MBIA INC
Form 10-Q
May 12, 2014
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 quarterly period ended March 31, 2014

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 þ 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 þ 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.

Large accelerated filer þ 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 þ

As of May 7, 2014, 195,209,782 shares of Common Stock, par value $1 per share, were outstanding.

Table of Contents

Table of Contents

FORWARD-LOOKING AND CAUTIONARY STATEMENTS

This quarterly report of MBIA Inc. (MBIA , the Company , we , us or our) includes statements that are not historical or current facts and are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words believe , anticipate , project , plan , expect , estimate , intend , will likely result , looking forward , or will continue and similar expr forward-looking statements. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. MBIA cautions readers not to place undue reliance on any such forward-looking statements, which speak only to their respective dates. We undertake no obligation to publicly correct or update any forward-looking statement if the Company later becomes aware that such result is not likely to be achieved.

The following are some of the factors that could affect financial performance or could cause actual results to differ materially from estimates contained in or underlying the Company s forward-looking statements:

- increased credit losses or impairments on public finance obligations we insure issued by state, local and territorial governments and finance authorities that are experiencing unprecedented fiscal stress;

- the possibility that MBIA Corp. will have inadequate liquidity to pay expected claims as a result of increased losses on certain structured finance transactions, in particular residential mortgage-backed securities transactions that include a substantial number of ineligible mortgage loans, or a delay or failure in collecting expected recoveries;

- the possibility that loss reserve estimates are not adequate to cover potential claims;

- a disruption in the cash flow from our subsidiaries or an inability to access capital and our exposure to significant fluctuations in liquidity and asset values within the global credit markets as a result of collateral posting requirements;

- our ability to fully implement our strategic plan, including our ability to maintain high stable ratings for National Public Finance Guarantee Corporation and generate investor demand for our financial guarantees;

- deterioration in the economic environment and financial markets in the United States (U.S.) or abroad, and adverse developments in European sovereign credit performance, real estate market performance, credit spreads, interest rates and foreign currency levels;

- the effects of governmental regulation, including insurance laws, securities laws, tax laws, legal precedents and accounting rules; and

- uncertainties that have not been identified at this time.

The above factors provide a summary of and are qualified in their entirety by the risk factors discussed under Risk Factors in Part I, Item 1A of MBIA Inc. s Annual Report on Form 10-K for the year ended December 31, 2013. In addition, refer to Note 1: Business Developments and Risks and Uncertainties in the Notes to Consolidated Financial Statements for a discussion of certain risks and uncertainties related to our financial statements.

Table of Contents

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions except share and per share amounts)

	March 31, 2014	December 31, 2013
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $5,173 and $5,064)	$ 5,200	$ 4,987
Investments carried at fair value	212	204
Investments pledged as collateral, at fair value (amortized cost $329 and $483)	278	424
Short-term investments held as available-for-sale, at fair value (amortized cost $1,318 and $1,203)	1,319	1,204
Other investments (includes investments at fair value of $12 and $11)	16	16
Total investments	7,025	6,835
Cash and cash equivalents	679	1,161
Premiums receivable	1,009	1,051
Deferred acquisition costs	250	260
Insurance loss recoverable	671	694
Assets held for sale	29	29
Deferred income taxes, net	917	1,109
Other assets	200	222
Assets of consolidated variable interest entities:		
Cash	54	97
Investments held-to-maturity, at amortized cost (fair value $2,695 and $2,651)	2,793	2,801
Investments held as available-for-sale, at fair value (amortized cost $35 and $136)	35	136
Fixed-maturity securities at fair value	504	587
Loans receivable at fair value	1,557	1,612
Loan repurchase commitments	364	359
Total assets	**$ 16,087**	**$ 16,953**
Liabilities and Equity		
Liabilities:		
Unearned premium revenue	$ 2,337	$ 2,441
Loss and loss adjustment expense reserves	602	641
Investment agreements	689	700
Medium-term notes (includes financial instruments carried at fair value of $215 and $203)	1,418	1,427
Long-term debt	1,731	1,702
Derivative liabilities	381	1,152
Other liabilities	287	294
Liabilities of consolidated variable interest entities:		
Variable interest entity notes (includes financial instruments carried at fair value of $2,194 and $2,356)	5,012	5,286
Derivative liabilities	5	11

Total liabilities	**12,462**	**13,654**
Commitments and contingencies (See Note 13)		
Equity:		
Preferred stock, par value $1 per share; authorized shares 10,000,000; issued and outstanding none	-	-
Common stock, par value $1 per share; authorized shares 400,000,000; issued shares 281,291,579 and 277,812,430	281	278
Additional paid-in capital	3,115	3,115
Retained earnings	2,545	2,289
Accumulated other comprehensive income (loss), net of tax of $16 and $54	(13)	(86)
Treasury stock, at cost 86,086,648 and 85,562,546 shares	(2,324)	(2,318)
Total shareholders equity of MBIA Inc.	3,604	3,278
Preferred stock of subsidiary and noncontrolling interest	21	21
Total equity	**3,625**	**3,299**
Total liabilities and equity	**$ 16,087**	**$ 16,953**

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

1

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In millions except share and per share amounts)

	Three Months Ended March 31, 2014	2013
Revenues:		
Premiums earned:		
Scheduled premiums earned	$ 69	$ 79
Refunding premiums earned	19	41
Premiums earned (net of ceded premiums of $2 and $2)	88	120
Net investment income	50	38
Fees and reimbursements	4	6
Change in fair value of insured derivatives:		
Realized gains (losses) and other settlements on insured derivatives	(369)	12
Unrealized gains (losses) on insured derivatives	838	(73)
Net change in fair value of insured derivatives	469	(61)
Net gains (losses) on financial instruments at fair value and foreign exchange	(55)	63
Net gains (losses) on extinguishment of debt	1	4
Other net realized gains (losses)	1	-
Revenues of consolidated variable interest entities:		
Net investment income	12	16
Net gains (losses) on financial instruments at fair value and foreign exchange	3	33
Net gains (losses) on extinguishment of debt	4	-
Total revenues	577	219
Expenses:		
Losses and loss adjustment	50	(194)
Amortization of deferred acquisition costs	10	16
Operating	46	106
Interest	54	60
Expenses of consolidated variable interest entities:		
Operating	3	4
Interest	10	12
Total expenses	173	4
Income (loss) before income taxes	404	215
Provision (benefit) for income taxes	148	51
Net income (loss)	**$ 256**	**$ 164**
Net income (loss) per common share:		
Basic	$ 1.33	$ 0.84
Diluted	$ 1.32	$ 0.84
Weighted average number of common shares outstanding:		
Basic	189,033,982	189,111,170
Diluted	190,263,748	190,219,197

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

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

(In millions)

	Three Months Ended March 31, 2014	2013
Net income (loss)	$ 256	$ 164
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities:		
Unrealized gains (losses) arising during the period	105	13
Provision (benefit) for income taxes	38	4
Total	67	9
Reclassification adjustments for (gains) losses included in net income (loss)	2	(25)
Provision (benefit) for income taxes	1	(9)
Total	1	(16)
Available-for-sale securities with other-than-temporary impairments:		
Other-than-temporary impairments and unrealized gains (losses) arising during the period	3	5
Provision (benefit) for income taxes	-	2
Total	3	3
Foreign currency translation:		
Foreign currency translation gains (losses)	(2)	(43)
Reclassification adjustments for (gains) losses included in net income (loss)	4	-
Total other comprehensive income (loss)	73	(47)
Comprehensive income (loss)	**$ 329**	**$ 117**

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 Three Months Ended March 31, 2014

(In millions except share amounts)

	Common Stock		Additional	Retained	Accumulated Other Comprehensive	Treasury Stock		Total Shareholders Equity	Preferred Stock of Subsidiary and Noncontrolling Interest		
	Shares	Amount	Paid-in Capital	Earnings	Income (Loss)	Shares	Amount	of MBIA Inc.	Shares	Amount	Total Equity
Balance, December 31, 2013	**277,812,430**	**$ 278**	**$ 3,115**	**$ 2,289**	**$ (86)**	**(85,562,546)**	**$ (2,318)**	**$ 3,278**	**1,315**	**$ 21**	**$ 3,299**
Net income (loss)	-	-	-	256	-	-	-	256	-	-	256
Other comprehensive income (loss)	-	-	-	-	73	-	-	73	-	-	73
Share-based compensation net of tax of $2	3,479,149	3	-	-	-	(524,102)	(6)	(3)	-	-	(3)
Balance, March 31, 2014	**281,291,579**	**$ 281**	**$ 3,115**	**$ 2,545**	**$ (13)**	**(86,086,648)**	**$ (2,324)**	**$ 3,604**	**1,315**	**$ 21**	**$ 3,625**

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

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In millions)

	Three Months Ended March 31, 2014	2013
Cash flows from operating activities:		
Premiums, fees and reimbursements received	$ 30	$ 54
Investment income received	110	115
Insured derivative commutations and losses paid	(343)	-
Financial guarantee losses and loss adjustment expenses paid	(86)	(115)
Proceeds from recoveries and reinsurance	20	13
Operating and employee related expenses paid	(111)	(84)
Interest paid, net of interest converted to principal	(48)	(61)
Income taxes (paid) received	4	-
Net cash provided (used) by operating activities	(424)	(78)
Cash flows from investing activities:		
Purchases of available-for-sale investments	(325)	(471)
Sales of available-for-sale investments	16	620
Paydowns and maturities of available-for-sale investments	135	148
Purchases of investments at fair value	(386)	(87)
Sales, paydowns and maturities of investments at fair value	452	151
Sales, paydowns and maturities (purchases) of short-term investments, net	219	(103)
Sales, paydowns and maturities of held-to-maturity investments	8	4
Paydowns and maturities of loans	55	69
Consolidation (deconsolidation) of variable interest entities, net	(1)	-
(Payments) proceeds for derivative settlements	(8)	(31)
Collateral (to) from swap counterparty	46	23
Capital expenditures	(1)	-
Net cash provided (used) by investing activities	210	323
Cash flows from financing activities:		
Proceeds from investment agreements	6	8
Principal paydowns of investment agreements	(20)	(39)
Principal paydowns of medium-term notes	(28)	(23)
Principal paydowns of variable interest entity notes	(270)	(246)
Payments for retirement of debt	-	(1)
Net cash provided (used) by financing activities	(312)	(301)
Effect of exchange rate changes on cash and cash equivalents	1	-
Net increase (decrease) in cash and cash equivalents	(525)	(56)
Cash and cash equivalents beginning of period	1,258	990
Cash and cash equivalents end of period	$ 733	$ 934
Reconciliation of net income (loss) to net cash provided (used) by operating activities:		
Net income (loss)	$ 256	$ 164

Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:				
Change in:				
Premiums receivable		41		44
Deferred acquisition costs		10		12
Unearned premium revenue		(107)		(130)
Loss and loss adjustment expense reserves		(39)		(68)
Insurance loss recoverable		23		(229)
Accrued interest payable		27		2
Accrued expenses		(63)		57
Realized (gains) losses and other settlements on insured derivatives		30		-
Unrealized (gains) losses on insured derivatives		(838)		73
Net (gains) losses on financial instruments at fair value and foreign exchange		52		(96)
Deferred income tax provision (benefit)		148		53
Interest on variable interest entities, net		18		24
Other operating		18		16
Total adjustments to net income (loss)		(680)		(242)
Net cash provided (used) by operating activities	$	(424)	$	(78)

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Business Developments and Risks and Uncertainties

Summary

MBIA Inc., together with its consolidated subsidiaries, (collectively, MBIA or the Company) operates one of the largest financial guarantee insurance businesses in the industry and is a provider of asset management and advisory services. These activities are managed through three business segments: United States (U.S.) public finance insurance; structured finance and international insurance; and advisory services. The Company s U.S. public finance insurance business is primarily operated through National Public Finance Guarantee Corporation and its subsidiaries (National), its structured finance and international insurance business is primarily operated through MBIA Insurance Corporation and its subsidiaries (MBIA Corp.), and its asset management and advisory services business is primarily operated through Cutwater Holdings, LLC and its subsidiaries (Cutwater). MBIA Inc. and certain of its subsidiaries also manage certain other business activities, the results of which are reported in the corporate, asset/liability products, and conduit segments. The corporate segment includes revenues and expenses that arise from general corporate activities. While the asset/liability products and conduit businesses represent separate business segments, they may be referred to collectively as wind-down operations as the funding programs managed through those businesses are in wind-down. Refer to Note 10: Business Segments for further information about the Company s reporting segments.

Business Developments

National Ratings and New Business Opportunities

National s ability to write new business and compete with other financial guarantors is largely dependent on the financial strength ratings assigned to National by major rating agencies. During the first quarter of 2014, Standard & Poor s Financial Services LLC (S&P) upgraded National to a rating of AA- with a stable outlook and Moody s Investors Services, Inc. (Moody s) reaffirmed National s rating of Baa1 with a positive outlook.

National seeks to generate shareholder value through appropriate risk adjusted pricing; however, current market conditions and the competitive landscape may limit National s new business opportunities and its abilities to price and underwrite risk with attractive returns. Refer to Risks and Uncertainties below for a discussion of business risks related to National s strategy.

MBIA Inc. Liquidity

MBIA Inc. s liquidity resources support the Company s corporate and asset/liability products segments. The activities of MBIA Inc. consist of holding and managing investments, servicing outstanding corporate debt instruments, servicing investment agreements and medium-term notes (MTNs) issued by MBIA Inc. and its subsidiary, MBIA Global Funding, LLC (GFL), posting collateral under financing and hedging arrangements and investment agreements, making payments and collateral postings related to interest rate swaps, and paying operating expenses. The primary sources of cash within MBIA Inc. used to meet its liquidity needs include available cash and liquid assets not subject to collateral posting requirements, scheduled principal and interest on assets held in its investment portfolio, dividends from subsidiaries and payments under the MBIA group s tax sharing agreement (the Tax Escrow Account) from subsidiaries of the Company once the payments become unrestricted.

As of March 31, 2014, the liquidity position of MBIA Inc., which consists of the liquidity positions of its corporate and asset/liability products segments, was $499 million and comprised cash and liquid assets of $443 million available for general liquidity purposes, excluding the amounts held in the Tax Escrow Account, and $56 million not pledged directly as collateral for its asset/liability products segment. As of December 31, 2013, MBIA Inc. had $359 million of cash and liquid assets comprising $307 million available for general corporate liquidity purposes, excluding the amounts held in the Tax Escrow Account, and $52 million not pledged directly as collateral for its asset/liability products segment. MBIA Inc. s liquidity position has substantially improved during the first quarter of 2014 due to the release of $173 million from the Tax Escrow Account. The Company expects that MBIA Inc. will generate sufficient cash to satisfy its debt obligations and its general corporate needs over time from expected subsidiary dividends and additional anticipated releases from the Tax Escrow Account.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Business Developments and Risks and Uncertainties (continued)

MBIA Corp. Strategic Initiatives

During the first quarter of 2014, the Company continued to focus on the collection of excess spread and put-back recoveries and the mitigation of MBIA Corp. s high risk insurance exposure, primarily through terminations of insurance policies. During the three months ended March 31, 2014, MBIA Corp. commuted $3.8 billion of gross par exposure, primarily comprising structured commercial mortgage-backed securities (CMBS) pools, in which the referenced CMBS were originally rated single-A, commercial real estate (CRE) collateralized debt obligations (CDOs), and first-lien residential mortgage-backed securities (RMBS). The difference between the fair values of the Company s derivative liabilities for the commuted policies and the aggregate cost of the commutation was reflected in earnings for the three months ended March 31, 2014. In connection with this commutation, on February 14, 2014, Moody s placed the current rating of MBIA Corp., B3 with a positive outlook, on review for upgrade.

Risks and Uncertainties

The Company s financial statements include estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The outcome of certain significant risks and uncertainties could cause the Company to revise its estimates and assumptions or could cause actual results to differ from the Company s estimates. While the Company believes it continues to have sufficient capital and liquidity to meet all of its expected obligations, if one or more possible adverse outcomes were to be realized, its financial position, results of operations and cash flows, and its insurance companies statutory capital, could be materially and adversely affected. The discussion below highlights the significant risks and uncertainties that could have a material effect on the Company s financial statements and business objectives in future periods.

U.S. Public Finance Market Conditions

The majority of National s new business is expected to be in the general obligation, tax-backed and revenue bond sectors. In addition to the new issue market, there are attractive opportunities in the secondary market with respect to bonds issued in recent years which were not insured upon issuance and which currently meet National s underwriting criteria. Nonetheless, as a result of intense competition and the diminished use of financial guarantee insurance in the municipal finance market, among other factors, there can be no assurance that National will be able to write business that generates attractive returns. Financial guarantee insurance competes in nearly all instances with the issuer s alternative of foregoing insurance and paying a higher interest rate. If the interest savings from insurance are not greater than the cost, the issuer will generally choose to issue bonds without insurance.

Prevailing interest rate levels can affect demand for financial guarantee insurance. Higher interest rates and higher levels of issuance of new municipal debt in 2014 would present new business opportunities for National in the U.S. public finance market. Lower interest rates are typically accompanied by narrower spreads between insured and uninsured obligations. This is, in part, due to the fact that investors may choose to forego insurance to increase the yield on their investment. Therefore, the purchase of insurance during periods of relatively narrower interest rate spreads will generally provide lower cost savings to the issuer than during periods of relatively wider spreads. These lower cost savings could be accompanied by a corresponding decrease in demand for financial guarantee insurance.

National s insured portfolio continued to perform satisfactorily on the whole, however portions of the obligations that the Company insures were issued by a few of the state and local governments and territories that remain under extreme financial and budgetary stress. In addition, a few of these local governments have filed for protection under the United States Bankruptcy Code or have entered into state statutory proceedings established to assist municipalities in managing through periods of severe fiscal stress. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments on a greater number of the Company s insured transactions. The Company monitors and analyzes each situation closely, and the overall extent and duration of this stress is uncertain.

MBIA Inc. Liquidity

While MBIA Inc. s liquidity position improved during the first quarter of 2014 and management believes that MBIA Inc. has sufficient liquidity resources to meet all of its obligations for the foreseeable future, MBIA Inc. continues to have liquidity risk. If invested asset performance deteriorates or the flow of dividends from subsidiaries is interrupted and/or access to the capital markets is impaired, its liquidity position could be eroded over time. While the Company expects that MBIA Inc. will generate sufficient cash to satisfy its debt obligations and its general corporate needs over time from distributions from its operating subsidiaries and payments under the Tax Escrow Account from subsidiaries of the Company once the payments become unrestricted, there can be no assurance that such sources will generate sufficient cash. In addition, a failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Business Developments and Risks and Uncertainties (continued)

MBIA Corp. Recoveries and Insured Portfolio

The amount and timing of projected collections of excess spread and put-back recoverable from Credit Suisse Securities (USA) LLC, DLJ Mortgage Capital, Inc., and Select Portfolio Servicing Inc. (collectively, Credit Suisse) and the potential of claims from MBIA Corp. s remaining insured CMBS pools and second-lien RMBS are uncertain. Further, the remaining insured portfolio, aside from these exposures, could deteriorate and result in additional significant loss reserves and claim payments. Management s expected liquidity and capital forecasts for MBIA Corp., which include expected excess spread recoveries and put-back recoveries from Credit Suisse, reflect adequate resources to pay claims when due. However, if MBIA Corp. experiences higher than expected claim payments or is unable to terminate the remaining exposures that represent substantial risk to the Company, MBIA Corp. may ultimately have insufficient resources to continue to pay claims, which could cause the New York State Department of Financial Services (NYSDFS) to put MBIA Corp. into a rehabilitation or liquidation proceeding. Such a proceeding could have an adverse impact on MBIA Inc. and would result in material adverse consequences for MBIA Corp., including the termination of insured credit default swaps (CDS) contracts for which counterparties may assert market-based claims, the acceleration of debt obligations issued by affiliates and insured by MBIA Corp., the loss of control of MBIA Corp. to a rehabilitator or liquidator, and unplanned costs. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about MBIA Corp. s loss reserves and recoveries. Management does not believe that a rehabilitation or liquidation proceeding of MBIA Corp. by the NYSDFS will result in a rehabilitation or liquidation proceeding of MBIA UK Insurance Limited.

Note 2: Significant Accounting Policies

The Company has disclosed its significant accounting policies in Note 2: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013. The following significant accounting policies provide an update to those included in the Company s Annual Report on Form 10-K.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, do not include all of the information and disclosures required by 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 year ended December 31, 2013. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the Company s consolidated financial position and results of operations. All material intercompany balances and transactions have been eliminated.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. As additional information becomes available or actual amounts become determinable, the recorded estimates are revised and reflected in operating results.

The results of operations for the three months ended March 31, 2014 may not be indicative of the results that may be expected for the year ending December 31, 2014. The December 31, 2013 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. Certain amounts have been reclassified in the prior year s financial statements to conform to the current presentation. Such reclassifications had no impact on total revenues, expenses, assets, liabilities, shareholders equity, operating cash flows, investing cash flows, or financing cash flows for all periods presented.

8

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 3: Recent Accounting Pronouncements

Recently Adopted Accounting Standards

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (ASU 2013-11)

In July 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2013-11, Income Taxes (Topic 740) Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU 2013-11 requires presentation of an unrecognized tax benefit (UTB) as a reduction to a deferred tax asset when a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward exists in the same tax year and jurisdiction as the UTB. ASU 2013-11 does not affect the recognition or measurement of uncertain tax positions under Income Taxes (Topic 740) and does not affect any related tax disclosures. ASU 2013-11 is effective for interim and annual periods beginning January 1, 2014 with early adoption permitted. The Company previously presented any UTBs as a reduction to a deferred tax asset in accordance with ASU 2013-11 as all of its UTBs relate to the same tax years and jurisdictions in which NOLs exist, therefore, this standard did not affect the Company s consolidated balance sheets, results of operations, or cash flows.

The Company has not adopted any other new accounting pronouncements that had a material impact on its consolidated financial statements. In addition, the Company has reviewed all recently issued, but not yet effective, accounting pronouncements and concluded the future adoption of any such pronouncements will have not have a material impact on the Company s balance sheets, results of operations, or cash flows.

Note 4: Variable Interest Entities

Structured Finance and International Insurance

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

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

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

Wind-down Operations

In its asset/liability products segment, the Company invests in obligations issued by issuer-sponsored SPEs which are included in fixed-maturity securities held as available-for-sale (AFS). The Company evaluates issuer-sponsored SPEs to determine if the entity is a VIE. For all entities determined to be VIEs, the Company evaluates whether its investment is determined to have both of the characteristics of a controlling financial interest in the VIE. The Company performs an ongoing reassessment of controlling financial interests in issuer-sponsored VIEs based on investments held. MBIA s wind-down operations do not have a controlling financial interest in any issuer-sponsored VIEs and are not the primary beneficiary of any issuer-sponsored VIEs.

In the conduit segment, the Company manages and administers a conduit that invested primarily in debt securities and was funded through the issuance of VIE notes. MBIA Corp. insures the debt obligations of this conduit, and provides credit protection on certain assets held by the conduit. The conduit is a VIE and is consolidated by the Company as primary beneficiary.

Nonconsolidated VIEs

Insurance

The following tables present the total assets of nonconsolidated VIEs in which the Company holds a variable interest as of March 31, 2014 and December 31, 2013, through its insurance operations. The following tables also present the Company s maximum exposure to loss for nonconsolidated VIEs and carrying values of the assets and liabilities for its interests in these VIEs as of March 31, 2014 and December 31, 2013. The Company has aggregated nonconsolidated VIEs based on the underlying credit exposure of the insured obligation. The nature of the Company s variable interests in nonconsolidated VIEs is related to financial guarantees, insured CDS contracts and any investments in obligations issued by nonconsolidated VIEs.

			March 31, 2014					
			Carrying Value of Assets			Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Investments(1)	Premiums Receivable(2)	Insurance Loss Recoverable(3)	Unearned Premium Revenue(4)	Loss and Loss Adjustment Expense Reserves(5)	Derivative Liabilities(6)
Insurance:								

Global structured finance:								
Collateralized debt obligations	$ 9,371	$ 6,516	$ 125	$ 34	$ -	$ 29	$ 15	$ 91
Mortgage-backed residential	16,247	8,537	12	50	639	48	327	5
Mortgage-backed commercial	634	332	-	1	-	1	-	-
Consumer asset-backed	5,486	2,513	-	18	-	17	11	-
Corporate asset-backed	11,481	6,069	1	67	18	82	-	-
Total global structured finance	43,219	23,967	138	170	657	177	353	96
Global public finance	53,364	20,219	-	200	-	242	6	-
Total insurance	$ 96,583	$ 44,186	$ 138	$ 370	$ 657	$ 419	$ 359	$ 96

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

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

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

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

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

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

			December 31, 2013					
			Carrying Value of Assets			Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Investments(1)	Premiums Receivable(2)	Insurance Loss Recoverable(3)	Unearned Premium Revenue(4)	Loss and Loss Adjustment Expense Reserves(5)	Derivative Liabilities(6)
Insurance:								
Global structured finance:								
Collateralized debt obligations	$ 12,565	$ 7,693	$ 120	$ 43	$ -	$ 37	$ 21	$ 108
Mortgage-backed residential	21,738	9,251	10	53	658	51	327	5
Mortgage-backed commercial	1,367	447	-	1	-	1	-	-
Consumer asset-backed	7,830	2,740	9	19	-	19	13	-
Corporate asset-backed	13,028	7,248	2	80	18	96	-	-
Total global structured finance	56,528	27,379	141	196	676	204	361	113
Global public finance	52,317	20,162	-	206	-	248	5	-
Total insurance	$ 108,845	$ 47,541	$ 141	$ 402	$ 676	$ 452	$ 366	$ 113

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

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

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

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

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

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

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

Consolidated VIEs

The carrying amounts of assets and liabilities of consolidated VIEs were $5.3 billion and $5.0 billion, respectively, as of March 31, 2014, and $5.6 billion and $5.3 billion, respectively, as of December 31, 2013. The carrying amounts of assets and liabilities are presented separately in

Assets of consolidated variable interest entities and Liabilities of consolidated variable interest entities on the Company s consolidated balance sheets. Additional VIEs are consolidated or deconsolidated based on an ongoing reassessment of controlling financial interest, when events occur or circumstances arise, and whether the ability to exercise rights that constitute power to direct activities of any VIEs are present according to the design and characteristics of these entities. No additional VIEs were consolidated for the three months ended March 31, 2014, and 2013, respectively. There was an immaterial amount of net realized gains recorded for the three months ended March 31, 2014 and no realized gains or losses recorded for the three months ended March 31, 2013 related to the deconsolidation of VIEs.

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

Note 5: Loss and Loss Adjustment Expense Reserves

Loss and Loss Adjustment Expense Process

U.S. Public Finance

U.S. public finance insured transactions consist of 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. The Company estimates future losses by utilizing probability-weighted scenarios that are customized to each insured transaction. Future loss estimates consider debt service due for each insured transaction, which includes par outstanding and interest due.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

As of March 31, 2014 and December 31, 2013, the Company established loss and loss adjustment expense (LAE) reserves totaling $62 million and $87 million, respectively and insurance loss recoverable of $9 million and $13 million, respectively. For the three months ended March 31, 2014, losses and LAE incurred was a benefit of $14 million, primarily related to certain general obligation bonds.

Certain local governments remain under extreme financial and budgetary stress and a few have filed for protection under the United States Bankruptcy Code, or have entered into state statutory proceedings established to assist municipalities in managing through periods of severe fiscal stress. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments on a greater number of the Company s insured transactions. The Company monitors and analyzes these situations closely, however, the overall extent and duration of such events are uncertain and the filing for protection under the United States Bankruptcy Code or entering state statutory proceedings does not result in a default or indicate that an ultimate loss will occur. As of March 31, 2014 and December 31, 2013, the Company had $120.1 billion and $124.9 billion, respectively, of gross par outstanding on general obligations, of which $161 million was reflected on the Company s Classified List. Capital appreciation bonds are reported at the par amount at the time of issuance of the insurance policy.

Structured Finance and International

As of March 31, 2014, the majority of the structured finance and international insurance segment s case basis reserves and insurance loss recoveries recorded in accordance with GAAP were related to insured second and first-lien RMBS transactions. These reserves and recoveries do not include estimates for policies insuring credit derivatives or losses and recoveries on financial guarantee VIEs that are eliminated in consolidation. Policies insuring credit derivative contracts are accounted for as derivatives and carried at fair value under GAAP. The fair values of insured derivative contracts are influenced by a variety of market and transaction-specific factors that may be unrelated to potential future claim payments under the Company s insurance policies. In the absence of credit impairments on insured derivative contracts or the early termination of such contracts at a loss, the cumulative unrealized losses recorded from fair valuing these contracts should reverse before or at the maturity of the contracts.

Notwithstanding the difference in accounting under GAAP for financial guarantee policies and the Company s insured derivatives, insured derivatives have similar terms, conditions, risks, and economic profiles to financial guarantee insurance policies, and therefore, are evaluated by the Company for loss (referred to as credit impairment herein) and LAE periodically in a manner similar to the way that loss and LAE reserves are estimated for financial guarantee insurance policies. Credit impairments represent actual payments and collections plus the present value of estimated expected future claim payments, net of recoveries. MBIA Corp. s expected future claim payments for insured derivatives were discounted using a rate of 5.09%, the same rate it used to calculate its statutory loss reserves as of March 31, 2014. MBIA UK Insurance Limited used a rate of 2.50% to discount its expected future claim payments and statutory loss reserves. These credit impairments, calculated in accordance with statutory accounting principles (U.S. STAT) differ from the fair values recorded in the Company s consolidated financial statements. The Company considers its credit impairment estimates as critical information for investors as it provides information about loss payments the Company expects to make on insured derivative contracts. As a result, the following loss and LAE process discussion includes information about loss and LAE activity recorded in accordance with GAAP for financial guarantee insurance policies and credit impairments estimated in accordance with U.S. STAT for insured derivative contracts. Refer to Note 6: Fair Value of Financial Instruments included herein for additional information about the Company s insured credit derivative contracts.

RMBS Case Basis Reserves and Recoveries (Financial Guarantees)

The Company s RMBS reserves and recoveries relate to financial guarantee insurance policies. The Company calculated RMBS case basis reserves as of March 31, 2014 for both second and first-lien RMBS transactions using a process called the Roll Rate Methodology. The Roll Rate Methodology is a multi-step process using a database of loan level information, a proprietary internal cash flow model, and a commercially available model to estimate losses on insured bonds. Roll Rate is defined as the probability that current loans become delinquent and that loans in the delinquent pipeline are charged-off or liquidated. Generally, Roll Rates are calculated for the previous three months and averaged. The loss reserve estimates are based on a probability-weighted average of three scenarios of loan losses (base case, stress case, and an additional stress case).

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Second-lien RMBS Reserves

The Company s second-lien RMBS case basis reserves as of March 31, 2014 relate to RMBS backed by home equity lines of credit (HELOC) and closed-end second mortgages (CES).

The Roll Rates for 30-59 day delinquent loans and 60-89 day delinquent loans are calculated on a transaction-specific basis. The Company assumes that the Roll Rate for 90+ day delinquent loans, excluding foreclosures and Real Estate Owned (REO) is 95%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of February 28, 2014 to estimate future losses from loans that are delinquent as of the current reporting period.

Roll Rates for loans that are current as of February 28, 2014 (Current Roll to Loss) are also calculated on a transaction-specific basis. A proportion of loans reported current as of February 28, 2014 is assumed to become delinquent every month, at a Current Roll to Loss rate that persists at a high level for a time and subsequently starts to decline. A key assumption in the model is the period of time in which the Company projects high levels of Current Roll to Loss to persist. The Company runs multiple scenarios, each with varying periods of time, for which the high levels of Current Roll to Loss rates persist. Loss reserves are calculated by using a weighted average of these scenarios, with the majority of the probability assigned to stressful scenarios where the high levels of Current Roll to Loss rates persist for six or twenty four months before reverting to historic levels. For example, in the base case scenario, the Company assumes that the Current Roll to Loss begins to decline immediately and continues to decline over the next six months to 25% of their levels as of February 28, 2014. If the amount of current loans which become 30-59 days delinquent is 10%, and recent performance suggests that 30% of those loans will be charged-off, the Current Roll to Loss for the transaction is 3%. In the base case, the Current Roll to Loss will then reduce linearly to 25% of its original value over the next six months (i.e., 3% will linearly reduce to 0.75% over the six months from March 2014 to August 2014). After that six-month period, the Company further reduces the Current Roll to Loss to 0% by late-2014 with the expectation that the performing seasoned loans will eventually result in loan performance reverting to lower levels of default consistent with history. In developing multiple loss scenarios, stress is applied by elongating the Current Roll to Loss rate for various periods, simulating a slower improvement in the transaction performance.

In addition, in the Company s loss reserve models for transactions secured by HELOCs, the Company considers borrower draw and prepayment rates and factors that could affect the excess spread generated by current loans, which offsets losses and reduces payments. For HELOCs, the current three-month average draw rate is generally used to project future draws on the line. For HELOCs and transactions secured by fixed-rate CES, the Company uses historical average voluntary prepayment rates to model its loss reserves. For HELOCs, projected cash flows are also based on an assumed constant basis spread between floating rate assets and floating rate insured debt obligations (the difference between prime and London Interbank Offered Rate (LIBOR) interest rates, minus any applicable fees). For all transactions, cash flow models consider allocations and other structural aspects, including managed amortization periods, rapid amortization periods and claims against MBIA Corp. s insurance policy consistent with such policy s terms and conditions. The estimated net claims from the procedure above are then discounted using a risk-free rate to a net present value reflecting MBIA s general obligation to pay claims over time and not on an accelerated basis. The above assumptions represent MBIA s probability-weighted estimates of how transactions will perform over time.

As of March 31, 2014 and December 31, 2013, the Company established loss and LAE reserves totaling $109 million and $126 million, respectively, related to second-lien RMBS issues after the elimination of $38 million and $43 million, respectively, as a result of consolidating VIEs. For the three months ended March 31, 2014, the Company incurred $25 million of losses and LAE recorded in earnings related to second-lien RMBS issues after the elimination of a $12 million expense as a result of consolidating VIEs.

The Company monitors portfolio performance on a monthly basis against projected performance, reviewing delinquencies, Roll Rates, and prepayment rates (including voluntary and involuntary). However, loan performance remains difficult to predict and losses may exceed expectations. In the event of a material deviation in actual performance from projected performance, the Company would increase or decrease the case basis reserves accordingly. If actual performance were to remain at the peak levels for six additional months compared to the probability-weighted outcome currently used by the Company, the addition to the case basis reserves would be approximately $70 million.

Second-lien RMBS Recoveries

The Company primarily records two types of recoveries related to insured second-lien RMBS exposures: put-back claims related to those mortgage loans whose inclusion in insured securitizations failed to comply with representations and warranties (ineligible loans) and excess spread that is generated from performing loans in the insured transactions.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Excess Spread

As of March 31, 2014 and December 31, 2013, the Company recorded estimated recoveries of $651 million and $681 million, respectively, for the reimbursement of past and future expected claims through excess spread in insured second-lien RMBS transactions. As of March 31, 2014 and December 31, 2013, $626 million and $647 million, respectively, was included in Insurance loss recoverable and $25 million and $34 million, respectively, was included in Loss and loss adjustment expense reserves on the Company s consolidated balance sheets.

Excess spread is generated by performing loans within insured second-lien RMBS securitizations and is the difference between interest inflows on mortgage loan collateral and interest outflows on insured beneficial interests. The amount of excess spread depends on the future loss trends (which include future delinquency trends, average time to charge-off delinquent loans, and the availability of pool mortgage insurance), the future spread between prime and LIBOR interest rates; and borrower refinancing behavior which results in voluntary prepayments. Minor deviations in loss trends and voluntary prepayments may substantially impact the amounts collected from excess spread and caused the reduction in estimated recoveries during the first quarter of 2014.

Ineligible Mortgage Loans

To date, MBIA has settled the majority of the Company s put-back claims, with its claims against only Credit Suisse remaining as outstanding. The settlement amounts have been consistent with the put-back recoveries previously included in the Company s financial statements. Additional information on the status of the litigation against Credit Suisse can be found within Note 13: Commitments and Contingencies.

The contract claim remaining with Credit Suisse is related to the inclusion of ineligible mortgage loans in the 2007-2 Home Equity Mortgage Trust (HEMT) securitization. Credit Suisse has challenged the Company s assessment of the ineligibility of individual mortgage loans and the dispute is the subject of litigation for which there is no assurance that the Company will prevail.

As of March 31, 2014 and December 31, 2013, the Company recorded estimated recoveries of $364 million and $359 million, respectively, related to second-lien RMBS put-back claims on ineligible mortgage loans, reflected in Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company s consolidated balance sheets.

The Company believes that it will prevail in enforcing its contractual put-back rights against Credit Suisse. Based on the Company s assessment of the strength of these claims, the Company believes it is entitled to collect the full amount of its incurred losses, which totaled $423 million through March 31, 2014. The Company is entitled to collect interest on amounts paid. However, uncertainty remains with respect to the ultimate outcome of the litigation with Credit Suisse, which is contemplated in the scenario based-modeling the Company utilizes. The Credit Suisse recovery scenarios are based on the amount of incurred losses measured against certain probabilities of ultimate resolution of the dispute with Credit Suisse over the inclusion of ineligible mortgage loans in the HEMT securitization. Most of the probability weight is assigned to partial recovery scenarios and are discounted using the current risk-free discount rates associated with the underlying transaction s cash flows.

The Company frequently reviews the approach and assumptions it applies to calculate put-back recoveries. Refer to Note 5: Loss and Loss Adjustment Expense Reserves in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013, for the Company s assessment of the remaining unsettled recoveries related to insured Credit Suisse second-lien RMBS.

First-lien RMBS Reserves

The Company s first-lien RMBS case basis reserves as of March 31, 2014, which primarily relate to RMBS backed by Alternative A-paper and subprime mortgage loans, were determined using the Roll Rate Methodology. The Company assumes that the Roll Rate for loans in foreclosure, REO and bankruptcy are 90%, 90% and 75%, respectively. Roll Rates for current, 30-59 day delinquent loans, 60-89 day delinquent loans and 90+ day delinquent loans are calculated on a transaction-specific basis. The Current Roll to Loss rates stay at the February 28, 2014 level for one month before declining to 25% of this level over a 24-month period.

The Company estimates future losses by utilizing three different probability-weighted scenarios: base; stress; and additional stress. The three scenarios differ in the Roll Rates to loss of 90+ day delinquent loans. In the base scenario, the Company uses deal-specific Roll Rates obtained from historic loan level Roll Rate data for 90+ day delinquent loans. In the stress scenario, the Company assumes a 90% Roll Rate for all 90+ day delinquent loans. In the additional stress scenario, the Roll Rates for each deal are an average of the deal-specific Roll Rate used in the base scenario and the 90% rate. The Roll Rates are applied to the amounts in each deal s respective 90+ delinquency bucket based on delinquencies as of February 28, 2014 in order to estimate future losses from loans that are delinquent as of March 31, 2014.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

In calculating ultimate cumulative losses for first-lien RMBS, the Company estimates the amount of loans that are expected to be liquidated through foreclosure or short sale. The time to liquidation for a defaulted loan is specific to the loan s delinquency bucket, with the latest three-month average loss severities generally used to start the projection for trends in loss severities at loan liquidation. The loss severities are reduced over time to account for reduction in the amount of foreclosure inventory, anticipated future increases in home prices, principal amortization of the loan and government foreclosure moratoriums.

As of March 31, 2014, the Company established loss and LAE reserves totaling $246 million related to first-lien RMBS issues. As of December 31, 2013, the Company established loss and LAE reserves totaling $241 million related to first-lien RMBS issues after the elimination of $2 million as a result of consolidating VIEs. For the three months ended March 31, 2014, the Company incurred $30 million of losses and LAE recorded in earnings related to first-lien RMBS issues after the elimination of a $2 million benefit as a result of consolidating VIEs.

ABS CDOs (Financial Guarantees and Insured Derivatives)

MBIA s insured asset-backed securities (ABS) CDOs are transactions that include a variety of collateral ranging from corporate bonds to structured finance assets (which includes but are not limited to RMBS related collateral, ABS CDOs, corporate CDOs and collateralized loan obligations). These transactions were insured as either financial guarantee insurance policies or credit derivatives with the majority currently insured in the form of financial guarantees. Since the fourth quarter of 2007, MBIA s insured par exposure within the ABS CDO portfolio has been substantially reduced through a combination of terminations and commutations. Accordingly, as of March 31, 2014, the insured par exposure of the ABS CDO financial guarantee insurance policies and credit derivatives portfolio has declined by approximately 96% of the insured amount as of December 31, 2007.

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

The primary factor in estimating reserves on insured ABS CDO policies written as financial guarantee insurance policies and in estimating impairments on insured ABS CDO credit derivatives is the losses associated with the underlying collateral in the transactions. MBIA s approach to establishing reserves or impairments in this portfolio employs a methodology which is similar to other structured finance asset classes insured by MBIA. The Company utilizes up to a total of five probability-weighted scenarios in order to estimate its reserves or impairments for ABS CDOs.

As of March 31, 2014 and December 31, 2013, the Company established loss and LAE reserves totaling $120 million and $115 million, respectively, related to ABS CDO financial guarantee insurance policies after the elimination of $236 million and $226 million, respectively, as a result of consolidating VIEs. For the three months ended March 31, 2014, the Company incurred $6 million of losses and LAE recorded in earnings related to ABS CDO financial guarantee insurance policies after the elimination of a $10 million expense as a result of consolidating VIEs. In the event of further deteriorating performance of the collateral referenced or held in ABS CDO transactions, the amount of losses estimated by the Company could increase substantially.

Credit Impairments Related to Structured CMBS Pools, CRE CDOs and CRE Loan Pools (Financial Guarantees and Insured Derivatives)

MBIA s insured CRE transactions comprise structured CMBS pools, CRE CDOs and CRE loan pools. The majority of this portfolio is accounted for as insured credit derivatives and carried at fair value in the Company s consolidated financial statements. Refer to Note 8: Derivative Instruments for a further discussion of the Company s use of derivatives and their impact on the Company s consolidated financial statements. Since the Company s insured credit derivatives have similar terms, conditions, risks, and economic profiles to its financial guarantee insurance policies, the Company evaluates them for impairment in the same way that it estimates loss and LAE for its financial guarantee policies. The following discussion provides information about the Company s process for estimating credit impairments on these contracts using its statutory loss reserve methodology, determined as the present value of the probability-weighted potential future losses, net of estimated recoveries, across multiple scenarios, plus actual payments and collections.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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

1. A commutation scenario that is customized by counterparty and considers historical commutation prices, the level of dialogue with the counterparty and the credit quality and payment profile of the underlying exposure.

2. Utilize current delinquency rates and current and projected net operating income (NOI) and capitalization rates (Cap Rates) to project losses under two scenarios. These scenarios assume that property performance remains flat for the near term and then improves gradually. Additionally, certain large loans are reviewed individually so that performance and loss severity can be more accurately determined, while other loans are also reviewed for factors that may impact potential performance.

3. A proprietary model was developed by reviewing performance data on over 80,000 securitized CRE loans originated between 1992 and 2011. The Company found property type and the debt service coverage ratio to be the most significant determinants of a loan s average annual default probability, and developed a model based on these factors. The Company then ran Monte Carlo simulations to estimate the timing of defaults and losses at the property level by applying property type-based Cap Rates to estimate the property s NOI.

The loss severities projected by these approaches vary widely. Actual losses will be a function of the proportion of loans in the pools that are foreclosed and liquidated and the loss severities associated with those liquidations.

For the three months ended March 31, 2014, additional credit impairments and LAE for insured derivatives on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be $20 million as a result of additional delinquencies and loan level liquidations, as well as continued refinements of MBIA s assessment of various commutation possibilities. The cumulative credit impairments and LAE on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be $4.2 billion through March 31, 2014. Since 2013, the Company has been paying claims on a CMBS pool transaction that had experienced deterioration such that all remaining deductible was eliminated.

Loss and LAE Activity

Financial Guarantee Insurance Losses (Non-Derivative and Non-Consolidated VIEs)

The Company s financial guarantee insurance losses and LAE for the three months ended March 31, 2014 are presented in the following table:

	Three Months Ended March 31, 2014			
In millions	**Second-lien RMBS**	**First-lien RMBS**	**Other[1]**	**Total**
Losses and LAE related to expected payments	$ 7	$ 28	$ (12)	$ 23
Recoveries of expected payments	18	2	8	28

Gross losses incurred	25	30	(4)	51
Reinsurance	-	-	(1)	(1)
Losses and LAE	$ 25	$ 30	$ (5)	$ 50

(1) - Includes ABS CDOs, CMBS, U.S. public finance and other issues.

The losses and LAE related to expected payments in the preceding table primarily related to increases in previously established reserves on insured first-lien RMBS transactions. The recoveries of expected payments primarily related to decreases in excess spread within the insured second-lien RMBS securitizations.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of March 31, 2014:

	Surveillance Categories				
$ in millions	**Caution List Low**	**Caution List Medium**	**Caution List High**	**Classified List**	**Total**
Number of policies	208	16	5	193	422
Number of issues[1]	30	12	4	140	186
Remaining weighted average contract period (in years)	11.6	4.6	11.3	8.7	9.8
Gross insured contractual payments outstanding:[2]					
Principal	$ 7,585	$ 1,008	$ 40	$ 7,399	$ 16,032
Interest	5,356	229	23	3,942	9,550
Total	$ 12,941	$ 1,237	$ 63	$ 11,341	$ 25,582
Gross Claim Liability	$ -	$ -	$ -	$ 1,166	$ 1,166
Less:					
Gross Potential Recoveries	-	-	-	1,006	1,006
Discount, net[3]	-	-	-	217	217
Net claim liability (recoverable)	$ -	$ -	$ -	$ (57)	$ (57)
Unearned premium revenue	$ 137	$ 18	$ -	$ 89	$ 244

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

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

(3) - Represents discount related to Gross Claim Liability and Gross Potential Recoveries.

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of December 31, 2013:

	Surveillance Categories				
$ in millions	**Caution**	**Caution List**	**Caution List**	**Classified List**	**Total**

	List Low	Medium	High		
Number of policies	83	19	5	192	299
Number of issues[1]	26	14	4	136	180
Remaining weighted average contract period (in years)	11.0	4.9	11.5	9.5	9.7
Gross insured contractual payments outstanding:[2]					
Principal	$ 5,290	$ 1,073	$ 40	$ 7,861	$ 14,264
Interest	3,829	253	24	4,526	8,632
Total	$ 9,119	$ 1,326	$ 64	$ 12,387	$ 22,896
Gross Claim Liability	$ -	$ -	$ -	$ 1,235	$ 1,235
Less:					
Gross Potential Recoveries	-	-	-	1,085	1,085
Discount, net[3]	-	-	-	205	205
Net claim liability (recoverable)	$ -	$ -	$ -	$ (55)	$ (55)
Unearned premium revenue	$ 112	$ 19	$ -	$ 96	$ 227

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

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

(3) - Represents discount related to Gross Claim Liability and Gross Potential Recoveries.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

The gross claim liability in the preceding tables represents the Company s estimate of undiscounted probability-weighted future claim payments. As of March 31, 2014 and December 31, 2013, the gross claim liability primarily related to insured first and second-lien RMBS issues, ABS CDOs and an international road transaction.

The gross potential recoveries represent the Company s estimate of undiscounted probability-weighted recoveries of actual claim payments and recoveries of estimated future claim payments. As of March 31, 2014, the gross potential recoveries principally related to insured second-lien RMBS issues. As of December 31, 2013, the gross potential recoveries principally related to insured second-lien RMBS and U.S. public finance issues. The Company s recoveries have been, and remain based on either salvage rights, the rights conferred to MBIA through the transactional documents (inclusive of the insurance agreement), or subrogation rights embedded within financial guarantee insurance policies. Expected salvage and subrogation recoveries, as well as recoveries from other remediation efforts, reduce the Company s claim liability. Once a claim payment has been made, the claim liability has been satisfied and MBIA s right to recovery is no longer considered an offset to future expected claim payments, it is recorded as a salvage asset. The amount of recoveries recorded by the Company is limited to paid claims plus the present value of projected future claim payments. As claim payments are made, the recorded amount of potential recoveries may exceed the remaining amount of the claim liability for a given policy. The gross claim liability and gross potential recoveries reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by the Company.

The following table presents the components of the Company s loss and LAE reserves and insurance loss recoverable as reported on the Company s consolidated balance sheets as of March 31, 2014 and December 31, 2013 for insured obligations within MBIA s Classified List. The loss reserves (claim liability) and insurance claim loss recoverable included in the following table represent the present value of the probability-weighted future claim payments and recoveries reported in the preceding tables.

In millions	As of March 31, 2014		As of December 31, 2013	
Loss reserves (claim liability)	$	555	$	580
LAE reserves		47		61
Loss and LAE reserves	$	602	$	641
Insurance claim loss recoverable	$	(671)	$	(694)
LAE insurance loss recoverable		-		-
Insurance loss recoverable	$	(671)	$	(694)
Reinsurance recoverable on unpaid losses	$	7	$	7
Reinsurance recoverable on unpaid LAE reserves		-		1
Reinsurance recoverable on paid and unpaid losses	$	7	$	8

As of March 31, 2014, loss and LAE reserves include $784 million of reserves for expected future payments offset by expected recoveries of such future payments of $182 million. As of December 31, 2013, loss and LAE reserves included $847 million of reserves for expected future payments offset by expected recoveries of such future payments of $206 million. As of March 31, 2014 and December 31, 2013, the insurance loss recoverable primarily related to expected future recoveries on second-lien RMBS transactions resulting from excess spread generated by performing loans in such transactions.

The decrease in insurance loss recoverable was primarily due to decreases in excess spread within insured second-lien RMBS securitizations.

The following table presents the amounts of the Company s second-lien RMBS exposure, gross undiscounted claim liability and potential recoveries related to non-consolidated VIEs and consolidated VIEs, included in the Company s Classified List, as of March 31, 2014:

Second-lien RMBS Exposure		**Outstanding**		**Gross Undiscounted**	
		Gross	**Gross**	**Claim**	**Potential**
$ in billions	**Issues**	**Principal**	**Interest**	**Liability**	**Recoveries**
Non-consolidated VIEs	24	$ 3.3	$ 1.2	$ 0.1	$ 0.7
Consolidated VIEs	11	$ 1.7	$ 0.6	$ 0.1	$ 0.6

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

The following table presents changes in the Company s loss and LAE reserves for the three months ended March 31, 2014. Changes in the loss and LAE reserves attributable to the accretion of the claim liability discount, changes in discount rates, changes in amount and timing of estimated payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations. As of March 31, 2014, the weighted average risk-free rate used to discount the Company s loss reserves (claim liability) was 2.12%. LAE reserves are expected to be settled within a one-year period and are not discounted.

In millions	Changes in Loss and LAE Reserves for the Three Months Ended March 31, 2014							
Gross Loss and LAE Reserves as of December 31, 2013	Loss Payments for Cases with Reserves	Accretion of Claim Liability Discount	Changes in Discount Rates	Changes in Assumptions	Changes in Unearned Premium Revenue	Changes in LAE Reserves	Other(1)	Gross Loss and LAE Reserves as of March 31, 2014
$ 641	$ (66)	$ 4	$ 20	$ 20	$ -	$ (14)	$ (3)	$ 602

(1) - Primarily changes in amount and timing of payments.

The decrease in the Company s gross loss and LAE reserves reflected in the preceding table was primarily related to loss payments and changes in LAE reserves associated with issues outstanding as of December 31, 2013. These were partially offset by increases in reserves due to changes in discount rate and changes in assumptions on insured first and second-lien RMBS issues outstanding as of December 31, 2013.

Current period changes in the Company s estimate of potential recoveries may be recorded as an insurance loss recoverable asset, netted against the gross loss and LAE reserve liability, or both. The following tables present changes in the Company s insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company s claim liability for the three months ended March 31, 2014. Changes in insurance loss recoverable attributable to the accretion of the discount on the recoverable, changes in discount rates, changes in amount and timing of estimated collections, changes in assumptions and changes in LAE recoveries are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations.

In millions	Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses for the Three Months Ended March 31, 2014							
	As of December 31, 2013	Collections for Cases	Accretion of Recoveries	Changes in Discount	Changes in Assumptions	Changes in LAE Recoveries	Other(1)	As of March 31, 2014

		with Recoveries		Rates				
Insurance loss recoverable	$ 694	$ (17)	$ 4	$ 6	$ (7)	$ -	$ (9)	$ 671
Recoveries on unpaid losses	206	-	1	7	(32)	-	-	182
Total	$ 900	$ (17)	$ 5	$ 13	$ (39)	$ -	$ (9)	$ 853

(1) Primarily changes in amount and timing of collections.

The decrease in the Company s insurance loss recoverable and recoveries on unpaid losses during 2014 was primarily due to changes in assumptions associated with insured first and second-lien RMBS and U.S. public finance issues and collections associated with issues outstanding as of December 31, 2013.

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Costs associated with remediating insured obligations assigned to the Company s Caution List Low, Caution List Medium, Caution List High a Classified List are recorded as LAE. LAE is primarily recorded as part of the Company s provision for its loss reserves and included in Losses and loss adjustment expenses on the Company s consolidated statements of operations. The following table presents the gross expenses related to remedial actions for insured obligations. Gross expenses related to remediating insured obligations decreased for the three months ended March 31, 2014 compared with the same period of 2013 due to lower litigation expenses as a result of settlements.

In millions	Three Months Ended March 31, 2014	2013
Loss adjustment expense incurred, gross	$ 4	$ 18

Note 6: Fair Value of Financial Instruments

Fair Value Measurement

Fair value is a market-based measure considered from the perspective of a market participant. Therefore, even when market assumptions are not readily available, the Company s own assumptions are set to reflect those which it believes market participants would use in pricing an asset or liability at the measurement date. The fair value measurements of financial instruments held or issued by the Company are determined through the use of observable market data when available. Market data is obtained from a variety of third-party sources, including dealer quotes. If dealer quotes are not available for an instrument that is infrequently traded, the Company uses alternate valuation methods, including either dealer quotes for similar instruments or modeling using market data inputs. The use of alternate valuation methods generally requires considerable judgment in the application of estimates and assumptions and changes to such estimates and assumptions may produce materially different fair values.

The accounting guidance for fair value measurement establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available and reliable. Observable inputs are those the Company believes that market participants would use in pricing an asset or liability based on available market data. Unobservable inputs are those that reflect the Company s beliefs about the assumptions market participants would use in pricing an asset or liability based on the best information available. The fair value hierarchy is broken down into three levels based on the observability and reliability of inputs, as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company can access. Valuations are based on quoted prices that are readily and regularly available in an active market, with significant trading volumes.

Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. Level 2 assets include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, securities which are priced using observable inputs and derivative contracts whose values are determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3 Valuations based on inputs that are unobservable and supported by little or no market activity and that are significant to the overall fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques where significant inputs are unobservable, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The availability of observable inputs can vary from product to product and period to period and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, and other characteristics particular to the product. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the Company assigns the level in the fair value hierarchy for which the fair value measurement in its entirety falls, based on the least observable input that is significant to the fair value measurement.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Financial Assets (excluding derivative assets)

Financial assets, excluding derivative assets, held by the Company primarily consist of investments in debt securities. Substantially all of the Company s investments are priced by independent third parties, including pricing services and brokers. Typically, the Company receives one pricing service value or broker quote for each instrument, which represents a non-binding indication of value. The Company reviews the assumptions, inputs and methodologies used by pricing services and brokers to obtain reasonable assurance that the prices used in its valuations reflect fair value. When the Company believes a third-party quotation differs significantly from its internally developed expectation of fair value, whether higher or lower, the Company reviews its data or assumptions with the provider. This review includes comparing significant assumptions such as prepayment speeds, default ratios, forward yield curves, credit spreads and other significant quantitative inputs to internal assumptions, and working with the price provider to reconcile the differences. The price provider may subsequently provide an updated price. In the event that the price provider does not update its price, and the Company still does not agree with the price provided, the Company will obtain a price from another third-party provider, such as a broker, or use an internally developed price which it believes represents the fair value of the investment. The fair values of investments for which internal prices were used were not significant to the aggregate fair value of the Company s investment portfolio as of March 31, 2014 or December 31, 2013. All challenges to third-party prices are reviewed by staff of the Company with relevant expertise to ensure reasonableness of assumptions.

Financial Liabilities (excluding derivative liabilities)

Financial liabilities, excluding derivative liabilities, issued by the Company primarily consist of investment agreements and MTNs within its wind-down operations, debt issued for general corporate purposes, debt in VIEs and warrants. Investment agreements, MTNs, and corporate debt are typically recorded at face value adjusted for premiums or discounts. The majority of the financial liabilities that the Company has elected to fair value or that require fair value reporting or disclosures are valued based on the estimated value of the underlying collateral, the Company s or a third-party s estimate of discounted cash flow model estimates, or quoted market values for similar products. These valuations include adjustments for expected nonperformance risk of the Company.

Derivative Liabilities

The Company s derivative liabilities are primarily insured credit derivatives that reference structured pools of cash securities and CDSs. The Company generally insured the most senior liabilities of such transactions, and at the inception of transactions its exposure generally had more subordination than needed to achieve triple-A ratings from credit rating agencies. The types of collateral underlying its insured derivatives consist of cash securities and CDSs referencing primarily corporate obligations, ABS, RMBS, CMBS, CRE loans, and CDOs.

The Company s insured credit derivative contracts are non-traded structured credit derivative transactions. Since insured derivatives are highly customized and there is generally no observable market for these derivatives, the Company estimates their fair values in a hypothetical market based on internal and third-party models simulating what a similar company would charge to assume the Company s position in the transaction at the measurement date. This pricing would be based on the expected loss of the exposure. The Company reviews its valuation 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 or securities prices are observable for similar transactions, those spreads are an integral part of the analysis. New insured transactions that resemble existing (previously insured) transactions, if any, would be considered, as well as negotiated settlements of existing transactions.

The Company may from time to time make changes in its valuation techniques if the change results in a measurement that it believes is equally or more representative of fair value under current circumstances.

Internal Review Process

All significant financial assets and liabilities, including derivative assets and liabilities, are reviewed by committees created by the Company to ensure compliance with the Company s policies and risk procedures in the development of fair values of financial assets and liabilities. These valuation committees review, among other things, key assumptions used for internally developed prices, significant changes in sources and uses of inputs, including changes in model approaches, and any adjustments from third-party inputs or prices to internally developed inputs or prices. The committees also review any significant impairment or improvements in fair values of the financial instruments from prior periods. From time to time, these committees will consult with the Company s valuation experts to better understand key methods and assumptions used for the determination of fair value, including understanding significant changes in fair values. These committees are comprised of senior finance team members with the relevant experience in the financial instruments their committee is responsible for. For each quarter, these committees document their agreement with the fair values developed by management of the Company as reported in the quarterly and annual financial statements.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Valuation Techniques

Valuation techniques for financial instruments measured at fair value or disclosed at fair value are described below.

Fixed-Maturity Securities (including short-term investments) Held as Available-For-Sale, Investments Carried at Fair Value, Investments Pledged as Collateral, Investments Held-to-Maturity, and Other Investments

These investments include investments in U.S. Treasury and government agencies, foreign governments, corporate obligations, mortgage-backed securities (MBS) and ABS (including CMBS and CDOs), state and municipal bonds and perpetual debt and equity securities (including money market mutual funds).

These investments are generally valued based on recently executed transaction prices or quoted market prices. When quoted market prices are not available, fair value is generally determined using quoted prices of similar investments or a valuation model based on observable and unobservable inputs. Inputs vary depending on the type of investment. Observable inputs include contractual cash flows, interest rate yield curves, CDS spreads, prepayment and volatility scores, diversity scores, cross-currency basis index spreads, and credit spreads for structures similar to the financial instrument in terms of issuer, maturity and seniority. Unobservable inputs include cash flow projections and the value of any credit enhancement.

The fair value of the held-to-maturity (HTM) investments is determined using discounted cash flow models. Key inputs include unobservable cash flows projected over the expected term of the investment discounted using observable interest rate yield curves of similar securities.

Investments based on quoted market prices of identical investments in active markets are classified as Level 1 of the fair value hierarchy. Level 1 investments generally consist of U.S. Treasury and government agency, foreign government and money market investments. Quoted market prices of investments in less active markets, as well as investments which are valued based on other than quoted prices for which the inputs are observable, such as interest rate yield curves, are categorized in Level 2 of the fair value hierarchy. Investments that contain significant inputs that are not observable are categorized as Level 3.

Cash and Cash Equivalents, Receivable for Investments Sold, Net Cash Collateral Pledged to Swap Counterparties, Payable for Investments Purchased and Accrued Investment Income

The carrying amounts of cash and cash equivalents, receivable for investments sold, net cash collateral pledged to swap counterparties, payable for investments purchased, and accrued investment income approximate fair values due to the short-term nature and credit worthiness of these instruments. These items are categorized in Level 1 or Level 2 of the fair value hierarchy.

Loans Receivable at Fair Value

Loans receivable at fair value are comprised of loans held by consolidated VIEs consisting of residential mortgage loans. Fair values of residential mortgage loans are determined using quoted prices for MBS issued by the respective VIE and adjustments for the fair values of the financial guarantees provided by MBIA Corp. on the related MBS. Loans receivable at fair value are categorized in Level 3 of the fair value hierarchy.

Loan Repurchase Commitments

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