligations issued by issuer-sponsored SPEs which are included in fixed-maturity securities held as available-for-sale. The Company evaluates issuer-sponsored SPEs to determine if the entity is a VIE. For all entities determined to be VIEs, the Company evaluates whether its investment is determined to have both of the characteristics of a controlling financial interest in the VIE. The Company performs an ongoing reassessment of controlling financial interests in issuer-sponsored VIEs based on investments held. MBIA s wind-down operations do not have a controlling financial interest in any issuer-sponsored VIEs and is not the primary beneficiary of any issuer-sponsored VIEs. The Company s exposure to the aforementioned VIEs is limited to its investments in these entities. In the third quarter of 2011, the one VIE that the Company formed, sponsored and was the primary beneficiary, included in the asset/liability products segment, was dissolved and deconsolidated by the Company. The Company was the sole variable interest holder of the VIE and retained all the fixed-maturity securities, consisting of alternative A-paper (Alt-A) non-agency RMBS securities, and recognized no gain or loss upon deconsolidation.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

In the conduit segment, the Company manages and administers two multi-seller conduit SPEs (Conduits). The Conduits invest primarily in debt securities and fund the investments through the issuance of VIE notes and long-term debt. The liabilities and certain of the assets of the Conduits are supported by credit enhancement provided through MBIA Corp. The Conduits were designed to provide issuers an efficient source of funding for issued obligations, and to provide an opportunity for MBIA Corp. to issue financial guarantee insurance policies. The Conduits are VIEs and are consolidated by the Company as primary beneficiary.

Nonconsolidated VIEs

The following tables present the total assets of nonconsolidated VIEs in which the Company holds a variable interest as of September 30, 2011 and December 31, 2010. The following tables present the Company s maximum exposure to loss for nonconsolidated VIEs as well as the value of the assets and liabilities the Company has recorded for its interest in these VIEs as of September 30, 2011 and December 31, 2010. The Company has aggregated nonconsolidated VIEs based on the underlying credit exposure of the insured obligation. The nature of the Company s variable interests in nonconsolidated VIEs is related to financial guarantees, insured credit default swaps (CDS) and any investments in obligations issued by nonconsolidated VIEs.

			September 30, 2011					
			Carrying Value of Assets			Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Investments (1)	Premiums Receivable (2)	Insurance Loss Recoverable (3)	Unearned Premium Revenue (4)	Loss and Loss Adjustment Expense Reserves (5)	Derivative Liabilities (6)
Insurance:								
Global structured finance:								
Collateralized debt obligations	$ 27,830	$ 15,690	$ 61	$ 66	$ -	$ 57	$ -	$ 122
Mortgage-backed residential	49,725	16,537	63	88	2,505	87	469	4
Mortgage-backed commercial	5,293	2,906	-	2	-	2	-	-
Consumer asset-backed	8,396	4,854	17	27	-	26	30	-
Corporate asset-backed	30,640	16,235	245	209	27	224	-	1
Total global structured finance	$ 121,884	$ 56,222	$ 386	$ 392	$ 2,532	$ 396	$ 499	$ 127
Global public finance	41,272	21,879	-	211	-	265	-	-
Total insurance	$ 163,156	$ 78,101	$ 386	$ 603	$ 2,532	$ 661	$ 499	$ 127

(1) - Reported within Investments on MBIA s consolidated balance sheets.

(2) - Reported within Premiums receivable on MBIA s consolidated balance sheets.

(3) - Reported within Insurance loss recoverable on MBIA s consolidated balance sheets.

(4) - Reported within Unearned premium revenue on MBIA s consolidated balance sheets.

(5) - Reported within   Loss and loss adjustment expense reserves   on MBIA   s consolidated balance sheets.

(6) - Reported within   Derivative liabilities   on MBIA   s consolidated balance sheets.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

			December 31, 2010					
			Carrying Value of Assets			Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Investments (1)	Premiums Receivable (2)	Insurance Loss Recoverable (3)	Unearned Premium Revenue (4)	Loss and Loss Adjustment Expense Reserves (5)	Derivative Liabilities (6)
Insurance:								
Global structured finance:								
Collateralized debt obligations	$ 30,628	$ 18,068	$ 126	$ 78	$ -	$ 68	$ -	$ 360
Mortgage-backed residential	56,828	18,494	71	95	2,270	93	598	3
Mortgage-backed commercial	5,547	3,138	-	2	-	2	-	-
Consumer asset-backed	11,709	6,780	19	30	-	29	-	-
Corporate asset-backed	42,380	22,468	246	325	5	340	-	-
Total global structured finance	$ 147,092	$ 68,948	$ 462	$ 530	$ 2,275	$ 532	$ 598	$ 363
Global public finance	42,370	21,201	-	225	-	280	-	-
Total insurance	$ 189,462	$ 90,149	$ 462	$ 755	$ 2,275	$ 812	$ 598	$ 363

(1) - Reported within Investments on MBIA s consolidated balance sheets.

(2) - Reported within Premiums receivable on MBIA s consolidated balance sheets.

(3) - Reported within Insurance loss recoverable on MBIA s consolidated balance sheets.

(4) - Reported within Unearned premium revenue on MBIA s consolidated balance sheets.

(5) - Reported within Loss and loss adjustment expense reserves on MBIA s consolidated balance sheets.

(6) - Reported within Derivative liabilities on MBIA s consolidated balance sheets.

The Company s maximum exposure to loss as a result of its variable interests in nonconsolidated VIEs is represented by insurance in force. Insurance in force is the maximum future payments of principal and interest that may be required under commitments to make payments on insured obligations issued by nonconsolidated VIEs.

Consolidated VIEs

The carrying amounts of assets and liabilities of consolidated VIEs were $12.1 billion and $11.3 billion, respectively, as of September 30, 2011, and $14.1 billion and $13.1 billion, respectively, as of December 31, 2010. The carrying amounts of assets and liabilities are presented separately in Assets of consolidated variable interest entities and Liabilities of consolidated variable interest entities on the Company s consolidated balance sheets. Additional VIEs are consolidated or deconsolidated based on an ongoing reassessment of controlling financial interest, when events occur or circumstances arise, and whether the ability to exercise rights that constitute power to direct activities of any VIEs are present according to the design and characteristics of these entities. No gains or losses were recognized on initial consolidation of additional VIEs during the nine months ended September 30, 2011 and net realized losses of $74 million were recognized on initial consolidation of additional VIEs during the nine months ended September 30, 2010. Net realized gains related to the deconsolidation of VIEs were immaterial for the nine months ended September 30, 2011 and 2010.

Holders of insured obligations of issuer-sponsored VIEs related to the Company s structured finance and international insurance segment do not have recourse to the general assets of MBIA. In the event of nonpayment of an insured obligation issued by a consolidated VIE, the Company is obligated to pay principal and interest, when due, on the respective insured obligation only. The Company s exposure to consolidated VIEs is limited to the credit protection provided on insured obligations and any additional variable interests held by MBIA. Creditors of the Conduits do not have recourse to the general assets of MBIA apart from the financial guarantee insurance policies provided by MBIA Corp. on insured obligations issued by the Conduits.

Note 5: Loss and Loss Adjustment Expense Reserves

As of September 30, 2011, the majority of the Company s case basis reserves and insurance loss recoveries recorded in accordance with GAAP were related to insured first and second-lien RMBS transactions. These reserves and recoveries do not include estimates for policies insuring credit derivatives. Policies insuring credit derivative contracts are accounted for as derivatives and carried at fair value under GAAP. The fair values of insured derivative contracts are influenced by a variety of market and transaction-specific factors that may be unrelated to potential future claim payments under the Company s insurance policies. In the absence of credit impairments on insured derivative contracts or the early termination of such contracts at a loss, the cumulative unrealized losses recorded from fair valuing these contracts should reverse before or at the maturity of the contracts.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

Notwithstanding the difference in accounting under GAAP for financial guarantee policies and the Company s insured derivatives, insured derivatives have similar terms, conditions, risks, and economic profiles to financial guarantee insurance policies, and, therefore, are evaluated by the Company for loss (referred to as credit impairment herein) and loss adjustment expense (LAE) periodically in the same way that loss and LAE reserves are estimated for financial guarantee insurance policies. Credit impairments represent the present value of estimated expected future claim payments, net of recoveries, for such transactions using a discount rate of 5.93%, consistent with the calculation of the Company s statutory loss reserves. These credit impairments, calculated in accordance with U.S. STAT, differ from the fair values recorded in the Company s consolidated financial statements. The Company regards its credit impairment estimates as critical information for investors as it provides information about loss payments the Company expects to make on insured derivative contracts. As a result, the following loss and LAE process discussion includes information about loss and LAE activity recorded in accordance with GAAP for financial guarantee insurance policies and credit impairments estimated in accordance with U.S. STAT for insured derivative contracts. Refer to Note 6: Loss and Loss Adjustment Expense Reserves in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010 for information about the Company s monitoring of outstanding insured obligations and for additional information about its loss reserving process. Refer to Note 6: Fair Value of Financial Instruments included herein for additional information about the Company s insured credit derivative contracts.

Loss and Loss Adjustment Expense Process

RMBS Case Basis Reserves and Recoveries

The Company s RMBS reserves and recoveries relate to financial guarantee insurance policies. The Company calculated RMBS case basis reserves as of September 30, 2011 for both second-lien RMBS and first-lien RMBS transactions using a process called the Roll Rate Methodology. The Roll Rate Methodology is a multi-step process using a database of loan level information, a proprietary internal cash flow model, and a commercially available model to estimate expected ultimate cumulative losses on insured bonds. Roll Rate is defined as the probability that current loans become delinquent and that loans in the delinquent pipeline are charged-off or liquidated. Generally, Roll Rates are calculated for the previous three months and averaged. The loss reserve estimates are based on a probability-weighted average of three scenarios of loan losses (base case, stress case, and an additional stress case).

In calculating ultimate cumulative losses for RMBS, the Company estimates the amount of loans that are expected to be charged-off (deemed uncollectible by servicers of the transactions) or liquidated in the future. The Company assumes that such charged-off loans have zero recovery values. In calculating ultimate cumulative losses for first-lien RMBS, the Company estimates the amount of loans that are expected to be liquidated through foreclosure or short sale.

Second-lien RMBS Reserves

The Company s second-lien RMBS case basis reserves as of September 30, 2011 relate to RMBS backed by home equity lines of credit (HELOCs) and closed-end second mortgages (CES).

The Company assumes that the Roll Rate for 90+ day delinquent loans is 100%. The Roll Rates for 30-59 day delinquent loans and 60-89 day delinquent loans are calculated on a transaction-specific basis. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of August 31, 2011 to estimate future losses from loans that are delinquent as of the current reporting period.

Roll Rates for loans that are current as of August 31, 2011 (Current Roll to Loss) are calculated on a transaction-specific basis. A proportion of loans reported current as of August 31, 2011 is assumed to become delinquent every month, at a Current Roll to Loss rate that persists at a high level for a time and subsequently starts to decline. A key assumption in the model is the period of time in which the Company projects high levels of Current Roll to Loss to persist. In the Company s base case, the Company assumes that the Current Roll to Loss begins to decline immediately and continues to decline over the next six months to 25% of their levels as of August 31, 2011. In the stress case, the period of elevated delinquency and loss is extended by six months. In the additional stress case, the Company assumes that the current trends in losses will remain through early 2013, after which time they will revert to the base case. For example, in the base case, as of August 31, 2011, if the amount of current loans which became 30-59 days delinquent is 10%, and recent performance suggests that 30% of those loans will be charged-off, the Current Roll to Loss for the transaction is 3%. In the base case, it is then assumed that the Current Roll to Loss will reduce linearly to 25% of its original value over the next six months (i.e., 3% will linearly reduce to 0.75% over the six months from September 2011 to March 2012). After that six-month period, the Company further reduces the Current Roll to Loss to 0% by early 2014 with the expectation that the performing seasoned loans and an economic recovery will eventually result in loan performance reverting to historically low levels of default. In the model, the Company assumes that all current loans that become delinquent are charged-off after six months of delinquency.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

In addition, in the Company s loss reserve models for transactions secured by HELOCs, the Company considers borrower draw and prepayment rates and factors that could reduce the excess spread generated by current loans which offset losses and reduce payments. For HELOCs, the current three-month average draw rate is generally used to project future draws on the line. For HELOCs and transactions secured by fixed-rate CES, the three-month average conditional prepayment rate is generally used to project voluntary principal prepayments. Projected cash flows are also based on an assumed constant basis spread between floating rate assets and floating rate insured debt obligations (the difference between Prime and London Interbank Offered Rate (LIBOR) interest rates, minus any applicable fees). For all transactions, cash flow models consider allocations and other structural aspects of the transactions, including managed amortization periods, rapid amortization periods and claims against MBIA Corp. s insurance policy consistent with such policy s terms and conditions. For loans that remain current (not delinquent) throughout the projection period, the Company generally assumes that voluntary prepayments occur at the average rate experienced in the most recent three-month period. In developing multiple loss scenarios, stress is applied by elongating the Current Roll to Loss rate for various periods, simulating a slower improvement in the transaction performance. The estimated net claims from the procedure above are then discounted using a risk-free rate to a net present value reflecting MBIA s general obligation to pay claims over time and not on an accelerated basis. The above assumptions represent MBIA s best estimates of how transactions will perform over time.

The Company monitors portfolio performance on a monthly basis against projected performance, reviewing delinquencies, Roll Rates, and prepayment rates (including voluntary and involuntary). However, given the large percentage of mortgage loans that were not underwritten by the sellers/servicers in accordance with applicable underwriting guidelines, performance remains difficult to predict and losses may exceed expectations. In the event of a material deviation in actual performance from projected performance, the Company would increase or decrease the case basis reserves accordingly. If actual performance were to remain at the peak levels the Company is modeling for six months longer than in the probability-weighted outcome, the addition to the case basis reserves before considering potential recoveries would be approximately $110 million.

Since the third quarter of 2009, paid claims in each month have been somewhat below that projected in the Company s model. The Company has not modified its expectations to reflect this lower paid claims rate. The difference between actual and projected paid claims has not been significant.

First-lien RMBS Reserves

The Company s first-lien RMBS case basis reserves as of September 30, 2011, which relate to RMBS backed by Alt-A and subprime transactions were also determined using Roll Rate Methodology. The Company assumes that the Roll Rate for loans in foreclosure, Real Estate Owned (REO) and bankruptcy are 90%, 90% and 75%, respectively. Roll Rates for current, 30-59 day delinquent loans, 60-89 day delinquent loans and 90+ day delinquent loans are calculated on a transaction-specific basis. Current Roll to Loss stays at the August 31, 2011 level for three months before declining to 25% of this level over a 24-month period. Additionally, the Company runs scenarios where the 90+ day roll rate to loss is set at 90%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of August 31, 2011 to estimate future losses from loans that are delinquent as of the current reporting period.

The timelines to liquidation for defaulted loans are specific to a loan s delinquency bucket with the latest three-month average loss severities generally used to calculate losses at loan liquidation. The loss severities are reduced over time to account for reduction in the amount of foreclosure inventory, future increases in home prices, and principal amortization of the loans.

RMBS Recoveries

As of September 30, 2011, the Company recorded estimated recoveries of $2.8 billion, gross of income taxes, related to second-lien RMBS put-back claims on ineligible loans, consisting of $1.9 billion included in Insurance loss recoverable and $938 million included in Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company s consolidated balance sheets. As of September 30, 2011 and December 31, 2010, the Company s estimated recoveries after income taxes calculated at the federal statutory rate of 35%, were $1.8 billion and $1.6 billion, respectively, which was 78% and 58% of the consolidated total shareholders equity of MBIA, excluding preferred stock of subsidiaries and noncontrolling interest, respectively. The percentage increase of recoveries relative to shareholders equity was principally driven by realized losses on insured derivatives, unrealized losses on insured derivatives as a result of MBIA s nonperformance risk on the derivative liabilities and an increase in recorded estimated recoveries related to put-back claims of ineligible loans. As of September 30, 2011 and December 31, 2010, the related statutory measures were 69% and 59%, respectively, of the statutory capital of MBIA Corp. These estimated recoveries relate to the Company s put-back claims of ineligible loans, which have been disputed by the loan sellers/servicers and are currently subject to litigation initiated by the Company to pursue recovery. While the Company believes that it will prevail in enforcing its contractual rights, there is uncertainty with respect to the ultimate outcome. Furthermore, there is a risk that sellers/servicers or other responsible parties might not be able to satisfy their put-back obligations. However, there can be no assurance that MBIA will successfully make recoveries on its contract claims.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

Beginning in 2008, the Company utilized loan level forensic review consultants to re-underwrite/review mortgage loan files underlying certain first and second-lien RMBS transactions insured by MBIA. The consultants graded the individual mortgages that were sampled into an industry standard three level grading scale, defined as (i) Level 1 loans complied with specific underwriting guidelines, (ii) Level 2 loans contained some deviation from underwriting guidelines but also contained sufficient compensating factors and (iii) Level 3 loans contained material deviation from the underwriting guidelines without any compensating factors. MBIA s forensic review consultants utilized the same underwriting guidelines that the originators were to have used to qualify borrowers when originally underwriting the loans and determined that more than 80% of the loans reviewed were considered to be ineligible mortgage loans. The Company has developed estimates of breach rates primarily based upon loans with credit breaches or credit and compliance breaches because the Company believes that loans with these types of breaches are not judgmental and cannot be cured. Breach rates were determined by dividing the number of loans that contained credit and/or credit and compliance breaches by the total number of loans reviewed for a particular transaction.

Recent legal decisions have led the Company to conclude that the practice of reviewing individual loans for purpose of assessing put-back recoveries is no longer necessary. First, the Company determined that a sufficient number of loans in each securitization have already been reviewed to demonstrate widespread breaches of the contractual provisions of the agreements with the sponsors. Second, the Company received a favorable decision on its motion in limine addressing the use of sampling in the Countrywide litigation (MBIA Insurance Corp. v. Countrywide Home Loans, Inc., et al, Index No. 602825/08 (N.Y. Sup. Ct.)). That decision provided that MBIA can present representative samples of loans from each of the securitizations at issue in the case to establish its causes of action, including its breach-of-contract claims. Further, in May 2011, the court in MBIA Insurance Corp. v. Morgan Stanley, et al, Index No. 29951-10 (N.Y. Sup. Ct.) confirmed recent precedent and held that MBIA is not limited to a loan-by-loan put-back remedy and can seek a pool-wide remedy based on sampling and extrapolation.

Based upon the above-referenced developments, the Company utilizes probability-based scenarios primarily based on the percentage of incurred losses the Company expects to collect as opposed to recoveries based primarily on loan file reviews. The Company s recovery estimates are based on five scenarios that include full recovery of its incurred losses and limited/reduced recoveries due to litigation delays and risks and/or potential financial distress of the sellers/servicers. Probabilities were assigned across these scenarios, with most of the probability weight on partial recovery scenarios. However, based on the Company s assessment of the strength of its contract claims, the Company believes it is entitled to collect the full amount of its incurred losses on these transactions, which totaled $4.6 billion through September 30, 2011.

The Company has not recognized potential recoveries related to sellers/servicers that MBIA has determined did not have sufficient capital and resources to honor their obligations. The Company assesses the financial abilities of the sellers/servicers using external credit ratings and other factors. The impact of such factors on cash flows related to expected recoveries is incorporated into the Company s probability-weighted scenarios. The indicative scenarios and related probabilities assigned to each scenario based on the Company s judgment about their relative likelihoods of being realized are used to develop a distribution of possible outcomes. The sum of the probabilities assigned to all scenarios is 100%. Expected cash inflows from recoveries are discounted using the current risk-free rate associated with the underlying transaction, which ranged from 0.75% to 2.06%, depending upon the transaction s expected average life.

The Company s potential recoveries are typically based on either salvage rights, the rights conferred to MBIA through the transactional documents (inclusive of the insurance agreement), or subrogation rights embedded within financial guarantee insurance policies. The second-lien RMBS transactions with respect to which MBIA has estimated put-back recoveries provide the Company with such rights. Expected salvage and subrogation recoveries, as well as recoveries from other remediation efforts, reduce the Company s claim liability. Once a claim payment has been made, the claim liability has been satisfied and MBIA s right to recovery is no longer considered an offset to future expected claim payments, but is recorded as a salvage asset. The amount of recoveries recorded by the Company is limited to paid claims plus the present value of projected future claim payments. As claim payments are made, the recorded amount of potential recoveries may exceed the remaining amount of claim liability for a given policy.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

To date, sellers/servicers have not substituted loans which MBIA has put back, and the amount of loans repurchased has been insignificant. The unsatisfactory resolution of these put-backs has led MBIA to initiate litigation against five of the sellers/servicers to enforce their obligations. The Company has alleged several causes of action in its complaints, including breach of contract, fraudulent inducement and indemnification. MBIA s aggregate $2.8 billion of estimated potential recoveries do not include damages from causes of action other than breach of contract. Irrespective of amounts recorded in its financial statements, MBIA is seeking to recover the full amount of its incurred losses and other damages on these transactions. Currently, MBIA has received five decisions with regard to the motions to dismiss the Company s claims. On each motion, the respective New York State Supreme Court denied the defendants motions to dismiss, allowing each of the cases to proceed on, at minimum, the fraud and breach-of-contract claims. In one of those cases, MBIA Insurance Corp. v. Credit Suisse Securities et al., Index No. 603751/09E (N.Y. Sup. Ct.), the court had issued two previous inconsistent rulings on defendants motion to dismiss the fraud claim. On October 13, 2011, the Court confirmed that MBIA can proceed to litigate the fraud claims. Additional information on the status of these litigations can be found in the Recovery Litigation discussion within Note 13: Commitments and Contingencies.

The Company s assessment of the recovery outlook for insured second-lien RMBS issues is principally based on the following factors:

1. the strength of the Company s existing contract claims related to ineligible loan substitution/repurchase obligations;

2. the settlement for $1.1 billion of Assured Guaranty s put-back related claims with Bank of America in April 2011;

3. the improvement in the financial strength of the sellers/servicers due to mergers and acquisitions and/or government assistance, which should facilitate their ability to comply with required loan repurchase/substitution obligations. The Company is not aware of any provisions that explicitly preclude or limit the successors obligations to honor the obligations of the original sponsor. The Company s assessment of any credit risk associated with these sponsors (or their successors) is reflected in the Company s probability-weighted potential recovery scenarios;

4. evidence of loan repurchase/substitution compliance by sellers/servicers for put-back requests made by other harmed parties with respect to ineligible loans; this factor is further enhanced by (i) Bank of America s disclosure that it has resolved $8.0 billion of repurchase requests in the fourth quarter of 2010; (ii) the Fannie Mae settlements with Ally Bank announced on December 23, 2010 and with Bank of America (which also involved Freddie Mac) announced on December 31, 2010, and (iii) the Company s settlement agreement entered into on July 16, 2010 between MBIA Corp. and the sponsor of several MBIA-insured mortgage loan securitizations in which MBIA Corp. received a payment in exchange for a release relating to its representation and warranty claims against the sponsor. This settlement also resolved all of MBIA s representation and warranty claims against the sponsor on mutually beneficial terms and is substantially consistent with the recoveries previously recorded by the Company related to these exposures;

5. the favorable outcome for MBIA on defendants motions to dismiss in the actions captioned MBIA Insurance Corp. v. Countrywide Home Loans, Inc., et al, Index No. 602825/08 (N.Y. Sup. Ct.), MBIA Insurance Corp. v. Residential Funding Co., LLC, Index No. 603552/08 (N.Y. Sup. Ct.), MBIA v. GMAC Mortgage LLC, Index No. 600837/10E (N.Y. Sup. Ct.), MBIA Insurance Corp. v. Credit Suisse Securities et al., Index No. 603751/09E (N.Y. Sup. Ct.) and MBIA Insurance Corp. v. Morgan Stanley, et al, Index No. 29951-10 (N.Y. Sup. Ct.), where the respective courts each allowed MBIA s fraud claims against the Countrywide, RFC, GMAC, Credit Suisse and Morgan Stanley defendants to proceed;

6. the favorable outcome for MBIA on its motion to present evidence of Countrywide s liability and damages through the introduction of statistically valid random samples of loans rather than on a loan-by-loan basis;

7. the unanimous ruling from the New York State Appellate Division, First Department in the Countrywide litigation allowing MBIA to pursue its fraud claims; and

8. loan repurchase reserves and/or settlements which have been publicly disclosed by certain sellers/servicers to cover such obligations.

The Company continues to consider all relevant facts and circumstances, including the factors described above, in developing its assumptions on expected cash inflows, probability of potential recoveries (including the outcome of litigation) and recovery period. The estimated amount and likelihood of potential recoveries are expected to be revised and supplemented as developments in the pending litigation proceedings occur or new litigation is initiated. While the Company believes it will be successful in realizing recoveries from contractual and other claims, the ultimate amounts recovered may be materially different from those recorded by the Company given the inherent uncertainty of the manner of resolving the claims (e.g., litigation) and the assumptions used in the required estimation process for accounting purposes which are based, in part, on judgments and other information that are not easily corroborated by historical data or other relevant benchmarks.

All of the Company s policies insuring second-lien RMBS for which litigation has been initiated against sellers/servicers are in the form of financial guarantee insurance contracts. The Company has not recorded a gain contingency with respect to pending litigation.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

Credit Impairments Related to Structured CMBS Pools and CRE CDOs Accounted for as Derivatives

Most of the structured CMBS pools and CRE CDOs insured by MBIA are accounted for as insured credit derivatives and are carried at fair value in the Company s consolidated financial statements. The following discussion provides information about the Company s process for estimating credit impairments on these contracts using its statutory reserve methodology. For the nine months ended September 30, 2011, additional credit impairments on structured CMBS pools and CRE CDO portfolios was estimated to be $858 million as a result of additional delinquencies and loan level liquidations, as well as continued refinements of MBIA s assessment of various commutation possibilities. The aggregate credit impairment on structured CMBS pools and CRE CDO portfolios were estimated to be $2.0 billion through September 30, 2011. The impairment is estimated using the Company s statutory loss reserve methodology, determined as the present value of the probability-weighted potential future losses, net of estimated recoveries, across multiple scenarios as described below. Although the pace of increases in the delinquency rate has slowed and many loans are being modified, liquidations have taken place. Some loans were liquidated with minimal losses of 1% to 2% while others experienced near complete losses. These have led to losses in the CMBS market, and in many cases, have resulted in reductions of enhancement to the individual insured CMBS bonds secured by the structured CMBS pools. In certain insured transactions, these losses have resulted in deductible erosion. Bond level enhancement and pool level deductibles are structural features intended to mitigate losses to the Company and, as that protection erodes, impairments increase even in the absence of significant further collateral deterioration.

In the CRE CDO portfolio, transaction specific structures require managers to report reduced enhancement according to certain guidelines which often include downgrades even when the bond is still performing. As a result, as well as additional collateral defaults, reported enhancement has been reduced significantly in some CRE CDOs. Moreover, many of the CRE CDO positions are amortizing more quickly than originally expected as most or all interest that would have been allocated to more junior classes within the CDO have been diverted and redirected to pay down the senior most classes insured by MBIA.

The Company has developed multiple scenarios to consider the range of potential outcomes in the CRE market and their impact on MBIA. The approaches require substantial judgments about the future performance of the underlying loans, and include the following:

The first approach considers the range of commutations achieved in the course of 2010 and through the second quarter of 2011, which included commutations of 22 structured CMBS pools and CRE CDO policies totaling $10.3 billion of gross insured exposure. The Company considers the range of commutations achieved over the past several years with multiple counterparties. This approach results in an estimated price to commute the remaining policies with price estimates, based on this experience. It is customized by counterparty and is dependent on the level of dialogue with the counterparty and the credit quality of the underlying exposure.

The second approach considers current delinquency rates and uses current and projected net operating income (NOI) and capitalization rates (Cap Rates) to project losses under three scenarios. In the first scenario, NOI and Cap Rates remain flat with no improvement over the remaining life of the loans (often five to six more years). In the second and third scenarios, loans are stratified by size with larger loans being valued utilizing lower Cap Rates than for smaller loans. These scenarios also assume that Cap Rates and NOIs remain flat for the near term and then begin to improve slowly. Additionally, in these scenarios, any loan with a balance greater than $75 million with a debt service coverage ratio less than 1.0x or that was reported as being in any stage of delinquency, was reviewed individually so that performance and loss severity could be more accurately determined. Specific loan level assumptions for this large loan subset were then incorporated into this scenario, as well as certain smaller loans when there appeared to be a material change in the asset s financial or delinquency performance over the preceding three months. The second and third scenarios project different levels of additional defaults with respect to loans that are current. This approach relies heavily on year-end financial statements at the property level. In modeling these scenarios, the Company has received financial statements for year-end 2010 for 80% of the properties in the pools.

The third approach stratifies loans into debt service coverage buckets and projects defaults by using probabilities implied by a third-party default study for each bucket, and relies on year-end financial statements at the property level. The implied defaults are converted into losses using a loss severity assumption. As the Company continues to see more current market performance statistics regarding modifications and liquidations in this cycle, the Company will continue to de-emphasize this more actuarial-based approach and focus more on those scenarios which best reflect current market observations.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

The fourth approach stratifies loans into buckets based on delinquency status (including a current bucket) and utilizes recent Roll Rates actually experienced within each of the commercial mortgage-backed index (CMBX) series in order to formulate an assumption to predict future delinquencies. Ultimately, this generates losses over a projected time horizon based on the assumption that loss severities will begin to decline from the high levels seen in 2010 and early 2011. The Company further examines those loans referenced in the CMBX indices which were categorized as 90+ day delinquent or in the process of foreclosure and determined the monthly ratio of such loans which were cured versus those which were liquidated or still delinquent between December 2008 and August 2011. The Company then applies the most recent rolling six-month average of this cure ratio to all loans in the 90+ day delinquent bucket or in the foreclosure process (and those projected to roll into late stage delinquency from the current and lesser stage levels of delinquency) and assumes all other loans are liquidated. The Company assumes all loans in the REO category liquidate over the next twelve months.

The loss severities projected by these scenarios vary widely, from moderate to substantial losses. The Company assigns a wide range of probabilities to these scenarios, with lower severity scenarios being weighted more heavily than higher severity scenarios. This reflects the view that liquidations will continue to be mitigated by loan extensions and modifications, and that property values and NOIs have bottomed for many sectors and markets in the U.S. Beginning with the first quarter of 2010 through September 30, 2011, the probability-weighted loss estimate was $2.0 billion, and is inclusive of any claim or settlement payments. As macroeconomic stress escalates, including the possibility of a double dip recession, higher delinquencies, higher levels of liquidations of delinquent loans and/or higher severities of loss upon liquidation, MBIA may incur substantial additional losses. The Company believes the likelihood of a double dip recession has increased since the second quarter of 2011 and has weighted its highest severity more heavily than in prior quarters. The weighting of these scenarios are customized by counterparty.

Actual losses will be a function of the proportion of loans in the pools that are foreclosed and liquidated and the loss severities associated with those liquidations. If the deductibles in the Company s insured transactions and underlying referenced CMBS transactions are fully eroded, additional property level losses upon foreclosures and liquidations could result in substantial losses for MBIA. Since foreclosures and liquidations have only begun to take place during this economic cycle, particularly for larger properties, ultimate loss rates remain uncertain. Whether CMBS collateral is included in a structured pool or in a CRE CDO, the Company believes the modeling related to the underlying bond should be the same.

ABS CDOs

MBIA s insured ABS CDOs are transactions that include a variety of collateral ranging from corporate bonds to structured finance assets (which includes but is not limited to RMBS related collateral, CDOs of ABS, corporate CDOs and collateralized loan obligations). These transactions were insured as either financial guarantee insurance policies or credit derivatives with the majority insured in the form of credit derivatives. Since the fourth quarter of 2007, MBIA s insured par exposure within the ABS CDO portfolio has been substantially reduced through a combination of terminations and commutations. Accordingly, as of September 30, 2011, the insured par exposure of the ABS CDO portfolio has declined by approximately 80% of the insured amount as of December 31, 2007.

The Company s ABS CDOs originally benefited from two sources of credit enhancement. First, the subordination in the underlying securities collateralizing the transaction must be fully eroded and second, the subordination below the insured tranche in the CDO transaction must be fully eroded before the insured tranche is subject to a claim. The Company s payment obligations after a default vary by transaction and by insurance type.

The primary factor in estimating reserves associated with insured ABS CDO policies written as financial guarantees or insured credit derivatives is the losses associated with the underlying collateral in the transactions. MBIA s approach to establishing reserves in this portfolio employs a methodology which is similar to other structured finance asset classes insured by MBIA. The Company uses a total of five probability-weighted scenarios (which range from commutation based scenarios to a lengthened RMBS liquidation scenario) in order to estimate its reserves for ABS CDOs. As of September 30, 2011, the Company had loss and LAE reserves totaling $179 million and insurance loss recoverables of $92 million related to financial guarantee insurance policies. In addition, the Company estimated insured credit derivative impairments and LAE reserves, net of reinsurance and recoveries, totaling $511 million. For the nine months ended September 30, 2011, the Company incurred $51 million of losses and LAE expense related to financial guarantee insurance policies after the elimination of $79 million as a result of consolidating VIEs. Estimated losses and LAE incurred related to insured credit derivative impairments was a benefit of $484 million for the nine months ended September 30, 2011, which was primarily due to commutations of credit derivative exposures at less than estimated reserves. In the event of further deteriorating performance of the collateral referenced or held in ABS CDO transactions, the amount of losses estimated by the Company could increase materially.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

Loss and LAE Activity

Financial Guarantee Insurance Losses (Non-Derivative)

The Company s financial guarantee insurance losses and LAE for the nine months ended September 30, 2011 are presented in the following table:

Losses and LAE

In millions	**Nine Months Ended September 30, 2011** Second-lien RMBS	Other	Total
Losses and LAE related to actual and expected payments	$ 157	$ 98	$ 255
Recoveries of actual and expected payments	(122)	73	(49)
Gross losses incurred	35	171	206
Reinsurance	0	(2)	(2)
Losses and LAE	$ 35	$ 169	$ 204

The second-lien RMBS losses and LAE related to actual and expected payments included in the preceding table comprise net increases of previously established reserves. The second-lien RMBS recoveries of actual and expected payments comprise $198 million in recoveries resulting from ineligible mortgage loans included in insured exposures that are subject to contractual obligations by sellers/servicers to repurchase or replace such mortgages, offset by a $76 million reduction in excess interest cash flows from the securitizations. Other losses and LAE were primarily driven by first-lien RMBS mortgage and ABS CDO transactions as a result of continued credit deterioration within those sectors. Additionally, the reversal of loss and LAE reserves related to lower expected future claim payments from an insured tax-backed transaction were offset by the reversal of the corresponding recoveries of such payments.

Current period changes in the Company s estimate of potential recoveries may impact the amount recorded as an insurance loss recoverable asset, the amount of expected recoveries on unpaid losses netted against the gross loss and LAE reserve liability, or both. Total paid losses, net of reinsurance and collections, for the nine months ended September 30, 2011 was $634 million, including $463 million related to insured second-lien RMBS transactions. For the nine months ended September 30, 2011, the increase in insurance loss recoverable related to paid losses totaled $231 million, and primarily related to insured second-lien RMBS transactions.

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of September 30, 2011:

$ in millions	**Surveillance Categories**	**Total**

	Caution List Low	Caution List Medium	Caution List High	Classified List	
Number of policies	50	28	14	194	286
Number of issues[1]	33	18	11	126	188
Remaining weighted average contract period (in years)	7.9	6.1	6.0	8.8	8.3
Gross insured contractual payments outstanding[2]:					
Principal	$ 4,728	$ 974	$ 543	$ 10,753	$ 16,998
Interest	2,743	334	139	5,509	8,725
Total	$ 7,471	$ 1,308	$ 682	$ 16,262	$ 25,723
Gross claim liability	$ -	$ -	$ -	$ 1,988	$ 1,988
Less:					
Gross potential recoveries	-	-	-	3,632	3,632
Discount, net	-	-	-	172	172
Net claim liability (recoverable)	$ -	$ -	$ -	$ (1,816)	$ (1,816)
Unearned premium revenue	$ 161	$ 14	$ 3	$ 135	$ 313

(1) - An issue represents the aggregate of financial guarantee policies that share the same revenue source for purposes of making debt service payments.

(2) - Represents contractual principal and interest payments due by the issuer of the obligations insured by MBIA.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of December 31, 2010:

	Surveillance Categories				
$ in millions	Caution List Low	Caution List Medium	Caution List High	Classified List	Total
Number of policies	199	43	12	179	433
Number of issues[1]	40	26	12	110	188
Remaining weighted average contract period (in years)	9.4	6.9	9.1	9.4	9.2
Gross insured contractual payments outstanding[2]:					
Principal	$ 5,041	$ 1,419	$ 1,446	$ 11,190	$ 19,096
Interest	3,439	536	746	6,132	10,853
Total	$ 8,480	$ 1,955	$ 2,192	$ 17,322	$ 29,949
Gross claim liability	$ -	$ -	$ -	$ 2,692	$ 2,692
Less:					
Gross potential recoveries	-	-	-	4,045	4,045
Discount, net	-	-	-	27	27
Net claim liability (recoverable)	$ -	$ -	$ -	$ (1,380)	$ (1,380)
Unearned premium revenue	$ 148	$ 16	$ 72	$ 141	$ 377

(1) - An issue represents the aggregate of financial guarantee policies that share the same revenue source for purposes of making debt service payments.

(2) - Represents contractual principal and interest payments due by the issuer of the obligations insured by MBIA.

The gross claim liability as of September 30, 2011 and December 31, 2010 in the preceding tables represents the Company s estimate of undiscounted probability-weighted future claim payments, which principally relate to insured first and second-lien RMBS transactions and U.S. public finance transactions. The gross potential recoveries principally relate to insured second-lien RMBS transactions. Both amounts reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by the Company.

The following table presents the components of the Company s insurance loss reserves and recoverables for insured obligations within MBIA s classified list as reported on the Company s consolidated balance sheets as of September 30, 2011 and December 31, 2010. The loss reserves (claim liability) and insurance claim loss recoverable included in the following table represent the present value of the probability-weighted future claim payments and recoveries reported in the preceding tables.

In millions	As of September 30, 2011	As of December 31, 2010
Loss reserves (claim liability)	$ 873	$ 1,059
LAE reserves	59	70
Loss and LAE reserves	$ 932	$ 1,129
Insurance claim loss recoverable	$ (2,761)	$ (2,531)
LAE insurance loss recoverable	(9)	-
Insurance loss recoverable	$ (2,770)	$ (2,531)
Reinsurance recoverable on unpaid losses	$ 16	$ 14
Reinsurance recoverable on LAE reserves	0	1
Reinsurance recoverable on paid losses	2	0
Reinsurance recoverable on paid and unpaid losses	$ 18	$ 15

20

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

As of September 30, 2011, loss and LAE reserves include $1.6 billion of reserves for expected future payments offset by expected recoveries of such future payments of $687 million. As of December 31, 2010, loss and LAE reserves included $2.0 billion of reserves for expected future payments offset by expected recoveries of such future payments of $896 million. As of September 30, 2011 and December 31, 2010, the insurance loss recoverable primarily related to estimated recoveries of payments made by the Company resulting from ineligible mortgage loans in certain insured second-lien residential mortgage loan securitizations that are subject to a contractual obligation by the sellers/servicers to repurchase or replace the ineligible mortgage loans and expected future recoveries on second-lien RMBS transactions resulting from expected excess spread generated by performing loans in such transactions. The Company expects to be reimbursed for the majority of its potential recoveries related to ineligible mortgage loans by year-end 2012.

The following table presents the Company s second-lien RMBS exposure, gross undiscounted claim liability and potential recoveries, before the elimination of amounts related to consolidated VIEs, as of September 30, 2011. All loan files reviewed with potential recoveries are included within the Classified List.

Second-lien RMBS Exposure		**Outstanding**		**Gross Undiscounted**	
$ in billions	**Issues**	**Gross Principal**	**Gross Interest**	**Claim Liability**	**Potential Recoveries**
Insured issues designated as Classified List	34	$ 7.9	$ 3.1	$ 0.7	$ 4.2
Loan files reviewed with potential recoveries	27	$ 7.5	$ 3.0	$ 0.7	$ 4.2

The Company has performed loan file reviews on 29 of the 34 issues and recorded recoveries on 27 of those 29 issues, primarily related to five issuers (Countrywide, RFC, GMAC, Morgan Stanley and Credit Suisse). The gross potential recoveries include estimated recoveries based on the Company s incurred loss to date. In addition, the Company has recognized a recovery on one first-lien Alt-A transaction which has been excluded from the preceding table.

The following table presents changes in the Company s loss and LAE reserve for the nine months ended September 30, 2011. Changes in the loss and LAE reserve attributable to the accretion of the claim liability discount, changes in discount rates, changes in the timing and amounts of estimated payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations. As of September 30, 2011, the weighted average risk-free rate used to discount the Company s loss reserve (claim liability) was 1.51%. LAE reserves are expected to be settled within a one year period and are not discounted.

In millions	**Changes in Loss and LAE Reserves for the Nine Months Ended September 30, 2011**								
Gross Loss and LAE Reserve as of December 31, 2010	**Loss Payments for Cases with Reserves**	**Accretion of Claim Liability Discount**	**Changes in Discount Rates**	**Changes in Timing of Payments**	**Changes in Amount of Net Payments**	**Changes in Assumptions**	**Changes in Unearned Premium Revenue**	**Change in LAE Reserves**	**Gross Loss and LAE Reserve as of September 30, 2011**
$ 1,129	$ (431)	$ 12	$ 9	$ 37	$ (2)	$ 168	$ 22	$ (12)	$ 932

The decrease in the Company s gross loss and LAE reserves reflected in the preceding table was primarily due to a decrease in reserves related to loss payments. Offsetting these decreases were changes in assumptions due to additional defaults and charge-offs of ineligible mortgage loans on insured second-lien RMBS issues outstanding as of December 31, 2010 and changes in the timing of payments.

21

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves (continued)

The following table presents changes in the Company s insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company s claim liability for the nine months ended September 30, 2011. Changes in insurance loss recoverable attributable to the accretion of the discount on the recoverable, changes in discount rates, changes in the timing and amounts of estimated collections, changes in assumptions and changes in LAE recoveries are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations.

Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses for the Nine Months Ended September 30, 2011

In millions	Gross Reserve as of December 31, 2010	Collections for Cases with Recoveries	Accretion of Recoveries	Changes in Discount Rates	Changes in Timing of Collections	Changes in Amount of Collections	Changes in Assumptions	Change in LAE Recoveries	Gross Reserve as of September 30, 2011
Insurance Loss Recoverable	$ 2,531	$ (5)	$ 48	$ 47	$ -	$ (175)	$ 315	$ 9	$ 2,770
Recoveries on Unpaid Losses	896	-	13	60	-	-	(297)	15	687
Total	$ 3,427	$ (5)	$ 61	$ 107	$ -	$ (175)	$ 18	$ 24	$ 3,457

The Company s insurance loss recoverable increased primarily due to changes in assumptions associated with estimates of potential recoveries on issues outstanding as of December 31, 2010, and relate to ineligible mortgage loans included in insured second-lien residential mortgage securitization exposures that are subject to contractual obligations by sellers/servicers to repurchase or replace such mortgages, partially offset by changes in the amount of collections. Recoveries on unpaid losses decreased primarily due to changes in assumptions as a result of reduced expectations of future claim payments on U.S. public finance transactions, which resulted in a corresponding reduction in future expected recoveries.

The following table presents the Company s total estimated recoveries from ineligible mortgage loans included in certain insured second-lien mortgage loan securitizations. The total estimated recoveries from ineligible loans of $2.8 billion as of September 30, 2011 include $1.9 billion recorded as Insurance loss recoverable and $938 million recorded as Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company s consolidated balance sheets.

In millions Total Estimated Recoveries from Ineligible Second-lien Loans as of December 31, 2010	Accretion of Future Collections	Changes in Discount Rates	Recoveries (Collections)	Changes in Assumptions	Total Estimated Recoveries from Ineligible Second-lien Loans as of September 30, 2011
$ 2,517	$ 55	$ 33	$ -	$ 213	$ 2,818

The Company s total estimated recoveries from ineligible loans in the preceding table increased primarily as a result of the probability-weighted scenarios as described within the preceding RMBS Recoveries section.

Remediation actions may involve, among other things, waivers or renegotiations of financial covenants or triggers, waivers of contractual provisions, the granting of consents, transfer of servicing, consideration of restructuring plans, acceleration, security or collateral enforcement, actions in bankruptcy or receivership, litigation and similar actions. The types of remedial actions pursued are based on the insured obligation s risk type and the nature and scope of the event giving rise to the remediation. As part of any such remedial actions, MBIA seeks to improve its security position and to obtain concessions from the issuer of the insured obligation. From time to time, the issuer of an MBIA-insured obligation may, with the consent of MBIA, restructure the insured obligation by extending the term, increasing or decreasing the par amount or decreasing the related interest rate, with MBIA insuring the restructured obligation.

Costs associated with remediating insured obligations assigned to the Company s Caution List Low, Caution List Medium, Caution List High a Classified List are recorded as LAE. LAE is primarily recorded as part of the Company s provision for its loss reserves and included in Losses and loss adjustment expense on the Company s consolidated statements of operations. The following table presents the expenses (gross and net of reinsurance) related to remedial actions for insured obligations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
In millions	**2011**	**2010**	**2011**	**2010**
Loss adjustment expense incurred, gross	$ 31	$ 14	$ 76	$ 30
Loss adjustment expense incurred, net	$ 31	$ 14	$ 76	$ 29

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments

Financial Instruments

The following table presents the carrying value and fair value of financial instruments reported on the Company s consolidated balance sheets as of September 30, 2011 and December 31, 2010:

	As of September 30, 2011		As of December 31, 2010	
In millions	**Carrying Value**	**Estimated Fair Value**	**Carrying Value**	**Estimated Fair Value**
Assets:				
Investments held as available-for-sale and held at fair value	$ 10,182	$ 10,182	$ 11,739	$ 11,739
Other investments	151	151	188	188
Cash and cash equivalents	659	659	366	366
Receivable for investments sold	46	46	8	8
Derivative assets:				
Insured derivatives	-	-	0	0
Non-insured derivatives	2	2	4	4
Total derivative assets	2	2	4	4
Assets of consolidated VIEs:				
Cash	580	580	764	764
Investments held-to-maturity	3,886	3,492	4,039	3,760
Fixed-maturity securities held as available-for-sale	532	532	339	339
Fixed-maturity securities held as trading	3,276	3,276	5,241	5,241
Loans receivable	2,218	2,218	2,183	2,183
Loan repurchase commitments	938	938	835	835
Derivative assets	713	713	699	699
Liabilities:				
Investment agreements	1,635	1,931	2,005	2,172
Medium-term notes	1,636	774	1,740	766
Securities sold under agreements to repurchase	387	385	471	454
Short-term debt	-	-	65	65
Long-term debt	1,841	983	1,851	1,155
Payable for investments purchased	54	54	2	2
Derivative liabilities:				
Insured derivatives	4,901	4,901	4,375	4,375
Non-insured derivatives	365	365	242	242
Total derivative liabilities	5,266	5,266	4,617	4,617
Warrants	12	12	58	58
Liabilities of consolidated VIEs:				
Variable interest entity notes	9,033	8,572	10,590	10,285
Long-term debt	360	355	360	340
Derivative liabilities	1,888	1,888	2,104	2,104
Financial Guarantees:				
Gross	4,580	3,599	5,275	3,906
Ceded	109	97	112	48

23

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Valuation Techniques

Valuation techniques for financial instruments measured at fair value and included in the preceding table are described below. The Company s assets and liabilities measured at fair value have been categorized according to the fair value hierarchy based on the lowest level input that is significant to the fair value measurement in its entirety.

Fixed-Maturity Securities (including short-term investments) Held as Available-For-Sale and Fixed-Maturity Securities Held at Fair Value

U.S. Treasury and government agency U.S. Treasury securities are valued based on quoted market prices in active markets. The fair value of U.S. Treasuries is based on live trading feeds. U.S. Treasury securities are categorized in Level 1 of the fair value hierarchy. Government agency securities include debentures and other agency mortgage pass-through certificates as well as to-be-announced (TBA) securities. TBA securities are liquid and have quoted market prices based on live data feeds. Fair value of mortgage pass-through certificates is obtained via a simulation model, which considers different rate scenarios and historical activity to calculate a spread to the comparable TBA security. Government agency securities generally use market-based and observable inputs. As such, these securities are classified as Level 2 of the fair value hierarchy.

Foreign governments Foreign government obligations are generally valued based on quoted market prices in active markets, and are categorized in Level 1 of the fair value hierarchy. When quoted market prices are not available, fair value is determined using a valuation model based on observable inputs including interest rate yield curves, cross-currency basis index spreads, and country credit spreads for structures similar to the financial instrument in terms of issuer, maturity and seniority. These financial instruments are generally categorized in Level 2 of the fair value hierarchy. Bonds that contain significant inputs that are not observable are categorized as Level 3.

Corporate obligations Corporate obligations are valued using recently executed transaction prices or quoted market prices where observable. When observable price quotations are not available, fair value is determined using a valuation model based on observable inputs including interest rate yield curves, CDS spreads for similar instruments, and diversity scores. Corporate obligations are generally categorized in Level 2 of the fair value hierarchy or categorized in Level 3 when significant inputs are unobservable. Corporate obligations are classified as Level 1 of the fair value hierarchy when quoted market prices in an active market for identical financial instruments are available.

Mortgage-backed securities and asset-backed securities Mortgage-backed securities (MBS) and asset-backed securities (ABS) are valued using recently executed transaction prices. When position-specific quoted prices are not available, MBS and ABS are valued based on quoted prices for similar securities. If quoted prices are not available, MBS and ABS are valued using a valuation model based on observable inputs including interest rate yield curves, spreads, prepayments and volatilities, and categorized in Level 2 of the fair value hierarchy. MBS and ABS are categorized in Level 3 of the fair value hierarchy when significant inputs are unobservable.

State and municipal bonds State and municipal bonds are valued using recently executed transaction prices, quoted prices or valuation models based on observable inputs including interest rate yield curves, bond or CDS spreads, and volatility. State and municipal bonds are generally categorized in Level 2 of the fair value hierarchy, or categorized in Level 3 when significant inputs are unobservable.

Investments Held-To-Maturity

The fair values of investments held-to-maturity are determined using recently executed transaction prices or quoted prices when available. When position-specific quoted prices are not available, fair values of investments held-to-maturity are based on quoted prices of similar securities. When quoted prices for similar investments are not available, fair values are based on valuation models using observable inputs including interest rate yield curves, and bond spreads of similar securities.

Other Investments

Other investments include the Company s interest in equity securities. Fair values of other investments are determined by using quoted prices, or valuation models that use market-based and observable inputs. Other investments are categorized in Level 1, Level 2, or Level 3 of the fair value hierarchy.

Cash and Cash Equivalents, Receivable for Investments Sold and Payable for Investments Purchased

The carrying amounts of cash and cash equivalents, receivable for investments sold and payable for investments purchased approximates fair values due to the short maturities of these instruments.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Loans Receivable at Fair Value

Loans receivable at fair value comprise loans held by consolidated VIEs consisting of residential mortgage loans, commercial mortgage loans and other whole business loans. Fair values of residential mortgage loans are determined using quoted prices for MBS with similar characteristics and adjusted for the fair values of the financial guarantee obligations provided by MBIA Corp. on the related MBS. Fair values of commercial mortgage loans and other whole business loans are valued based on quoted prices of similar collateralized MBS. Loans receivable at fair value are categorized in Level 3 of the fair value hierarchy.

Loan Repurchase Commitments

Loan repurchase commitments are obligations owed by the sellers/servicers of mortgage loans to either MBIA as reimbursement of paid claims or to the RMBS trusts as defined in the transaction documents. Loan repurchase commitments are consolidated under the amended accounting principles for the consolidation of VIEs. This asset represents the rights of the trusts against the sellers/servicers for representations and warranties that the securitized residential mortgage loans sold to the trust comply with stated underwriting guidelines and for the sellers/servicers to cure, replace, or repurchase mortgage loans that fail to comply. Fair value measurements of loan repurchase commitments represent the amounts owed by the sellers/servicers to the trusts. Loan repurchase commitments are not securities and no quoted prices or comparable market transaction information are observable or available. Loan repurchase commitments at fair value are categorized in Level 3 of the fair value hierarchy. Fair values of loan repurchase commitments are determined using discounted cash flow techniques based on observable inputs including:

- estimates of future cash flows for the asset;
- expectations about possible variations in the amount and/or timing of the cash flows representing the uncertainty inherent in the cash flows;
- time value of money, represented by the rate on risk-free monetary assets;
- the price for bearing the uncertainty inherent in the cash flows (risk premium); and
- other case-specific factors that would be considered by market participants.

Refer to the discussion of "RMBS Recoveries" within "Note 5: Loss and Loss Adjustment Expense Reserves" for a further description of how these estimates of future cash flows for the assets are determined, as well as the additional risk margins and discounts applied.

Investment Agreements

The fair values of investment agreements are determined using discounted cash flow techniques based on observable interest rates currently being offered for similar agreements with comparable maturity dates. Investment agreements contain collateralization and termination agreements that substantially mitigate the nonperformance risk of the Company.

Medium-Term Notes

The fair values of MTNs are determined using discounted cash flow techniques based on inputs including observable interest rates currently being offered for similar notes with comparable maturity dates, and nonperformance risk. Nonperformance risk is determined using the Company s own credit spreads.

The Company has elected to record four MTNs at fair value. Fair values of such notes are determined using quoted market prices or discounted cash flow techniques. Significant inputs into the valuation include yield curves and spreads to the swap curve. As these notes are not actively traded, certain significant inputs (e.g., spreads to the swap curve) are unobservable. MTNs are categorized as Level 3 of the fair value hierarchy.

Variable Interest Entity Notes

The fair values of VIE notes are determined based on recently executed transaction prices or quoted prices where observable. When position-specific quoted prices are not observable, fair values are based on quoted prices of similar securities. Fair values based on quoted prices of similar securities may be adjusted for factors unique to the securities, including any credit enhancement. When observable quoted prices are not available, fair value is determined based on discounted cash flow techniques of the underlying collateral using observable inputs including interest rate yield curves and bond spreads of similar securities. VIE notes are categorized in Level 2 or Level 3 of the fair value hierarchy based on the lowest level input that is significant to the fair value measurement in its entirety.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Securities Sold Under Agreements to Repurchase

The fair values of securities sold under agreements to repurchase are determined using discounted cash flow techniques based on observable inputs including interest rates on similar repurchase agreements. Securities sold under agreements to repurchase include term reverse repurchase agreements that contain credit enhancement provisions including over-collateralization agreements to sufficiently mitigate the nonperformance risk of the Company.

Long-term Debt

Long-term debt consists of notes, debentures, surplus notes and floating rate liquidity loans. The fair value of long-term notes, debentures and surplus notes are estimated based on quoted prices for the identical or similar securities. The fair value for floating rate liquidity loans are determined using discounted cash flow techniques of the underlying collateral pledged to the specific loans, as these loans are non-recourse and fully backed by a pool of underlying assets.

Derivatives Asset/Liability Products

The asset/liability products business has entered into derivative transactions primarily consisting of interest rate, cross currency, credit default and principal protection guarantees. Fair values of over-the counter derivatives are determined using valuation models based on observable inputs, nonperformance risk of the Company s own credit and nonperformance risk of the counterparties. Observable and market-based inputs include interest rate yields, credit spreads and volatilities. These derivatives are categorized in Level 2 or Level 3 of the fair value hierarchy based on the lowest level input that is significant to the fair value measurement in its entirety.

The Company has policies and procedures in place regarding counterparties, including review and approval of the counterparty and the Company s exposure limit, collateral posting requirements, collateral monitoring and margin calls on collateral. The Company manages counterparty credit risk on an individual counterparty basis through master netting arrangements covering derivative transactions in the asset/liability products and corporate segments. These agreements allow the Company to contractually net amounts due from a counterparty with those amounts due to such counterparty when certain triggering events occur. The Company only executes swaps under master netting agreements, which typically contain mutual credit downgrade provisions that generally provide the ability to require assignment or termination in the event either the Company or the counterparty is downgraded below a specified credit rating. The netting agreements minimize the potential for losses related to credit exposure and thus serve to mitigate the Company s nonperformance risk under these derivatives.

In certain cases, the Company also manages credit risk through collateral agreements that give the Company the right to hold or the obligation to provide collateral when the current market value of derivative contracts exceeds an exposure threshold. Under these arrangements, the Company may receive or provide U.S. Treasury and other highly rated securities or cash to secure the derivative. The delivery of high-quality collateral can minimize credit exposure and mitigate the potential for nonperformance risk impacting the fair values of the derivatives.

Derivatives Insurance

The derivative contracts insured by MBIA cannot be legally traded and generally do not have observable market prices. MBIA Corp. determines the fair values of insured credit derivatives using valuation models. These models include the Binomial Expansion Technique (BET) model and an internally developed model referred to as the Direct Price Model. For a limited number of other insured credit derivatives, fair values are determined using a dual-default model. The valuation of insured derivatives includes the impact of its own credit standing. All of these derivatives are categorized as Level 3 of the fair value hierarchy as their fair value is derived using significant unobservable inputs.

Description of MBIA s Insured Derivatives

As of September 30, 2011, the Company had $91.6 billion of gross par outstanding on insured derivatives. The majority of MBIA s insured derivatives are credit derivatives that reference structured pools of cash securities and CDS. The Company generally insured the most senior liabilities of such transactions and, at transaction closing, the Company s exposure generally had more subordination than needed to achieve triple-A ratings from credit rating agencies (referred to as Super Triple-A exposure). The collateral underlying the Company s insured derivatives consists of cash securities and CDS referencing primarily corporate, asset-backed, residential mortgage-backed, commercial mortgage-backed, CRE loans, and CDO securities. As of September 30, 2011, the gross par outstanding of the Company s insured credit derivatives totaled $84.2 billion. The remaining $7.4 billion of gross par outstanding on insured derivatives as of September 30, 2011 primarily related to insured interest rate and inflation-linked swaps for which the Company has insured counterparty credit risk.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Most of MBIA s insured CDS contracts require MBIA to make payments for losses of the principal outstanding under the contracts when losses on the underlying referenced collateral exceed a predetermined deductible. MBIA s gross par outstanding and maximum payment obligation under these contracts as of September 30, 2011 was $65.5 billion. The underlying referenced collateral for contracts executed in this manner largely consist of investment grade corporate debt, structured CMBS pools and, to a lesser extent, corporate and multi-sector CDOs. MBIA s multi-sector CDOs are classified into CDOs of high-grade U.S. ABS, including one CDO-squared transaction, and CDOs of mezzanine U.S. ABS. As of September 30, 2011, gross par outstanding on MBIA Corp.-insured CDOs of high-grade U.S. ABS totaled $4.4 billion. The majority of the collateral contained within the Company s ABS multi-sector CDOs comprised RMBS. MBIA also had $18.7 billion of gross par outstanding on insured CDS contracts that require MBIA to make timely interest and ultimate principal payments.

Valuation Models Used

Approximately 81% of the balance sheet fair value of insured credit derivatives as of September 30, 2011 was valued using the BET Model. Approximately 19% of the balance sheet fair value of insured credit derivatives as of September 30, 2011 was valued using the internally developed Direct Price Model. An immaterial amount of insured credit derivatives were valued using other methods, including a dual default model.

A. Description of the BET Model

1. Valuation Model Overview

The BET Model estimates what a bond insurer would charge to guarantee a transaction at the measurement date, based on the market-implied default risk of the underlying collateral and the remaining structural protection in a deductible or subordination. This approach assumes that bond insurers would be willing to accept these contracts from the Company at a price equal to what the Company could issue them for in the current market. While the premium charged by financial guarantors is not a direct input into the Company s model, the model estimates such premium and this premium increases as the probability of loss increases, driven by various factors including rising credit spreads, negative credit migration, lower recovery rates, lower diversity score and erosion of deductible or subordination.

Inputs to the process of determining fair value for structured transactions using the BET Model include estimates of collateral loss, allocation of loss to separate tranches of the capital structure, and calculation of the change in value.

Estimates of aggregated collateral losses are calculated by reference to the following (described in further detail under BET Model Inputs below):

- credit spreads of underlying collateral based on actual spreads or spreads on similar collateral with similar ratings, or in some cases is benchmarked; for collateral pools where the spread distribution is characterized by extremes, each segment of the pool is modeled separately instead of using an overall pool average;

- diversity score of the collateral pool as an indication of correlation of collateral defaults; and recovery rate for all defaulted collateral.

Allocation of losses to separate tranches of the capital structure according to priority of payments in a transaction.

The unrealized gain or loss on a transaction inception to date is the difference between the original price of the risk (the original market-implied expected loss) and the current price of the risk based on the assumed market-implied expected losses derived from the model.

Additional structural assumptions of the BET Model are:

Default probabilities are determined by three factors: credit spread, recovery rate after default, and the time period under risk.

Frequencies of defaults are modeled evenly over time.

Collateral assets are generally considered on an average basis rather than being modeled on an individual basis.

Collateral asset correlation is modeled using a diversity score which is calculated based on industry or sector concentrations. Recovery rates are based on historical averages and updated based on market evidence.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

2. BET Model Inputs

a. Credit spreads

The average spread of collateral is a key input as the Company assumes credit spreads reflect the market s assessment of default probability for each piece of collateral. Spreads are obtained from market data sources published by third parties (e.g., dealer spread tables for assets most closely resembling collateral within the Company s transactions) as well as collateral-specific spreads on the underlying reference obligations provided by trustees or market sources. Also, when these sources are not available, the Company benchmarks spreads for collateral against market spreads or prices. This data is reviewed on an ongoing basis for reasonableness and applicability to the Company s derivative portfolio. The Company also calculates spreads based on quoted prices and on internal assumptions about expected life, when pricing information is available and spread information is not.

The Company uses the spread hierarchy listed below in determining which source of spread information to use, with the rule being to use CDS spreads where available and cash security spreads as the next alternative. Cash security spreads reflect trading activity in funded fixed-income instruments while CDS spreads reflect trading levels for non-funded derivative instruments. While both markets are driven partly by an assessment of the credit quality of the referenced security, there are factors which create significant differences. These factors include CDS spreads driven by speculative activity as the CDS market facilitates both long and short positions without ownership of the underlying security, allowing for significant leverage.

Spread Hierarchy:

Collateral-specific credit spreads when observable.

Sector-specific spread tables by asset class and rating.

Corporate spreads, including Bloomberg and Risk Metrics spread tables based on rating.

Benchmark from most relevant market source when corporate spreads are not directly relevant.

If current market-based spreads are not available, the Company applies either sector-specific spreads from spread tables provided by dealers or corporate spread tables. The sector-specific spread applied depends on the nature of the underlying collateral. Transactions with corporate collateral use the corporate spread table. Transactions with asset-backed collateral use one or more of the dealer asset-backed tables. If there are no observable market spreads for the specific collateral, and sector-specific and corporate spread tables are not appropriate to estimate the spread for a specific type of collateral, the Company uses the fourth alternative in its hierarchy. This includes using tranched corporate collateral, where the Company applies corporate spreads as an input with an adjustment for its tranched exposure.

As of September 30, 2011, sector-specific spreads were used in 7% of the transactions valued using the BET Model. Corporate spreads were used in 48% of the transactions and spreads benchmarked from the most relevant spread source were used for 45% of the transactions. When determining the percentages above, there were some transactions where MBIA incorporated multiple levels within the hierarchy, including using actual collateral-specific credit spreads in combination with a calculated spread based on an assumed relationship. In those cases, MBIA classified the transaction as being benchmarked from the most relevant spread source even though the majority of the average spread was from actual collateral-specific spreads. The spread source can also be identified by whether or not it is based on collateral weighted average rating factor (WARF). No collateral-specific spreads are based on WARF, sector-specific and corporate spreads are based on WARF, and some benchmarked spreads are based on WARF. WARF-sourced and/or ratings-sourced credit spreads were used for 91% of the transactions.

Over time, the data inputs change as new sources become available, existing sources are discontinued or are no longer considered to be reliable or the most appropriate. It is always the Company s objective to move to higher levels on the spread hierarchy table defined above. However, the Company may on occasion move to lower priority inputs due to the discontinuation of data sources or due to the Company considering higher priority inputs no longer representative of market spreads.

b. Diversity Scores

Diversity scores are a means of estimating the diversification in a portfolio. The diversity score estimates the number of uncorrelated assets that are assumed to have the same loss distribution as the actual portfolio of correlated assets. A lower diversity score represents higher assumed correlation, increasing the chances of a large number of defaults, and thereby increasing the risk of loss in the senior tranche. A lower diversity score will generally have a negative impact on the valuation for the Company s senior tranche. The calculation methodology for a diversity score includes the extent to which a portfolio is diversified by industry or asset class, which is either calculated internally or reported by the trustee on a regular basis. Diversity scores are calculated at transaction origination, and adjusted as the collateral pool changes over time. MBIA s internal modeling of the diversity score is based on Moody s methodology.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

c. Recovery Rate

The recovery rate represents the percentage of par expected to be recovered after an asset defaults, indicating the severity of a potential loss. MBIA generally uses rating agency recovery assumptions which may be adjusted to account for differences between the characteristics and performance of the collateral used by the rating agencies and the actual collateral in MBIA-insured transactions. The Company may also adjust rating agency assumptions based on the performance of the collateral manager and on empirical market data.

d. Input Adjustments for Insured CMBS Derivatives in the Current Market

Approximately $35.3 billion gross par of MBIA s insured derivative transactions as of September 30, 2011 includes substantial amounts of CMBS and commercial mortgage collateral. Since the CMBX is now quoted in price terms and the BET Model requires a spread input, it is necessary to convert CMBX prices to spreads. Through the third quarter of 2010, the Company assumed that a portion of the CMBX price reflected market illiquidity. The Company assumed this illiquidity component was the difference between par and the price of the highest priced CMBX triple-A series. The Company assumed that the price of each CMBX index has two components: an illiquidity component and a loss component. The market implied losses were assumed to be the difference of par less the liquidity adjusted price. These loss estimates were converted to spreads using an internal estimate of duration. Beginning in the fourth quarter of 2010, the Company determined that it would not be appropriate to continue to use a CMBS illiquidity component in the models due to increased liquidity in the marketplace.

e. Nonperformance Risk

The Company s valuation methodology for insured credit derivative liabilities incorporates the Company s own nonperformance risk. The Company calculates the fair value by discounting the market value loss estimated through the BET Model at discount rates which include MBIA CDS spreads as of September 30, 2011. The CDS spreads assigned to each deal are based on the weighted average life of the deal. The Company limits the nonperformance impact so that the derivative liability could not be lower than the Company s recovery derivative price multiplied by the unadjusted derivative liability.

B. Description of Direct Price Model

1. Valuation Model Overview

There are three significant model inputs used in determining fair value using the Direct Price Model. Significant inputs include market prices obtained or estimated for all collateral within a transaction, the present value of the market-implied potential losses calculated for the transaction, and the impact of nonperformance risk.

2. Model Inputs

Collateral prices

Fair value of collateral is based on quoted prices when available. When quoted prices are not available, a matrix pricing grid is used based on security type and rating to determine fair value of collateral which applies an average based on securities with the same rating and security type categories.

Interest rates

The present value of the market-implied potential losses was calculated assuming that MBIA deferred all principal losses to the legal final maturity. This was done through a cash flow model that calculated potential interest payments in each period and the potential principal loss at the legal final maturity. These cash flows were discounted using the LIBOR flat swap curve.

Nonperformance risk

The methodology for calculating MBIA s nonperformance risk is the same as used for the BET Model. Due to the current level of MBIA CDS spread rates and the long tenure of these transactions, the derivative recovery rate was used to estimate nonperformance risk for all transactions marked by this model.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Overall Model Results

As of September 30, 2011 and December 31, 2010, the Company s net insured derivative liability was $4.9 billion and $4.4 billion, respectively, and was primarily related to the fair values of insured credit derivatives, based on the results of the aforementioned pricing models. In the current environment, the most significant driver of changes in fair value is nonperformance risk. In aggregate, the nonperformance calculation resulted in a pre-tax net insured derivative liability that was $9.5 billion and $12.1 billion lower than the net liability that would have been estimated if the Company excluded nonperformance risk in its valuation as of September 30, 2011 and December 31, 2010, respectively. Nonperformance risk is a fair value concept and does not contradict the Company s internal view, based on fundamental credit analysis of the Company s economic condition, that the Company will be able to pay all claims when due.

The Company reviews the model results on a quarterly basis to assess the appropriateness of the assumptions and results in light of current market activity and conditions. This review is performed by internal staff with relevant expertise. If live market spreads are observable for similar transactions, those spreads are an integral part of the analysis. For example, new insured transactions that resemble existing (previously insured) transactions are considered, as well as negotiated settlements of existing transactions. MBIA Corp. negotiated settlements of insured CDS transactions in 2010 and 2011. In assessing the reasonableness of the fair value estimate for insured CDS, the Company considered the executed prices for those transactions as well as a review of internal consistency with MBIA s methodology.

Warrants

Stock warrants issued by the Company are recorded at fair value based on a modified Black-Scholes model. Inputs into the warrant valuation include interest rates, stock volatilities and dividend data. As all significant inputs are market-based and observable, warrants are categorized in Level 2 of the fair value hierarchy.

Financial Guarantees

<u>Gross Financial Guarantees</u> The fair value of gross financial guarantees is determined using discounted cash flow techniques based on inputs that include (i) assumptions of expected losses on financial guarantee policies where loss reserves have not been recognized, (ii) amount of losses expected on financial guarantee policies where loss reserves have been established, (iii) the cost of capital reserves required to support the financial guarantee liability and (iv) discount rates. The MBIA Corp. CDS spread and recovery rate are used as the discount rate for MBIA Corp., while the Assured Guaranty Corp. CDS spread and recovery rate are used as the discount rate for National. Discount rates are adjusted to reflect nonperformance risk of the Company. Fair value of gross financial guarantees does not consider future installment premium receipts or returns on invested upfront premiums as inputs.

The carrying value of MBIA s gross financial guarantees consists of unearned premium revenue and loss and LAE reserves as reported on MBIA s consolidated balance sheets.

<u>Ceded Financial Guarantees</u> The fair value of ceded financial guarantees is determined by applying the percentage ceded to reinsurers to the related fair value of the gross financial guarantees. The carrying value of ceded financial guarantees consists of prepaid reinsurance premiums and reinsurance recoverable on paid losses as reported on MBIA s consolidated balance sheets.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Fair Value Measurements

The following fair value hierarchy tables present information about the Company s assets (including short-term investments) and liabilities measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010:

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of September 30, 2011**
Assets:					
Investments:					
Fixed-maturity investments:					
Taxable bonds:					
U.S. Treasury and government agency	$ 749	$ 149	$ -	$ -	$ 898
Foreign governments	295	70	11	-	376
Corporate obligations	1	1,584	342	-	1,927
Mortgage-backed securities:					
Residential mortgage-backed agency	-	1,419	1	-	1,420
Residential mortgage-backed non-agency	-	421	25	-	446
Commercial mortgage-backed	-	35	32	-	67
Asset-backed securities:					
Collateralized debt obligations	-	84	67	-	151
Other asset-backed	-	185	272	-	457
State and municipal bonds	-	852	-	-	852
Total taxable bonds	1,045	4,799	750	-	6,594
Tax exempt bonds:					
State and municipal bonds	-	2,815	30	-	2,845
Other fixed-maturity investments	-	15	-	-	15
Total fixed-maturity investments	1,045	7,629	780	-	9,454
Money market securities	693	-	-	-	693
Perpetual preferred securities	-	146	1	-	147
Other	27	-	-	-	27
Total	1,765	7,775	781	-	10,321
Derivative assets:					
Non-insured derivative assets:					
Credit derivatives	-	1	-	-	1
Interest rate derivatives	-	89	3	-	92
Other	-	-	-	(91)	(91)

Total derivative assets	-	90	3	(91)	2

31

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of September 30, 2011
Assets of consolidated VIEs:					
Corporate obligations	-	204	63	-	267
Mortgage-backed securities:					
Residential mortgage-backed agency	-	4	-	-	4
Residential mortgage-backed non-agency	-	1,703	15	-	1,718
Commercial mortgage-backed	-	595	17	-	612
Asset-backed securities:					
Collateralized debt obligations	-	437	206	-	643
Other asset-backed	-	275	71	-	346
Total fixed maturity securities at fair value	-	3,218	372	-	3,590
Money market securities	218	-	-	-	218
Loans receivable	-	-	2,218	-	2,218
Loan repurchase commitments	-	-	938	-	938
Derivative assets:					
Credit derivatives	-	-	708	-	708
Interest rate derivatives	-	5	-	-	5
Total assets	$ 1,983	$ 11,088	$ 5,020	$ (91)	$ 18,000
Liabilities:					
Medium-term notes	$ -	$ -	$ 128	$ -	$ 128
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	21	4,880	-	4,901
Non-insured derivatives:					
Interest rate derivatives	-	450	-	-	450
Currency derivatives	-	6	-	-	6
Other	-	-	-	(91)	(91)
Other liabilities:					
Warrants	-	12	-	-	12
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,992	3,131	-	5,123
Derivative liabilities:					
Credit derivatives	-	-	1,473	-	1,473
Interest rate derivatives	-	397	-	-	397
Currency derivatives	-	-	18	-	18
Total liabilities	$ -	$ 2,878	$ 9,630	$ (91)	$ 12,417

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of December 31, 2010**
Assets:					
Investments:					
Fixed-maturity investments:					
Taxable bonds:					
U.S. Treasury and government agency	$ 915	$ 149	$ -	$ -	$ 1,064
Foreign governments	409	49	11	-	469
Corporate obligations	-	2,602	246	-	2,848
Mortgage-backed securities:					
Residential mortgage-backed agency	-	1,548	41	-	1,589
Residential mortgage-backed non-agency	-	414	48	-	462
Commercial mortgage-backed	-	120	41	-	161
Asset-backed securities:					
Collateralized debt obligations	-	108	191	-	299
Other asset-backed	-	310	350	-	660
State and municipal bonds	-	738	14	-	752
Total taxable bonds	1,324	6,038	942	-	8,304
Tax exempt bonds:					
State and municipal bonds	-	2,787	36	-	2,823
Other fixed-maturity investments	13	19	-	-	32
Total fixed-maturity investments	1,337	8,844	978	-	11,159
Money market securities	553	-	-	-	553
Perpetual preferred securities	-	192	-	-	192
Other	16	5	-	-	21
Total	1,906	9,041	978	-	11,925
Derivative assets:					
Non-insured derivative assets:					
Credit derivatives	-	3	-	-	3
Interest rate derivatives	-	57	5	-	62
Other	-	-	-	(61)	(61)
Total derivative assets	-	60	5	(61)	4

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of December 31, 2010
Assets of consolidated VIEs:					
U.S. Treasury and government agency	4	-	-	-	4
Corporate obligations	7	360	80	-	447
Mortgage-backed securities:					
Residential mortgage-backed agency	-	37	-	-	37
Residential mortgage-backed non-agency	-	2,706	40	-	2,746
Commercial mortgage-backed	-	907	23	-	930
Asset-backed securities:					
Collateralized debt obligations	-	583	245	-	828
Other asset-backed	-	352	83	-	