MBIA INC
Form 10-Q
November 09, 2009
Table of Contents

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, 2009

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 ¨ 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 October 30, 2009, 207,954,051 shares of Common Stock, par value $1 per share, were outstanding.

Table of Contents

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In thousands except per share amounts)

	September 30, 2009	December 31, 2008
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $11,330,409 and $13,245,574) (includes hybrid financial instruments at fair value $30,710 and $25,498)	$ 9,955,464	$ 11,223,716
Fixed-maturity securities held as trading, at fair value (amortized cost $115,946)	123,467	-
Investments held-to-maturity, at amortized cost (fair value $2,405,860 and $3,109,248)	2,861,353	3,156,969
Investments pledged as collateral, at fair value (amortized cost $652,992 and $1,101,929)	617,249	845,887
Short-term investments held as available-for-sale, at fair value (amortized cost $2,895,514 and $4,728,090)	2,895,530	4,693,283
Short-term investments held-to-maturity, at amortized cost (fair value $605,650 and $485,857)	1,032,388	498,865
Other investments (includes investments at fair value $373,097 and $216,805)	376,150	220,412
Total investments	17,861,601	20,639,132
Cash and cash equivalents	1,645,453	2,279,783
Accrued investment income	111,558	201,688
Premiums receivable	2,059,389	7,744
Deferred acquisition costs	477,429	560,632
Prepaid reinsurance premiums	367,110	216,609
Insurance loss recoverable	2,207,625	458,512
Reinsurance recoverable on paid and unpaid losses	53,440	173,548
Goodwill	76,938	76,938
Property and equipment, at cost (less accumulated depreciation of $148,453 and $141,295)	84,349	105,364
Receivable for investments sold	203,093	77,464
Derivative assets	780,795	911,188
Current income taxes	75,035	240,871
Deferred income taxes, net	1,309,423	2,374,164
Other assets	539,822	706,812
Total assets	$ 27,853,060	$ 29,030,449
Liabilities and Equity		
Liabilities:		
Unearned premium revenue	$ 5,121,978	$ 3,424,402
Loss and loss adjustment expense reserves	1,322,873	1,557,884
Reinsurance premiums payable	208,422	8,672
Investment agreements	2,881,757	4,666,944
Medium-term notes (includes financial instruments at fair value $142,017 and $176,261)	3,932,747	6,339,527
Variable interest entity notes	2,668,798	1,791,597
Securities sold under agreements to repurchase	501,961	802,938
Long-term debt	2,718,076	2,396,059
Deferred fee revenue	88,000	44,989
Payable for investments purchased	303,949	239
Derivative liabilities	4,988,759	6,470,874
Other liabilities	362,171	504,306

Total liabilities	25,099,491	28,008,431
Commitments and contingencies (See Note 16)		
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 274,837,483 and 273,199,801	274,837	273,200
Additional paid-in capital	3,056,500	3,050,506
Retained earnings	2,633,690	1,629,187
Accumulated other comprehensive loss, net of deferred income tax of $500,600 and $946,759	(1,044,568)	(1,775,954)
Treasury stock, at cost 66,892,054 and 65,278,904 shares	(2,183,668)	(2,182,519)
Total shareholders equity of MBIA Inc.	2,736,791	994,420
Preferred stock of subsidiary	16,778	27,598
Total equity	2,753,569	1,022,018
Total liabilities and equity	$ 27,853,060	$ 29,030,449

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 thousands except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Revenues:				
Premiums earned:				
Scheduled premiums earned	$ 144,414	$ 141,049	$ 492,515	$ 434,205
Refunding premiums earned	36,834	93,696	95,350	189,248
Premiums earned (net of ceded premiums of $21,540, $31,607, $70,159 and $93,840)	181,248	234,745	587,865	623,453
Net investment income	156,775	354,419	524,965	1,286,829
Fees and reimbursements	14,291	12,120	55,317	31,968
Change in fair value of insured derivatives:				
Realized gains (losses) and other settlements on insured derivatives	(30,282)	34,263	33,536	102,325
Unrealized gains (losses) on insured derivatives	(810,189)	104,818	1,222,761	(147,972)
Net change in fair value of insured derivatives	(840,471)	139,081	1,256,297	(45,647)
Net gains (losses) on financial instruments at fair value and foreign exchange	(87,296)	(234,200)	74,462	(70,853)
Net realized gains (losses)	(78,121)	(292,241)	(13,710)	(618,932)
Investment losses related to other-than-temporary impairments:				
Investment losses related to other-than-temporary impairments	(199,094)	(134,058)	(786,501)	(793,837)
Other-than-temporary impairments recognized in accumulated other comprehensive loss	105,814	-	349,566	-
Net investment losses related to other-than-temporary impairments	(93,280)	(134,058)	(436,935)	(793,837)
Net gains on extinguishment of debt	126,696	239,898	253,097	319,115
Total revenues	(620,158)	319,764	2,301,358	732,096
Expenses:				
Losses and loss adjustment	238,760	982,514	203,174	1,292,466
Amortization of deferred acquisition costs	19,896	24,618	66,663	63,147
Operating	77,113	95,011	249,603	224,790
Interest	110,136	264,211	359,889	962,767
Total expenses	445,905	1,366,354	879,329	2,543,170
Income (loss) before income taxes	(1,066,063)	(1,046,590)	1,422,029	(1,811,074)
Provision (benefit) for income taxes	(341,530)	(240,111)	547,900	(298,222)
Net income (loss)	(724,533)	(806,479)	874,129	(1,512,852)
Preferred stock dividends of subsidiary	3,271	-	10,484	-
Net income (loss) available to common shareholders	$ (727,804)	$ (806,479)	$ 863,645	$ (1,512,852)

Net income (loss) per common share:				
Basic	$ (3.50)	$ (3.42)	$ 4.15	$ (6.87)
Diluted	$ (3.50)	$ (3.42)	$ 4.15	$ (6.87)
Weighted-average number of common shares outstanding:				
Basic	208,219,324	235,706,851	208,278,589	220,137,758
Diluted	208,219,324	235,706,851	208,278,589	220,137,758

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

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

For the Nine Months Ended September 30, 2009

(In thousands except per share amounts)

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Income	Treasury Stock		Total Shareholders Equity of MBIA	Preferred Stock of Subsidiary	
	Shares	Amount	Capital	Earnings	(Loss)	Shares	Amount	Inc.	Shares	Amount
Balance, January 1, 2009	273,200	$ 273,200	$ 3,050,506	$ 1,629,187	$ (1,775,954)	(65,279)	$ (2,182,519)	$ 994,420	2,759	$ 27,598
ASC 944-20 transition adjustment net of deferred income taxes of $27,170	-	-	-	55,346	-	-	-	55,346	-	-
ASC 320-10 transition adjustment net of deferred income taxes of $29,930	-	-	-	85,512	(55,582)	-	-	29,930	-	-
Comprehensive income:										
Net income	-	-	-	874,129	-	-	-	874,129	-	-
Other comprehensive loss:										
Change in unrealized gains and losses on investments, net of deferred income taxes of $492,583	-	-	-	-	1,014,311	-	-	1,014,311	-	-
Portion of other-than-temporary impairment losses recognized in other comprehensive loss, net of deferred income taxes of $54,286	-	-	-	-	(271,189)	-	-	(271,189)	-	-
Change in fair value of derivative instruments, net of deferred income taxes of $33,411	-	-	-	-	62,048	-	-	62,048	-	-
Change in foreign currency translation, net of deferred income taxes of $4,381	-	-	-	-	(18,202)	-	-	(18,202)	-	-
Other comprehensive loss								786,968		
Total comprehensive income								1,661,097		
Treasury shares acquired under share repurchase program	-	-	-	-	-	(1,690)	(4,196)	(4,196)	-	-

Share-based compensation net of deferred income taxes of $2,858	1,637	1,637	5,994	-	-	77	3,047	10,678	-	-
Preferred stock of subsidiary acquired	-	-	-	-	-	-	-	-	(1,082)	(10,820)
Preferred stock dividends of subsidiary	-	-	-	(10,484)	-	-	-	(10,484)	-	-
Balance, September 30, 2009	274,837	$ 274,837	$ 3,056,500	$ 2,633,690	$ (1,044,568)	(66,892)	$ (2,183,668)	$ 2,736,791	1,677	$ 16,778

	2009
Disclosure of reclassification amount:	
Change in unrealized gains and losses and other-than-temporary impairment losses on investments arising during the period, net of taxes	$ 275,579
Reclassification adjustment, net of taxes	467,543
Change in net unrealized gains and losses and other-than-temporary impairment losses, net of taxes	$ 743,122

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 thousands)

	Nine Months Ended September 30, 2009	2008
Cash flows from operating activities:		
Net income (loss)	$ 874,129	$ (1,512,852)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Amortization of bond discounts (premiums), net	(55,036)	(25,534)
Decrease in accrued investment income	89,797	247,120
Decrease (increase) in premiums receivable	317,423	(148,433)
Decrease (increase) in deferred acquisition costs	91,574	(82,507)
(Decrease) increase in unearned premium revenue	(736,393)	406,877
Decrease in prepaid reinsurance premiums	170,793	44,262
Decrease in reinsurance premiums payable	(197,851)	(22,873)
(Decrease) increase in loss and loss adjustment expense reserves	(60,791)	566,807
Decrease (increase) in reinsurance recoverable on paid and unpaid losses	124,671	(25,221)
Increase in insurance loss recoverable	(1,750,297)	(157,647)
Increase in payable to reinsurers on recoveries	100,592	2,417
Depreciation	7,059	7,217
Decrease in accrued interest payable	(55,577)	(185,705)
Decrease in accounts receivable	29,111	4,655
Decrease in accrued expenses	(148,572)	(11,654)
Increase in deferred fee revenue	43,011	391
Amortization of medium-term notes (premiums) discounts, net	(11,583)	(11,683)
Net realized losses	13,710	618,931
Investment losses on other-than-temporarily impaired investments	436,935	793,838
Unrealized (gains) losses on insured derivatives	(1,222,761)	147,972
Net (gains) losses on financial instruments at fair value and foreign exchange	(74,462)	70,853
Increase (decrease) in current income taxes	162,978	(209,061)
Deferred income tax provision	601,662	141,643
Gains on extinguishment of debt	(253,097)	(319,115)
Share-based compensation	4,822	(28,715)
Other, operating	29,911	87,867
Total adjustments to net income (loss)	(2,342,371)	1,912,702
Net cash provided (used) by operating activities	(1,468,242)	399,850
Cash flows from investing activities:		
Purchase of fixed-maturity securities	(7,782,580)	(11,812,003)
Increase in payable for investments purchased	303,706	67,256
Sale and redemption of fixed-maturity securities	9,874,826	24,686,648
Increase in receivable for investments sold	(125,841)	(1,200,027)
Purchase of held-to-maturity investments	(236,817)	(1,108,649)
Redemptions of held-to-maturity investments	665,215	3,558,827
Sale (purchase) of short-term investments, net	1,888,549	(5,074,218)
Sale (purchase) of other investments, net	72,655	315,494
Capital expenditures	(5,025)	(4,509)
Disposals of capital assets	8	-

Net cash provided by investing activities	4,654,696	9,428,819
Cash flows from financing activities:		
Proceeds from issuance of investment agreements	308,983	1,882,609
Payments for drawdowns of investment agreements	(2,066,377)	(7,294,253)
Decrease in commercial paper	-	(863,039)
Issuance of medium-term notes	185,904	2,106,756
Principal paydown of medium-term notes	(2,209,391)	(6,062,672)
Principal paydown of variable interest entity notes	(121,717)	(109,818)
Securities sold under agreements to repurchase	(285,642)	(77,939)
Dividends paid	(9,477)	(42,640)
Gross proceeds from issuance of common stock	-	1,628,405
Capital issuance costs	-	(78,510)
Net proceeds from issuance of warrants	-	21,467
Net proceeds from issuance of long-term debt	333,078	983,278
Repayment for retirement of long-term debt	-	(82,822)
Repayment for retirement of short-term debt	-	(6,225)
Proceeds from bank loans	-	338,820
Proceeds from derivative settlements	41,457	372,167
Purchase of treasury stock	(4,196)	(90,041)
Purchase of subsidiary preferred stock	(10,820)	-
Restricted stock awards settlements	1,561	2,207
Excess tax benefit on share-based payment	-	(15,441)
Collateral from reverse repurchase agreement counterparties	25,000	-
Collateral posted under investment agreements	-	(40,018)
Collateral to swap counterparty	(9,147)	(110,200)
Other, financing	-	1,356
Net cash used by financing activities	(3,820,784)	(7,536,553)
Net increase (decrease) in cash and cash equivalents	(634,330)	2,292,116
Cash and cash equivalents - beginning of period	2,279,783	263,732
Cash and cash equivalents - end of period	$ 1,645,453	$ 2,555,848
Supplemental cash flow disclosures:		
Income taxes refunded	$ (209,975)	$ (221,037)
Interest paid:		
Investment agreements	$ 104,633	$ 506,185
Commercial paper	-	15,445
Medium-term notes	95,899	321,689
Variable interest entity notes	54,939	40,678
Securities sold under agreements to repurchase	58,621	29,406
Liquidity loans	3,904	1,670
Other borrowings and deposits	-	2,319
Long-term debt	182,900	121,683
Non cash items:		
Share-based compensation	$ 4,822	$ (28,715)
Dividends declared but not paid	1,005	-

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note 1: Business and Organization

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 investment advisory services. The Company also manages asset/liability products and conduit programs, which are in wind-down. Corporate operations include revenues and expenses that arise from general corporate activities.

MBIA s financial guarantee business is currently operated through two subsidiaries, National Public Finance Guarantee Corporation (National) and MBIA Insurance Corporation and its subsidiaries (MBIA Corp.). In February 2009, after receiving the required regulatory approvals, MBIA established and capitalized National as a U.S. public finance-only financial guarantor. In connection with the establishment of National, MBIA Insurance Corporation paid dividends and returned capital to MBIA Inc. and entered into a reinsurance agreement and an assignment agreement with National, the latter of which was with respect to financial guarantee insurance policies that had been reinsured from Financial Guaranty Insurance Company (FGIC). As a result, the Company established its U.S. public finance insurance business as a separate operating segment.

Refer to MBIA Inc. s Annual Report on Form 10-K for the fiscal year ended December 31, 2008 for further information about these changes to the Company s operating and legal entity structure.

MBIA s insurance and certain investment management services programs have historically relied upon triple-A credit ratings. The loss of those ratings in the second quarter of 2008 resulted in a dramatic reduction in the Company s business activities. As of September 30, 2009, National was rated A with a developing outlook by Standard & Poor s Corporation (S&P) and Baa1 with a developing outlook by Moody s Investors Service, Inc. (Moody s). As of September 30, 2009, MBIA Insurance Corporation was rated BB+ with a negative outlook by S&P and B3 with a negative outlook by Moody s.

U.S. Public Finance Insurance Operations

As described above, since February 2009, MBIA s U.S. public finance insurance business has been conducted through National. The financial guarantees issued by National provide unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due or, in the event National has the right at its discretion to accelerate insured obligations upon default or otherwise, upon National s acceleration. National s guarantees insure municipal bonds, including tax-exempt and taxable indebtedness of U.S. political subdivisions, as well as utility districts, airports, health care institutions, higher educational facilities, student loan issuers, housing authorities and other similar agencies and obligations issued by private entities that finance projects that serve a substantial public purpose. Municipal bonds and privately issued bonds used for the financing of public purpose projects are generally supported by taxes, assessments, fees or tariffs related to the use of these projects, lease payments or other similar types of revenue streams.

National s insurance portfolio principally comprises exposure assumed by National under the previously disclosed quota share reinsurance agreement it entered into with MBIA Insurance Corporation effective January 1, 2009 pursuant to which MBIA Insurance Corporation ceded all of its U.S. public finance exposure to National and under the assignment by MBIA Insurance Corporation of its rights and obligations with respect to the U.S. public finance business that MBIA Insurance Corporation assumed from FGIC.

Structured Finance and International Insurance Operations

MBIA s structured finance and international insurance operations have been conducted through MBIA Corp. The financial guarantees issued by MBIA Corp. provide unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due, or in the event MBIA Corp. has the right at its discretion to accelerate insured obligations upon default or otherwise, upon MBIA Corp. s acceleration. Certain investment agreement contracts written by MBIA Inc. are insured by MBIA Corp. and if MBIA Inc. were to have insufficient assets to pay amounts due, MBIA Corp. would make such payments under its insurance policies. MBIA Corp. also insured debt obligations of other affiliates, including MBIA Global Funding LLC (GFL) and Meridian Funding Company LLC (Meridian), and provides reinsurance to its insurance subsidiaries. Additionally, insurance policies include payments due under credit and other derivatives, including termination payments that may become due upon certain events including the insolvency or payment default of MBIA Corp.

MBIA Corp. s guarantees insure structured finance and asset-backed obligations, privately issued bonds used for the financing of public purpose projects, which are primarily located outside of the U.S. and that include toll roads, bridges, airports, public transportation facilities and other types of infrastructure projects serving a substantial public purpose, and obligations of sovereign and sub-sovereign issuers. Structured finance and asset-backed securities (ABSs) typically are securities repayable from expected cash flows generated by a specified pool of assets, such as residential and commercial mortgages, insurance policies, consumer loans, corporate loans and bonds, trade and export receivables, leases for equipment, aircraft and real property.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

The Company is no longer insuring new credit derivative contracts except in transactions related to the reduction of existing derivative exposure. The structured finance market continues to recover from the global credit crisis with new issuance volume, though increasing, still well below historical averages. It is unclear how or when the Company may be able to re-engage this market.

Investment Management Services Operations

MBIA s investment management services operations consist of an asset management advisory business, which provides cash management, discretionary asset management and structured products to the public, not-for-profit, corporate and financial sectors. The advisory services segment primarily consists of the operations of MBIA Municipal Investor Service Corporation (MBIA-MISC), MBIA Capital Management Corp. (CMC) and MBIA Asset Management UK (AM-UK). MBIA-MISC provides investment management programs, including pooled investments products and customized asset management services. In addition, MBIA-MISC provides portfolio accounting and reporting for state and local governments, including school districts. MBIA-MISC is a Securities and Exchange Commission (SEC)-registered investment adviser. CMC provides fee-based asset management services to the Company, its affiliates and third-party institutional clients. CMC is an SEC-registered investment advisor and Financial Industry Regulatory Authority member firm. AM-UK provides fee-based asset management services to the Company s foreign insurance affiliates and Euro Asset Acquisition Limited (EAAL), and to third-party institutional clients and investment structures. AM-UK is registered with the Financial Services Authority in the United Kingdom (U.K.).

The Company also has an asset/liability products business, in which it has issued debt and investment agreements, which are insured by MBIA Corp., to capital markets and municipal investors and then initially purchased assets that largely matched the duration of those liabilities, and a conduit business in which the Company has funded MBIA-insured transactions by issuing debt, which is insured by MBIA Corp. The ratings downgrades of MBIA Corp. have resulted in the termination and collateralization of certain investment agreements and, together with the rising cost and declining availability of funding and illiquidity of many asset classes, have caused the Company to begin winding down its asset/liability products and conduit businesses.

Liquidity

As a financial services company, MBIA is materially affected by conditions in global financial markets. Current conditions and events in these markets have created substantial liquidity risk for the Company.

The Company has instituted a liquidity risk management framework to evaluate its enterprise-wide liquidity position. The primary objective of this risk management system is to monitor potential liquidity constraints and guide the proactive management of liquidity resources to ensure adequate protection against liquidity risk. MBIA s liquidity risk management framework monitors the Company s cash and liquid asset resources using stress-scenario testing. Members of MBIA s senior management meet frequently 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 also evaluates and manages liquidity on both a legal entity basis and a segment basis. Segment liquidity is an important consideration for the Company as it conducts the operations of its corporate segment and certain activities within the asset/liability products segment of the Company s investment management services operations from MBIA Inc. Dislocation in the global financial markets, the overall economic downturn in the U.S., and the loss of MBIA Corp. s triple-A insurance financial strength ratings in 2008 have significantly increased the liquidity needs and decreased the financial flexibility in the Company s segments. However, MBIA continued to satisfy all of its payment obligations and the Company believes that it has adequate resources to meet its ongoing liquidity needs in both the short-term and the long-term. However, if the current market dislocation and economic conditions persist or worsen, the Company s liquidity resources will experience further stress.

U.S. Public Finance Insurance Liquidity

Liquidity risk arises in the Company s U.S. public finance insurance segment when claims on insured exposures result in payment obligations, when operating cash inflows fall due to depressed new business writings, lower investment income, or unanticipated expenses, or when invested assets experience credit defaults or significant declines in fair value.

The Company s U.S. public finance insurance business s financial guarantee contracts cannot be accelerated, thereby mitigating liquidity risk. However, defaults, credit impairments and adverse capital markets conditions such as the Company is currently experiencing, can create payment requirements as the Company has made irrevocable pledges to pay principal and interest, or other amounts owing on insured obligations, when due. Additionally, the Company s U.S. public finance insurance segment requires cash for the payment of operating expenses. Finally, National also provides liquid assets to the Company s asset/liability products segment through matched repurchase and reverse repurchase agreements to support its business operations and liquidity position, as described below.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Structured Finance and International Insurance Liquidity

Liquidity risk arises in the Company s structured finance and international insurance segment when claims on insured exposures result in payment obligations, when operating cash inflows fall due to depressed new business writings, lower investment income, or unanticipated expenses, or when invested assets experience credit defaults or significant declines in fair value.

In general, the Company s structured finance and international business s financial guarantee contracts and credit default swap (CDS) contracts cannot be accelerated, thereby mitigating liquidity risk. Under the terms of the Company s insured CDS contracts, the insured counterparty may have a right to terminate the CDS contracts upon an insolvency or payment default of MBIA Corp. However, defaults, credit impairments and adverse capital markets conditions such as the Company is currently experiencing, can create payment requirements as the Company has made irrevocable pledges to pay principal and interest, or other amounts owing on insured obligations, when due. Additionally, the Company s structured finance and international insurance segment requires cash for the payment of operating expenses, as well as principal and interest related to its surplus notes and preferred stock issuance. MBIA Corp. also provides guarantees to the holders of our asset/liability products debt obligations. If the Company s asset/liability products segment or MBIA Inc. were unable to service the principal and interest payments on its debt and investment agreements, the holders of the insured liabilities would make a claim under the MBIA Corp. insurance policies. MBIA Corp. has lent $2.0 billion to the asset/liability products segment on a secured basis for the purpose of minimizing the risk that such claim would be made. The loan matures in the fourth quarter of 2011. During October and November of 2009, a total of $100 million of the loan was repaid. The timing of the ultimate repayment may be affected by the performance of assets in the asset/liability product s investment portfolio.

Since the fourth quarter of 2007, MBIA Corp. made $4.4 billion of cash payments, before reinsurance, associated with insured second-lien residential mortgage-backed securities (RMBS), as well as settlement payments relating to CDS contracts referencing collateralized debt obligation (CDO)-squared and multi-sector CDOs. Among MBIA Corp. s outstanding insured portfolio, these types of insured exposures have exhibited the highest degree of payment volatility and continue to pose material liquidity risk to the Company s structured finance and international insurance segment. As a result of the current economic stress, MBIA could incur additional payment obligations beyond these mortgage-related exposures, which may be substantial, increasing the stress on MBIA Corp. s liquidity.

In order to monitor liquidity risk and maintain appropriate liquidity resources for payments associated with our residential mortgage related exposures, MBIA employs a stress scenario-based liquidity model using the same Roll Rate Default Methodology as it uses in its loss reserving. Using this methodology, the Company estimates the level of payments that would be required to be made under low probability stress-level default assumptions of the underlying collateral taking into account MBIA s obligation to cover such defaults under our insurance policies. These estimated payments, together with all other significant operating, financing and investing cash flows are forecasted over the next 24-month period on a monthly basis and then annually thereafter to the final maturity of the longest dated outstanding insured obligation. The stress-loss scenarios and cash flow forecasts are frequently updated to account for changes in risk factors and to reconcile differences between forecasted and actual payments.

In addition to MBIA s residential mortgage stress scenario, it also monitors liquidity risk using a Monte Carlo estimation of potential stress-level claims for all insured principal and interest payments due in the next 12-month period. These probabilistically determined payments are then compared to the Company s invested assets. This theoretic liquidity model supplements the scenario-based liquidity model described above providing the Company with a robust set of liquidity metrics with which to monitor its risk position.

The Company manages the investment portfolios of its insurance segments to maintain cash and liquid securities in an amount in excess of all stress scenario payment requirements. To the extent the Company s liquidity resources fall short of its target liquidity cushions under the stress-loss scenario testing, the Company will seek to increase its cash holdings position, primarily through the sale of high-quality bonds held in its investment portfolio.

Investment Management Services Liquidity

Within MBIA s investment management services operations, the asset/liability products segment has material liquidity risk. In addition to the payment of operating expenses, cash needs in the asset/liability products segment are primarily for the payment of principal and interest on investment agreements and medium-term notes, and for posting collateral under repurchase agreements, derivatives and investment agreements.

The primary sources of cash within the asset/liability products segment used to meet its liquidity needs include scheduled principal and interest on assets held in the segment s investment portfolio and dedicated capital held within the investment management services operations. If needed, assets held within the segment can be sold or used in secured repurchase agreement borrowings to raise cash. However, the Company s ability to sell assets or borrow against non-U.S. government securities in the fixed-income markets decreased dramatically and the cost of such transactions increased dramatically over the last year due to the impact of the credit crisis on the willingness of investors to purchase or lend against even very high-quality assets. In addition, negative net interest spread between asset and liability positions resulted from the need to hold cash as collateral against terminable investment agreement contracts and reduced the cash flow historically provided by net investment income.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

The asset/liability products segment, through MBIA Inc., maintained simultaneous repurchase and reverse repurchase agreements with National for the purpose of borrowing government securities to pledge under collateralized investment agreements and repurchase agreements. As a result of increased liquidity needs within the asset/liability products segment, the asset/liability products segment, through MBIA Inc., maintained a repurchase agreement with MBIA Insurance Corporation under which MBIA Inc. may transfer securities in its portfolio in exchange for up to $2.0 billion in cash. Additionally, $600 million was transferred to the asset/liability products segment from the Company s corporate segment in the fourth quarter of 2008.

In order to monitor liquidity risk and maintain appropriate liquidity resources for near-term cash and collateral requirements within MBIA s asset/liability products segment, the Company calculates monthly forecasts of asset and liability maturities, as well as collateral posting requirements. Cash availability at the low point of the Company s 12-month forecasted cash flows is measured against liquidity needs using stress-scenario testing of each of the potential liquidity needs described above. To the extent there is a shortfall in MBIA s liquidity coverage, the Company proactively manages its cash position and liquidity resources to maintain an adequate cushion to the stress scenario. These resources include the sale of unpledged assets, the use of free cash at the holding company including the assets in the corporate segment, and potentially increased securities borrowings from National.

Corporate Liquidity

Liquidity needs in MBIA s corporate segment are highly predictable and comprise principal and interest payments on corporate debt, operating expenses and dividends to MBIA Inc. shareholders. Liquidity risk is associated primarily with the dividend capacity of National and MBIA Corp., the distributable earnings of the investment management services operations conducted by MBIA Inc., dividends from asset management subsidiaries, investment income and the Company s ability to issue equity and debt. Additionally, the corporate segment maintains excess cash and investments to ensure it is able to meet its ongoing cash requirements over a multi-year period in the event that cash becomes unavailable from one or more sources.

In addition to MBIA Inc. s corporate liquidity needs described above, it issued investment agreements reported within the Company s asset/liability products segment, all of which are currently collateralized by high-quality liquid investments. The Company s corporate debt and investment agreements can be accelerated by the holders of such instruments upon the occurrence of certain events, including a breach of covenant or representation, a bankruptcy of MBIA Inc. and the filing of an insolvency proceeding in respect of MBIA Corp. In the event of any such acceleration, the Company may not have sufficient liquid resources to pay amounts due with respect to its corporate debt obligations.

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 fiscal year ended December 31, 2008. The following significant accounting policies provide an update to those included under the same captions 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 accounting principles generally accepted in the United States of America (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 fiscal year ended December 31, 2008. 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 (United States), 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 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. As additional information becomes available or actual amounts become determinable, the recorded

estimates are revised and reflected in operating results. Actual results could differ from those estimates.

The results of operations for the three and nine months ended September 30, 2009 may not be indicative of the results that may be expected for the year ending December 31, 2009. The December 31, 2008 balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. 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 revenues and expenses have been eliminated. Certain amounts have been reclassified in prior years financial statements to conform to the current presentation.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

In addition, the Company evaluated all events subsequent to September 30, 2009 through November 9, 2009 for inclusion in the Company s consolidated financial statements and/or accompanying notes.

Financial Guarantee Insurance Premiums

Unearned Premium Revenue and Receivable for Future Premiums

The Company recognizes and measures financial guarantee insurance premiums in accordance with the accounting guidance for financial guarantee insurance and reinsurance contracts. The accounting guidance requires the Company to recognize a liability for unearned premium revenue at the inception of financial guarantee insurance and reinsurance contracts on a contract-by-contract basis. Unearned premium revenue recognized at inception of a contract is measured at the present value of the premium due. For most financial guarantee insurance contracts, the Company receives the entire premium due at the inception of the contract, and recognizes unearned premium revenue liability at that time. For certain other financial guarantee contracts, the Company receives premiums in installments over the term of the contract. Unearned premium revenue and a receivable for future premiums is recognized at the inception of an installment contract, and measured at the present value of premiums expected to be collected over the contract period or expected period using a risk-free discount rate. The expected period is used in the present value determination of unearned premium revenue and receivable for future premiums for contracts where (a) the insured obligation is contractually prepayable, (b) prepayments are probable, (c) the amount and timing of prepayments are reasonably estimable, and (d) a homogenous pool of assets is the underlying collateral for the insured obligation. The Company has determined that substantially all of its installment contracts meet the conditions required to be treated as expected period contracts. The receivable for future premiums is reduced as installment premiums are collected. The Company reports the accretion of the discount on installment premiums receivable as premium revenue and discloses the amount recognized in Note 4: Insurance Premiums. The Company assesses the receivable for future premiums for collectability each reporting period, adjusts the receivable for uncollectible amounts and recognizes any write-off as operating expense and discloses the amount recognized in Note 4: Insurance Premiums. As premium revenue is recognized, the unearned premium revenue liability is reduced.

Premium Revenue Recognition

The Company recognizes and measures premium revenue over the period of the contract in proportion to the amount of insurance protection provided. Premium revenue is measured by applying a constant rate to the insured principal amount outstanding in a given period to recognize a proportionate share of the premium received or expected to be received on a financial guarantee insurance contract. A constant rate for each respective financial guarantee insurance contract is determined as the ratio of (a) the present value of premium received or expected to be received over the period of the contract to (b) the sum of all insured principal amounts outstanding during each period over the term of the contract.

An issuer of an insured financial obligation may retire the obligation prior to its scheduled maturity through legal defeasance in satisfaction of the obligation according to its indenture, which results in the Company s obligation being extinguished under the financial guarantee contract. The Company recognizes any remaining unearned premium revenue on the insured obligation as premium revenue in the period the contract is extinguished to the extent the unearned premium revenue has been collected.

Non-refundable commitment fees are considered insurance premiums and are initially recorded under unearned premium revenue in the consolidated balance sheets when received. Once the related financial guarantee insurance policy is issued, the commitment fees are recognized as premium written and earned using the constant rate method. If the commitment agreement expires before the related financial guarantee is issued, the non-refundable commitment fee is immediately recognized as premium written and earned at that time.

Loss and Loss Adjustment Expenses

The accounting guidance for financial guarantee insurance and reinsurance contracts requires a claim liability (loss reserve) to be recognized on a contract-by-contract basis when the present value of expected net cash outflows to be paid under the contract using a risk-free rate as of the measurement date exceeds the unearned premium revenue. A claim liability is subsequently remeasured each reporting period for expected increases or decreases due to changes in the likelihood of default and potential recoveries. Subsequent changes to the measurement of the claim liability are recognized as claim expense in the period of change. Measurement and recognition of claim liability is reported gross of any

reinsurance. The Company estimates the likelihood of possible claims payments and possible recoveries using probability-weighted expected cash flows based on information available as of the measurement date, including market information. Accretion of the discount on a claim liability is included in claim expense. The Company s claim liability and accruals for loss adjustment expenses (LAE) incurred are disclosed in Note 10: Loss and Loss Adjustment Expense Reserves.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Other-Than-Temporary Impairments on Investment Securities

The Company s consolidated statement of operations reflects the full impairment (the difference between a security s amortized cost basis and fair value) on debt securities that the Company intends to sell or would more likely than not be required to sell before the expected recovery of the amortized cost basis. For available-for-sale and held-to-maturity debt securities that management has no intent to sell and believes that it is more likely than not such securities will not be required to be sold prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the rest of the fair value loss is recognized in accumulated other comprehensive income. The credit loss component recognized in earnings is identified as the amount of cash flows not expected to be received over the remaining term of the security as projected using the Company s discounted cash flow projections.

Fee and Reimbursement Revenue Recognition

The Company collects insurance related fees for services performed in connection with certain transactions. In addition, the Company may be entitled to reimbursement of third-party insurance expenses that it incurs in connection with certain transactions. Depending upon the type of fee received and whether it is related to an insurance policy, the fee is either earned when it is received or deferred and earned over the life of the related transaction. Work, waiver and consent, termination, administrative and management fees are earned when the related services are completed and the fee is received. Structuring fees are earned on a straight-line basis over the life of the related insurance policy. Expense reimbursements are recognized when received.

Fees related to investment management services are recognized in earnings over the period that the related services are provided. Asset management fees are typically based on the net asset values of assets under management.

Cash and Other Collateral

Under certain non-insurance derivative contracts entered into by the Company, collateral postings are required by either MBIA or the counterparty when the aggregate market value of derivative contracts entered into with the same counterparty exceeds a predefined threshold. Cash or securities may be posted as collateral at the option of the party posting the collateral. Refer to Note 8: Derivative Instruments for further information on these collateral arrangements.

The Company has entered into reverse repurchase agreements that require MBIA to post collateral at a predetermined multiple of the contract amount. Cash or securities may be posted by MBIA under these agreements. As of September 30, 2009, the Company had cash collateral of $6 million posted to counterparties under these term reverse repurchase agreements.

The Company reports cash received or posted in its Consolidated Statements of Cash Flows as either operating, investing or financing consistent with the classification of the asset or liability that created the posting requirement.

Offsetting of Fair Value Amounts Related to Derivative Instruments

In the second quarter of 2009, the Company re-evaluated its election regarding offsetting the fair value amounts recognized for derivative contracts executed with the same counterparty under a master netting agreement. As a result, the Company began presenting the fair value amounts recognized for eligible derivative contracts executed with the same counterparty on a net basis. The implementation of the counterparty netting resulted in a decrease in the Company s derivative assets and derivative liabilities of $225 million and $509 million as of June 30, 2009 and December 31, 2008, respectively. Additionally, counterparty netting resulted in a decrease in accrued investment income and other liabilities of $33 million and $52 million as of June 30, 2009 and December 31, 2008, respectively.

Note 3: Recent Accounting Pronouncements

Recently Adopted Accounting Standards

In June 2009, the Financial Accounting Standards Board (FASB) issued new accounting guidance on the Accounting Standards Codification (Codification) and the hierarchy of generally accepted accounting principles (Accounting Standards Codification (ASC) 105-10). The Codification is now the single source of authoritative GAAP applied by nongovernmental entities and supersedes all existing non-SEC accounting and reporting standards. The Codification is effective for the Company for financial statements issued for interim and annual periods ending after September 15, 2009. The Company adopted this guidance as of the third quarter of 2009. The Codification is not intended to change GAAP but rather reorganize divergent accounting literature into an accessible and user-friendly system which materially impacts cited references of GAAP in the Company s Notes to Consolidated Financial Statements.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

In May 2009, the FASB issued accounting guidance for subsequent events (ASC 855-10) which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued. The accounting guidance is effective for the Company in the interim and annual periods ending after June 15, 2009 and should be applied prospectively. The Company adopted this standard as of the second quarter of 2009. The adoption of this standard did not have a material effect on the Company s consolidated balance sheets, results of operations or cash flows.

In April 2009, the FASB issued accounting guidance that amends fair value measurements and disclosures (ASC 820-10) for determining the fair value when the volume and level of activity for the asset or liability have significantly decreased and for identifying transactions that are not orderly. This standard provides additional guidance to highlight and expand on the factors that should be considered when there has been a significant decrease in market activity for a financial asset or financial liability being measured. The accounting guidance also provides additional factors that entities should consider to determine whether events or circumstances indicate that a transaction is or is not orderly (i.e., distressed). The Company adopted this standard as of the second quarter of 2009. The adoption of this standard did not have a material effect on the Company s consolidated balance sheets, results of operations or cash flows.

In April 2009 the FASB issued accounting guidance for debt and equity investment securities (ASC 320-10) which amends the recognition criteria for other-than-temporary impairment guidance to improve the presentation of other-than-temporary impairments in the financial statements. This accounting guidance replaced the requirement that the entity s management assert it has both the ability and intent to hold an impaired security until recovery with a requirement that management assert (a) it does not have the intent to sell the security and (b) it is more likely than not it would not have to sell the security before recovery of its cost basis. When these two criteria are met, the entity will recognize only the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. The Company adopted this standard as of the second quarter of 2009. Upon adoption and implementation of the standard, the Company recorded a cumulative-effect adjustment to reclassify the non-credit component of previously recognized other-than-temporary impairments from retained earnings to accumulated other comprehensive income. The cumulative-effect adjustment resulted in an increase in retained earnings of $86 million and an increase in accumulated other comprehensive loss of $56 million, net of deferred taxes of $30 million. Refer to Note 7: Investment Income and Gains and Losses for further information on the Company s investment securities and other-than-temporary impairments.

In April 2009, the FASB issued accounting guidance for interim disclosures about financial instruments (ASC 825-10) to require disclosures about the fair value of financial instruments in interim and annual financial statements, and the method(s) and significant assumptions used to estimate the fair value of those financial instruments. The accounting guidance also requires those disclosures in all interim financial statements (ASC 270-10). The Company adopted this standard in the second quarter of 2009. As the standard requires only additional disclosures, the adoption did not have an impact on the Company s consolidated balance sheets, results of operations or cash flows. Refer to Note 5: Fair Value of Financial Instruments for further information.

In May 2008, the FASB issued accounting guidance for financial guarantee insurance and reinsurance contracts (ASC 944-20) effective prospectively as of January 1, 2009. This accounting guidance amends accounting and reporting by insurance enterprises to clarify how existing guidance applies to financial guarantee insurance and reinsurance contracts. The accounting guidance amends the recognition and measurement of premium revenue and claim liabilities, and expands disclosure requirements. Recognition and measurement of unearned premium revenue and receivable for future premiums are also amended. The accounting guidance does not apply to financial guarantee insurance contracts that are derivative instruments included within the scope of derivatives and hedging (ASC 815-10). Refer to Note 4: Insurance Premiums for disclosures related to premiums and Note 10: Loss and Loss Adjustment Expense Reserves for disclosures related to loss reserves.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Upon the adoption and implementation of the accounting guidance for financial guarantee insurance and reinsurance contracts, the Company recognized a cumulative transition adjustment of $55 million net of tax, $83 million pre-tax, as an increase to its beginning retained earnings balance as of January 1, 2009. The cumulative transition adjustment represents the recognized changes in assets and liabilities resulting from the adoption. The following table summarizes the adjustments made to the Company s consolidated assets and liabilities as of January 1, 2009 on a pre-tax basis:

In thousands	Increase/ (Decrease)
Assets:	
Deferred acquisition costs	$ 8,731
Prepaid reinsurance premiums	313,660
Reinsurance recoverable on paid and unpaid losses	4,563
Premiums receivable	2,287,451
Deferred income taxes, net	(27,170)
Liabilities:	
Unearned premium revenue	$ 2,381,487
Loss and LAE reserves	(174,220)
Reinsurance premiums payable	324,262

In December 2008, the FASB issued accounting guidance for transfers of financial assets (ASC 860-10) and interests in variable interest entities (VIEs) (ASC 810-10) which requires enhanced disclosures about transfers of financial assets and involvement with VIEs. The Company adopted this guidance for financial statements prepared as of December 31, 2008 and is effective for interim reporting periods ending after January 1, 2009. Since the guidance only requires additional disclosures concerning transfers of financial assets and interests in VIEs, the adoption did not affect the Company s consolidated balance sheets, results of operations or cash flows. Refer to Note 9: Variable Interest Entities for mandated disclosures.

In June 2008, the FASB issued accounting guidance for determining whether instruments granted in share-based payment transactions are participating securities (ASC 260-10) effective January 1, 2009 with retrospective application. The guidance requires companies to consider unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents as participating securities, which shall be included in the calculation of basic and diluted earnings per share. The Company s restricted and deferred share awards meet the definition of participating securities. The Company adopted the guidance on January 1, 2009, which resulted in a $0.10 reduction in its previously reported loss per common share for the nine months ended September 30, 2008. The previously reported amounts for diluted earnings per share for the three and nine months ended September 30, 2008 were income of $3.48 and a loss of $6.97, respectively.

In March 2008, the FASB issued accounting guidance that expands the disclosure requirements about an entity s derivative instruments and hedging activities (ASC 815-10). The disclosure provisions apply to all entities with derivative instruments subject to the accounting guidance and its related interpretations. The provisions also apply to related hedged items, bifurcated derivatives, and non-derivative instruments that are designated and qualify as hedging instruments. The Company adopted the disclosure provisions on January 1, 2009. Since the guidance requires only additional disclosures concerning derivatives and hedging activities, adoption of the accounting guidance did not affect the Company s consolidated balance sheets, results of operations or cash flows. Refer to Note 8: Derivative Instruments for mandated disclosures.

In February 2008, the FASB issued accounting guidance for fair value measurements and disclosures (ASC 820-10) that delayed the effective date to fiscal years beginning after November 15, 2008, for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption on January 1, 2009 did not have a material impact on the Company s consolidated balance sheets, results of operations or cash flows.

In December 2007, the FASB issued accounting guidance for consolidation (ASC 810-10) which requires reporting entities to present noncontrolling (minority) interest as equity (as opposed to liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. The presentation and disclosure requirements are to be applied retrospectively. The Company adopted the prescribed guidance on January 1, 2009 which resulted in preferred stock issued by a subsidiary to be reclassified from

minority interest to a separate component of equity. The adoption did not have a material impact on the Company s consolidated results of operations or cash flows.

Recent Accounting Developments

In September 2009, the FASB issued Accounting Standards Update No. (ASU) 2009-12 for investments in certain entities that calculate net asset value per share which will require the Company to measure the fair value of an investment on the basis of the net asset value per share of the investment (or its equivalent) if its calculated in a manner that is consistent with the accounting principles for investment companies (ASC 946-10). The ASU will also require disclosures by major category of the investment about the attributes of investments and will be required to be determined on the basis of the nature and risks of the investment. The new guidance is effective for the Company as of December 31, 2009. The Company is currently evaluating the potential impact of adopting this guidance.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

In August 2009, the FASB issued accounting guidance for measuring liabilities at fair value (ASU 2009-05) to clarify that in circumstances in which a quoted price in an active market for the identical liability is not available, the Company should not make an adjustment to fair value for restrictions that prevent the transfer of a liability. The new guidance is effective for the Company as of December 31, 2009. The Company is currently evaluating the potential impact of adopting this guidance.

In June 2009, the FASB issued FASB Statement No. 167, which has not yet been incorporated into the Codification, to include qualifying special purpose entities (QSPEs) in its scope and to require the holder of a variable interest(s) in a VIE to determine whether it holds a controlling financial interest in a VIE. A holder of a variable interest (or combination of variable interests) that provides a controlling financial interest in a VIE is considered the primary beneficiary and is required to consolidate the VIE. The accounting guidance deems controlling financial interest as both a) the power to direct the activities of a VIE that most significantly impact the VIE s economic performance and b) the obligation to absorb losses or the rights to receive benefits of the VIE that could potentially be significant to the VIE. The accounting guidance eliminates the quantitative approach for determining the primary beneficiary of a VIE. The accounting guidance will require an ongoing reassessment of whether a holder of a variable interest is the primary beneficiary of a VIE and is effective for the Company as of January 1, 2010. Early application is prohibited. The Company is currently evaluating the potential impact of adopting this guidance.

In June 2009, the FASB issued Statement No. 166, which has not yet been incorporated into the Codification, to remove the concept of a QSPE. The accounting guidance also clarifies whether a transferor has surrendered control over transferred financial assets and meets the conditions to derecognize transferred financial assets or a portion of an entire financial asset that meets the definition of a participating interest. The accounting guidance requires enhanced disclosures about transfers of financial assets and a transferor s continuing involvement with transferred financial assets. The guidance is effective for the Company as of January 1, 2010 and earlier application is prohibited. The Company is currently evaluating the potential impact of adopting this guidance.

Note 4: Insurance Premiums

The Company recognizes and measures premiums related to financial guarantee (non-derivative) insurance and reinsurance contracts in accordance with the accounting principles for financial guarantee insurance contracts. Refer to Note 2: Significant Accounting Policies and Note 3: Recent Accounting Pronouncements for a description of the Company s accounting policy for insurance premiums and the impact of its adoption on the Company s financial statements.

As of September 30, 2009, the Company reported premiums receivable of $2.1 billion primarily related to installment policies for which premiums will be collected over the estimated term of the contracts. Premiums receivable for an installment policy is initially measured at the present value of premiums expected to be collected over the expected period or contract period of the policy using a risk-free discount rate. Premiums receivable for policies that use the expected period of risk due to expected prepayments are adjusted in subsequent measurement periods when prepayment assumptions change using the risk-free discount rate as of the remeasurement date. The weighted average risk-free rate used to discount future installment premiums was 3.02% and the weighted average expected collection term of the premiums receivable was 9.12 years. For the three and nine months ended September 30, 2009, the accretion of the premiums receivable was $14 million and $42 million, respectively, and is reported in Scheduled premiums earned on the Company s Consolidated Statements of Operations.

As of September 30, 2009, the Company reported reinsurance premiums payable of $208 million, which represents the portion of the Company s premiums receivable that is due to reinsurers. The reinsurance premiums payable is accreted and paid to reinsurers as premiums due to MBIA are accreted and collected.

The following table presents a roll forward of the Company s premiums receivable for the nine months ended September 30, 2009:

In millions	Nine Months Ended September 30, 2009							
				Adjustments				
Premiums Receivable	Accounting Transition	Premium Payments	Premiums from New	Changes in Expected	Accretion of Premiums	Other	Premiums Receivable as	Reinsurance Premiums

as of December 31, 2008	Adjustment[1]	Received	Business Written	Term of Policies	Receivable Discount		of September 30, 2009	Payable as of September 30, 2009
$ 8	$ 2,288	$ (235)	$ -	$ (22)	$ 42	$ (22)	$ 2,059	$ 208

[1] - Reflects the adoption of the accounting principles for financial guarantee insurance contracts as described in Note 3: Recent Accounting Pronouncements.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

The following table presents the undiscounted future amount of premiums expected to be collected and the period in which those collections are expected to occur:

In millions	Expected Collection of Premiums
Three months ended:	
December 31, 2009	$ 88
Twelve months ended:	
December 31, 2010	278
December 31, 2011	247
December 31, 2012	219
December 31, 2013	178
Five years ended:	
December 31, 2018	640
December 31, 2023	402
December 31, 2028 and thereafter	610
Total	$ 2,662

For the three and nine months ended September 30, 2009, the Company reported premiums earned of $181 million and $588 million, respectively, which includes $144 million and $493 million of scheduled premiums earned and $37 million and $95 million of refunding premiums earned, respectively. Refunding premiums earned represent premiums earned on policies for which the underlying insured obligations have been refunded, called, or terminated and for which MBIA s obligation has been extinguished.

The following table presents the unearned premium revenue balance and the future expected premiums earned revenue as of and for the periods presented:

		Expected Future Premium Earnings			
In millions	Unearned Premium Revenue	Upfront	Installments	Accretion	Total Expected Future Premium Earnings
Three months ended:					
September 30, 2009	$ 5,122				
December 31, 2009	4,977	76	69	15	160
Twelve months ended:					
December 31, 2010	4,433	288	256	55	599
December 31, 2011	3,944	265	224	51	540
December 31, 2012	3,511	244	189	46	479
December 31, 2013	3,136	226	149	42	417
Five years ended:					
December 31, 2018	1,731	879	526	164	1,569
December 31, 2023	879	536	316	104	956

December 31, 2028 and thereafter	-	505	374	126	1,005
Total		$ 3,019	$ 2,103	$ 603	$ 5,725

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note 5: 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, 2009 and December 31, 2008:

	September 30, 2009		December 31, 2008	
In millions	**Carrying Value**	**Estimated Fair Value**	**Carrying Value**	**Estimated Fair Value**
Assets:				
Fixed-maturity securities held as available-for-sale and held as trading	$ 13,592	$ 13,592	$ 16,763	$ 16,763
Investments held-to-maturity	3,894	3,012	3,656	3,595
Other investments	376	376	220	220
Cash and cash equivalents	1,645	1,645	2,280	2,280
Receivable for investments sold	203	203	77	77
Derivative assets	781	781	911	911
Note receivable	473	473	423	423
Liabilities:				
Investment agreements	2,882	2,972	4,667	5,182
Medium-term notes	3,933	2,189	6,340	4,773
Variable interest entity notes	2,669	2,127	1,792	1,792
Securities sold under agreements to repurchase	502	472	803	758
Long-term debt	2,718	1,581	2,396	1,367
Payable for investments purchased	304	304	0	0
Derivative liabilities	4,989	4,989	6,471	6,471
Warrants	74	74	22	22
Financial Guarantees:				
Gross	6,445	5,900	4,982	6,078
Ceded	420	282	390	407

Valuation Techniques

The valuation techniques for fair valuing financial instruments included in the preceding table are described below. The Company s assets and liabilities recorded at fair value have been categorized according to the fair value hierarchy prescribed by fair value measurements and disclosures.

Fixed-Maturity Securities Held As Available-for-Sale and Held for Trading

U.S. Treasury and government agency U.S. Treasury securities are liquid and generally have quoted market prices. 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 The fair value of foreign government obligations is generally based on observable inputs in active markets. When quoted prices are not available, fair value is determined based on a valuation model that has as inputs interest rate yield curves, cross-currency basis index spreads, and country credit spreads for structures similar to the bond in terms of issuer, maturity and seniority. These bonds 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 while bonds that have quoted prices in an active market are classified as Level 1.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Corporate obligations The fair value of corporate bonds is obtained using recently executed transactions or market price quotations where observable. When observable price quotations are not available, fair value is determined based on cash flow models with yield curves, bond or single name CDS spreads and diversity scores as key inputs. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the hierarchy. Corporate obligations may be classified as Level 1 if quoted prices in an active market are available.

Mortgage-backed securities and asset-backed securities Mortgage-backed securities (MBSs) and ABSs are valued based on recently executed prices. When position-specific external price data is not observable, the valuation is based on prices of comparable securities. In the absence of market prices, MBSs and ABSs are valued as a function of cash flow models with observable market-based inputs (e.g. yield curves, spreads, prepayments and volatilities). MBSs and ABSs are categorized in Level 3 if significant inputs are unobservable, otherwise they are categorized in Level 2 of the fair value hierarchy.

The Company records under the fair value measurement provisions, certain structured investments, which are included in available-for-sale securities. Fair value is derived using quoted market prices or cash flow models. As these securities are not actively traded, certain significant inputs are unobservable. These investments are categorized as Level 3 of the fair value hierarchy.

State and municipal bonds The fair value of state and municipal bonds is estimated using recently executed transactions, market price quotations and pricing models that factor in, where applicable, interest rates, bond or CDS spreads and volatility. These bonds are generally categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3.

Investments Held-To-Maturity

The fair value of investments held-to-maturity is obtained using recently executed transactions or market price quotations where observable. When position-specific external price data is not observable, the valuation is based on prices of comparable securities. When observable price quotations are not available, fair value is determined based on internal cash flow models with yield curves and bond spreads of comparable entities as key inputs.

Other Investments

Other investments include the Company s interest in equity securities (including exchange-traded closed-end funds), money market mutual funds and perpetual securities. Fair value of other investments is determined by using quoted prices, live trades, 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.

Other investments also include premium tax credit investments that are carried at amortized cost. The carrying value of these investments approximates fair value.

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 approximate their fair values as they are short-term in nature.

Note Receivable

The note receivable represents a non-recourse loan secured by collateral pledged by the counterparty to the note receivable. The fair value of the note receivable is calculated as the most recent appraised value of the underlying collateral pledged against the note receivable.

Investment Agreements

The fair values of investment agreements are estimated using discounted cash flow calculations based upon interest rates currently being offered for similar agreements with maturities consistent with those remaining for the investment agreements being valued. These agreements contain collateralization and termination agreements that sufficiently mitigate the nonperformance risk of the Company.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Medium-Term Notes

The fair values of medium-term notes recorded at amortized cost are estimated using discounted cash flow calculations based upon interest rates currently being offered for similar notes with maturities consistent with those remaining for the medium-term notes being valued. Nonperformance risk of the Company is incorporated into the valuation by using the Company s own credit spreads.

The Company has elected to record at fair value four medium-term notes. Fair value of such notes is derived using quoted market prices or an internal cash flow model. 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. These notes are categorized as Level 3 of the fair value hierarchy.

Variable Interest Entity Notes

The fair value of variable interest entity notes is obtained using recently executed transactions or market price quotations where observable. When position-specific external price data is not observable, the valuation is based on prices of comparable securities. When observable price quotations are not available, fair value is determined based on internal cash flow models of the underlying collateral with yield curves and bond spreads of comparable entities as key inputs.

Securities Sold Under Agreements to Repurchase

The fair value is estimated using discounted cash flow calculations based upon interest rates currently being offered for similar agreements. Securities sold under agreements to repurchase include term reverse repurchase agreements that contain credit enhancement provisions via over-collateralization agreements to sufficiently mitigate the nonperformance risk of the Company.

Long-term Debt

Long-term debt consists of long-term notes, debentures, surplus notes, Federal Reserve term asset-backed securities loan facility (TALF) and floating rate liquidity loans. The fair value of long-term notes, debentures, TALF and surplus notes are estimated based on quoted market prices for the same or similar securities. The fair value for floating rate liquidity loans in Triple-A One Funding Corporation (Triple-A One) are estimated using discounted cash flow calculations based upon the underlying collateral pledged to the specific loans, as these loans are non-recourse and fully backed by a pool of underlying assets.

Derivatives Investment Management Services

The investment management services operations have entered into derivative transactions primarily consisting of interest rate, cross currency, credit default and total return swaps and principal protection guarantees. These over-the-counter derivatives are valued using industry standard models developed by vendors. Observable and market-based inputs include interest rate yields, credit spreads and volatilities. These derivatives are categorized as Level 2 within the fair value hierarchy except with respect to certain complex derivatives where observable pricing inputs were not able to be obtained, which have been categorized as Level 3.

In compliance with the requirements of fair value measurements and disclosures, the Company considers its own credit risk and that of counterparties when valuing derivative assets and liabilities. 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 Investment Management Services and Corporate operations. 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 value of the derivatives.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Derivatives Insurance

The derivative contracts that the Company insures cannot be legally traded and generally do not have observable market prices. In the cases with no active price quote, the Company uses a combination of internal and third-party models to estimate the fair value of these contracts. Most insured CDSs are valued using an enhanced Binomial Expansion Technique (BET) model (originally developed by Moody s). Significant inputs include collateral spreads, diversity scores and recovery rates. For a limited number of other insured derivatives, the Company uses industry standard models as well as proprietary models such as Black-Scholes option models and dual-default models, depending on the type and structure of the contract. The valuation of these derivatives includes the impact of its own credit standing and the credit standing of its reinsurers. All of these derivatives are categorized as Level 3 of the fair value hierarchy as a significant percentage of their value is derived from unobservable inputs. For insured swaps (other than CDSs), the Company uses internally and vendor developed models with market-based inputs (e.g. interest rate, foreign exchange rate, spreads), and are classified as Level 2 within the fair value hierarchy.

Insured Derivatives

The majority of the Company s derivative exposure is in the form of credit derivative instruments insured by MBIA Corp. Prior to 2008, MBIA Corp. insured CDSs entered into by LaCrosse Financial Products LLC (LaCrosse), an entity that is consolidated into MBIA s financial statements under the criteria for variable interest entities. In February 2008, the Company ceased insuring such derivative instruments except in transactions reducing its existing insured derivative exposure.

In most cases, the Company s insured credit derivatives are measured at fair value as they do not qualify for the financial guarantee scope exception. Because the Company s insured derivatives are highly customized and there is generally no observable market for these derivatives, the Company estimates their value in a hypothetical market based on internal and third-party models simulating what a bond insurer would charge to guarantee the transaction at the measurement date. This pricing would be based on expected loss of the exposure calculated using the value of the underlying collateral within the transaction structure. The fair values of insured derivatives recorded on our balance sheet are principally related to our insured credit derivatives exposure

Description of MBIA s Insured Derivatives

As of September 30, 2009, we had $124.8 billion of net par outstanding on insured derivatives. The majority of MBIA s insured credit derivatives reference structured pools of cash securities and CDSs. 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 backing the Company s insured derivatives was cash securities and CDSs referencing primarily corporate, asset-backed, residential mortgage-backed, commercial mortgage-backed, commercial real estate (CRE) loans, and CDO securities. As of September 30, 2009, the net par outstanding of such transactions totaled $110.3 billion. The remaining $14.5 billion of net par outstanding on insured credit derivatives as of September 30, 2009 primarily related to insured interest rate and inflation-linked swaps for which we have insured counterparty credit risk.

Most of MBIA s insured CDS contracts require that MBIA make payments for losses of the principal outstanding under the contracts when losses on the underlying referenced collateral exceed a predetermined deductible. MBIA s net par outstanding and maximum payment obligation under these contracts as of September 30, 2009 was $81.5 billion. The underlying referenced collateral for contracts executed in this manner largely consist of investment grade corporate debt, structured commercial mortgage-backed securities (CMBS) pools and, to a lesser extent, corporate and multi-sector CDOs (in CDO-squared transactions). As of September 30, 2009, MBIA also had $28.8 billion of net par outstanding on insured CDS contracts that require MBIA to make timely interest and ultimate principal payments.

The Company also has guarantees under principal protection fund programs, which are also accounted for as derivatives. Under these programs the Company guaranteed the return of principal to investors and is protected by a daily portfolio rebalancing obligation that is designed to minimize the risk of loss to MBIA. As of September 30, 2009, the maximum amount of future payments that the Company would be required to make under these guarantees was $25 million, but the Company has not made any payments to date relating to these guarantees. The unrealized gains (losses) on these derivatives for the years ended 2007 and 2008 and the nine months ended September 30, 2009 were zero, reflecting the extremely remote likelihood that MBIA will incur a loss.

18

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Changes in fair value of the insured derivatives are recorded in Net change in fair value of insured derivatives. The net change in the fair value of the Company s insured derivatives has two primary components; (i) realized gains (losses) and other settlements on insured derivatives and (ii) unrealized gains (losses) on insured derivatives. Realized gains (losses) and other settlements on insured derivatives include (i) net premiums received and receivable on written CDS contracts, (ii) net premiums paid and payable to reinsurers in respect of CDS contracts, (iii) net amounts received or paid on reinsurance commutations, (iv) losses paid and payable to CDS contract counterparties due to the occurrence of a credit event or settlement agreement, (v) losses recovered and recoverable on purchased CDS contracts due to the occurrence of a credit event or commutation agreement and (vi) fees relating to CDS contracts. The Unrealized gains (losses) on insured derivatives include all other changes in fair value of the derivative contracts.

Considerations Regarding an Observable Market for MBIA s Insured Derivatives

In determining fair value, the Company s valuation approach uses observable market prices if available and reliable. Market prices are generally available for traded securities and market standard CDSs but are less available or accurate for highly customized CDSs. Most of the derivative contracts the Company insures are the latter as they are non-traded structured credit derivative transactions. In contrast, typical market CDSs are standardized, liquid instruments that reference tradable securities such as corporate bonds that themselves have observable prices. These market standard CDSs also involve collateral posting, and upon a default of the underlying reference obligation, can be settled in cash.

MBIA s insured CDS contracts do not contain typical CDS market standard features as they have been designed to replicate the Company s financial guarantee insurance policies. At inception of the transactions, the Company s insured CDS instruments provided protection on pools of securities or CDSs with either a stated deductible or subordination beneath the MBIA-insured tranche. The Company is not required to post collateral in any circumstances. Payment by MBIA under an insured CDS is due after the aggregate amount of losses on the underlying reference obligations, based on actual losses as determined pursuant to the settlement procedure in each transaction, exceed the deductible or subordination in the transaction. Once such losses exceed the deductible or the subordination, MBIA is obligated to pay the losses, net of recoveries, if any, on any subsequent reference obligations that default. Some contracts also provide for further deferrals of payment at the Company s option. In the event of MBIA Corp. s failure to pay a claim under the insured CDS or the insolvency of MBIA, the insured CDS contract provides that the counterparty can terminate the CDS and make a claim for the amount due, which would be based on the fair value of the insured CDS at such time. An additional difference between the Company s CDS and typical market standard contracts is that the Company s contract, like its financial guarantee contracts, cannot be accelerated by the counterparty in the ordinary course of business. Similar to the Company s financial guarantee insurance, all insured CDS policies are unconditional and irrevocable and the Company s obligations thereunder cannot be transferred unless the transferees are also licensed to write financial guarantee insurance policies. Since insured CDS contracts are accounted for as derivatives under accounting guidance for derivative instruments and hedging activities, the Company did not defer the charges associated with underwriting the CDS policies and they were expensed at origination.

The Company s payment obligations are structured to prevent large one-time claims upon an event of default of underlying reference obligations and to allow for payments over time (i.e. pay-as-you-go basis) or at final maturity. However, the size of payments will ultimately depend on the timing and magnitude of losses. There are three types of payment provisions:

(i) timely interest and ultimate principal;

(ii) ultimate principal only at final maturity; and

(iii) payments upon settlement of individual referenced collateral losses in excess of policy-specific deductibles and subordination. The deductible or loss threshold is the amount of losses experienced with respect to the underlying or referenced collateral that would be required to occur before a claim against an MBIA insurance policy can be made.

All of the contracts with settlement based on ultimate principal only at final maturity have been terminated under the terms of the agreements. MBIA had transferred some of the risk of loss on insured CDS transactions using reinsurance to other financial guarantee insurance and reinsurance companies. The fair value of the transfer under the reinsurance contract with the reinsurers is accounted for as a derivative asset. These derivative assets are valued consistently with the Company s valuation policies.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Valuation Modeling of MBIA-Insured Derivatives

As a result of the significant differences between market standard CDS contracts and the CDS contracts insured by MBIA, the Company believes there are no relevant third-party exit value market observations for its insured structured credit derivative contracts and, therefore, no principal market as described in the guidance on fair value measurements and disclosures. In the absence of a principal market, the Company values these insured credit derivatives in a hypothetical market where market participants are assumed to be other comparably-rated primary financial guarantors. Since there are no observable transactions in the financial guarantee market that could be used to value the Company s transactions, the Company generally uses internal and third-party models, depending on the type and structure of the contract, to estimate the fair value of its insured derivatives.

The Company s primary model for insured CDSs simulates 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 they 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.

A. Valuation Models Used

Approximately 63% of the balance sheet fair value of insured credit derivatives as of September 30, 2009 is valued using the BET model, which is a probabilistic approach to calculating expected loss on the Company s exposure based on market variables for underlying referenced collateral. During the third quarter of 2009 the Company changed the model it used to estimate the fair value of most of its insured multi-sector CDOs. Previous to the third quarter of 2009, these transactions were valued using the BET model. Beginning with the third quarter of 2009, we valued these transactions using an internally-developed valuation model, referred to as the Direct Price Model. Approximately 37% of the balance sheet fair value of insured credit derivatives as of September 30, 2009 was valued using the Direct Price Model. As a result of the change in model, the fair value of the Company s liability for insured derivatives as of September 30, 2009 was $390 million lower compared to what it would have been using the BET model.

There were four factors that led to the development of the Direct Price Model. (1) Market spreads for RMBS and ABS CDO collateral were no longer available. RMBS and ABS CDO collateral comprised the majority of the collateral for the multi-sector CDOs that were transitioned to a new marking model. Although market prices were available for the collateral, the BET model requires a spread input and the conversion from price to spread can be subjective for securities that trade substantially below par, which was the case for most of the collateral in these transactions. (2) The BET model contemplates a multi-tranche structure and allocates potential losses to each tranche. Many of the multi-sector CDOs insured by MBIA have experienced collateral erosion to the extent that there is no market value to the subordinated tranches. As a result this key feature of the BET model is no longer relevant. (3) The BET model requires a recovery rate assumption. This is not readily observable on all the collateral. As the market-implied probability of default of collateral has increased the recovery rate assumption has become increasingly important, which has gradually increased the relative importance in the model of internal assumptions as opposed to observable market inputs. (4) For all insured transactions that have been transitioned to a new model MBIA has an option to defer losses on principal to the legal final maturity, which is typically decades in the future. As a result of increased actual and market-implied future potential losses, as well as the significant widening of CDS spreads for MBIA, the value of this deferral option has increased. It currently has a very significant effect on the estimated fair value of MBIA s guaranty so it was appropriate to use a model that explicitly valued that deferral option.

B. Description of the BET Model

1. Valuation Model Overview

There are three steps within BET modeling to arrive at fair value for a structured transaction: pool loss estimation, loss allocation to separate tranches of the capital structure and calculation of the change in value.

The pool loss estimation is calculated by reference to the following (described in further detail under Model Inputs below):

credit spreads of the underlying collateral. This is based on actual spreads or spreads on similar collateral with similar ratings, or in some cases is benchmarked;

diversity score of the collateral pool as an indication of correlation of collateral defaults; and

recovery rate for all defaulted collateral.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Losses are allocated to specific tranches of the transaction according to their subordination level within the capital structure.

For example, if the expected total collateral pool loss is 4% and the transaction has an equity tranche and three progressively more senior C, B, and A tranches with corresponding underlying subordination levels of 0%, 3%, 5% and 10%, then the 4% loss will have the greatest impact on the equity tranche. It will have a lower, but significant impact on the C tranche and a lesser impact on the B tranche. MBIA usually insures the most senior triple-A tranche with lowest exposure to collateral losses due to the underlying subordination provided by all junior tranches.

At any point in time, the unrealized gain or loss on a transaction 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 model worth noting are listed below:

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

Defaults are modeled spaced out evenly over time.

Collateral is generally considered on an average basis rather than being modeled separately.

Correlation is modeled using a diversity score, which is calculated based on rules regarding industry or sector concentrations. Recovery rates are based on historical averages and updated based on market evidence.

2. Model Strengths and Weaknesses

The primary strengths of this CDS valuation model are:

1) The model takes account of transaction structure and key drivers of market value. The transaction structure includes par insured, weighted average life, level of deductible or subordination and composition of collateral.

2) The model is a consistent approach to marking positions that minimizes the level of subjectivity. Model structure, inputs and operation are well documented both by Moody s and by MBIA s internal controls, creating a strong controls process in execution of the model. The Company has also developed a hierarchy for usage of various market-based spread inputs that reduces the level of subjectivity, especially during periods of high illiquidity.

3) The model uses market inputs with the most relevant being credit spreads for underlying referenced collateral, assumed recovery rates specific to the type and rating of referenced collateral, and the diversity score of the entire collateral pool. These are key parameters affecting the fair value of the transaction and all inputs are market-based whenever available and reliable.

The primary weaknesses of this CDS valuation model are:

1) There is no market in which to test and verify the fair values generated by the Company s model, and at September 30, 2009, the model inputs were also either unobservable or highly illiquid, adversely impacting their reliability.

2) There are diverse approaches to estimating fair value of such transactions among other financial guarantee insurance companies.

3) The BET model requires an input for collateral spreads. However, some securities are quoted only in price terms. For securities that trade substantially below par, the conversion from price to spread can be subjective.

4) Results may be affected by averaging of spreads and use of a single diversity factor, rather than using specific spreads for each piece of underlying collateral and collateral-specific correlation assumptions. While more specific data could improve the reliability of the results, it is not currently available and neither is a model that could produce more reliable results in the absence of that data.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

3. BET Model Inputs

Specific detail regarding these model inputs are listed below:

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, including in some cases, assumed relationships between the two spreads. 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 actual calculation of pool average spread varies depending on whether the Company is able to use collateral-specific credit spreads or generic spreads as an input.

If collateral-specific spreads are available, the spread for each individual piece of collateral is identified and a weighted average is calculated by weighting each spread by the corresponding par exposure.

If collateral-specific credit spreads are not available, the Company uses generic spread tables based on asset class and average rating of the collateral pool. Average credit rating for the collateral is calculated from the weighted average rating factor (WARF) for the collateral portfolio and then mapped to an appropriate spread. WARF is based on a 10,000 point scale designed by Moody s where lower numbers indicate better credit quality. Ratings are not spaced equally on this scale because the marginal difference in default probability at higher rating quality is much less than at lower rating levels. The Company obtains WARF from the most recent trustee s report or the Company calculates it based on the collateral credit ratings. For a WARF calculation, the Company identifies the credit ratings of all collateral (using, in order of preference as available, Moody s, S&P or Fitch ratings), then converts those credit ratings into a rating factor on the WARF scale, averages those factors (weighted by par) to create a portfolio WARF, and then maps the portfolio WARF back into an average credit rating for the pool. The Company then applies this pool rating to a market spread table or index appropriate for the collateral type to determine the generic spread for the pool, which becomes the market-implied default input into the BET model.

If there is a high dispersion of ratings within a collateral pool, the collateral is segmented into different rating buckets and each bucket is used in calculating the overall average.

When spreads are not available on either a collateral-specific basis or ratings-based generic basis, MBIA uses its hierarchy of spread sources (discussed below) to identify the most appropriate spread for that asset class to be used in the model.

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 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, such as CDS spreads can be driven by speculative activity since the CDS market facilitates both long and short positions without ownership of the underlying security, allowing for significant leverage.

Spread Hierarchy:

1) Actual collateral-specific credit spreads. If up-to-date and reliable market-based spreads are available, they are used.

2) Sector-specific spreads (JP Morgan and Banc of America Securities-Merrill Lynch (BAS-ML) spread tables by asset class and rating).

3) Corporate spreads (Bloomberg and Risk Metrics spread tables based on rating).

4) Benchmark from most relevant spread source (for example, if no specific spreads are available and corporate spreads are not directly relevant, an assumed relationship is used between corporate spreads or sector-specific spreads and collateral spreads). Benchmarking can also be based on a combination of market spread data and fundamental credit assumptions.

For example, if current market-based spreads are not available then the Company applies either sector-specific spreads from spread tables provided by dealers or corporate cash 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. An example is tranched corporate collateral, where the Company applies corporate spreads as an input with an adjustment for its tranched exposure.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

As of September 30, 2009, actual collateral credit spreads were used in one transaction. Sector-specific spreads were used in 12% of the transactions. Corporate spreads were used in 29% of the transactions and spreads benchmarked from the most relevant spread source (number 4 above) were used for 58% of the transactions. When determining the percentages above, there were some transactions where MBIA incorporated multiple levels within the hierarchy. For example, for some transactions MBIA used actual collateral-specific credit spreads (number 1 above) in combination with a calculated spread based on an assumed relationship (number 4 above). In those cases, MBIA classified the transaction as being benchmarked from the most relevant spread source (number 4 above) 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 WARF. No Level 1 spreads are based on WARF, all Level 2 and 3 spreads are based on WARF and some Level 4 spreads are based on WARF. WARF-sourced and/or ratings-sourced credit spread was used for 72% 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 hierarchy, but the Company sometimes moves to lower priority inputs because of discontinued data sources or because the Company considers higher priority inputs no longer representative of market spreads. This occurs when transaction volume changes such that a previously used spread index is no longer viewed to reflect current market levels, as was the case for CMBS collateral in insured CDSs beginning in 2008. Refer to section Input Adjustments for Insured CMBS Derivatives in the Current Market below.

b. Diversity Scores

The diversity score is a measure to estimate 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. For example, if a portfolio of 100 assets had a diversity score of 50, this means that the 100 correlated assets are assumed to have the same loss distribution as 50 uncorrelated 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 but uses MBIA s internal assumptions on default correlation, including variables such as collateral rating and amount, asset type and remaining life.

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. In the first nine months of 2009, the Company lowered recovery rates for CMBS collateral, certain RMBS collateral, and certain Collateralized loan obligation (CLO) collateral. The recovery rates for CLO collateral were lowered in the third quarter of 2009, which increased the Company s liability by $51 million.

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

History of Input Adjustments

Approximately $44.5 billion gross par of MBIA s insured derivative transactions as of September 30, 2009 include substantial amounts of CMBS and commercial mortgage collateral. Prior to 2008, the Company had used spreads drawn from CMBX indices and CMBS spread tables as pricing input on the underlying referenced collateral in these transactions. In 2008, as the financial markets became illiquid, the Company saw a significant disconnect between cumulative loss expectations of market analysts on underlying commercial mortgages, which were based on the continuation of low default and loss rates, and loss expectations implied by the CMBX indices and CMBS spread tables. CMBS collateral in MBIA s insured credit derivatives has performed in line with the market.

In addition, due to financial market uncertainty since last year, transaction volume in CMBS and trading activity in the CMBX were both dramatically lower than in prior periods. The Company also considered that the implied loss rates within the CMBX index were much higher than that forecast by fundamental researchers and MBIA s internal analysis. As a result of these issues, the Company concluded that the CMBX indices and the CMBS spread tables were unreliable model inputs for the purpose of estimating fair value in the Company s hypothetical market among monoline insurers.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

As a result, in the first quarter of 2008, the Company modified the spread used for these transactions to reflect a combination of market spread pricing and third-party fundamental analysis of CMBS credit. The Company s revised spread input was a CMBX index analog that combines expectations for CMBS credit performance (as forecasted by the average of three investment banks research departments) together with the illiquidity premium implied by the CMBX indices. The illiquidity premium the Company used was the senior triple-A tranche spread of the CMBX index that matches the origination vintage of collateral in each transaction. For example, collateral originated in the second half of 2006 used the triple-A tranche spread of the CMBX series 1 as the illiquidity premium. The sum of the illiquidity premium plus the derived credit spread based on the average cumulative net loss estimates of three investment bank s research department was used as a CMBX analog index.

In the third quarter of 2009, MBIA reassessed the reasonableness of CMBX inputs. CMBX levels are now quoted in price terms instead of spread. It was observed that trading activity in CMBX indices is more liquid than in recent quarters. Also there has been some convergence between the loss rates implied by the CMBX indices and that of fundamental analysts. During fundamental assessments, the loss rates for CMBS increased and MBIA concluded that it was again appropriate and reasonable to use CMBX as an input for the BET model.

Current CMBX Input Adjustment

Since CMBX is now quoted in price terms and the BET model requires a spread input, it is necessary to convert CMBX prices to spreads. To do this, 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. At the end of the third quarter of 2009 the highest priced triple-A CMBX index was series 1 and its price was $91.66 corresponding to an illiquidity premium of 8.34%. The Company assumed that the price of each CMBX index has two components: an illiquidity component and a loss component. So 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 for duration. The illiquidity premium was also converted to spreads using the same approach and the CBMX spread was calculated as the sum of those two numbers.

As a result of this change in input spreads for CMBS, the fair value of the Company s liability for insured derivatives as of September 30, 2009 increased by $591 million compared to what it would have been had the Company used the same CMBS input approach that was used in the second quarter of 2009.

During the third quarter of 2009, the Company modified its inputs for RMBS collateral in insured CDO squared transactions because an appropriate source was no longer available for RMBS collateral spreads. Previously, spread levels were provided by securities firms, however, these firms no longer provide this information. As a result, the Company assumed that all RMBS collateral defaulted and there was a recovery based on the current recovery rate assumption. This modification increased the derivative liability for insured derivatives by $103 million.

e. Nonperformance Risk

In compliance with the requirements of fair value measurement, the Company s valuation methodology for insured credit derivative liabilities incorporates the Company s own nonperformance risk and the nonperformance risk of its reinsurers. The Company calculates the fair value by discounting the market value loss estimated through the BET model at discount rates which include MBIA Corp. s and the reinsurers CDS spreads (or an estimate if there is not a traded CDS contract referencing a reinsurer) at September 30, 2009. Prior to the second quarter of 2009, MBIA used the 5-year CDS spread on MBIA Corp. to calculate nonperformance risk. This assumption was compatible with the average life of the CDS portfolio, which was approximately 5 years. In the second quarter, the Company has refined this approach to include a full term structure for CDS spreads. Under the refined approach, the CDS spreads assigned to each deal is based on the weighted average life of the deal.

Beginning in the first quarter of 2009, the Company limited the effective spread on CDS on MBIA so that the derivative liability, after giving effect to nonperformance risk, could not be lower than MBIA s recovery derivative price multiplied by the unadjusted derivative liability.

Prior to the third quarter of 2008, the Company did not apply nonperformance risk to the excess (if any) of insured par over the par value of remaining collateral (such excess referred to as burn-through) within CDS transactions. Most obligations insured by MBIA do not have burn-through, however, an increasing number of multi-sector CDOs insured by MBIA had developed burn-through. As a result, in the third quarter of 2008 the Company began applying its nonperformance calculation to burn-through, which resulted in a reduction of the fair value of

its derivative liability by $683 million. Most of the insured transactions with burn-through are now valued using the Direct Price Model.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

C. Description of Direct Price Model

1. Valuation Model Overview

The Direct Price Model was developed internally to address weaknesses in our BET model specific to valuing insured multi-sector CDOs, as previously discussed. There are three steps in the model. First, market prices are obtained or estimated for all collateral within a transaction. Second, the present value of the market-implied potential losses is calculated for the transaction, assuming that MBIA defers all principal losses to the legal final maturity. This is determined by the contractual terms of each agreement and interest rates. Third, the impact of nonperformance risk is calculated.

2. Model Strengths and Weaknesses

The primary strengths of the Direct Price Model are:

1) The model takes account of transaction structure and key drivers of market value. The transaction structure includes par insured, legal final maturity, level of deductible or subordination (if any) and composition of collateral.

2) The model is a consistent approach to marking positions that minimizes the level of subjectivity. Model structure, inputs and operation are well documented by MBIA s internal controls, creating a strong controls process in execution of the model.

3) The model uses market inputs for each transaction with the most relevant being market prices for collateral, MBIA s CDS and derivative recovery rate level and interest rates. Most of the market inputs are observable.

The primary weaknesses of the Direct Price Model are:

1) There is no market in which to test and verify the fair values generated by our model.

2) There are diverse approaches to estimating fair value of similar transactions among other financial guarantee insurance companies.

3) The model does not take into account potential future volatility of collateral prices. When the market value of collateral is substantially lower than insured par and there is no or little subordination left in a transaction, which is the case for most of the transactions marked with this model, the Company believes this assumption still allows a reasonable estimate of fair value.

3. Model Inputs

a. Collateral prices

MBIA was able to obtain broker quotes for the majority of the collateral. For any collateral not directly priced, a matrix pricing grid was used based on security type and rating. For each security that was not directly priced, an average was used based on securities with the same rating and security type categories.

b. 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. These cash flows were discounted using the libor flat swap curve.

c. 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 rates and the long tenor of these transactions, the derivative recovery rate was used to estimate nonperformance risk for all transactions marked by this model.

D. Overall Model Results

In the current environment the most significant driver of fair value is nonperformance risk. In aggregate, the nonperformance calculation results in a pre-tax derivative liability which is $15.9 billion lower than the liability that would have been estimated if we did not include nonperformance risk in our valuation. Nonperformance risk is a fair value concept and does not contradict the Company s internal view, based on fundamental credit analysis of our 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 would be considered, as would negotiated settlements of existing transactions.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

However, this data has been scarce or non-existent in recent periods. As a result, our recent reviews have focused more on internal consistency and relativity, as well as the reasonableness of modeled results given current market conditions.

The Company believes that it is important to apply its valuation techniques consistently. However, we may consider making changes in the valuation technique if the change results in a measurement that is equally or more representative of fair value under current circumstances.

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 dividends data. As all significant inputs are market-based and observable, warrants are categorized in Level 2 of the fair value hierarchy.

Financial Guarantees

Gross Financial Guarantees The Company estimates the fair value of its gross financial guarantee liability using a discounted cash flow model with significant inputs that include (i) an assumption of expected loss on financial guarantee policies for which case basis reserves have not been established, (ii) the amount of loss expected on financial guarantee policies for which case basis reserves have been established, (iii) the cost of capital reserves required to support the financial guarantee liability, and (iv) the discount rate. 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. The discount rates incorporate the nonperformance risk of the Company. As the Company s gross financial guarantee liability represents its obligation to pay claims under its insurance policies, the Company s calculation of fair value does not consider future installment premium receipts or returns on invested upfront premiums as inputs.

The carrying value of the Company s gross financial guarantee liability consists of deferred premium revenue and loss and LAE reserves as reported on the Company s consolidated balance sheets.

Ceded Financial Guarantees The Company estimates the fair value of its ceded financial guarantee liability by calculating the portion of the gross financial guarantee liability that has been ceded to reinsurers. The carrying value of ceded financial guarantee liability consists of prepaid reinsurance premiums and reinsurance recoverable on paid and unpaid losses as reported on the Company s consolidated balance sheets.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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, 2009 and December 31, 2008:

	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 [1]**	**Balance as of September 30, 2009**
Assets:					
Investments:					
Fixed-maturity investments:					
Taxable bonds:					
U.S. Treasury and government agency	$ 720	$ 91	$ 6	$ -	$ 817
Foreign governments	345	195	72	-	612
Corporate obligations	-	2,312	331	-	2,643
Mortgage-backed securities					
Residential mortgage-backed agency	-	1,739	81	-	1,820
Residential mortgage-backed non-agency	-	620	252	-	872
Commercial mortgage-backed	-	12	32	-	44
Asset-backed securities					
Collateralized debt obligations	-	185	240	-	425
Other asset-backed	-	631	627	-	1,258
Total	1,065	5,785	1,641	-	8,491
State and municipal bonds					
Tax-exempt bonds	-	2,334	64	-	2,398
Taxable bonds	-	750	-	-	750
Total state and municipal bonds	-	3,084	64	-	3,148
Total fixed-maturity investments	1,065	8,869	1,705	-	11,639
Other investments					
Perpetual preferred securities	-	343	62	-	405
Other investments	16	147	25	-	188
Money market securities	1,733	-	-	-	1,733
Total other investments	1,749	490	87	-	2,326
Derivative assets	-	288	779	(286)	781
Total assets	$ 2,814	$ 9,647	$ 2,571	$ (286)	$ 14,746
Liabilities:					
Medium-term notes	$ -	$ -	$ 142	$ -	$ 142

Derivative liabilities	-	413	4,962	(386)	4,989
Other Liabilities:					
Warrants	-	74	-	-	74
Total liabilities	$ -	$ 487	$ 5,104	$ (386)	$ 5,205

(1) - The net effect of cash and counterparty collateral netting is included in the column entitled Counterparty and Cash Collateral Netting.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

	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 [1]**	**Balance as of December 31, 2008**
Assets:					
Investments:					
Fixed-maturity investments:					
Taxable bonds:					
U.S. Treasury and government agency	$ 1,042	$ 194	$ 32	$ -	$ 1,268
Foreign governments	369	336	130	-	835
Corporate obligations	-	2,776	587	-	3,363
Mortgage-backed securities					
Residential mortgage-backed agency	-	1,218	156	-	1,374
Residential mortgage-backed non-agency	-	627	397	-	1,024
Commercial mortgage-backed	-	16	37	-	53
Asset-backed securities					
Collateralized debt obligations	-	365	553	-	918
Other asset-backed	-	79	905	-	984
Total	1,411	5,611	2,797	-	9,819
State and municipal bonds					
Tax-exempt bonds	-	3,011	49	-	3,060
Taxable bonds	-	379	46	-	425
Total state and municipal bonds	-	3,390	95	-	3,485
Total fixed-maturity investments	1,411	9,001	2,892	-	13,304
Other investments					
Perpetual preferred securities	-	275	45	-	320
Other investments	23	40	58	-	121
Money market securities	3,235	-	-	-	3,235
Total other investments	3,258	315	103	-	3,676
Derivative assets	-	613	807	(509)	911
Total assets	$ 4,669	$ 9,929	$ 3,802	$ (509)	$ 17,891
Liabilities:					
Medium-term notes	$ -	$ -	$ 176	$ -	$ 176
Derivative liabilities	-	741	6,305	(575)	6,471
Other Liabilities:					
Warrants	-	22	-	-	22
Total liabilities	$ -	$ 763	$ 6,481	$ (575)	$ 6,669

(1) - The net effect of cash and counterparty collateral netting is included in the column entitled Counterparty and Cash Collateral Netting. As of December 30, 2008, $66 million of cash collateral, which was previously recorded in Other Assets, was included in the derivative liability balance.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Level 3 Analysis

Level 3 assets were $2.6 billion and $3.8 billion as of September 30, 2009 and December 31, 2008, respectively, and represented approximately 17% and 21% of total assets measured at fair value, respectively. Level 3 liabilities were $5.1 billion and $6.5 billion as of September 30, 2009 and December 31, 2008, respectively, and represented approximately 98% and 97% of total liabilities measured at fair value, respectively. The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the three months ended September 30, 2009 and 2008:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended September 30, 2009

In millions	Balance, Beginning of Interim Period	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases, Issuances and Settlements, net	Transfers in (out) of Level 3, net [1]	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held at September 30, 2009
Assets:									
U.S. Treasury and government agency	$ 6	$ -	$ -	$ -	$ -	$ -	$ -	$ 6	$ -
Foreign governments	70	-	-	-	2	-	-	72	-
Corporate obligations	371	(1)	-	55	1	(66)	(29)	331	-
Residential mortgage-backed agency	98	-	-	1	-	(8)	(10)	81	-
Residential mortgage-backed non-agency	252	(1)	-	31	-	(19)	(11)	252	-
Commercial mortgage-backed	37	-	-	5	1	(2)	(9)	32	-
Collateralized debt obligations	414	(23)	-						