

MBIA INC  
Form 10-Q  
November 05, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

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

For the Quarter Ended September 30, 2008

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**  
(State of Incorporation)

**06-1185706**  
(I.R.S. Employer Identification No.)

**113 King Street, Armonk, New York**  
(Address of principal executive offices)

**10504**  
(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  No

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

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

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

As of October 31, 2008, 273,296,036 shares of Common Stock, par value \$1 per share, were outstanding.

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**Table of Contents****Item 1.****MBIA INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS (Unaudited)**

(In thousands except per share amounts)

	September 30, 2008	December 31, 2007
<b>Assets</b>		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$16,039,190 and \$30,199,471)(includes hybrid financial instruments at fair value \$28,523 and \$596,537)	\$ 14,093,370	\$ 29,589,098
Investments held-to-maturity, at amortized cost (fair value \$3,127,058 and \$5,036,465)	3,155,847	5,053,987
Investments pledged as collateral, at fair value (amortized cost \$1,432,821 and \$1,243,245)	1,215,805	1,227,153
Short-term investments held as available-for-sale, at fair value (amortized cost \$9,745,125 and \$4,915,581)	9,737,260	4,915,581
Short-term investments held-to-maturity, at amortized cost (2007 fair value \$545,769)		549,127
Other investments	328,502	730,711
<b>Total investments</b>	<b>28,530,784</b>	<b>42,065,657</b>
Cash and cash equivalents	2,555,848	263,732
Accrued investment income	342,940	590,060
Deferred acquisition costs	555,023	472,516
Prepaid reinsurance premiums	274,478	318,740
Reinsurance recoverable on unpaid losses	107,262	82,041
Goodwill	79,406	79,406
Property and equipment, at cost (less accumulated depreciation of \$139,738 and \$132,930)	101,232	104,036
Receivable for investments sold	1,311,157	111,130
Derivative assets	1,099,969	1,722,696
Current income taxes	351,824	142,763
Deferred income taxes, net	1,537,063	1,173,658
Other assets	804,815	288,639
<b>Total assets</b>	<b>\$ 37,651,801</b>	<b>\$ 47,415,074</b>
<b>Liabilities and Shareholders' Equity</b>		
Liabilities:		
Deferred premium revenue	\$ 3,514,710	\$ 3,107,833
Loss and loss adjustment expense reserves	1,913,230	1,346,423
Investment agreements	10,646,317	16,107,909
Commercial paper		850,315
Medium-term notes (includes hybrid financial instruments at fair value \$284,594 and \$399,061)	8,550,813	12,830,777
Variable interest entity floating rate notes	1,244,260	1,355,792
Securities sold under agreements to repurchase	1,085,960	1,163,899
Short-term debt	7,158	13,383
Long-term debt	2,418,219	1,225,280
Deferred fee revenue	15,450	15,059
Payable for investments purchased	108,615	41,359
Derivative liabilities	5,029,653	5,037,112
Other liabilities	494,545	664,128
<b>Total liabilities</b>	<b>35,028,930</b>	<b>43,759,269</b>

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Commitments and contingencies (See Note 10)

**Shareholders 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	273,296,036 and		
	160,244,614		273,296	160,245
Additional paid-in capital			3,056,863	1,649,511
Retained earnings			2,789,028	4,301,880
Accumulated other comprehensive loss, net of deferred income tax of (\$771,161) and (\$275,291)			(1,443,224)	(490,829)
Treasury stock, at cost	42,548,156 and 34,872,515 shares		(2,053,092)	(1,965,002)
<b>Total shareholders equity</b>			<b>2,622,871</b>	<b>3,655,805</b>
<b>Total liabilities and shareholders equity</b>			<b>\$ 37,651,801</b>	<b>\$ 47,415,074</b>

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

**Table of Contents****MBIA INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

(In thousands except per share amounts)

	Three months ended September 30		Nine months ended September 30	
	2008	2007	2008	2007
Gross premiums written	\$ 901,505	\$ 206,641	\$ 1,145,082	\$ 602,201
Ceded premiums	(15,079)	(17,869)	(52,371)	(54,472)
Net premiums written	886,426	188,772	1,092,711	547,729
Revenues:				
Scheduled premiums earned	141,048	151,868	434,205	444,838
Refunding premiums earned	93,696	16,447	189,248	95,296
Premiums earned (net of ceded premiums of \$31,607, \$24,672, \$93,840 and \$86,693)	234,744	168,315	623,453	540,134
Net investment income	354,359	573,854	1,286,544	1,621,265
Fees and reimbursements	12,179	13,859	32,253	47,131
Realized gains (losses) and other settlements on insured derivatives	34,264	31,218	102,325	83,941
Unrealized gains (losses) on insured derivatives	104,818	(341,706)	(147,972)	(357,772)
Net change in fair value of insured derivatives	139,082	(310,488)	(45,647)	(273,831)
Net realized gains (losses)	(426,298)	339	(1,412,769)	29,838
Net gains (losses) on financial instruments at fair value and foreign exchange	(234,200)	(14,659)	(70,853)	(34,837)
Net gains (losses) on extinguishment of debt	239,898		319,115	
Insurance recoveries				6,400
Total revenues	319,764	431,220	732,096	1,936,100
Expenses:				
Losses and loss adjustment	982,514	22,203	1,292,466	63,655
Amortization of deferred acquisition costs	24,619	16,052	63,147	50,114
Operating	95,010	57,260	224,790	179,065
Interest	264,210	418,528	962,767	1,156,031
Total expenses	1,366,353	514,043	2,543,170	1,448,865
Income (loss) before income taxes	(1,046,589)	(82,823)	(1,811,074)	487,235
Provision (benefit) for income taxes	(240,111)	(46,183)	(298,222)	113,433
Net income (loss)	\$ (806,478)	\$ (36,640)	\$ (1,512,852)	\$ 373,802
Net income (loss) per common share:				
Basic	\$ (3.48)	\$ (0.30)	\$ (6.97)	\$ 2.93
Diluted	\$ (3.48)	\$ (0.30)	\$ (6.97)	\$ 2.84

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**Weighted average number of common shares outstanding:**

Basic	231,758,958	123,705,544	217,089,104	127,658,105
Diluted	231,758,958	123,705,544	217,089,104	131,537,515

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

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**MBIA INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)**

**For the nine months ended September 30, 2008**

(In thousands except per share amounts)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total Shareholders' Equity
	Shares	Amount				Shares	Amount	
Balance, January 1, 2008	160,245	\$ 160,245	\$ 1,649,511	\$ 4,301,880	\$ (490,829)	(34,873)	\$ (1,965,002)	\$ 3,655,805
Comprehensive loss:								
Net loss				(1,512,852)				(1,512,852)
Other comprehensive loss:								
Change in unrealized depreciation of investments net of change in deferred income taxes of \$(554,974)					(1,057,302)			(1,057,302)
Change in fair value of derivative instruments net of change in deferred income taxes of \$49,151					91,281			91,281
Change in foreign currency translation net of change in deferred income taxes of \$9,953					13,626			13,626
Other comprehensive loss								(952,395)
<b>Total comprehensive loss</b>								(2,465,247)
Issuance of common stock	110,779	110,779	1,448,908					1,559,687
Share-based compensation net of change in deferred income taxes of \$(15,441)	2,272	2,272	(41,556)			(7,675)	(88,090)	(127,374)
Balance, September 30, 2008	273,296	\$ 273,296	\$ 3,056,863	\$ 2,789,028	\$ (1,443,224)	(42,548)	\$ (2,053,092)	\$ 2,622,871
<b>2008</b>								
Disclosure of reclassification amount:								
Change in unrealized depreciation of investments arising during the period, net of taxes					\$ (1,321,519)			
Reclassification adjustment, net of taxes					264,217			
Change in net unrealized depreciation, net of taxes					\$ (1,057,302)			

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



**Table of Contents****MBIA INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

(In thousands)

	<b>Nine months ended September 30</b>	
	<b>2008</b>	<b>2007</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (1,512,852)	\$ 373,802
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization of bond discounts (premiums), net	(25,534)	13,528
Decrease (increase) in accrued investment income	247,120	(88,244)
Increase in deferred acquisition costs	(82,507)	(17,371)
Increase (decrease) in deferred premium revenue	406,877	(12,455)
Decrease in prepaid reinsurance premiums	44,262	32,221
(Increase) decrease in premium receivable	(148,433)	666
Increase in loss and loss adjustment expense reserves	566,807	8,042
Increase in reinsurance recoverable on unpaid losses	(25,221)	(3,732)
(Increase) decrease in salvage and subrogation	(157,647)	59,968
Depreciation	7,217	7,627
(Decrease) increase in accrued interest payable	(185,705)	140,047
Decrease in accrued expenses	(11,654)	(28,001)
Decrease in penalties and disgorgement accrual		(75,000)
Amortization of medium-term notes and commercial paper (premiums) discounts, net	(11,683)	(12,093)
Net realized losses (gains) on sale of investments	618,931	(29,838)
Realized losses on other than temporarily impaired investments	793,838	
Unrealized losses on insured derivatives	147,972	357,772
Net losses on financial instruments at fair value and foreign exchange	70,853	34,837
Current income tax (benefit) provision	(209,061)	4,298
Deferred income tax provision (benefit)	141,643	(91,662)
Net gains on debt repurchases	(319,115)	
Share-based compensation	(28,715)	12,805
Other, operating	72,457	10,614
<b>Total adjustments to net income (loss)</b>	<b>1,912,702</b>	<b>324,029</b>
<b>Net cash provided by operating activities</b>	<b>399,850</b>	<b>697,831</b>
<b>Cash flows from investing activities:</b>		
Purchase of fixed-maturity securities	(11,812,003)	(23,777,848)
Increase in payable for investments purchased	67,256	200,583
Sale of fixed-maturity securities	24,677,047	18,777,069
Increase in receivable for investments sold	(1,200,027)	(131,571)
Redemption of fixed-maturity securities	9,601	44,383
Purchase of held-to-maturity investments	(1,108,649)	(1,072,850)
Redemptions of held-to-maturity investments	3,558,827	723,782
Purchase of short-term investments, net	(5,074,218)	(71,266)
Sale (purchase) of other investments, net	315,494	(44,410)
Capital expenditures	(4,509)	(4,386)
Disposals of capital assets		4,188
Other, investing		11,123

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Net cash provided (used) by investing activities	9,428,819	(5,341,203)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of investment agreements	1,882,609	7,007,284
Payments for drawdowns of investment agreements	(7,294,253)	(4,558,455)
(Decrease) increase in commercial paper	(863,039)	71,187
Issuance of medium-term notes	2,106,756	5,272,029
Principal paydown of medium-term notes	(6,062,672)	(2,667,430)
Principal paydown of variable interest entity floating rate notes	(109,818)	(77,085)
Securities sold under agreements to repurchase, net	(77,939)	558,181
Dividends paid	(42,640)	(130,306)
Gross proceeds from issuance of common stock	1,628,405	
Capital issuance costs	(78,510)	(3,997)
Net proceeds from issuance of warrants	21,467	
Net proceeds from issuance of long-term debt	983,278	
Repayment for retirement of long-term debt	(82,822)	
Repayment for retirement of short-term debt	(6,225)	(27,515)
Net proceeds from bank loans	338,820	
Payments or terminations for derivatives	372,167	(9,313)
Purchase of treasury stock	(90,041)	(736,615)
Exercise of stock options		37,516
Restricted stock awards settlements	2,207	
Excess tax benefit on share-based payment	(15,441)	6,937
Collateral posted under investment agreements	(40,018)	
Collateral from swap counterparties	(110,200)	
Other, financing	1,356	(2,494)
Net cash provided (used) by financing activities	(7,536,553)	4,739,924
Net increase in cash and cash equivalents	2,292,116	96,552
Cash and cash equivalents beginning of period	263,732	269,277
Cash and cash equivalents end of period	\$ 2,555,848	\$ 365,829

**Supplemental cash flow disclosures:**

Income taxes (refunded) paid	\$ (221,037)	\$ 197,352
Interest paid:		
Investment agreements	\$ 506,185	\$ 473,232
Commercial paper	15,445	30,915
Medium-term notes	321,689	464,466
Variable interest entity floating rate notes	40,678	54,879
Securities sold under agreements to repurchase	29,406	14,663
Liquidity loans	1,670	
Other borrowings and deposits	2,319	1,604
Long-term debt	121,683	52,148
Non cash items:		
Share-based compensation	\$ (28,715)	\$ 12,805
Dividends declared but not paid		42,645

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

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**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****NOTE 1: 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 ). These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2007 for MBIA Inc. and Subsidiaries ( MBIA or the Company ). The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (United States), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the Company s financial position and results of operations.

The results of operations for the nine months ended September 30, 2008 may not be indicative of the results that may be expected for the year ending December 31, 2008. The December 31, 2007 balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. The consolidated financial statements include the accounts of MBIA Inc., its wholly owned subsidiaries and all other entities in which the Company has a controlling financial interest. All material intercompany revenues and expenses have been eliminated. Certain amounts have been reclassified in prior years financial statements to conform to the current presentation. This includes the reclassification of premiums from the Company s insured derivatives portfolio from Scheduled premiums earned , Refunding premiums earned , Premiums earned and Fees and reimbursements to Realized gains (losses) and other settlements on insured derivatives and the reclassification of the mark-to-market of the insured derivatives portfolio from Net gains (losses) on financial instruments at fair value and foreign exchange to Unrealized gains (losses) on insured derivatives, both of which had no effect on total revenues and total expenses as previously reported. Additionally, Gross premiums written , Ceded premiums written and Net premiums written exclude premiums from the Company s insured derivatives portfolio. Amounts reclassified in prior years financial statements also include the reclassification of net interest income and expense and net realized gains and losses related to non-hedging derivative instruments from Net investment income , Interest expense, and Net realized gains (losses), respectively, to Net gains (losses) on financial instruments at fair value and foreign exchange . Refer to Note 7: Business Segments for amounts reclassified.

**NOTE 2: Significant Accounting Policies**

The Company has disclosed its significant accounting policies in Note 2: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007. The following significant accounting policies provide an update to those included under the same captions in the Company s Annual Report on Form 10-K.

***Loss and Loss Adjustment Expenses***

The Company s financial guarantee insurance provides an unconditional and irrevocable guarantee of the payment of the principal of, and interest or other amounts owing on, insured obligations when due or, in the event that the Company has the right, at its discretion, to accelerate insured obligations upon default or otherwise, upon such acceleration by the Company. Loss and loss adjustment expense ( LAE ) reserves are established by the Company s Loss Reserve Committee, which consists of members of senior management, and require the use of judgment and estimates with respect to the occurrence, timing and amount of a loss on an insured obligation.

The Company establishes two types of loss and LAE reserves for non-derivative financial guarantees: an unallocated loss reserve and case basis reserves. The unallocated loss reserve is established on an undiscounted basis with respect to the Company s entire non-derivative insured portfolio. The Company s unallocated loss reserve represents the Company s estimate of losses that have or are probable to occur as a result of credit deterioration in the Company s insured portfolio but which have not yet been specifically identified and applied to specific insured obligations. The unallocated loss reserve is increased on a quarterly basis using a formula that applies a loss factor to the Company s scheduled net earned premium for the respective quarter, both of which are defined and set forth below. This increase in the unallocated reserve is the Company s provision for loss and loss adjustment expenses as reported on the Company s consolidated statements of operations. Scheduled net earned premium represents total quarterly premium earnings, net of reinsurance, from all policies in force less the portion of quarterly premium earnings that have been accelerated as a result of the refunding or defeasance of insured obligations. Total earned premium as reported on the Company s consolidated statements of operations includes both scheduled net earned premium and premium earnings that have been accelerated, net of reinsurance. Once a policy is originated, the amount of scheduled net earned premium recorded in earnings will be included in the Company s calculation of its unallocated loss reserve. When an insured obligation is refunded, defeased or matures, the Company does not

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reverse the unallocated loss reserve previously generated from the scheduled net earned premium on such obligation as the Company's unallocated loss reserve is not specific to any individual obligation.

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**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries**

Each quarter the Company calculates its provision for the unallocated loss reserve as a fixed percent of scheduled net earned premium of the insurance operations. Prior to the first quarter of 2008, scheduled net earned premium of the insurance operations included premiums from its non-derivative insured portfolio and from its insured derivative portfolio. Effective January 1, 2008, premiums from insured derivative contracts are no longer included as part of scheduled net earned premium but are rather reported as part of Realized gains (losses) and other settlements on insured derivatives. As a result, the Company increased its loss factor to 14.5% from 12% in order to maintain a loss and LAE provision each period consistent with that calculated using historical scheduled net earned premium.

The accounting for non-derivative financial guarantee loss reserves will change when the Company adopts Statement of Financial Accounting Standards ( SFAS ) No. 163, Accounting for Financial Guarantee Insurance Contracts an interpretation of Financial Accounting Standards Board ( FASB ) Statement No. 60, which is effective January 1, 2009. See Note 3: Recent Accounting Pronouncements for additional information on the adoption of SFAS 163.

***Derivatives***

MBIA has entered into derivative transactions as an additional form of financial guarantee and for purposes of hedging risks associated with existing assets and liabilities and forecasted transactions. Credit default swap ( CDS ) contracts are also entered into in the investment management services operations to replicate investments in cash assets consistent with the Company's risk objectives and credit guidelines for its investment management business. The Company accounts for derivative transactions in accordance with SFAS 133, Accounting for Derivative Instruments and Hedging Activities, as amended, which requires that all such transactions be recorded on the Company's balance sheet at fair value. The fair value of derivative instruments is determined as the amount that would be received to sell the derivative when in an asset position or transfer the derivative when in a liability position. Changes in the fair value of derivatives, exclusive of insured derivatives, are recorded each period in current earnings within Net gains (losses) on financial instruments at fair value and foreign exchange or in shareholders' equity within Accumulated other comprehensive loss, depending on whether the derivative is designated as a hedge, and if so designated, the type of hedge.

***Insured Derivatives***

The Company sells credit protection by entering into CDS contracts with various financial institutions. In certain cases the Company purchases back-to-back credit protection on all or a portion of the risk written, primarily from reinsurance companies. The Company has entered into CDS contracts as an extension of its core financial guarantee business, under which the Company intends to hold its written and purchased positions for the entire term of the related contracts. These CDS contracts are accounted for at fair value since they do not qualify for the financial guarantee scope exception under SFAS 133, as amended.

The total changes in fair value of the insured derivatives are recorded in Net change in fair value of insured derivatives. Realized gains (losses) and other settlements on insured derivatives includes (i) net premiums received and receivable on written CDS contracts, (ii) net premiums paid and payable on purchased CDS contracts, (iii) losses paid and payable to CDS contract counterparties due to the occurrence of a credit event, (iv) losses recovered and recoverable on purchased CDS contracts due to the occurrence of a credit event and (v) fees relating to CDS contracts. Losses paid and payable and losses recovered and recoverable reported in Realized gains (losses) and other settlements on insured derivatives include claims and recoveries thereof, respectively, only after a credit event has occurred that would require a payment under contract terms. The Unrealized gains (losses) on insured derivatives includes all other changes in fair value of the derivative contracts.

***Cash and Other Collateral***

Under certain non-insurance derivative contracts entered into by the Company, collateral postings are required by either MBIA or the counterparty when the aggregate market value of derivative contracts entered into with the same counterparty exceeds a predefined threshold. Cash or securities may be posted as collateral at the option of the party posting the collateral. As of September 30, 2008, the Company did not hold cash collateral from derivative counterparties and did not post cash collateral to derivative counterparties. As of September 30, 2008, the Company had securities with a fair value of \$420 million posted to derivative counterparties.

The Company has entered into reverse repurchase agreements that require MBIA to post collateral at a predetermined multiple of the contract amount. Cash or securities may be posted by MBIA under these agreements. As of September 30, 2008, the Company had cash collateral of

\$40.0 million posted to counterparties under these term reverse repurchase agreements.

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

***Fair Value Measurement Definition and Hierarchy***

MBIA adopted the provisions of SFAS 157, Fair Value Measurements excluding non-financial assets and liabilities per FASB Staff Position ( FSP ) FAS 157-2, Effective Date of FASB Statement No. 157, beginning January 1, 2008. Under this standard, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MBIA Inc. and Subsidiaries**

In determining fair value, the Company uses various valuation approaches, including both market and income approaches. SFAS 157 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 the asset or liability developed based on market data. Unobservable inputs are those that reflect the Company's beliefs about the assumptions market participants would use in pricing the asset or liability developed based on the best information available. The 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 has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail any degree of judgment. Assets utilizing Level 1 inputs generally include United States ( U.S. ) treasuries, foreign government bonds and certain corporate obligations that are highly liquid and actively traded.

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. Assets and liabilities utilizing Level 2 inputs include: U.S. government and agency mortgage-backed securities; most over-the-counter ( OTC ) derivatives; corporate and municipal bonds; and certain mortgage-backed securities ( MBS ) or asset-backed securities ( ABS ).

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, as well as instruments for which the determination of fair value requires significant management judgment or estimation. Assets and liabilities utilizing Level 3 inputs include certain MBS, ABS and collateralized debt obligations ( CDO ) securities where observable pricing information was not able to be obtained for a significant portion of the underlying assets; and complex OTC derivatives (including certain foreign currency options; long-dated options and swaps; and certain credit derivatives) and insured derivatives that require significant management judgment and estimation in the valuation.

The level of activity in a market contributes to the determination of whether an input is observable. An active market is one in which transactions for an asset or liability occurs with sufficient frequency and volume to provide pricing information on an ongoing basis. In determining whether a market is active or inactive, the Company considers the following traits to be indicative of an active market:

Frequent observable actual transactions.

Prices in the market are current.

Price quotes among dealers do not vary significantly over time.

Sufficient information relevant to valuation is publicly available.

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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 transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that it believes market participants would use in pricing the asset or liability at the measurement date. The Company uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or Level 2 to Level 3.

Under SFAS 157, the Company has also taken into account its own nonperformance risk when measuring the fair value of liability positions.

See Note 6: Fair Value of Financial Instruments for additional fair value disclosures.



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**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****NOTE 3: Recent Accounting Pronouncements*****Recently Adopted Accounting Standards***

In October 2008, the FASB issued FSP No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active: An Amendment of FASB Statement No. 157*. FSP No. FAS 157-3 applies to financial assets within the scope of SFAS 157 for which other accounting pronouncements require or permit fair value measurements. FSP No. FAS 157-3 clarifies the application of SFAS 157 in an inactive market and provides an illustrative example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is not active. The provisions are effective upon issuance, including prior periods for which financial statements have not been issued. The provisions of this FSP need not be applied to immaterial items. Since FSP No. FAS 157-3 only illustrates additional guidance in determining the fair value of a financial asset when the market for that financial asset is not active, FSP No. FAS 157-3 is not material to the Company's financial statements and will not affect the Company's financial condition, results of operations or cash flows.

In May 2008, the FASB issued SFAS 163, *Accounting for Financial Guarantee Insurance Contracts*—an interpretation of FASB Statement No. 60. SFAS 163 requires financial guarantee insurance (and reinsurance) contracts issued by reporting entities considered insurance enterprises under SFAS No. 60, *Accounting and Reporting by Insurance Enterprises* to recognize and measure premium revenue based on the amount of insurance protection provided and the period in which it is provided and to recognize and measure claim liabilities based on the present value of expected net cash outflows to be paid, using a risk-free rate, in excess of the unearned premium revenue. SFAS 163 does not apply to financial guarantee insurance contracts accounted for as derivative instruments within the scope of SFAS 133. SFAS 163 is effective for the Company prospectively as of January 1, 2009, except for the presentation and disclosure requirements related to claim liabilities effective for financial statements prepared as of September 30, 2008 as presented and disclosed in Note 8: Loss and Loss Adjustment Expense Reserves (LAE) in the Notes to Consolidated Financial Statements. The cumulative effect of initially applying SFAS 163 is required to be recognized as an adjustment to the opening balance of retained earnings for the fiscal year beginning January 1, 2009. The Company is currently evaluating the potential impact of adopting SFAS 163.

The Company adopted the provisions of SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, effective January 1, 2008. SFAS 159 provides entities the option to measure certain financial assets and financial liabilities at fair value with changes in fair value recognized in earnings each period. SFAS 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The Company applies the disclosure requirements of SFAS 159 for certain eligible instruments which it previously elected to fair value under SFAS 155, *Accounting for Certain Hybrid Financial Instruments*. These instruments included certain medium-term notes (MTNs) and certain available-for-sale securities which contained embedded derivatives requiring bifurcation. The Company did not elect the fair value option under SFAS 159 for any eligible financial instruments.

The Company adopted the provisions of SFAS 157, excluding non-financial assets and liabilities per FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157*, beginning January 1, 2008. SFAS 157 defines fair value as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. SFAS 157 requires that fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available. Assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model. SFAS 157 also clarifies that an issuer's credit standing should be considered when measuring liabilities at fair value. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurements). In February 2008, the FASB issued FSP FAS 157-2, which delayed the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). A transition adjustment to opening retained earnings was not required.

In April 2007, the FASB issued FSP FASB Interpretation No. (FIN) 39-1, *Amendment of FASB Interpretation No. 39*. FSP FIN 39-1 permits a reporting entity that is a party to a master netting agreement to offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments that have been offset under the same master netting agreement. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007 and is required to be applied retrospectively for

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all financial statements presented unless it is impracticable to do so. The Company adopted the provisions of the FSP beginning January 1, 2008 and elected not to offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral under a master netting agreement against fair value amounts recognized for derivative instruments that have been offset under the same master netting agreement. The Company may reevaluate in the future its election to not offset the fair value amounts recognized for derivative contracts executed with the same counterparty under a master netting agreement.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries*****Recent Accounting Developments***

In September 2008, the FASB issued FSP No. FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*. FSP No. FAS 133-1 and FIN 45-4 requires enhanced disclosures about credit derivatives and guarantees and amends FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* to exclude derivative instruments accounted for at fair value under SFAS No. 133. The Company will adopt FSP No. FAS 133-1 and FIN 45-4 for financial statements prepared as of December 31, 2008. Since FSP No. FAS 133-1 and FIN 45-4 only requires additional disclosures concerning credit derivatives and guarantees, adoption of FSP No. FAS 133-1 and FIN 45-4 will not affect the Company's financial condition, results of operations or cash flows.

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities* an amendment of FASB Statement No. 133. SFAS 161 expands the disclosure requirements about an entity's derivative instruments and hedging activities. The disclosure provisions of SFAS 161 apply to all entities with derivative instruments subject to SFAS 133 and its related interpretations. The provisions also apply to related hedged items, bifurcated derivatives, and non-derivative instruments that are designated and qualify as hedging instruments. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. MBIA will adopt the disclosure provisions of SFAS 161 on January 1, 2009. Since SFAS 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS 161 will not affect the Company's financial condition, results of operations or cash flows.

In February 2008, the FASB issued FSP No. FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*. FSP No. FAS 140-3 requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with, or in contemplation of the initial transfer to be evaluated as a linked transaction under SFAS 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* unless certain criteria are met. FSP No. FAS 140-3 is effective for fiscal years beginning after November 15, 2008, and will be applied to new transactions entered into after the date of adoption. Early adoption is prohibited. The Company is currently evaluating the potential impact of adopting FSP No. FAS 140-3.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of Accounting Research Bulletin No. 51. SFAS 160 requires reporting entities to present noncontrolling (minority) interest as equity (as opposed to liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 and earlier adoption is prohibited. MBIA is currently evaluating the provisions of SFAS 160 and their potential impact on the Company's financial statements.

**NOTE 4: Capital Strengthening Plan**

The Company implemented a capital strengthening plan during the first quarter of 2008 by issuing 110.8 million common shares which resulted in an increase to shareholders' equity of \$1.6 billion and by issuing long-term debt of \$1.0 billion. Specific components of the capital strengthening plan are outlined below.

***Warburg Pincus Agreement / Common Stock Offering***

On December 10, 2007, the Company announced that it had entered into an agreement, subsequently amended on February 6, 2008, with Warburg Pincus (the *Warburg Pincus Agreement*), a private equity firm, which committed to invest up to \$1.25 billion in the Company through a direct purchase of MBIA common stock and a backstop for a common stock offering.

Under the Warburg Pincus Agreement, Warburg Pincus made an initial investment of \$500 million in MBIA through the acquisition of 16.1 million shares of MBIA common stock at a price of \$31.00 per share, which was completed on January 30, 2008. In connection with its initial investment, Warburg Pincus received warrants to purchase 8.7 million shares of MBIA common stock at a price of \$40 per share and B warrants, which, upon obtaining certain approvals, became exercisable to purchase 7.4 million shares of common stock at a price of \$40 per share. The term of the warrants is seven years. In addition, the securities purchased by Warburg Pincus are subject to significant transfer

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restrictions for a minimum of one year and up to three years. The Company's senior management team originally committed to invest a total of \$2 million in the Company's common stock at the same price as Warburg Pincus, which commitment was later adjusted downward. Since that time, the current senior management team has satisfied their purchase commitment. The majority of the net proceeds received under Warburg Pincus' initial investment were contributed to the surplus of MBIA Insurance Corporation and its subsidiaries ( MBIA Corp. ).

On February 6, 2008, the Company and Warburg Pincus amended the Warburg Pincus Agreement to provide that Warburg Pincus would backstop a common stock offering by agreeing to purchase up to \$750 million of convertible participating preferred stock. Warburg Pincus was also granted the option to purchase up to \$300 million of preferred stock prior to the closing of a common stock offering on February 15, 2008. Finally, Warburg Pincus was granted B2 warrants which, upon obtaining certain approvals, became exercisable to purchase between 4 million and 8 million shares of MBIA common stock, whether or not the common stock offering was completed.

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On February 13, 2008, the Company completed a public offering of 94.65 million shares of MBIA common stock at \$12.15 per share. Warburg Pincus informed the Company that it purchased \$300 million in common stock as part of the offering. The Company did not use the \$750 million Warburg Pincus backstop. In addition, Warburg Pincus did not exercise its right to purchase up to \$300 million in preferred stock. Pursuant to the amended Warburg Pincus Agreement, Warburg Pincus was granted 4 million of B2 warrants at a price of \$16.20 per share. In addition, under anti-dilution provisions in the Warburg Pincus Agreement, the terms of the warrants issued to Warburg Pincus on January 30, 2008 were amended, which resulted in (a) the 8.7 million of warrants exercisable at \$40 per share were revised to 11.5 million warrants exercisable at \$30.25 per share and (b) the 7.4 million of B warrants exercisable at \$40 per share were revised to 9.8 million B warrants exercisable at \$30.25 per share. The Company intends to use most of the net proceeds of the common stock offering to support its insurance operations. The offering proceeds were allocated to the warrant liability, included in Other liabilities, based on its relative fair value and the residual proceeds were allocated to the common stock issued. Costs associated with the warrants, including the B warrants, were expensed as incurred.

***Surplus Notes***

On January 16, 2008, MBIA Corp. issued surplus notes due January 15, 2033. The surplus notes have an initial interest rate of 14 percent until January 15, 2013 and thereafter at an interest rate of three-month LIBOR plus 11.26 percent. Interest payments on the surplus notes are subject to prior approval by the Superintendent of the New York State Insurance Department. The surplus notes are callable at par at MBIA Corp.'s option on the fifth anniversary of the date of issuance and every fifth anniversary thereafter, subject to prior approval by the Superintendent and other restrictions. The cash received from the surplus notes liability will be used for general corporate purposes and the deferred debt issuance costs are being amortized over the surplus notes term. In the three months ended September 30, 2008, MBIA Corp. repurchased \$47.3 million par value outstanding of its surplus notes at an average price of 77.08.

***Dividends***

On February 25, 2008, the Company announced the elimination of its quarterly shareholder dividend to provide additional capital flexibility. In addition, the Company will now declare dividends on an annual basis rather than a quarterly basis.

**NOTE 5: Earnings Per Share**

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the dilutive effect of all stock options and other items outstanding during the period that could potentially result in the issuance of common stock. For the three months ended September 30, 2008, there were 6,462,247 stock options and 3,947,893 restricted stock and units outstanding that were not included in the diluted earnings per share calculation because they were antidilutive. For the nine months ended September 30, 2008, there were 6,595,547 stock options and 3,048,654 restricted stock and units outstanding that were not included in the diluted earnings per share calculation because they were antidilutive. For the three months ended September 30, 2007, there were 1,404,106 stock options and 2,019,394 restricted stock and units outstanding that were not included in the diluted earnings per share calculation because they were antidilutive. For the nine months ended September 30, 2007, there were 361,680 stock options outstanding that were not included in the diluted earnings per share calculation because they were antidilutive.

The following table presents the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2008 and 2007:

Dollars in thousands except per share amounts	3 <sup>rd</sup> Quarter		Year-to-date	
	2008	2007	2008	2007
Net income (loss)	\$ (806,478)	\$ (36,640)	\$ (1,512,852)	\$ 373,802
Basic weighted average shares	231,758,958	123,705,544	217,089,104	127,658,105

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Effect of common stock equivalents:				
Stock options				1,712,521
Restricted stock and units				2,166,889
Diluted weighted average shares	231,758,958	123,705,544	217,089,104	131,537,515
Basic EPS:				
Net income (loss)	\$ (3.48)	\$ (0.30)	\$ (6.97)	\$ 2.93
Diluted EPS:				
Net income (loss)	\$ (3.48)	\$ (0.30)	\$ (6.97)	\$ 2.84

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****NOTE 6: Fair Value of Financial Instruments**

The Company's assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with SFAS 157. See Note 2: Significant Accounting Policies for a discussion of Fair Value Measurement Definition and Hierarchy.

The following fair value hierarchy table presents information about the Company's assets (including short-term investments) and liabilities measured at fair value on a recurring basis as of September 30, 2008:

**Assets and Liabilities Measured at Fair Value on a Recurring Basis as of September 30, 2008**

In thousands	September 30, 2008	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Investments:				
Fixed-maturity securities:				
U.S. Treasury and government agency	\$ 3,712,362	\$ 3,016,729	\$ 695,633	\$
Foreign governments	1,027,854	446,056	500,203	81,595
Corporate obligations	5,931,080		4,864,513	1,066,567
Mortgage-backed	2,014,689		1,588,004	426,685
Asset-backed	2,570,970		1,209,367	1,361,603
State and municipal bonds	4,789,615		4,767,067	22,548
Other investments	5,325,483	4,771,310	477,173	77,000
Derivative assets	1,099,969		300,441	799,528
Other assets:				
Put options	268,057		268,057	
Total assets	\$ 26,740,079	\$ 8,234,095	\$ 14,670,458	\$ 3,835,526
<b>Liabilities:</b>				
Medium-term notes	\$ 284,594	\$	\$	\$ 284,594
Derivative liabilities	5,029,653		404,388	4,625,265
Other liabilities:				
Warrants	127,321		127,321	
Total liabilities	\$ 5,441,568	\$	\$ 531,709	\$ 4,909,859

**Level 3 Analysis**

Level 3 assets were \$3.8 billion as of September 30, 2008, and represented approximately 14.3% of total assets measured at fair value. Level 3 liabilities were \$4.9 billion as of September 30, 2008, and represented approximately 90.2% of total liabilities measured at fair value.





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The following tables present additional information about Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis:

**Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months ended September 30, 2008**

In thousands	Balance, beginning of interim period	Realized gains / (losses)	Unrealized gains / (losses) included in earnings	Unrealized gains / (losses) included in OCI	Foreign exchange	Purchases, issuances and settlements, net	Transfers in (out) of Level 3, net	Ending balance	Change in unrealized gains (losses) for the period included in earnings for assets still held at September 30, 2008
<b>Assets:</b>									
Foreign governments	\$ 73,008	\$	\$	\$ (3,582)	\$ (4,854)	\$ 17,023	\$	\$ 81,595	\$
Corporate obligations	1,589,553	(24,738)		(36,790)	(11,874)	(435,330)	(14,254)	1,066,567	
Mortgage-backed securities	542,241	(5,989)		(33,396)	(3,789)	(82,588)	10,206	426,685	
Asset-backed securities	2,134,256	(494,075)		326,520	7,445	(813,764)	201,221	1,361,603	
State and municipal						22,548		22,548	
Other investments	82,500			(5,098)		(402)		77,000	
Total assets	\$ 4,421,558	\$ (524,802)	\$	\$ 247,654	\$ (13,072)	\$ (1,292,513)	\$ 197,173	\$ 3,035,998	\$
<b>Liabilities:</b>									
Medium-term notes	\$ 314,311	\$	\$ 3,298	\$	\$ (33,015)	\$	\$	\$ 284,594	\$ (3,298)
Derivative contracts, net	3,655,310	416,732	(269,984)	316	(10,558)	33,922		3,825,738	108,303
Total liabilities	\$ 3,969,621	\$ 416,732	\$ (266,686)	\$ 316	\$ (43,573)	\$ 33,922	\$	\$ 4,110,332	\$ 105,005



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months ended September 30, 2008**

In thousands	Balance, beginning of year	Realized gains / (losses)	Unrealized gains / (losses) included in earnings	Unrealized gains / (losses) included in OCI	Foreign exchange	Purchases, issuances and settlements, net	Transfers in (out) of Level 3, net	Ending balance	Change in unrealized gains (losses) for the period included in earnings for assets still held at September 30, 2008
<b>Assets:</b>									
Foreign governments	\$ 36,917	\$	\$	\$ (4,958)	\$ (3,767)	\$ 35,469	\$ 17,934	\$ 81,595	\$
Corporate obligations	1,841,828	(43,232)		(125,304)	11,841	(1,027,160)	408,594	1,066,567	
Mortgage-backed securities	1,085,323	(17,282)		(159,113)	3,647	(312,808)	(173,082)	426,685	
Asset-backed securities	3,799,053	(979,286)		308,440	(27,768)	(1,595,571)	(143,265)	1,361,603	
State and municipal						22,548		22,548	
Other investments	103,841			(25,658)		(1,183)		77,000	
Total assets	\$ 6,866,962	\$ (1,039,800)	\$	\$ (6,593)	\$ (16,047)	\$ (2,878,705)	\$ 110,181	\$ 3,035,998	\$

In thousands	Balance, beginning of year	Realized (gains) / losses	Unrealized (gains) / losses included in earnings	Unrealized (gains) / losses included in OCI	Foreign exchange	Purchases, issuances and settlements, net	Transfers in (out) of Level 3, net	Ending balance	Change in unrealized gains (losses) for the period included in earnings for liabilities still held at September 30, 2008
<b>Liabilities:</b>									
Medium-term notes	\$ 399,061	\$ (6,002)	\$ (29,804)	\$	\$ (10,713)	\$ (67,948)	\$	\$ 284,594	\$ (3,298)
Derivative contracts, net	3,405,595	231,367	109,272	316	(20,945)	100,132		3,825,737	109,272
Total liabilities	\$ 3,804,656	\$ 225,365	\$ 79,468	\$ 316	\$ (31,658)	\$ 32,184	\$	\$ 4,110,331	\$ 105,974

Net transfers into Level 3 were \$197 million and \$110 million for the three and nine months ended September 30, 2008, respectively. These net transfers were principally for available-for-sale securities where inputs, which are significant to their valuation, became unobservable or observable during the quarter. Foreign governments, corporate obligations, MBS and ABS constituted the majority of the affected instruments. The net unrealized loss related to the transfers in (out) of Level 3 as of September 30, 2008 was \$114.4 million.

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Gains and losses (realized and unrealized) included in earnings pertaining to Level 3 assets and liabilities for the three months ended September 30, 2008 are reported on the Consolidated Statements of Operations as follows:

<b>In thousands</b>	<b>Unrealized gains (losses) on insured derivatives</b>	<b>Net realized gains (losses)</b>	<b>Net gains (losses) on financial instruments at fair value and foreign exchange</b>
Total gains (losses) included in earnings for the period	\$ 104,202	\$ (432,296)	\$ 193,071
Change in unrealized gains (losses) for the period included in earnings for assets and liabilities still held at September 30, 2008	\$ 100,904	\$	\$ 4,103

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries**

Gains and losses (realized and unrealized) included in earnings pertaining to Level 3 assets and liabilities for the nine months ended September 30, 2008 are reported on the Consolidated Statements of Operations as follows:

In thousands	Unrealized gains (losses) on insured derivatives	Net realized gains (losses)	Net gains (losses) on financial instruments at fair value and foreign exchange
Total gains (losses) included in earnings for the period	\$ (145,777)	\$ (1,264,924)	\$ 87,506
Change in unrealized gains (losses) for the period included in earnings for assets and liabilities still held at September 30, 2008	\$ (149,075)	\$	\$ 36,505

***Valuation Techniques*****U.S. Treasury and government agency**

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

**Foreign governments**

The fair value of foreign government obligations are generally based on observable inputs in active markets. When quoted prices are not available, fair value is determined based on a valuation model that has as inputs interest rate yield curves, cross-currency basis index spreads, and country credit spreads for structures similar to the bond in terms of issuer, maturity and seniority. These bonds are generally categorized in Level 2 of the fair value hierarchy. Bonds that contain significant inputs that are not observable are categorized as Level 3 while bonds that have quoted prices in an active market are classified as Level 1.

**Corporate obligations**

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

**Mortgage-backed securities and asset-backed securities**

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

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The Company records under the fair value provisions of SFAS 155 certain structured investments, which are included in available-for-sale securities. Fair value is derived using quoted market prices or cash flow models. As these securities are not actively traded, certain significant inputs are unobservable. These investments are categorized as Level 3 of the fair value hierarchy.

### State and municipal bonds

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

### Other investments

Other investments include the Company's interest in equity securities (including exchange-traded closed-end funds), money market mutual funds and perpetual securities. Fair value of other investments is determined by using quoted prices, live trades, or valuation models that use market-based and observable inputs. Other investments are categorized in Level 1, Level 2 or Level 3 of the fair value hierarchy.

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Put Options

The Company has access to Money Market Committed Preferred Custodial Trust ( CPCT ) securities issued in multiple trusts. The Company can put the perpetual preferred stock to the trust on any auction date in exchange for the assets of the trusts. The put option, recorded at fair value, is internally valued using LIBOR/swap rates and the Company's credit spread. As all significant inputs are market-based and observable, put options are categorized in Level 2 of the fair value hierarchy.

Medium-term notes

The Company has elected to record at fair value under the provisions of SFAS 155 four MTNs. Fair value is derived using quoted market prices or an internal cash flow model. Significant inputs into the valuation include yield curves and spreads to the swap curve. As these notes are not actively traded, certain significant inputs (e.g. spreads to the swap curve) are unobservable. These investments are categorized as Level 3 of the fair value hierarchy.

Warrants

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

Derivatives Investment Management Services & Corporate

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

In compliance with requirements of SFAS 157, the Company considers its own credit risk and that of counterparties when valuing derivative assets and liabilities. The Company has policies and procedures in place regarding counterparties, including review and approval of the counterparty and the Company's exposure limit, collateral posting requirements, collateral monitoring and margin calls on collateral. The Company manages counterparty credit risk on an individual counterparty basis through master netting arrangements covering derivative transactions in the Investment Management Services and Corporate operations. These agreements allow the Company to contractually net amounts due from a counterparty with those amounts due to such counterparty when certain triggering events occur. The Company only executes swaps under master netting agreements, which typically contain mutual credit downgrade provisions that generally provide the ability to require assignment or termination in the event either the Company or the counterparty is downgraded below a specified credit rating. The netting agreements minimize the potential for losses related to credit exposure and thus serve to mitigate the Company's nonperformance risk under these derivatives.

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

As of September 30, 2008, the mark-to-market was positive on five different Credit Support Annexes ( CSAs ) which govern collateral posting requirements between MBIA and its derivative counterparties. The aggregate positive mark-to-market for these five CSAs was \$66.0 million for which the Company did not receive collateral due to the exposure from each CSA being below the threshold for collateral posting. All five of the counterparties are rated at least A/A2 by Standard & Poor's Corporation ( S&P ) and Moody's Investor Service, Inc. ( Moody's ).

Derivatives Insurance

The derivative contracts that the Company insures cannot be legally traded and generally do not have observable market prices. In the cases with no active price quote, the Company uses a combination of internal and third-party models to estimate the fair value of these contracts. Most insured CDSs are valued using an enhanced Binomial Expansion Technique ( BET ) model (originally developed by Moody s). Significant inputs include collateral spreads, diversity scores and recovery rates. For a limited number of other insured derivatives, the Company uses industry standard models as well as proprietary models such as Black-Scholes option models and dual-default models, depending on the type and structure of the contract. All of these derivatives are categorized as Level 3 of the fair value hierarchy as a significant percentage of their value is derived from unobservable inputs. For insured swaps (other than CDSs), the Company uses internally and vendor developed models with market-based inputs (e.g. interest rate, foreign exchange rate, spreads), and are classified as Level 2 within the fair value hierarchy. Effective January 1, 2008, the Company updated its methodology to include the impact of both the counterparty and its own credit standing.



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The majority of the Company's notional derivative exposure arises from credit derivative instruments insured by MBIA Corp. As part of its core financial guarantee business until February 2008, MBIA Corp. insured CDSs entered into by LaCrosse Financial Products LLC (LaCrosse), an entity that is consolidated into MBIA's GAAP financial statements under the FIN 46(R), Consolidation of Variable Interest Entities an interpretation of ARB No. 51, criteria. In February 2008, the Company decided to cease insuring credit derivative instruments except in transactions related to the reduction of its existing insured derivative exposure.

In most cases, the Company's insured credit derivatives must be stated at fair value as they do not qualify for the financial guarantee scope exception under SFAS 133. Because they are highly customized, as described further below, there is generally no observable market for these derivatives. In the absence of such a market, the Company estimates the value of these derivatives in a hypothetical market based on internal and third-party models that simulate what a bond insurer would charge to guarantee the transaction. Such a price would be based on the expected loss for the Company's exposure based on the value of the underlying collateral within the transaction.

Description of MBIA's Insured Credit Derivatives

MBIA's insured credit derivatives referenced primarily structured pools of cash securities and CDSs. The Company generally provided CDS protection on the most senior liabilities of structured finance transactions, and at inception of the contract its exposure generally had more subordination than needed to achieve triple-A ratings from credit rating agencies (referred to as Super Triple-A exposure). The collateral for the insured derivatives was cash securities and CDSs referencing primarily corporate, asset-backed, residential mortgage-backed, commercial mortgage-backed and collateralized debt obligation securities.

MBIA also issued guarantees under principal protection fund programs, which are also accounted for as derivatives. Under these programs, MBIA's insurance operations guaranteed the return of principal to investors. Structurally, MBIA is protected by a portion of the portfolio that is rebalanced daily to match the present value of MBIA's guarantee. As of September 30, 2008, the maximum amount of future payments that the Company would be required to make under these guarantees was \$147 million. The Company has not made any payments to date relating to these guarantees and the mark-to-market gains (losses) on these derivatives for the years ended 2005, 2006 and 2007 were \$0, reflecting the extremely remote likelihood that MBIA will incur a loss.

A portion of MBIA's insured CDS contracts require that MBIA make payments for losses of the principal outstanding under the contracts only once losses on the underlying referenced collateral exceed a predetermined deductible. The total notional amount and MBIA's maximum payment obligation under these contracts as of September 30, 2008 was \$79.2 billion. The underlying referenced collateral for contracts executed in this manner largely consist of investment grade corporate debt CDOs, structured commercial mortgage-backed securities (CMBS) pools and, to a lesser extent, multi-sector CDO-squared transactions.

The total changes in fair value of the insured derivatives are recorded in Net change in fair value of insured derivatives. Realized gains (losses) and other settlements on insured derivatives include (i) net premiums received and receivable on written CDS contracts, (ii) net premiums paid and payable to reinsurers in respect of CDS contracts, (iii) losses paid and payable to CDS contract counterparties due to the occurrence of a credit event, (iv) losses recovered and recoverable on purchased CDS contracts due to the occurrence of a credit event and (v) fees relating to CDS contracts. Losses paid and payable and losses recovered and recoverable reported in Realized gains and other settlements on insured derivatives include claims and estimated recoveries thereof, respectively, only after a credit event has occurred that would require a payment under contract terms. The Unrealized gains (losses) on insured derivatives include all other changes in fair value of the derivative contracts.

Lack of an Observable Market for the Company's Insured Credit Derivatives

In determining fair value, the Company uses various valuation methods with priority given to observable market prices when they are available. Market prices are generally available for traded securities and market standard CDSs but are less available or unavailable for highly-customized CDSs. Most of the derivative contracts the Company insures are structured credit derivative transactions that are not traded and do not have observable market prices. Typical market CDSs are standardized, liquid instruments that reference tradable securities such as corporate bonds that also have observable prices. These market standard CDSs also involve collateral posting, and upon a default of the

reference bond, can be settled in cash.

In contrast, the Company's insured CDS contracts do not contain the typical CDS market standard features as described above but have been customized to replicate its financial guarantee insurance policies. The Company's insured derivative instruments provide protection on a specified or managed pool of securities or CDS with a stated deductible or with subordination beneath the MBIA-insured tranche. The Company is not required to post collateral. Under the insured CDS contract, payment is not due unless there is a

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default of an underlying reference obligation and then only after and to the extent that the aggregate amount of losses with respect to defaults of underlying reference obligations exceed the deductible or subordination in the transaction. Some contracts also provide for further deferrals of payment at the Company's option. In the event of the insolvency of or payment default by MBIA Insurance Corporation, the contracts give the counterparty the right to terminate and settle the contract.

The Company's payment obligations after a default on the underlying reference obligation vary by deal and by insurance type. There are three primary types of policy payment requirements:

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

The Company's insured credit derivative policies are structured to prevent large one-time claims upon an event of default and to allow for payments over time (i.e. pay-as-you-go basis) or at final maturity. Also, each insured CDS the Company enters into is governed by a single transaction International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement relating only to that particular transaction/insurance policy. There is no requirement for mark-to-market termination payments, under most monoline standard termination provisions, upon the early termination of the insured CDS. However, these contracts generally have mark-to-market termination payments for termination events related to MBIA Corp.'s failure to pay or insolvency and some have other mark-to-market termination payments for events within the Company's control, such as the sale of all or substantially all of the assets of MBIA Corp. An additional difference between the Company's CDS and the typical market standard CDS is that there is no acceleration of the payment to be made under the Company's insured CDS contract in the ordinary course of business unless the Company elects to accelerate at its option. Furthermore, MBIA's policies are unconditional and irrevocable and cannot be transferred to most other capital market participants as they are not licensed to write financial guarantee insurance policies. As the insured CDS contracts are accounted for as derivatives under SFAS 133, the Company does not defer the charges associated with underwriting the CDS policies and expenses them immediately.

Through reinsurance, MBIA has transferred some of the risk of loss on these contracts to other financial guarantee insurance and reinsurance companies. The fair value of the transfer under the reinsurance contract with the reinsurers is accounted for as a derivative asset. These derivative assets are valued consistently with the Company's SFAS 157 valuation policies as described in Note 2: Significant Accounting Policies. The fair value measurement for these derivative assets assumes an in-exchange premise for valuation as defined by SFAS 157 as the highest and best use by market participants. When the Company enters into a reinsurance agreement on an insured credit derivative, the Company receives a ceding commission. Ceding commissions are retained by the Company, as the primary insurer, from the ceded premium as compensation for placing the business with the reinsurer and to cover the acquisition expenses incurred by the Company to issue the CDS. Ceding commissions are calculated based on a fixed percentage of the ceded premium to the reinsurer, and the reinsurer receives the net ceded premium (total ceded premium less the ceding commission). The fixed percentage of the ceding commission is determined at the beginning of a reinsurance treaty agreement. Currently, the Company recognizes ceding commissions as a contra-expense to the Company's deferred acquisition cost amortization.

**The Company's Valuation Technique for Insured Credit Derivatives**

As a result of the differences between market standard CDS contracts and the CDS contracts insured by MBIA as described above, the Company believes there are no relevant third-party exit value market observations for its insured credit derivative contracts. Accordingly, there is no principal market for such highly structured insured credit derivatives as described in SFAS 157. In the absence of a principal market, the

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Company values these insured credit derivatives in a hypothetical market where the market participants include other comparably-rated primary financial guarantors. Since there are no active market transactions in its exposures, the Company generally uses internal and third-party models, depending on the type and structure of the contract, to estimate the fair value of its derivative contracts.

The Company's insured CDS valuation model simulates what a bond insurer would charge to guarantee the transactions at the measurement date, based on the market-implied default risk of the underlying collateral and the remaining deductible or subordination. Implicit in this approach is the notion that bond insurers would be willing to accept these contracts from the Company at a price equal to what they could issue them for in the current market. While the fee charged by financial guarantors is not an input into the Company's model, the model does estimate the amount a financial guarantor would charge to assume an insured derivative obligation at the measurement date. The estimate of the cost to transfer an obligation increases as the probability of default increases, as reflected by any combination of increased underlying credit spreads, negative credit migration, lower assumed recovery rates, lower diversity, and erosion of the deductible or subordination.

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**Model Overview**

Approximately 96% of the balance sheet fair value of insurance derivatives as of September 30, 2008 is valued using a probabilistic approach to determine the price that a bond insurer would charge to assume the risk associated with the Company's exposure on the credit derivative contract. For each transaction, the Company applies a Binomial Expansion Technique ( BET ) based model to the insured obligation to derive a probabilistic measure of expected loss for its exposure using market pricing on the underlying referenced collateral within the transaction. The BET was developed and published by Moody's to estimate a probability distribution of losses on a diverse pool of assets. The main modifications the Company has made to the BET model developed by Moody's are that a) the Company uses market credit spreads, when available and reliable, to determine default probability instead of using historical loss experience, and b) for collateral pools where the spread distribution is characterized by extremes, the Company models each segment of the pool individually instead of using an overall pool average.

The BET-based model

Calculates expected losses on a collateral pool within an insured credit derivative transaction by reference to the following (each described in further detail under Assumptions and Inputs below):

Credit spreads of the underlying collateral, based on actual spreads or spreads on similar collateral with similar ratings,

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

recovery rate for all defaulted collateral.

Allocates the expected losses for each tranche of the transaction according to its subordination level within the transaction structure.

For example, if the expected total collateral pool loss is 4% and the transaction has equity and three progressively more senior C, B, and A tranches with corresponding underlying subordination levels of 0%, 3%, 5% and 10%, then the 4% loss will have the greatest impact on the equity tranche, a lower, but significant impact on the C tranche and progressively lower impacts on the B and A tranches. MBIA usually insures the super senior tranche which has strong structural protection and the lowest exposure to collateral losses due to the underlying subordination.

At any point in time, the mark-to-market gain or loss on a transaction is the difference between the original price of the risk (the original market-implied expected loss) and the current price of the risk based on the assumed expected losses derived from the model.

The Company reports the net premiums received and receivable on written insured CDS transactions in Realized gains and other settlements on insured derivatives. Other changes in fair value of the derivative contracts are reported in Unrealized gains (losses) on insured derivatives. See Note 2: Significant Accounting Policies for further information.

**Strengths and Weaknesses**

The primary strengths of the Company's insured CDS modeling techniques are:

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- 1) The model takes account of transaction structure and the key drivers of market value. The transaction structure includes par insured, weighted average life, level of deductible or subordination and composition of collateral.
- 2) The model is a well-documented, consistent approach to marking positions that minimizes the level of subjectivity since it was originally developed by Moody's and has been modified by MBIA. The model structure, inputs and operation are well-documented so the Company believes there are strong controls around the execution of the model. MBIA has also developed a hierarchy for market-based spread inputs that helps reduce the level of subjectivity, especially during periods of high illiquidity.
- 3) The model uses market inputs whenever they are available. The key inputs to the BET model for any transactions are market-based spreads for the underlying referenced collateral, assumed recovery rates specific to the type and rating of the referenced collateral, and the diversity score of the collateral pool. These are viewed by MBIA to be the key parameters that affect the fair value of the transaction and, to the extent practicable, the inputs are market-based inputs.

The primary weaknesses of the Company's insured CDS modeling techniques are:

- 1) There is no market in which to verify the fair values developed by the Company's model, and at September 30, 2008, the markets for the inputs to the model were highly illiquid, which impacts their reliability.
- 2) There is diversity of approach to estimating the fair value of these transactions among the financial guarantee insurance companies.

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- 3) The averaging of spreads in the Company's model and use of a single diversity factor rather than using specific spreads for each piece of underlying collateral and collateral-specific correlation assumptions may distort results. Neither the data nor the analytical tools exist today to be more specific in the Company's calculation of fair value.

MBIA uses the approach described above to value almost all of the insured CDSs on tranching portfolios of credits ( portfolio CDS ) or on senior tranches of CDOs of the insured portfolio. Listed below are the key inputs and assumptions used within this approach.

**Assumptions**

The assumed credit quality, the assumed credit spread for credit risk exclusive of funding costs and the appropriate reference credit index or price source are significant assumptions that, if changed, could result in materially different fair values. Accordingly, market perceptions of credit deterioration would result in an increase in the expected price at which a bond insurer would assume the risk from MBIA due to wider credit spreads.

The key assumptions of the BET model include:

Collateral default probabilities are determined by spreads which are based on market data when available. The BET model uses the average spread of the collateral as a key input and it is assumed that market spreads reflect the market's assessment of default probability for each piece of collateral. The average spread is calculated differently depending on whether MBIA uses collateral-specific credit spreads as an input or generic spreads.

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

If collateral-specific credit spreads are not available, the next alternative is to use generic spread tables based on asset class and rating. When this is done, the Company uses the spread table that matches the average rating of the collateral portfolio. To determine the average credit rating for the collateral, the Company identifies a weighted average rating factor ( WARF ) for the collateral portfolio as described below, and then use that average rating to choose an appropriate spread.

The WARF is based on a 10,000 point scale designed by Moody's. On the WARF scale, lower numbers indicate better credit quality and ratings are not spaced equally on this scale (because, for example, the difference in default probability between AA1 and AA2 is much less than between B1 and B2). The WARF is obtained from the most recent trustee's report or calculated by the Company based on the credit ratings of the collateral in the transaction. To accomplish this calculation, MBIA first identifies the credit ratings of each piece of collateral (using, in order of preference as available, Moody's, S&P or Fitch ratings), then converts that credit rating into a rating factor on the WARF scale, averages those factors (weighted by par) to create a portfolio WARF, and then converts the portfolio WARF into an average credit rating for the pool. MBIA then uses a market index that is based on collateral type and average rating to determine the generic spread for the pool, which is input into the BET model.

These approaches have been used for most of the insured CDS transactions in MBIA's portfolio. There have been a few cases where modified approaches have been used if either there was high dispersion of ratings within an asset class or no collateral-specific or ratings-based generic spreads were available. When ratings dispersion is high, the collateral

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within an asset class has been segmented into different rating buckets and each bucket is used in calculating the overall average.

When spreads have not been available on either a collateral-specific basis or ratings-based generic basis, MBIA has used its hierarchy of spread sources (see [Inputs](#) below) to identify the most appropriate spread for that asset class and that spread is used to calculate the average spread.

The default probability is calculated using a standard model as an appropriate way to do this calculation. The model assumes that the default probability is determined by three factors: credit spread, recovery rate after default and the time period under risk.

Collateral in the portfolio is generally considered on an average basis instead of modeling each piece of collateral separately.

Correlation is modeled using a diversity score, which is calculated based on rules regarding industry or sector concentrations.

Defaults are modeled such that they are spaced evenly over time.

Recovery rates are based on historical averages and updated as market evidence warrants.



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The specific model inputs the Company uses are listed below, including how it derives inputs for market credit spreads on the underlying transaction collateral, how it determines credit quality (WARF), how it determines diversity estimation, and how it determines recovery rates.

**Credit spreads** These are obtained from market data sources published by third parties (e.g. dealer spread tables for the collateral similar to collateralized or referenced assets within the Company's transactions) as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market data is used that most closely resembles the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. This data is obtained from recognized sources and is reviewed on an ongoing basis for reasonableness and applicability to the Company's derivative portfolio.

The Company uses the spread hierarchy listed below in determining which source of spread information to use, with the rule being to use CDS spreads where available. Within each category below, if CDS spreads are not available, the Company uses cash security spreads. Cash spreads reflect trading activity in funded fixed-income instruments while CDS spreads reflect trading levels for derivative instruments that do not require actual funding. While both markets are driven in part by an assessment of the credit quality of the referenced security, there are some factors which can create significant differences in these two markets. In particular, CDS spreads can be driven at times more by speculative activity since the CDS market facilitates both long and short positions and allows for significant leverage.

Spread Hierarchy:

- 1) Actual collateral-specific credit spreads (if up-to-date and reliable market-based spreads are available, they are used).
- 2) Sector-specific spreads (JP Morgan and Citigroup spread tables by asset class and rating).
- 3) Corporate spreads (Bloomberg and Risk Metrics spread tables based on rating).
- 4) Benchmark from most relevant spread source (if no specific spreads are available and corporate spreads are not directly relevant, an assumed relationship will be used between corporate spreads or sector-specific spreads and collateral spreads).

For example, if current market based spreads are not available then the Company utilizes sector-specific spreads from spread tables provided by dealers or corporate cash spread tables. The generic spread utilized is based on the nature of the underlying collateral in the deal. Deals with corporate collateral use the corporate spread table. Deals with asset-backed collateral use one or more of the dealer asset-backed tables as discussed below. If there are no observable market spreads for the specific collateral, and sector-specific and corporate spread tables are not appropriate to estimate the spread of a given type of collateral, the Company uses the fourth alternative in its hierarchy. An example is tranching corporate collateral, in which case the Company uses corporate spreads as an input and estimate the spread on the tranching position. In each case the priority is to use information for CDS spreads if available, and cash spreads as a second priority.

As of September 30, 2008, actual collateral credit spreads were used in one transaction. Sector-specific spreads were used in 24% of the transactions. Corporate spreads were used in 26% of the transactions and spreads benchmarked from the most relevant spread source (number 4 above) were used for 50% of the transactions. When determining the percentages above, there were some transactions where MBIA incorporated multiple levels within the hierarchy. For example, for some transactions MBIA used actual collateral-specific credit spreads (number 1 above) in combination with a calculated spread based on an assumed relationship (number 4 above). In those cases, MBIA classified the transaction as being benchmarked from the most relevant spread source (number 4 above) even though the majority of the average spread was from actual

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collateral-specific spreads. WARF was used to determine the credit rating which was used to determine the appropriate spread for 95% of the transactions.

Over time the data inputs can change as new sources become available or existing sources are discontinued or are no longer considered to be the most appropriate. It is the objective of the Company to move to higher levels on the hierarchy whenever possible, but it is sometimes necessary to move to lower priority inputs because of discontinued data sources or assessments that the higher priority inputs are no longer considered to be representative of market spreads for a given type of collateral. This can happen, for example, if transaction volume changes such that a previously used spread index is no longer viewed as being reflective of current market levels. The Company believes such a circumstance existed for CMBS collateral in insured CDSs during the first nine months of 2008. See section Impact of Current Market Conditions on Data Inputs for CMBS Transactions below.

The Company's process provides for a monthly update of the proportion of each type of collateral in each deal from the respective trustees. Using the most recent monthly applicable market spread data based on the hierarchy above, the

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Company then calculates a weighted average spread to be used in the valuation process (i.e., the spread for each component of collateral is weighted by its percentage of total collateral to calculate the weighted average spread). If collateral-specific spreads are not available, the WARF is used to determine the credit rating which is used to determine the appropriate spread.

**Diversity Scores** The diversity score estimates the number of uncorrelated assets that are assumed to have the same loss distribution as the actual portfolio of correlated assets. For example, if a portfolio of 100 assets had a diversity score of 50, this means that the 100 correlated assets are assumed to have the same loss distribution as 50 uncorrelated assets. A lower diversity score will generally negatively impact the valuation for the Company's senior tranche since a low diversity score represents higher assumed correlation, increasing the chances of a large number of defaults, and thereby increasing the risk of loss in the senior tranche. The calculation methodology for a diversity score takes into account the extent to which a portfolio is diversified by industry. The diversity of industry or asset class is calculated internally, if not reported by the trustee on a regular basis. The diversity score is calculated at the inception of the deal and refined as necessary as the portfolio statistics change over time. MBIA calculates the diversity score on a periodic basis for deals that do not require the trustee to provide this measure. The internally developed model used to calculate the diversity score is based on Moody's methodology and uses MBIA's internal assumptions on default correlation. Inputs such as underlying collateral rating, notional amount, asset type and remaining life are used in the model. The diversity score is a measure to estimate the diversification in a portfolio, specifically in the context of a CDO.

**Recovery Rate** The recovery rate represents the percentage of par expected to be recovered after an asset defaults. MBIA generally uses rating agency recovery assumptions. These assumptions may be adjusted to account for differences in the characteristics and performance of the collateral used by the rating agencies in determining their recovery rate assumptions and the actual collateral in MBIA-insured transactions. The Company may also adjust rating agency assumptions based on the performance of the collateral manager. The Company periodically reviews recovery rate assumptions in light of new market information and rating agency reports, and makes changes to these assumptions as necessary. For example, in the first quarter of this year, the Company received a new S&P publication showing that the agency was lowering its recovery rate assumptions for securities backed by ALT-A and subprime real estate collateral. Although the collateral that backs MBIA's transactions is on average of better quality than that referred to in the S&P report, the Company used this report in conjunction with the significantly wider trading spreads for these assets as an indication that recovery rates for MBS collateral warranted a change. Therefore, MBIA decided to lower recovery rate assumptions for MBS collateral by approximately 10 percentage points. Since there are differences in recovery rate assumptions among the rating agencies themselves, the Company is required to make a judgment as to the most appropriate recovery assumption to use. There were no changes to recovery rates in the second or third quarter of 2008.

**Net Par Outstanding and Net Unrealized Gains (Losses) on Insured Derivatives**

The following table presents the net par outstanding as of September 30, 2008 and net unrealized gains (losses) on insured derivatives for the nine months ended September 30, 2008 by fair value technique of all insured credit derivatives within the Company's insurance portfolio.

In millions	% of Net Par Outstanding	Net Par Outstanding	Net Unrealized Gains (Losses)
Binomial expansion valuation model	85.0%	\$ 122,032	\$ (54)
Specific dealer quotes	0.3	427	(104)
Other	14.7	21,099	10
Total	100.0%	\$ 143,558	\$ (148)

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The Company's investment management services operations and corporate operations enter into over-the-counter derivatives, such as interest rate swaps, currency swaps, credit default swaps and total return swaps, which predominately trade in liquid markets. The fair values for these derivatives are either based on specific dealer quotes or estimated using valuation models that combine observable market prices and market data inputs. For further information regarding the Company's derivative portfolio, see the Market Risk section included herein.

### Impact of Current Market Conditions on Data Inputs for CMBS Transactions

Approximately \$37 billion of the gross par of insured derivative transactions subject to fair value accounting under SFAS 133 include substantial amounts of CMBS and commercial mortgage collateral. In 2007, the spreads implied by the pricing on the CMBX indices had been used as an input for the spreads on the underlying referenced collateral in these transactions. In light of the current market

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conditions, the Company believes that there was a significant disconnect in the first nine months of the year between cumulative loss expectations of MBIA and market analysts on underlying commercial mortgages and the loss expectations implied by the CMBX index or the CMBS spread tables the Company had been using. During this period, commercial mortgage securities were experiencing historically low default and loss rates. The underlying mortgage collateral in the insured transactions in MBIA's portfolio have performed in line with general commercial mortgage performance and continue to be rated AAA by Moody's or S&P.

Transaction volume in CMBS and trading activity in the CMBX were both at dramatically lower levels during the first nine months of the year than they had been in prior periods, and the implied loss rates on underlying mortgages in MBIA's spread sources of these markets were far higher than that forecast by fundamental researchers and MBIA's internal analysis. In addition, the implied illiquidity premium on the index, in the context of MBIA's model, suggested that monoline insurers would capture 100% of the changes in spread on the underlying collateral, which has not been the case in other periods of market illiquidity (since monoline insurers have buy and hold portfolios, spread changes that reflect illiquidity versus changes in perceived credit fundamentals typically are not reflected in pricing). As a result, the unadjusted CMBX indices and the CMBS spread tables were deemed to be unreliable model inputs for the purpose of estimating fair value in the Company's hypothetical market among monoline insurers.

In the first quarter of 2008, MBIA modified the spread input in the BET model to reflect a combination of market pricing levels and fundamental analysis of CMBS credit, as determined by parties independent to MBIA. The Company's revised model input combines the expectations for CMBS credit performance as forecasted by the average of two investment banks' research departments with the illiquidity premium implied by the CMBX indices. The illiquidity premium that the Company used for CMBS collateral was the CMBS index for the senior triple-A tranche. The CMBX index is issued in series representing vintages of CMBS origination. The Company matches its collateral to the CMBX series appropriate to the vintage of the collateral since these spreads differ across the various CMBX series. For example, for collateral that was originated in the second half of 2006, the illiquidity premium was set as the CMBX series 1, triple-A index. The sum of the illiquidity premium plus the derived credit spread based on the average of the two investment banks' research department loss estimates is the analog index that is used as an alternative input in the Company's BET-based approach.

MBIA believes that it is important to apply consistently its valuation techniques. However, the Company may consider making enhancements to its valuation technique if they result in a measurement that is more representative of fair value in the circumstances. Additionally, it is the Company's policy to use observable inputs (Level 2 inputs) whenever possible. To calculate the spread for CMBS tranches, the Company divides a Wall Street research estimate of cumulative net losses (CNL) by an estimated average life of the tranche. The Company's preferred approach would be to use an average life that is known to be consistent with the CNL assumption. Unfortunately the research departments that published CNL assumptions have not provided corresponding average life assumptions. During prior quarters, the Company estimated average life as tranche duration, as published by independent sources. At the time it was thought that this would be the most consistent and appropriate approach. During the third quarter of 2008, as a result of continued widening of published credit spreads, it became clear that these tranche duration assumptions were not compatible with the expectations of future losses that a market participant would use in determining the fair value of the Company's insured CDS contracts. Therefore, during the third quarter of 2008, the Company determined a better estimate of average life would be an internally developed tranche weighted average life of the Company's CMBS transactions that is more consistent with other model assumptions. Management believes that this change results in a measurement that is more representative of fair value for its insured CDS portfolio. Management will continue to assess the reasonableness of observable market information in determining fair value of its insured CDS portfolio and may make further adjustments to the estimate based on what the Company believes a market participant would use in considering fair value. The impact of this change in the estimated fair value of its insured CDS portfolio was to reduce the liability by approximately \$901 million (pre-tax) as of September 30, 2008.

**Nonperformance Risk Adjustment**

In compliance with requirements of SFAS 157, effective January 1, 2008, the Company updated its valuation methodology for insured credit derivative liabilities to incorporate the Company's own nonperformance risk. This was calculated by discounting at MBIA Corp.'s CDS spreads the estimated market value loss on insured CDSs at September 30, 2008. This resulted in a pre-tax \$7.1 billion reduction in the fair value of the derivative liability. Nonperformance risk is a fair value concept and does not contradict the Company's internal view, based on fundamental credit analysis, that the Company will be able to pay all claims when due.

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Prior to the third quarter of 2008, the difference between the MBIA credit adjusted value of certain portions of the derivative liability and the non-MBIA credit adjusted value of those same portions of the derivative liability was immaterial relative to the Company's unrealized gains (losses) on insured derivatives reported on the Company's income statement. As a result, the Company made no nonperformance risk adjustment for this portion of the derivative liability. During the third quarter of 2008, the magnitude of the difference between the MBIA credit adjusted value of this portion of the derivative liability and the non-MBIA credit adjusted value of the same portion of the derivative liability was material relative to the Company's unrealized gains (losses) on insured derivatives reported on the Company's income statement. Therefore, the Company determined that other market participants would recognize that these liabilities should be treated as long-term because the Company has the option to pay these liabilities over time. Therefore, the Company adjusted its estimate of nonperformance risk to reflect the longer exposure period for this portion of the liability. Absent this valuation refinement, the estimated fair value liability of the insured CDS portfolio would have been higher by approximately \$683 million (pre-tax) as of September 30, 2008.

Effective January 1, 2008, for its ceded insured credit derivatives portfolio, the Company also made credit valuation adjustments by incorporating the nonperformance risk of the reinsurer.

### *Fair Value Option*

SFAS 159 provides the Company an irrevocable option to measure eligible financial assets and liabilities at fair value, with changes in fair value recorded in earnings, that otherwise are not permitted to be accounted for at fair value under other accounting standards. The option is applied, on a contract-by-contract basis, to an entire contract and not only to specific risks, specific cash flows or other portions of that contract. Upfront costs and fees related to a contract for which the fair value option is elected are recognized in earnings as incurred and not deferred.

Effective January 1, 2008, the Company adopted SFAS 159 and did not elect the fair value option for any eligible financial instruments.

The Company previously elected to record at fair value under SFAS 155, certain financial instruments that contained an embedded derivative requiring bifurcation under SFAS 133. These instruments included certain MTNs and certain available-for-sale securities. Management elected to fair value hybrid instruments in those instances where the host contract and the embedded derivative were not separately subject to a hedging relationship.

Changes in fair value of the hybrid instruments, as measured under the fair value provisions of SFAS 155, are reflected in Net gains (losses) on financial instruments at fair value and foreign exchange. The contractual interest coupon payments on the MTNs are recorded as Interest expense on the Consolidated Statements of Operations.

For the three and nine months ended September 30, 2008, the decrease in the fair value of financial assets, which related to hybrid financial instruments, totaled \$0.8 million and \$4.8 million on a pre-tax basis, respectively, or \$0.5 million and \$3.1 million on an after-tax basis, respectively.

For the three and nine months ended September 30, 2008, the decrease in fair value of financial liabilities, which related to four MTNs, totaled \$29.7 million and \$40.5 million on a pre-tax basis, respectively, or \$19.3 million and \$26.3 million on an after-tax basis, respectively.

### NOTE 7: Business Segments

MBIA manages its activities primarily through two principal business operations: insurance and investment management services. The Company's reportable segments within its business operations are determined based on the way management assesses the performance and resource requirements of such operations.

The insurance operations is a reportable segment and provides unconditional and irrevocable guarantees of the payment of principal of, and interest or other amounts owing on, insured obligations when due. The obligations are generally not subject to acceleration, except that MBIA may have the right, at its discretion, to accelerate insured obligations upon default or otherwise. Certain guaranteed investment contracts written by MBIA Inc. are terminable upon ratings downgrades, and if MBIA Inc. were to have insufficient assets to pay the termination payments, MBIA Corp. would make such payments. MBIA issues financial guarantees for municipal bonds, ABS and MBS, investor-owned utility bonds, bonds backed by publicly or privately funded public-purpose projects, bonds issued by sovereign and sub-sovereign entities, obligations collateralized by diverse pools of corporate loans and pools of corporate and asset-backed bonds, and bonds backed by other revenue sources such as corporate franchise revenues. Additionally, MBIA had insured credit default swaps primarily on pools of collateral, which it considered part of its core financial guarantee business. On February 25, 2008, the Company announced that it ceased insuring new credit derivative contracts except in transactions related to the reduction of existing derivative exposure. In addition, the Company announced that it suspended the writing of all new structured finance business for approximately six months. Currently, the structured finance industry is generating very little new business opportunities, and it continues to be highly uncertain how or when the company may re-engage this market. This segment includes all activities related to global credit enhancement services provided principally by MBIA Corp.



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**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries**

The Company's investment management services operations has a substantial asset/liability management portfolio, in which it has issued debt and investment agreements to capital markets and municipal investors, and then purchased assets that largely match the duration of those liabilities, which are insured by MBIA Corp. The ratings downgrades of MBIA Corp. have resulted in a reduction of funding activities and the termination of certain investment agreements. The Company's investment management services operations also provide an array of products and services to the public, not-for-profit and corporate sectors. Such products and services are provided primarily by MBIA Inc. and certain of its wholly owned subsidiaries and include cash management, discretionary asset management and fund administration services. The investment management services operations' reportable segments consist of: asset/liability products, which include investment agreements and MTNs not related to the conduit segment; advisory services, which consist of third-party and related-party fee-based asset management; and conduits.

The asset/liability products segment principally consists of the activities of MBIA Investment Management Corp. ( IMC ), MBIA Global Funding, LLC ( GFL ) and Euro Asset Acquisition Limited ( EAAL ). IMC, along with MBIA Inc., provides customized investment agreements, guaranteed by MBIA Corp., for bond proceeds and other public funds for such purposes as construction, loan origination, escrow and debt service or other reserve fund requirements. It also provides customized products for funds that are invested as part of asset-backed or structured product transactions. GFL raises funds through the issuance of MTNs with varying maturities, which are, in turn, guaranteed by MBIA Corp. GFL lends the proceeds of these MTN issuances to MBIA Inc. ( GFL Loans ). MBIA Inc. invests the proceeds of investment agreements and GFL Loans in eligible investments, which consist of investment grade securities at time of purchase with a minimum average double-A credit quality rating. MBIA Inc. primarily purchases domestic securities, which are pledged to MBIA Corp. as security for its guarantees on investment agreements and MTNs. Additionally, MBIA Inc. loans a portion of the proceeds from investment agreements and MTNs to EAAL. EAAL primarily purchases foreign assets as permitted under the Company's investment guidelines.

The advisory services segment primarily consists of the operations of MBIA Municipal Investors Service Corporation ( MBIA-MISC ), MBIA Capital Management Corp. ( CMC ) and MBIA Asset Management UK ( AM-UK ). MBIA-MISC provides investment management programs, including pooled investments products and customized asset management services. In addition, MBIA-MISC provides portfolio accounting and reporting for state and local governments, including school districts. MBIA-MISC is a Securities and Exchange Commission ( SEC )-registered investment adviser. CMC provides fee-based asset management services to the Company, its affiliates and third-party institutional clients. CMC is an SEC-registered investment adviser and Financial Industry Regulatory Authority member firm. AM-UK provides fee-based asset management services to the Company's foreign insurance affiliates and EAAL, and to third-party institutional clients and investment structures. AM-UK is registered with the Financial Services Authority in the United Kingdom ( U.K. ).

The Company's conduit segment administers two multi-seller conduit financing vehicles through MBIA Asset Finance, LLC. The conduits provide funding for multiple customers through special purpose vehicles that issue commercial paper and medium-term notes.

The Company's corporate operations are a reportable segment and include revenues and expenses that arise from general corporate activities, such as net investment income, net gains and losses, interest expense on MBIA Inc. debt and general corporate expenses.



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries**

The following tables summarize the Company's operations for the three and nine months ended September 30, 2008 and 2007:

In thousands	Three months ended September 30, 2008					Consolidated
	Insurance	Investment Management Services	Corporate	Eliminations	Derivative Reclassification	
Revenues <sup>(1)</sup>	\$ 422,763	\$ 210,340	\$ 6,554	\$	\$ (38,375)	\$ 601,282
Realized gains (losses) and other settlements on insured derivatives					34,264	34,264
Unrealized gains (losses) on insured derivatives	104,818					104,818
Net realized gains (losses)	25,992	(177,838)	(3,838)		(270,614)	(426,298)
Net gains (losses) on financial instruments at fair value and foreign exchange	(6,819)	(383,582)	(119,425)		275,626	(234,200)
Net gains on extinguishment of debt	9,980	205,394	24,524			239,898
Inter-segment revenues <sup>(2)</sup>	3,931	4,183	897	(9,011)		
Total revenues	560,665	(141,503)	(91,288)	(9,011)	901	319,764
Interest expense	47,723	197,100	18,486		901	264,210
Loss and LAE incurred	982,514					982,514
Operating expenses	87,822	21,389	10,418			119,629
Inter-segment expense <sup>(2)</sup>	361	8,271	379	(9,011)		
Total expenses	1,118,420	226,760	29,283	(9,011)	901	1,366,353
Income (loss) before taxes	\$ (557,755)	\$ (368,263)	\$ (120,571)	\$	\$	\$ (1,046,589)
Identifiable assets	\$ 17,999,923	\$ 19,178,522	\$ 473,356	\$	\$	\$ 37,651,801

In thousands	Three months ended September 30, 2007					Consolidated
	Insurance	Investment Management Services	Corporate	Eliminations	Derivative Reclassification	
Revenues <sup>(1)</sup>	\$ 352,108	\$ 430,636	\$ 1,052	\$	\$ (27,768)	\$ 756,028
Realized gains (losses) and other settlements on insured derivatives					31,218	31,218
Unrealized gains (losses) on insured derivatives	(341,706)					(341,706)
Net realized gains (losses)	6,411	(5,973)	(749)		650	339
Net gains (losses) on financial instruments at fair value and foreign exchange	6,389	(17,407)	317		(3,958)	(14,659)
Inter-segment revenues <sup>(2)</sup>	1,422	6,745	(330)	(7,837)		
Total revenues	24,624	414,001	290	(7,837)	142	431,220
Interest expense	19,514	378,685	20,187		142	418,528
Loss and LAE incurred	22,203					22,203
Operating expenses	46,569	21,138	5,605			73,312
Inter-segment expense <sup>(2)</sup>		6,898	939	(7,837)		

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Total expenses	88,286	406,721	26,731	(7,837)	142	514,043
Income (loss) before taxes	\$ (63,662)	\$ 7,280	\$ (26,441)	\$	\$	\$ (82,823)
Identifiable assets	\$ 12,967,367	\$ 31,702,852	\$ 658,787	\$	\$	\$ 45,329,006

- (1) Represents the sum of third-party financial guarantee net premiums earned, net investment income, insurance-related fees and reimbursements, investment management fees and other fees, and insurance recoveries.
- (2) Represents intercompany premium income and expense, intercompany asset management fees and expenses and intercompany interest income and expense pertaining to intercompany receivable and payables.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****Nine months ended September 30, 2008**

<b>In thousands</b>	<b>Insurance</b>	<b>Investment Management Services</b>	<b>Corporate</b>	<b>Eliminations</b>	<b>Derivative Reclassification</b>	<b>Consolidated</b>
Revenues <sup>(1)</sup>	\$ 1,196,888	\$ 856,677	\$ 22,504	\$	\$ (133,819)	\$ 1,942,250
Realized gains (losses) and other settlements on insured derivatives					102,325	102,325
Unrealized gains (losses) on insured derivatives	(147,972)					(147,972)
Net realized gains (losses)	68,106	(1,105,738)	(2,970)		(372,167)	(1,412,769)
Net gains (losses) on financial instruments at fair value and foreign exchange	155,239	(523,238)	(108,157)		405,303	(70,853)
Net gains on extinguishment of debt	9,980	284,611	24,524			319,115
Inter-segment revenues <sup>(2)</sup>	6,403	13,350	(189)	(19,564)		
<b>Total revenues</b>	<b>1,288,644</b>	<b>(474,338)</b>	<b>(64,288)</b>	<b>(19,564)</b>	<b>1,642</b>	<b>732,096</b>
Interest expense	141,134	761,414	58,577		1,642	962,767
Loss and LAE incurred	1,292,466					1,292,466
Operating expenses	213,654	50,570	23,713			287,937
Inter-segment expense <sup>(2)</sup>	361	20,066	(863)	(19,564)		
<b>Total expenses</b>	<b>1,647,615</b>	<b>832,050</b>	<b>81,427</b>	<b>(19,564)</b>	<b>1,642</b>	<b>2,543,170</b>
Income (loss) before taxes	\$ (358,971)	\$ (1,306,388)	\$ (145,715)	\$	\$	\$ (1,811,074)
Identifiable assets	\$ 17,999,923	\$ 19,178,522	\$ 473,356	\$	\$	\$ 37,651,801

**Nine months ended September 30, 2007**

<b>In thousands</b>	<b>Insurance</b>	<b>Investment Management Services</b>	<b>Corporate</b>	<b>Eliminations</b>	<b>Derivative Reclassification</b>	<b>Consolidated</b>
Revenues <sup>(1)</sup>	\$ 1,088,955	\$ 1,175,217	\$ 22,118	\$	\$ (71,360)	\$ 2,214,930
Realized gains (losses) and other settlements on insured derivatives					83,941	83,941
Unrealized gains (losses) on insured derivatives	(357,772)					(357,772)
Net realized gains (losses)	38,455	(1,949)	(9,244)		2,576	29,838
Net gains (losses) on financial instruments at fair value and foreign exchange	10,244	(29,024)	151		(16,208)	(34,837)
Inter-segment revenues <sup>(2)</sup>	2,833	19,533	(1,267)	(21,099)		
<b>Total revenues</b>	<b>782,715</b>	<b>1,163,777</b>	<b>11,758</b>	<b>(21,099)</b>	<b>(1,051)</b>	<b>1,936,100</b>
Interest expense	61,961	1,034,573	60,548		(1,051)	1,156,031
Loss and LAE incurred	63,655					63,655
Operating expenses	148,243	58,956	21,980			229,179
Inter-segment expense <sup>(2)</sup>		19,619	1,480	(21,099)		
<b>Total expenses</b>	<b>273,859</b>	<b>1,113,148</b>	<b>84,008</b>	<b>(21,099)</b>	<b>(1,051)</b>	<b>1,448,865</b>
Income (loss) before taxes	\$ 508,856	\$ 50,629	\$ (72,250)	\$	\$	\$ 487,235

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Identifiable assets	\$ 12,967,367	\$ 31,702,852	\$ 658,787	\$	\$	\$ 45,329,006
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- (1) Represents the sum of third-party financial guarantee net premiums earned, net investment income, insurance-related fees and reimbursements, investment management fees and other fees, and insurance recoveries.
- (2) Represents intercompany premium income and expense, intercompany asset management fees and expenses and intercompany interest income and expense pertaining to intercompany receivable and payables.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries**

The following table summarizes the segments within the investment management services operations for the three and nine months ended September 30, 2008 and 2007:

In thousands	Three months ended September 30, 2008				Total Investment Management Services
	Asset/ Liability Products	Advisory Services	Conduits	Eliminations	
Revenues <sup>(1)</sup>	\$ 186,055	\$ 11,089	\$ 17,379	\$	\$ 214,523
Net realized gains (losses)	(178,221)	383			(177,838)
Net gains (losses) on financial instruments at fair value and foreign exchange	(381,741)	773	(2,614)		(383,582)
Net gains on extinguishment of debt	205,394				205,394
Inter-segment revenues <sup>(2)</sup>	883	4,031		(4,914)	
Total revenues	(167,630)	16,276	14,765	(4,914)	(141,503)
Interest expense	182,012		19,024		201,036
Operating expenses	10,580	11,280	3,864		25,724
Inter-segment expenses <sup>(2)</sup>	3,289	1,497	128	(4,914)	
Total expenses	195,881	12,777	23,016	(4,914)	226,760
Income (loss) before taxes	\$ (363,511)	\$ 3,499	\$ (8,251)	\$	\$ (368,263)
Identifiable assets	\$ 16,222,198	\$ 119,277	\$ 2,809,424	\$ 27,623	\$ 19,178,522

  

In thousands	Three months ended September 30, 2007				Total Investment Management Services
	Asset/ Liability Products	Advisory Services	Conduits	Eliminations	
Revenues <sup>(1)</sup>	\$ 350,340	\$ 13,005	\$ 74,036	\$	\$ 437,381
Net realized gains (losses)	(5,980)	7			(5,973)
Net gains (losses) on financial instruments at fair value and foreign exchange	(12,663)	(34)	(4,710)		(17,407)
Inter-segment revenues <sup>(2)</sup>	1,914	5,869		(7,783)	
Total revenues	333,611	18,847	69,326	(7,783)	414,001
Interest expense	312,370		66,417		378,787
Operating expenses	10,314	13,139	4,481		27,934
Inter-segment expenses <sup>(2)</sup>	4,868	2,040	972	(7,880)	
Total expenses	327,552	15,179	71,870	(7,880)	406,721
Income (loss) before taxes	\$ 6,059	\$ 3,668	\$ (2,544)	\$ 97	\$ 7,280

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Identifiable assets	\$ 26,889,430	\$ 49,925	\$ 4,793,887	\$ (30,390)	\$ 31,702,852
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- (1) Represents the sum of third-party interest income, investment management services fees and other fees.
- (2) Represents intercompany asset management fees and expenses plus intercompany interest income and expense pertaining to intercompany debt.

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In thousands	Nine months ended September 30, 2008				Total Investment Management Services
	Asset/ Liability Products	Advisory Services	Conduits	Eliminations	
Revenues <sup>(1)</sup>	\$ 746,585	\$ 34,773	\$ 88,669	\$	\$ 870,027
Net realized gains (losses)	(1,106,026)	288			(1,105,738)
Net gains (losses) on financial instruments at fair value and foreign exchange	(519,916)	781	(4,103)		(523,238)
Net gains on extinguishment of debt	284,611				284,611
Inter-segment revenues <sup>(2)</sup>	3,399	15,675		(19,074)	
Total revenues	(591,347)	51,517	84,566	(19,074)	(474,338)
Interest expense	687,397		78,558		765,955
Operating expenses	28,750	27,347	9,998		66,095
Inter-segment expenses <sup>(2)</sup>	12,946	5,525	603	(19,074)	
Total expenses	729,093	32,872	89,159	(19,074)	832,050
Income (loss) before taxes	\$ (1,320,440)	\$ 18,645	\$ (4,593)	\$	\$ (1,306,388)
Identifiable assets	\$ 16,222,198	\$ 119,277	\$ 2,809,424	\$ 27,623	\$ 19,178,522

  

In thousands	Nine months ended September 30, 2007				Total Investment Management Services
	Asset/ Liability Products	Advisory Services	Conduits	Eliminations	
Revenues <sup>(1)</sup>	\$ 964,756	\$ 39,431	\$ 190,563	\$	\$ 1,194,750
Net realized gains (losses)	(1,705)	5	(249)		(1,949)
Net gains (losses) on financial instruments at fair value and foreign exchange	(23,220)	(74)	(5,730)		(29,024)
Inter-segment revenues <sup>(2)</sup>	6,320	16,720	511	(23,551)	
Total revenues	946,151	56,082	185,095	(23,551)	1,163,777
Interest expense	867,404		167,392		1,034,796
Operating expenses	27,981	36,751	13,620		78,352
Inter-segment expenses <sup>(2)</sup>	13,706	5,672	3,535	(22,913)	
Total expenses	909,091	42,423	184,547	(22,913)	1,113,148
Income (loss) before taxes	\$ 37,060	\$ 13,659	\$ 548	\$ (638)	\$ 50,629
Identifiable assets	\$ 26,889,430	\$ 49,925	\$ 4,793,887	\$ (30,390)	\$ 31,702,852

<sup>(1)</sup> Represents the sum of third-party interest income, investment management services fees and other fees.

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(2) Represents intercompany asset management fees and expenses plus intercompany interest income and expense pertaining to intercompany debt.

A portion of financial guarantee premiums and revenues on insured derivatives reported within the insurance segment are generated outside the U.S. The following table summarizes financial guarantee net premiums earned and revenues earned on insured derivatives by geographic location of risk for the three and nine months ended September 30, 2008 and 2007.

<b>In millions</b>	<b>3<sup>rd</sup> Quarter</b>		<b>Year-to-date</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Total premiums earned:</b>				
United States	\$ 213	\$ 144	\$ 562	\$ 463
United Kingdom	11	12	33	33
Europe (excluding United Kingdom)	8	8	26	21
Internationally diversified	18	20	53	65
Central and South America	13	11	39	28
Asia	8	8	23	24
Other	5	4	13	12
<b>Total</b>	<b>\$ 276</b>	<b>\$ 207</b>	<b>\$ 749</b>	<b>\$ 646</b>



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****NOTE 8: Loss and Loss Adjustment Expense Reserves (LAE)**

MBIA establishes two types of loss and LAE reserves for non-derivative financial guarantees: case basis reserves and an unallocated loss reserve. See Note 2: Significant Accounting Policies included herein and in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007 for a description of the Company's loss reserving policy. A summary of the case basis and unallocated activity and the components of the liability for loss and LAE reserves are presented in the following table:

<b>In thousands</b>	<b>3Q 2008</b>	<b>2Q 2008</b>	<b>1Q 2008</b>
<b>Case basis loss and LAE reserves:</b>			
Beginning balance	\$ 1,111,262	\$ 1,329,863	\$ 911,880
Less: reinsurance recoverable	72,556	107,783	82,041
<b>Net beginning balance</b>	<b>1,038,706</b>	<b>1,222,080</b>	<b>829,839</b>
<b>Case basis transfers from unallocated loss reserve related to:</b>			
Current year	495,654	6,788	461,822
Prior years	465,607	8,380	47,814
<b>Total</b>	<b>961,261</b>	<b>15,168</b>	<b>509,636</b>
<b>Net paid (recovered) related to:</b>			
Current year	148,627	94,313	3,948
Prior years	286,316	104,229	113,447
<b>Total net (recovered) paid</b>	<b>434,943</b>	<b>198,542</b>	<b>117,395</b>
<b>Net ending balance</b>	<b>1,565,024</b>	<b>1,038,706</b>	<b>1,222,080</b>
Plus: reinsurance recoverable	107,262	72,556	107,783
<b>Case basis loss and LAE reserve ending balance</b>	<b>1,672,286</b>	<b>1,111,262</b>	<b>1,329,863</b>
<b>Unallocated loss reserve:</b>			
Beginning balance	219,691	212,515	434,543
Losses and LAE incurred	982,514	22,344	287,608
Transfers to case basis and LAE reserves	(961,261)	(15,168)	(509,636)
<b>Unallocated loss reserve ending balance</b>	<b>240,944</b>	<b>219,691</b>	<b>212,515</b>
<b>Total</b>	<b>\$ 1,913,230</b>	<b>\$ 1,330,953</b>	<b>\$ 1,542,378</b>

The unallocated loss reserve approximated \$241 million as of September 30, 2008, which represents the Company's estimate of losses, associated with credit deterioration, that have occurred in the Company's insured portfolio but have not been specifically identified and is available for future case-specific activity. In the first nine months of 2008, additions to case basis reserves related to MBIA's insured exposure to second-lien residential mortgage-backed securities (RMBS) transactions consisting of home equity lines of credit and closed-end second-lien mortgages

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totaled \$1,659 million. The Company incurred \$1,292 million of loss and loss adjustment expenses for the nine months ended September 30, 2008. Of the \$1,292 million, \$66 million was based on the Company's loss factor of 14.5% of the insurance segment's scheduled net earned premium and \$1,226 million represented additional loss and loss adjustment expenses related to insured RMBS exposure.

Total net paid activity for the nine months ended September 30, 2008 of \$751 million primarily related to insured obligations within MBIA's RMBS and manufactured housing sectors. The Company had salvage and subrogation receivables of \$265 million as of September 30, 2008 included in Other assets. Amounts due to reinsurers related to salvage and subrogation totaled \$12 million as of September 30, 2008 and are included in Other liabilities.

The Company's Insured Portfolio Management Division (IPM) monitors MBIA's outstanding insured obligations with the objective of minimizing losses. IPM meets this objective by identifying issuers that, because of deterioration in credit quality or changes in the economic, regulatory or political environment, are at a heightened risk of defaulting on debt service of obligations insured by MBIA. In such cases, IPM works with the issuer, trustee, bond counsel, servicer, underwriter and other interested parties in an attempt to alleviate or remedy the problem and avoid defaults on debt service payments. IPM works closely with the Company's Risk Management function and the applicable business unit to analyze insured obligation performance and credit risk parameters, both before and after an obligation is insured.

Once an obligation is insured, MBIA typically requires the issuer, servicer (if applicable) and the trustee to furnish periodic financial and asset related information, including audited financial statements, to IPM for review. IPM also monitors publicly available information related to insured obligations. Potential problems uncovered through this review, such as poor financial results, low fund balances, covenant or trigger violations and trustee or servicer problems or other events that could have an adverse impact on the insured obligation, could result in an immediate surveillance review and an evaluation of possible remedial actions. IPM also monitors and evaluates the impact on issuers of general economic conditions, current and proposed legislation and regulations, as well as state and municipal finances and budget developments.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries**

Insured obligations are monitored periodically. The frequency and extent of such monitoring is based on the criteria and categories described below. Insured obligations that are judged to merit more frequent and extensive monitoring or remediation activities due a deterioration in the underlying credit quality of the insured obligation or the occurrence of adverse events related to the underlying credit of the issuer are assigned to a surveillance category ( Caution List-Low, Caution List-Medium, Caution List-High, or Classified List ) depending on the extent of credit deterioration or the nature of the adverse events. IPM monitors insured obligations assigned to a surveillance category more frequently and, if needed, develops a remediation plan to address any credit deterioration. The Company does not establish any case basis reserves for insured obligations that are assigned to Caution List-Low, Caution List-Medium or Caution List-High. In the event MBIA determines that it must pay a claim or that a claim is probable and estimable with respect to an insured transaction, it places the insured transaction on its Classified List and establishes a case basis reserve. The following provides a description of each surveillance category:

Caution List Low Includes issuers where debt service protection is adequate under current and anticipated circumstances. However, debt service protection and other measures of credit support and stability may have declined since the transaction was underwritten and the issuer is less able to withstand further adverse events. Transactions in this category generally require more frequent monitoring than transactions that do not appear within a surveillance category. IPM subjects issuers in this category to heightened scrutiny.

Caution List Medium Includes issuers where debt service protection is adequate under current and anticipated circumstances, although adverse trends have developed and are more pronounced than for Caution List Low. Issuers in this category may have breached one or more covenants or triggers. These issuers are more closely monitored by IPM but generally take remedial action on their own.

Caution List High Includes issuers where more proactive remedial action is needed but where no defaults on debt service payments are expected. Issuers in this category exhibit more significant weaknesses, such as low debt service coverage, reduced or insufficient collateral protection or inadequate liquidity, which could lead to debt service defaults in the future. Issuers in this category have breached one or more covenants or triggers, have not taken conclusive remedial action, and IPM adopts a remediation plan and takes more proactive remedial actions.

Classified List Includes all insured obligations where MBIA has paid a claim and where a claim payment is probable and estimable. Generally, IPM is actively remediating these credits where possible, including restructurings through legal proceedings, usually with the assistance of specialist counsel and advisors.

The following table provides information about the financial guarantees and related loss reserves ( claim liability ) included in each of MBIA's surveillance categories as of September 30, 2008:

\$ in millions	Surveillance Categories				Total
	Caution List-Low	Caution List-Medium	Caution List-High	Classified List	
Number of policies	170	41	32	84	327
Number of issues <sup>(1)</sup>	18	24	19	67	128
Remaining weighted average contract period (in years)	10.6	6.6	9.2	5.8	7.0
Gross insured contractual payments outstanding:					
Principal	\$ 4,289	\$ 2,299	\$ 1,721	\$ 14,078	\$ 22,387
Interest	3,641	794	1,184	1,840	7,459
<b>Total</b>	<b>\$ 7,930</b>	<b>\$ 3,093</b>	<b>\$ 2,905</b>	<b>\$ 15,918</b>	<b>\$ 29,846</b>
Gross claim liability	\$	\$	\$	\$ 2,518	\$ 2,518
Less:					
Gross potential recoveries				763	763
Discount, net				86	86

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Claim liability <sup>(2)</sup>	\$	\$	\$	\$	1,669	\$ 1,669
Deferred premium revenue	\$ 34	\$ 14	\$ 230	\$ 3	\$ 281	
Reinsurance recoverable on claim liability <sup>(3)</sup>	\$	\$	\$	\$	107	\$ 107

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

(2) Reported within Loss and loss adjustment expense reserves on the Company's consolidated balance sheets.

(3) Reported within Reinsurance recoverable on unpaid losses on the Company's consolidated balance sheets.

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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. If, as the result of such a restructuring, MBIA estimates that it will suffer an ultimate loss on the restructured obligation, MBIA will record a case basis reserve for the restructured obligation or, if it has already recorded a case basis reserve, it will re-evaluate the impact of the restructuring on the recorded reserve and adjust the amount of the reserve accordingly.

Costs associated with remediating insured obligations assigned to **Caution List Low**, **Caution-List Medium**, and **Caution List High** are recorded as loss prevention expenses (LPE) as incurred and are included in operating expenses on the Company's consolidated statements of operations. When the Company is reimbursed for LPE, such reimbursement is recorded as income when received and included in **Fees and reimbursements** on the Company's consolidated statements of operations. Costs associated with remediating insured obligations assigned to the Company's **Classified List** are recorded as LAE. LAE is recorded as part of the Company's provision for its unallocated loss reserve and included in **Losses and loss adjustment** on the Company's consolidated statement of operations. Case basis reserves related to LAE are established by transferring amounts from the Company's unallocated loss reserve to specific case basis LAE reserves and are included in **Loss and loss adjustment expense reserves** on the Company's consolidated balance sheets. As noted above, see **Note 2: Significant Accounting Policies** included herein and in the **Notes to Consolidated Financial Statements** included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007 for a description of the Company's loss reserving policy.

The following table provides information about the expenses, reimbursements and reserves, net of recoveries, (gross and net of reinsurance) related to remedial actions for insured obligations included in the Company's surveillance categories:

In thousands	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Loss prevention expense, gross	\$ 5,267	\$ 492	\$ 8,381	\$ 3,126
Loss prevention expense, net	\$ 5,142	\$ (127)	\$ 8,014	\$ 2,178
Loss prevention expense reimbursements, gross	\$ (35)	\$ (2,784)	\$ (36)	\$ (11,327)
Loss prevention expense reimbursements, net	\$ (33)	\$ (1,995)	\$ (34)	\$ (8,589)
Loss adjustment expense incurred (transferred from the unallocated loss reserve), gross	\$ 610	\$ (4,223)	\$ 6,719	\$ (5,324)
Loss adjustment expense incurred (transferred from the unallocated loss reserve), net	\$ 578	\$ (3,737)	\$ 6,339	\$ (4,878)
Loss adjustment expense reserve, gross	\$ 1,687	\$ (163)	\$ 1,687	\$ (163)
Reinsurance recoverable (payable) related to loss adjustment expense reserve	\$ 134	\$ (46)	\$ 134	\$ (46)

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****NOTE 9: Income Taxes***Provision for Income Taxes*

The Company's income taxes and the related effective tax rates for the three and nine months ended September 30, 2008 and 2007 are as follows:

<b>In millions</b>	<b>Three months ended September 30</b>			
	<b>2008</b>		<b>2007</b>	
Pre-tax income (loss) from continuing operations	\$ (1,047)		\$ (83)	
Provision (benefit) for income taxes	(240)	22.9%	(46)	55.8%

  

<b>In millions</b>	<b>Nine months ended September 30</b>			
	<b>2008</b>		<b>2007</b>	
Pre-tax income (loss) from continuing operations	\$ (1,811)		\$ 487	
Provision (benefit) for income taxes	(298)	16.5%	113	23.3%

The Company's effective tax rates of 22.9% and 55.8% for the third quarter of 2008 and 2007, respectively, reflect tax benefit positions on the Company's pre-tax losses for the quarters. The effective tax rate has decreased in the third quarter of 2008 compared with the same quarter in 2007 primarily due to the charge to the deferred tax asset for the valuation allowance recorded in the third quarter of 2008, partially offset by the amount of the tax effects attributable to permanent tax adjustments relative to the pre-tax loss recorded for each period at the statutory tax rate of 35%.

For the nine months in 2008 compared with same period in 2007, the effective tax rates reflect a tax benefit at a rate of 16.5% in 2008 and a tax charge at a rate of 23.3% in 2007. The Company's effective tax rate for the nine months in 2008 was affected by the amount of the tax effects attributable to permanent tax adjustments relative to the pre-tax loss recorded for the period. In addition, the Company has recorded a valuation allowance of \$292 million against the deferred tax asset attributable to the capital losses recognized in connection with the repositioning of the asset/liability products segment's investment portfolio. The Company has recorded \$199 million and \$93 million in valuation allowance in the second and third quarter of 2008, respectively.

Further, given its inability to estimate the mark-to-market net losses for the full year of 2008, which directly affects the Company's ability to estimate pre-tax results and the related effective tax rate for the full year of 2008, the Company believes that it is appropriate to treat these losses as a discrete item for purposes of calculating the effective tax rate for the quarter. As such, the tax benefit related to the net mark-to-market losses for the nine months ended September 30, 2008, calculated at the statutory tax rate of 35%, is an adjustment to the annual effective tax rate that the Company has estimated for all other pre-tax income. Further changes in the fair value of the Company's derivative portfolio during 2008 will impact the Company's annual effective tax rate.

*Deferred Tax Asset, Net of Valuation Allowance*

A valuation allowance is required to reduce a potential deferred tax asset when it is more likely than not that all or a portion of the potential deferred tax asset will not be realized. All evidence, both positive and negative, needs to be identified and considered in making the determination. Future realization of the existing deferred tax asset ultimately depends on the existence of sufficient taxable income of appropriate character (for example, ordinary versus capital) within the carryforward period available under the tax law. At September 30, 2008, the Company has reported a net deferred tax asset of \$1.5 billion primarily related to mark-to-market losses and unrealized losses recorded on the Company's derivative and investment portfolios, respectively. Included in the net deferred tax asset of \$1.5 billion is a valuation allowance of \$292 million established for the nine months resulting from the capital losses recognized in connection with the repositioning of the asset/liability products segment's investment portfolio.

**Mark-to-market Adjustment on Credit Derivative Contracts**

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Approximately \$1.4 billion of the net deferred tax asset was a result of the cumulative mark-to-market losses of \$4.1 billion, primarily related to insured credit derivatives. The Company believes that it is more likely than not that its total \$1.4 billion in deferred tax assets associated with the mark-to-market losses of \$4.1 billion will be realized as the Company expects the mark-to-market losses to substantially reverse over time, at which point the related deferred tax asset will reverse. As such, no valuation allowance with respect to this item was established. In its conclusion, the Company considered the following evidence (both positive and negative):

Due to the long-tail nature of the financial guarantee business, it is important to note that the Company, even without regard to any new business, will have a steady stream of scheduled premium earnings with respect to the existing insured portfolio. The Company's announcement in February 2008 of a temporary suspension in writing new structured finance transactions and a complete exit from the insurance of credit derivatives would not have an impact on the expected earnings related to the existing insured portfolio (i.e. the back-book business). Although the Company expects the majority of the mark-to-market adjustment to reverse at maturity, the Company performed a taxable income projection in a hypothetical extraordinary loss/impairment scenario in which the entire cumulative mark-to-market adjustment to date became fully impaired triggering deductible losses for tax purposes. In this analysis, the Company concluded that premium earnings, even without regard to any new business, combined with investment income, less deductible expenses, will be sufficient to recover the deferred tax asset of \$1.4 billion. Furthermore, the Company's back-book earnings have been further increased by the FGIC reinsurance transaction, which closed on September 30, 2008. Some of the other key assumptions were:

Hypothetical extraordinary loss/impairment of \$4.1 billion which is equal to the cumulative mark-to-market losses to date;

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**MBIA Inc. and Subsidiaries**

Built-in taxable income of contingency reserve deductions under Section 832(e)(5) of the Internal Revenue Code;

A haircut applied to back-book earned premium on future installments based on recent data; and

Recoupment of net operating losses through a two-year carryback as permitted under the current tax law.

The Company's decision to eliminate the current dividend on its common stock and raise \$2.6 billion in additional capital in January and February of 2008 is not a result of lack of liquidity in terms of working capital but rather was to meet the ratings agencies' additional capital requirement in order to preserve the Company's triple-A rating. While the Company was not able to retain its triple-A rating, the downgrade does not have a material impact to its earnings on the back-book insured portfolio which the Company believes will be sufficient to absorb losses in the event that the cumulative mark-to-market losses became fully impaired.

The Company believes that the recent ratings downgrade by S&P and Moody's will not have a material impact to the Company's earnings on its back-book insured portfolio. With respect to installment policies, the Company generally does not have an automatic cancellation provision solely in connection with ratings downgrades. For purposes of projecting future taxable income, the Company has applied a haircut to account for the cancellation of future installment premiums based on recent data. With regard to upfront policies, to the extent that the issuer chooses to terminate a policy, any unearned premium reserve with respect to that particular policy will be accelerated and earned (i.e. refundings).

The Company treats the CDS contracts as insurance contracts for U.S. tax purposes. The Company provides an insurance wrap with respect to CDS contracts written by LaCrosse. While LaCrosse's financial information is consolidated into MBIA's GAAP financial statements based on the FIN 46(R) criteria, MBIA does not hold any equity interest with respect to LaCrosse. MBIA's income derived from CDS contracts is treated as premium income for statutory income purposes. In the event that there is a default in which MBIA is required to pay claims on such CDS contracts, the Company believes that the losses should be characterized as an ordinary loss for tax purposes and, as such, the event or impairment will be recorded as case reserves for statutory accounting purposes in recognition of the potential claim payment. For tax purposes, MBIA follows the statutory accounting principle as the basis for computing its taxable income. Because the federal income tax treatment of CDS contracts is an unsettled area of tax law, in the event that the Internal Revenue Service has a different view in which the losses are considered capital losses, the Company would be required to establish a valuation allowance against substantially all of the deferred tax asset related to these mark-to-market losses.

The establishment of this valuation allowance would have a material adverse effect on MBIA's financial condition.

**Capital Losses Recognized due to the Repositioning of the Asset/Liability Products Segment's Investment Portfolio**

The Company has no deferred tax asset, net of valuation allowance, related to the expected capital loss carryforward (after the allowable three-year carryback and expected capital gains) for 2008 attributable to the losses realized in connection with the repositioning of the asset/liability products segment's investment portfolio. On a gross basis, the deferred tax asset is \$292 million and the valuation allowance is \$292 million.

**Unrealized Losses on FAS 115 Securities**

At September 30, 2008, the Company has approximately \$2.2 billion in unrealized losses, the majority of which are related to fixed-income securities. The Company has approximately \$773 million in deferred tax assets related to such unrealized losses. The Company expects, based on ability and intent, to hold these investments until maturity. As such, the Company expects the recovery of the value of these securities to par and the related deferred tax assets will reverse over the life of the securities.



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After reviewing all of the evidence available, both positive and negative, MBIA believes that it has appropriately valued the recoverability of its deferred tax assets, net of the valuation allowance, as of September 30, 2008. The Company continues to assess the need for additional valuation allowances as additional evidence becomes available.

### *Uncertain Tax Positions*

At September 30, 2008 and December 31, 2007, respectively, the total amounts of unrecognized tax benefit were \$30.6 million and \$38.3 million. During the third quarter of 2008, the Company recorded \$2.5 million in unrecognized tax benefits as a result of tax positions taken in the prior period.

MBIA's major tax jurisdictions include the U.S., the U.K. and France. MBIA and its U.S. subsidiaries file a U.S. consolidated federal income tax return. U.S. federal income tax returns have been examined through 2005 by the Internal Revenue Service ( IRS ). The Company recently received notice that the IRS intends to re-examine tax years 2004 and 2005 and also examine tax year 2006. The U.K. tax matters have been concluded through 2004. The former U.K. branch of MBIA Assurance S.A., which is now part of UK Insurance Ltd. is currently under inquiry for the 2005 tax year, which is expected to be concluded in the year-end of 2008. The French tax authority has concluded the examination through the 2003 tax year with the issue on the recognition of premium income for tax purposes pending resolution, as discussed below.

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In April 2005, the French tax authority commenced an examination of the Company's French tax return for 2002 and 2003. Upon completion of the audit, the Company received a notice of assessment in which the French tax authority has accelerated the manner in which the Company recognizes earned premium for tax purposes. Based on further discussions, the Company intends to concede this tax issue before year-end 2008 in which the Company will follow the method prescribed by the French tax authority and pay appropriate taxes due.

It is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next 12 months due to the possibility of the conclusion of all the tax examinations. The range of this possible change in the amount of uncertain tax benefits cannot be estimated at this time.

**NOTE 10: Commitments and Contingencies**

In the normal course of operating its businesses, the Company may be involved in various legal proceedings.

The Company was named as a defendant, along with certain of its current and former officers, in private securities actions that were consolidated in the United States District Court for the Southern District of New York as *In re MBIA Inc. Securities Litigation*; (Case No. 05 CV 03514(LLS); S.D.N.Y.) (filed October 3, 2005). The plaintiffs asserted claims under Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), Rule 10b-5 promulgated thereunder, and Section 20(a) of the Exchange Act. The lead plaintiffs purport to be acting as representatives for a class consisting of purchasers of the Company's stock during the period from August 5, 2003 to March 30, 2005 (the Class Period). The lawsuit asserts, among other things, violations of the federal securities laws arising out of the Company's allegedly false and misleading statements about its financial condition and the nature of the arrangements entered into by MBIA Corp. in connection with the Alleghany Health, Education and Research Foundation (AHERF) loss, and about the effectiveness of the Company's internal controls. The plaintiffs allege that, as a result of these misleading statements or omissions, the Company's stock traded at artificially inflated prices throughout the Class Period.

The defendants, including the Company, filed motions to dismiss this lawsuit on various grounds. On February 13, 2007, the Court granted those motions, and dismissed the lawsuit in its entirety, on the grounds that these claims are barred by the applicable statute of limitations. The Court did not reach the other grounds for dismissal argued by the Company and the other defendants. The plaintiffs have appealed that decision to the United States Court of Appeals for the Second Circuit. The plaintiffs argue that the dismissal should be reversed on several grounds. The appeal has been fully briefed and is scheduled to be argued on October 31, 2008. The Company does not expect the outcome of the private securities litigation to have a material adverse affect on its financial condition, although the outcome is uncertain and no assurance can be given that the Company will not suffer a loss.

On October 17, 2008, a consolidated amended class action complaint in a separate shareholder class action lawsuit against the Company and certain of its officers, *In re MBIA, Inc. Securities Litigation*, No. 08-CV-264, (KMK) (the Consolidated Class Action) was filed in the United States District Court for the Southern District of New York, alleging violations of the federal securities laws. Lead plaintiff the Teachers Retirement System of Oklahoma seeks to represent a class of shareholders who purchased MBIA stock between July 2, 2007 and January 9, 2008. The amended complaint alleges that defendants MBIA Inc., Gary C. Dunton and C. Edward Chaplin violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Among other things, the complaint alleges that defendants issued false and misleading statements with respect to the Company's exposure to losses stemming from the Company's insurance of CDOs containing RMBS, specifically its exposure to so-called CDO-squared securities, which allegedly caused the Company's stock to trade at inflated prices. Defendants' answers or motions to dismiss are due on December 15, 2008.

On February 13, 2008, a shareholder derivative lawsuit against certain of the Company's present and former directors, and against the Company, as nominal defendant, *Trustees of the Police and Fire Retirement System of the City of Detroit v. Clapp et al.*, No. 08-CV-1515, (the Detroit Complaint), was filed in the United States District Court for the Southern District of New York. The gravamen of the Detroit Complaint is similar to the aforementioned Consolidated Class Action, except that the legal claims are against the directors for breach of fiduciary duty and related claims. The Detroit Complaint purports to relate to a so-called Relevant Time Period from February 9, 2006, through the time of filing of the complaint. The board has formed a special litigation committee to evaluate the claims in the Detroit Complaint.

On August 11, 2008, a shareholder derivative lawsuit *Crescente v. Brown et al.*, No. 08-17595 was filed in the Supreme Court of the State of New York, County of Westchester against certain of the Company's present and former directors, and against the Company, as nominal

defendant. The gravamen of this complaint is similar to the Detroit Complaint except that the time period assertedly covered is from January, 2007, through the time of filing of this complaint. The board has formed a special litigation committee to evaluate the claims in this complaint.

The Company has received subpoenas or informal inquiries from a variety of regulators, including the SEC, the Securities Division of the Secretary of the Commonwealth of Massachusetts, and other states' regulatory authorities, regarding a variety of subjects, including disclosures made by the Company to underwriters and issuers of certain bonds, disclosures regarding the Company's structured finance exposure, the Company's communications with rating agencies, and the methodologies used by rating agencies for determining the credit rating of municipal debt. The Company is cooperating fully with each of these regulators and is in the process of satisfying all such requests. The Company may receive additional inquiries from these or other regulators and expects to provide additional information to such regulators regarding their inquiries in the future.

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On July 23, 2008, the City of Los Angeles filed two complaints in the Superior Court of the State of California for the County of Los Angeles against the Company and others. The first, against the Company, AMBAC Financial Group, Inc., XL Capital Assurance Inc., ACA Financial Guaranty Corp., Financial Guaranty Insurance Company, and CIFG Assurance North America, Inc., alleged (i) participation in a conspiracy in violation of California's antitrust laws to maintain a dual credit rating scale that misstated the credit default risk of municipal bond issuers and created market demand for municipal bond insurance and (ii) participation in risky financial transactions in other lines of business that damaged each bond insurer's financial condition (thereby undermining the value of each of their guaranties), and a failure adequately to disclose the impact of those transactions on their financial condition. These latter allegations form the predicate for five separate causes of action against each of the Insurers: breach of contract, breach of the covenant of good faith and fair dealing, fraud, negligence, and negligent misrepresentation. Complaints making the same allegations against the Company and nearly all of the same co-defendants were filed in Superior Court, San Francisco County, by the City of Stockton on July 23, 2008, by the City of Oakland on August 28, 2008, by the City of San Francisco on October 8, 2008, and by the County of San Mateo on October 23, 2008.

The City of Los Angeles's second complaint named as defendants certain other financial institutions as well as bond insurers, including the Company, AMBAC Financial Group, Inc., Financial Security Assurance, Inc., Financial Guaranty Insurance Company and Security Capital Assurance Inc., and alleged fraud and violations of California's antitrust laws through bid-rigging in the sale of municipal derivatives to municipal bond issuers. Complaints making the same allegations against the Company and nearly all of the same co-defendants were filed in Superior Court, Los Angeles County, by the County of San Diego on August 28, 2008, and in Superior Court, San Francisco County, by the City of Stockton on July 23, 2008, by the County of San Mateo on October 7, 2008, and by the County of Contra Costa on October 8, 2008.

On September 30, 2008, MBIA Corp. commenced an action in the New York State Supreme Court against Countrywide Home Loans, Inc., Countrywide Securities Corp. and Countrywide Financial Corp. (collectively, "Countrywide"). The complaint alleges fraudulent conduct in the origination and sale of home equity loans included in MBIA Corp.-backed securitizations of pools of home equity loans and breaches of both Countrywide's representations and warranties and its contractual obligation to cure or repurchase ineligible loans as well as its sales and servicing obligations, among other things. In addition, on October 15, 2008, MBIA Corp. commenced an action in the United States District Court for the Southern District of New York against Residential Funding Company, LLC ("RFC"). The complaint alleges that RFC fraudulently induced MBIA Corp. to provide financial guarantee policies with respect to five RFC closed end home equity second-lien and HELOC securitizations, and that RFC breached its contractual representations and warranties, as well as its obligation to repurchase ineligible loans, among other things. There can be no assurance that the Company will prevail in either the Countrywide or RFC actions. On October 16, 2008, MBIA Corp. received a demand for arbitration by a third-party reinsurer relating to cessions made to it under reinsurance treaty agreements entered into with the reinsurer by MBIA Corp. and certain of its subsidiary insurers in 2006 and 2007. The demand alleges that MBIA Corp. engaged in violations of the terms of the treaty agreements and of its duty of utmost good faith. Certain of the policies ceded pursuant to the treaties include those on which MBIA Corp. has identified loss reserves. MBIA is cooperating fully with the demand.

There are no other material lawsuits pending or, to the knowledge of the Company, threatened, to which the Company or any of its subsidiaries is a party.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**FORWARD-LOOKING AND CAUTIONARY STATEMENTS**

This quarterly report of MBIA Inc. ( MBIA, the Company or we ) 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, intend, will likely result, looking forward or will continue, and similar expressions identify 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. 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:

the possibility that we will experience severe losses due to the continued deterioration in the performance of residential mortgage-backed securities and collateralized debt obligations;

fluctuations in the economic, credit, interest rate or foreign currency environment in the United States ( U.S. ) and abroad;

level of activity within the national and international credit markets;

competitive conditions and pricing levels;

legislative or regulatory developments;

technological developments;

changes in tax laws;

changes in the Company's credit ratings;

the effects of mergers, acquisitions and divestitures; and

uncertainties that have not been identified at this time.

The Company undertakes no obligation to publicly correct or update any forward-looking statement if it later becomes aware that such results are not likely to be achieved.

**OVERVIEW**

MBIA operates the largest financial guarantee insurance business in the industry and a substantial asset/liability management program. MBIA also provides asset management and other specialized financial services. Our insurance and funding programs have historically depended upon triple-A credit ratings. The events and process leading to the loss of those ratings in the second quarter of 2008 resulted in a dramatic reduction

in the Company's insurance and funding activities. We are currently evaluating our business model, and may pursue a different set of strategies in the future. MBIA manages its activities primarily through two principal business operations: insurance and investment management services. The Company's corporate operations include revenues and expenses that arise from general corporate activities. The Company's results of operations for the three and nine months ended September 30, 2008 and 2007 are discussed in the "Results of Operations" section included herein.

### *Insurance Operations*

MBIA's insurance operations have been principally conducted through MBIA Insurance Corporation and its subsidiaries ( "MBIA Corp. "). MBIA Corp.'s guarantees insure municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, bonds backed by publicly or privately funded public-purpose projects, bonds issued by sovereign and sub-sovereign entities, obligations collateralized by diverse pools of corporate loans and pools of corporate and asset-backed bonds, and bonds backed by other revenue sources such as corporate franchise revenues. Additionally, MBIA Corp. has insured credit default swaps ( "CDSs" ) primarily on pools of collateral, which it previously considered part of its core financial guarantee business. The pools of collateral are primarily made up of corporate obligations, but also include commercial and residential mortgage-backed securities-related assets. The financial guarantees issued by MBIA Corp. provide unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due. The obligations are generally not acceleratable, except that MBIA Corp. may have the right, at its discretion, to accelerate insured obligations upon default or otherwise. Certain guaranteed investment contracts written by MBIA Inc. are terminable upon ratings downgrades, and if MBIA Inc. were to have insufficient assets to pay the termination payments, MBIA Corp. would make such payments.

On February 25, 2008, the Company announced that it had ceased insuring new credit derivative contracts except in transactions related to the reduction of existing derivative exposure. In addition, the Company announced that it suspended the writing of all new structured finance business for approximately six months. Currently, the structured finance industry is generating very little new business, and it is uncertain how or when the Company may re-engage this market. The municipal bond market has also seen a drop in the demand for bond insurance, but the Company expects to compete for this business in the future.

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While we have written almost no traditional direct insurance business in the third quarter of 2008, MBIA Corp. provided reinsurance for a portfolio of U.S. public finance bonds originally insured by Financial Guaranty Insurance Company (FGIC) with total net par outstanding of \$159.1 billion. Further details of this transaction are provided in the following Results of Operations section.

**Investment Management Services Operations**

MBIA's investment management services operations has a substantial asset/liability management portfolio, in which it has issued debt and investment agreements to capital markets and municipal investors and then purchased assets that largely match the duration of those liabilities, which are insured by MBIA Corp. The ratings downgrades of MBIA Corp. have significantly adversely affected our funding activities and resulted in the termination of certain investment agreements. Our investment management services operations also provide an array of products and services to the public, not-for-profit and corporate sectors. Such products and services are provided primarily by MBIA Inc. and certain of its wholly owned subsidiaries and include cash management, discretionary asset management and fund administration services.

**Financial Strength Credit Ratings**

MBIA Inc.'s and MBIA Corp.'s current financial strength ratings from Standard and Poor's Corporation (S&P), Moody's Investors Service, Inc. (Moody's) and Fitch, Inc. (Fitch) are summarized below:

Agency	Ratings (MBIA Inc./MBIA Corp.)	Outlook
S&P	A-/AA	Negative outlook
Moody's	Baa2/A2	Review for downgrade
Fitch	Withdrawn	Withdrawn

A brief summary of recent ratings actions from S&P, Moody's and Fitch follows:

**S&P**

On February 25, 2008, S&P affirmed the AAA insurance financial strength ratings of MBIA Corp. and its insurance affiliates, the AA- rating of MBIA Inc.'s senior debt and the AA ratings of MBIA Corp.'s North Castle Custodial Trusts I-VIII. S&P's outlook for these ratings was negative.

On June 5, 2008, S&P downgraded the insurance financial strength ratings of MBIA Corp. and its insurance affiliates to AA from AAA, MBIA Inc.'s senior debt to A- from AA- and MBIA Corp.'s North Castle Custodial Trusts I-VIII to A- from AA. The ratings remained on Credit Watch with negative implications.

On August 14, 2008, S&P affirmed the AA insurance financial strength ratings of MBIA Corp. and its insurance affiliates, as well as all dependent ratings. The ratings were removed from Credit Watch with negative implications. S&P's outlook for these ratings is negative.

**Moody's**

On February 26, 2008, Moody's affirmed the Aaa insurance financial strength ratings of MBIA Corp. and its insurance affiliates, the Aa2 ratings of MBIA Corp.'s surplus notes and the Aa3 ratings of the junior obligations of MBIA Corp. and the senior debt of MBIA Inc. Moody's outlook for these ratings was negative.

On June 19, 2008, Moody's downgraded the insurance financial strength ratings of MBIA Corp. and its insurance affiliates to A2 from Aaa, MBIA Inc.'s senior debt to Baa2 from Aa3 and MBIA Corp.'s surplus notes to Baa1 from Aa2. Moody's outlook for these ratings was negative.

On September 18, 2008, Moody's placed the insurance financial strength rating of MBIA Corp. and its insurance affiliates on review for possible downgrade.

*Fitch*

On March 7, 2008, MBIA requested that Fitch withdraw its insurer financial strength ratings for MBIA Corp. and its insurance affiliates. In addition, MBIA requested that Fitch continue to rate the outstanding debt obligations of MBIA Corp. and MBIA Inc. In conjunction with the above, MBIA also requested that Fitch cease utilizing and destroy all non-public information that MBIA supplied on transactions that Fitch did not rate. Fitch's ratings process differs in many significant respects from those of the other rating agencies, which affects how investors assess value. Fitch's coverage of the underlying credit quality of the transactions that MBIA insures is limited, and in turbulent times, the impact of this difference becomes significant, raising the risk of misinterpretation.



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On March 24, 2008, Fitch stated that it planned to maintain its insurer financial strength and debt ratings on MBIA Inc. and its subsidiaries, despite MBIA's request to withdraw the insurer financial strength ratings for MBIA Corp. and its insurance affiliates and MBIA's request for Fitch to cease utilizing and return or destroy all non-public information. Fitch stated that, due to MBIA's decision to stop providing non-public information about its portfolio, it may not be able to maintain the insurer financial strength ratings for MBIA Corp. and its insurance affiliates.

On April 4, 2008, Fitch downgraded the insurer financial strength ratings of MBIA Corp. and its subsidiaries to AA from AAA and the long-term rating of MBIA Inc. to A from AA. Fitch's outlook for these ratings was negative.

On June 26, 2008, Fitch withdrew all of its outstanding ratings on MBIA Inc., MBIA Corp. and its insurance affiliates.

***Competitive Environment***

MBIA Corp. competes with other monoline insurance companies, as well as multi-line insurance companies and other forms of credit enhancement, in writing financial guarantee business. Other forms of credit enhancement include senior-subordinated structures, credit derivatives, letters of credit and guarantees (for example, mortgage guarantees where pools of mortgages secure debt service payments) provided by banks and other financial institutions, some of which are governmental agencies. MBIA Corp.'s ability to attract and compete for financial guarantee business is largely dependent on the financial strength ratings assigned to it by the major rating agencies.

During the first nine months of 2008, several monoline financial guarantee insurers have been downgraded by one or more of the major rating agencies, while others have maintained their triple-A insurance financial strength ratings. However, the two remaining significant triple-A monoline financial guarantee insurers have been assigned a *Review for Possible Downgrade* status by Moody's. A new triple-A financial guarantee insurer began competing in the municipal finance market during the first quarter of 2008 and another received a license in October 2008 from the New York State Insurance Department (NYSID) to write financial guarantee insurance. The recent ratings actions by the major rating agencies, as described above and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, have adversely affected MBIA Corp.'s ability to attract new financial guarantee business and compete with those competitors that have or are anticipated to experience less severe negative ratings actions. As a result, MBIA Corp.'s market share of all financial guarantee insurance provided to the new issue U.S. municipal finance market decreased to approximately 2.1% for the nine months ended September 30, 2008 compared with approximately 23.0% for the nine months ended September 30, 2007. Additionally, MBIA Corp. did not underwrite any non-U.S. public finance transactions in the nine months ended September 30, 2008. MBIA Corp. did not compete in the structured finance market for most of the first nine months of 2008 as a result of our previously announced decision to suspend the writing of all new structured finance business for approximately six months from the end of February 2008. As discussed above, the structured finance industry is generating very little new business opportunities, and it continues to be highly uncertain how or when the company may re-engage this market.

The asset/liability products segment of our investment management services operations issues investment agreements and medium-term notes that are guaranteed by MBIA Corp. Assets purchased with the proceeds of investment agreements and medium-term notes, which consist of investment-grade securities with a minimum average double-A credit quality rating before giving effect to MBIA Corp.'s guarantee of any securities, are pledged to MBIA Corp. as security for its guarantees. Since the downgrades of MBIA Corp., and the resulting decrease in demand for MBIA-insured obligations, we have not issued new investment agreements or MTNs.

**CRITICAL ACCOUNTING ESTIMATES**

The Company has disclosed its critical accounting estimates in its Annual Report on Form 10-K for the fiscal year ended December 31, 2007. The following critical accounting estimates provide an update to and should be read in conjunction with those included under the same caption in the Company's Annual Report on Form 10-K.

***Loss and Loss Adjustment Expenses***

The Company's financial guarantee insurance provides unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due or, in the event that the Company has the right, at its discretion, to accelerate insured obligations upon default or otherwise, upon such acceleration by the Company. Loss and loss adjustment expense (LAE) reserves are established by the Company's Loss Reserve Committee, which consists of members of senior management, and require the use of judgment and estimates with respect to the occurrence, timing and amount of a loss on an insured obligation.



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The Company establishes two types of loss and LAE reserves for non-derivative financial guarantees: an unallocated loss reserve and case basis reserves. The unallocated loss reserve is established with respect to the Company's entire non-derivative insured portfolio. The Company's unallocated loss reserve represents the Company's estimate of losses that have occurred or are probable to occur as a result of credit deterioration in the Company's insured portfolio but which have not yet been specifically identified and applied to specific insured obligations.

Each quarter the Company calculates its provision for the unallocated loss reserve as a fixed percent of scheduled net earned premium of the insurance operations. Prior to the first quarter of 2008, scheduled net earned premium of the insurance operations included premiums from our non-derivative insured portfolio and from our insured derivative portfolio. Effective January 1, 2008, premiums from insured derivative contracts are no longer included as part of scheduled net earned premium but are rather reported as part of Realized gains (losses) and other settlements on insured derivatives. As a result, we have increased our loss factor to 14.5% from 12% in order to maintain a loss and LAE provision consistent with that calculated using historical scheduled net earned premium.

Annually, the Loss Reserve Committee evaluates the appropriateness of this fixed percent loss factor. In performing this evaluation, the Loss Reserve Committee considers the composition of the Company's insured portfolio by municipal sector, structured asset class, remaining maturity and credit quality, along with the latest industry data, including historical default and recovery experience for the relevant sectors of the fixed-income market. In addition, the Company considers its own historical loss activity and how those losses develop over time. The Loss Reserve Committee reviews the results of its annual evaluation over a period of several years to determine whether any long-term trends are developing that indicate the loss factor should be increased or decreased. Therefore, case basis reserves established in any year may be above or below the loss factor without requiring an increase or decrease to the loss factor. However, if a catastrophic or unusually large loss occurred in a single year, the Loss Reserve Committee would consider taking an immediate charge through Losses and loss adjustment expenses and possibly also increase the loss factor in order to maintain an adequate level of loss reserves.

Significant changes to any variables on which the loss factor is based, over an extended period of time, would likely result in an increase or decrease in the Company's loss factor with a corresponding increase or decrease in the amount of the Company's loss and LAE provision. For example, as external and internal statistical data are applied to the various sectors of the Company's insured portfolio, a shift in business written toward sectors with high default rates would likely increase the loss factor, while a shift toward sectors with low default rates would likely decrease the loss factor. Additionally, increases in statistical default rates relative to the Company's insured portfolio and in the Company's actual loss experience or decreases in statistical recovery rates and in the Company's actual recovery experience would likely increase the Company's loss factor. Conversely, decreases in statistical default rates relative to the Company's insured portfolio and in the Company's actual loss experience or increases in statistical recovery rates and in the Company's actual recovery experience would likely decrease the Company's loss factor.

During the nine months ended September 30, 2008 and 2007, the Company's loss and LAE provision for the unallocated loss reserve, based on the respective loss factor, was \$66 million and \$64 million, respectively. The provisions recorded for each year represent loss and loss adjustment expenses as reported on the Company's statements of operations. However, as a result of the stress in the mortgage markets and an increase in defaults on mortgage-backed securities, in the first and third quarters of 2008, the Company recorded \$265 million and \$961 million, respectively, of additional loss and LAE to increase case loss reserves on its residential mortgage-backed securities (RMBS) exposure. Therefore, loss and loss adjustment expenses for the first nine months of 2008 totaled \$1.3 billion. We believe that the current loss factor of 14.5% provides an adequate reserve for probable losses in our non-derivative insured portfolio, excluding the RMBS exposure that we have separately reserved for.

For the year ended December 31, 2006, the Company's additions to specific case basis reserves were less than its loss factor. However, additions to specific case basis reserves in the years ended December 31, 2005 and 2007 exceeded the loss factor. With the exception of the additional loss and LAE recorded in 2007 and 2008 related to RMBS exposure, the Company has calculated its provision for the unallocated loss reserve as a percentage of scheduled net earned premium of its insurance operations since 2002. MBIA continually monitors its insured portfolio and actual loss experience in order to identify trends that would indicate a reasonably likely significant change to one or more of the variables on which the loss factor is based. If MBIA determines that any changes to one or more of these variables is likely to have an impact on the level of probable losses in its insured portfolio, the Company will increase or decrease its loss factor accordingly, which will result in an increase or decrease in its loss and loss adjustment expenses. However, the Company may establish additional reserves for sectors within its insured portfolio that it believes have a significantly higher risk of loss relative to the insured portfolio taken as a whole, such as its RMBS exposure, and not increase or decrease its loss factor.

Given the increased level of specific case basis losses recorded in the last several years, such as those related to our RMBS exposure, if none of the other variables used in deriving the loss factor had changed, the Company's cumulative loss factor through September 30, 2008 would

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approximate 43%, which would have generated loss and LAE of \$196 million for the nine months ended September 30, 2008. However, another variable that changed over the last several years and that affects the determination of the loss factor is the mix of business among different sectors. During the last several years, the Company had ceased writing business in certain sectors in which loss experience has been high relative to its total portfolio, such as tax liens, lower rated high yield collateralized bond obligations,

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manufactured housing and certain direct corporate obligations, which offset the impact that the higher case basis incurred activity would have on the loss factor. Excluding actual loss experience incurred in the sectors listed above and the reserves established for RMBS exposure in 2007 and 2008 in addition to its loss factor, the Company's cumulative loss factor through September 30, 2008 would approximate 10%, which would have generated loss and LAE of \$44 million for the nine months ended September 30, 2008.

Considering all of the assumptions used in the assessment of the adequacy of the loss factor, including the higher case basis incurred activity and the offsetting effect of observed changes in the variables described above, the Company believes that its current loss factor of 14.5% continues to represent a reasonable estimate of losses that have occurred or are probable to occur as a result of credit deterioration in the Company's insured portfolio, excluding its RMBS exposure, but which have not yet been specifically identified and applied to specific insured obligations. In addition, the Company believes that the amount of unallocated loss reserves recorded on its balance sheet as of September 30, 2008 are adequate to cover specific losses that may develop from its existing insured portfolio, although a prolonged recession could result in incurred losses within the Company's non-RMBS insured portfolio that exceed its unallocated loss reserve. However, we do not believe that reasonably likely changes in the assumptions used to calculate the loss factor and the unallocated loss reserves would have a material impact on the amount of our unallocated loss reserves. Loss reserving for our RMBS exposure is discussed below.

The Company establishes specific reserves in an amount equal to the Company's estimate of identified or case basis reserves with respect to specific policies. A number of variables are taken into account in establishing specific case basis reserves for individual policies that depend primarily on the nature of the underlying insured obligation. These variables include the nature and creditworthiness of the underlying issuer of the insured obligation, whether the obligation is secured or unsecured and the expected recovery rates on the insured obligation, the projected cash flow or market value of any assets that support the insured obligation and the historical and projected loss rates on such assets. Factors that may affect the actual ultimate realized losses for any policy include the state of the economy, changes in interest rates, rates of inflation and the salvage values of specific collateral.

In the first nine months of 2008, additions to case basis reserves related to our RMBS exposure totaled \$1.7 billion, which represented the majority of our case basis activity for the period. The additions of case basis reserves have been partially offset by the establishment of salvage and subrogation receivables and collections totaling \$176 million as of September 30, 2008. RMBS case basis reserves, net of salvage and subrogation receivables, have been principally established from the additional loss and LAE provisions recorded in the fourth quarter of 2007 and the first and third quarters of 2008.

In determining the RMBS case basis reserves recorded in the first nine months of 2008, the Company employed a multi-step process using a database of loan level information which allowed the Company to determine borrower payment status, including delinquencies and charge-offs. The Company relied upon this database to determine the likelihood of a delinquent loan being charged off. The information was then used in conjunction with a proprietary internal cash flow model and a commercially available model to estimate ultimate cumulative losses to our insured bonds. The Company establishes a case basis reserve for any transaction to the extent that cumulative losses exceed credit support available to its insured bonds and, as such, result in a claim on our financial guarantee policy for which we do not expect a full recovery.

The Company continues to use the general procedure described above. However, based upon our review of the data, in the third quarter of 2008 we made one change related to our methodology for estimating future defaults for loans that are current (not delinquent) by utilizing the Current to Loss approach described below, versus the current three-month or derived conditional default rate (CDR) approach used in prior quarters. The change for this one component in our methodology was due to the increased unpredictability and volatility of loss timing observed in the third quarter of 2008 under the CDR approach, which rendered future outcomes under that approach increasingly unreliable. The following are the principal assumptions used with respect to the underlying loans to analyze the projected performance of a transaction:

We assumed that loans reported as delinquent as of August 31, 2008 would default during the following six months at an assumed default rate based on the number of days that the loan was delinquent at such time (the Roll Rate Default Methodology).

The Roll Rate Default Methodology involves reviewing on a transaction specific basis the percentage of 30-59 and 60-89 day delinquent loans that became 90 days delinquent (Roll to Loss). The Company made the assumption that 100% of the 90 or more days delinquent loans would result in a loss. The Roll to Loss was then applied to the amounts in the respective delinquency buckets based upon delinquencies as of August 31, 2008 to eliminate all delinquencies as of the current reporting period.

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For loans that are current (not delinquent), we derived the Roll to Loss rates by multiplying the percentage of loans in the 30-59 bucket and the Roll to Loss rates for the 30-59 delinquency bucket ( Current to Loss ). We applied this percentage each month going forward to the remaining current pool balance to project future losses.

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We have run various elevated default period duration scenarios when determining loss reserves. Our expected cases assume that the current elevated loss period will begin to decrease by mid-2009. As such, we begin to reduce monthly defaults over a period of six to eight months.

We assumed servicer advances for delinquent loans to be zero.

We assumed that all defaulted loans will result in a total loss of principal after a six-month liquidation period.

In addition, for transactions secured by home equity lines of credit ( HELOCs ), the model considered borrower draws and repayment rates. For HELOCs, the current three-month average draw rate was used to project future draws on the line. For HELOCs and transactions secured by fixed rate closed-end second mortgages ( CES ), the three-month average conditional repayment rate ( CRR ) was used to project voluntary principal repayments. Cash flows also assumed a constant basis spread between floating rate assets and floating rate insured debt obligations (the difference between Prime and LIBOR interest rates, minus any applicable fees). For all transactions, cash flows considered allocations and other structural aspects of a transaction, including managed amortization periods, rapid amortization periods and claims against MBIA's insurance policy consistent with such policy's terms and conditions.

The assumptions and cash flow structure referenced above resulted in a forecasted cumulative collateral loss that was added to existing actual cumulative collateral losses. The resulting estimated net claims on MBIA's insurance policies were discounted to a net present value reflecting MBIA's obligation to pay claims over time and not on an accelerated basis. The above assumptions represent MBIA's best estimate of how transactions will perform over time.

We monitor portfolio performance on a monthly basis against projected performance, reviewing delinquency, default and CDR trends. In the event of a material deviation in actual performance from projected performance, we would increase or decrease case loss reserves accordingly. We made such a change in the third quarter of 2008. Consequently, we have also revised our sensitivity analysis of those reserves. If defaults and losses remained at the peak levels we are now modeling for six months longer than in our base case, the addition to our case basis loss and LAE reserve would be approximately \$500 million.

The Company has not reflected any potential recoveries as salvage or subrogation resulting from either the repurchase of defective loans by the originators of the RMBS transactions with respect to which the Company has established case basis reserves or the potential impact of existing litigation. The Company believes that the existing litigation has the potential to result in recoveries of loss payments, which could significantly reduce the impact of current reserves and/or potential increases to reserves in future periods due to elevated peak loss rates.

As of September 30, 2008, the Company's total net loss reserves of \$1.9 billion represent 0.25% of its outstanding non-derivative net debt service insured of \$789 billion. We believe that these reserves are adequate to cover ultimate net losses. Given that the reserves are based on estimates, there can be no assurance that the ultimate liability will not exceed such estimates resulting in the Company recognizing additional loss and LAE in earnings. While the underlying principles applied to loss reserving are consistent across the financial guarantee industry, differences exist with regard to the methodology and measurement of loss reserves.

Alternative methods may produce different estimates than the method used by the Company. Additionally, the accounting for non-derivative financial guarantee loss reserves will change when the Company adopts Statement of Financial Accounting Standards ( SFAS ) 163, Accounting for Financial Guarantee Insurance Contracts an interpretation of Financial Accounting Standards Board ( FASB ) Statement No. 60, which is effective January 1, 2009. See the Recent Accounting Pronouncements section included herein. Also, see Note 2: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company's Annual report on Form 10-K for the fiscal year ended December 31, 2007 for a description of the Company's loss and loss adjustment expense accounting policy.

***Valuation of Financial Instruments***

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price ) in an orderly transaction between market participants at the measurement date. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices of comparable instruments in active markets generally have more pricing observability, and less judgment is utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted have less observability and are

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measured at fair value using valuation models that require more judgment. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction and overall market conditions in general, including whether any observed price reflects the underlying value of the instrument or is transacted at a distressed price level.



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The Company has categorized its financial instruments measured at fair value into a three-level classification in accordance with SFAS 157, Fair Value Measurements. Fair value measurements of financial instruments that use quoted prices in active markets for identical assets or liabilities are generally categorized as Level 1, and fair value measurements of financial instruments where significant inputs are not observable are generally categorized as Level 3. We categorize each financial instrument in the lowest level category at which we can generate reliable fair values. The determination of reliability relies on management's judgment.

The fair market values 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 data sources, including direct dealer quotes, for input into the Company's valuation systems. The type of valuation technique that is used to determine the fair value of a financial instrument is based on the characteristics of the financial instrument and the availability of market data. If dealer market data is not available for an instrument that is infrequently purchased and sold, the Company may use alternate methods for determining fair values, such as dealer market quotes for similar contracts or cash flow modeling. The use of alternate valuation methods generally require management to exercise considerable judgment in the use of estimates and assumptions to determine the estimated fair value of an instrument. Changes to estimates and assumptions used in estimating the fair value of an instrument may produce materially different values. In addition, actual market exchanges may occur at materially different amounts.

The pricing of assets or liabilities is a function of many components which may include interest rate risk, market risk, liquidity risk or credit risk. For financial instruments that are internally valued by the Company as well as those for which the Company uses broker quotes or pricing services to derive the fair value, credit risk is typically incorporated into the valuation by using appropriate credit spreads or discount rates as inputs.

See Note 2: Significant Accounting Policies and Note 6: Fair Value of Financial Instruments in the Notes to Consolidated Financial Statements for further information about the Company's financial assets and liabilities that are accounted for at fair value.

*Financial Assets*

The Company's financial instruments categorized as assets primarily comprise investments in debt and equity instruments. The majority of the Company's debt and equity investments are accounted for in accordance with SFAS 115, Accounting for Certain Investments in Debt and Equity Securities. SFAS 115 requires that all debt instruments and certain equity instruments be classified in the Company's balance sheet according to their purpose and, depending on that classification, be carried at either amortized cost or fair value. The majority of the Company's financial assets are valued using observable market-based inputs when available. If a security cannot be priced using observable market-based inputs, the Company receives a direct dealer quote which is used as the basis for recording fair value. Adverse credit market conditions since the second half of 2007 caused some markets to become illiquid, thus reducing the availability of certain observable data. Other financial assets that require fair value reporting or disclosures within the Company's notes to the financial statements are valued based on the estimated value of the underlying collateral or the Company's estimate of discounted cash flows.

Financial instruments for which the fair value is derived from broker quotes or pricing services may fall within Level 1, 2 or 3 of the SFAS 157 fair value hierarchy, depending on the observability of the inputs used to fair value. The Company typically receives one broker quote or pricing service valuation for each instrument, which represents a non-binding bid price. Broker quoted prices are classified as Level 3 within the fair value hierarchy if the Company cannot determine that the inputs used by the broker are market-based and observable. On a quarterly basis, the Company reviews the pricing assumptions, inputs and methodologies used by pricing services in determining an instrument's fair value as a basis for classification within the SFAS 157 fair value hierarchy. Pricing service data is received monthly and the Company performs an analysis of the reasonableness of the valuations using a variety of methods, including comparisons of asset valuations to similar quality and maturity assets, internal modeling of implied credit spreads by sector and quality and comparison to published spread estimates, and assessment relative to comparable dealer offerings or actual transactions, if any, from a recent time period. If the Company believes a third-party quotation differs significantly from its internal assessment, the Company will review its findings with the provider with respect to data sources or assumptions used and the price provider may subsequently provide a revised price. This approach is followed whether we believe the price provided is significantly higher or lower than our internal assessment. The Company does not make any internal adjustments to prices provided by a broker or pricing service.

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The following table presents the nature, amount and fair value hierarchy classification for financial assets in which pricing services or broker quotes are used by the Company in determining the fair value as of September 30, 2008:

**Assets Measured at Fair Value on a Recurring Basis as of September 30, 2008 using Pricing Services or Broker Quotes**

In thousands	September 30, 2008	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Investments:				
Fixed-maturity securities:				
U.S. Treasury and government agency	\$ 3,712,362	\$ 3,016,729	\$ 695,633	\$
Foreign governments	1,027,854	446,056	500,203	81,595
Corporate obligations	5,931,080		4,864,513	1,066,567
Mortgage-backed	2,014,689		1,588,004	426,685
Asset-backed	2,570,970		1,209,367	1,361,603
State and municipal bonds	4,789,615		4,767,067	22,548
Other investments	5,325,483	4,771,310	477,173	77,000
Derivative assets	31,136			31,136
Total assets	\$ 25,403,189	\$ 8,234,095	\$ 14,101,960	\$ 3,067,134

MBIA regularly monitors its investments in which fair value is less than amortized cost in order to assess whether such a decline in value is other than temporary and, therefore, should be reflected as a realized loss in net income. Such an assessment requires the Company to determine the cause of the decline and whether the Company possesses both the ability and intent to hold the investment to maturity or until the value recovers to an amount at least equal to amortized cost. Additionally, this assessment requires management to exercise judgment as to whether an investment is impaired based on market conditions and trends and the availability of relevant data. For further information regarding our investment portfolio, see the Liquidity section included herein.

*Financial Liabilities*

The Company's financial instruments categorized as liabilities primarily consist of investment agreements and medium-term notes issued by its asset/liability products and conduit segments within the Company's investment management services operations, and debt issued for general corporate purposes. These liabilities are typically recorded at their face value adjusted for premiums or discounts. The fair values of such instruments are generally not reported within the Company's financial statements, but rather disclosed in the accompanying notes. However, the carrying values of financial liabilities which qualify as part of fair value hedging arrangements under SFAS 133, Accounting for Derivative Instruments and Hedging Activities, as amended, are adjusted in the Company's balance sheet to reflect those risks being hedged. MBIA has instituted cash flow modeling techniques to estimate the value of its liabilities that qualify as hedged obligations under SFAS 133 based on current market data. Financial liabilities that the Company has elected to fair value under SFAS 155, Accounting for Certain Hybrid Financial Instruments or that require fair value reporting or disclosures within the Company's notes to its financial statements are valued based on estimated value of the underlying collateral, the Company's or a third party's estimate of discounted cash flows or quoted market values for similar transactions.

The following table presents the nature, amount and fair value hierarchy classification for financial liabilities in which pricing services or broker quotes are used by the Company in determining the fair value as of September 30, 2008:

**Liabilities Measured at Fair Value on a Recurring Basis as of September 30, 2008 using Pricing Services or Broker Quotes**

In thousands	September 30, 2008	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Liabilities:</b>				
Medium-term notes	\$ 284,594	\$	\$	\$ 284,594
Derivative liabilities	216,690			216,690
Total liabilities	\$ 501,284	\$	\$	\$ 501,284

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MBIA has entered into derivative transactions as part of its financial guarantee business and for purposes of hedging risks associated with its assets, liabilities and forecasted transactions. CDS contracts are also entered into in the investment management services operations to replicate investments in cash assets consistent with the Company's risk objectives and credit guidelines for its investment management business. The Company accounts for derivative transactions in accordance with SFAS 133, which requires that all such transactions be recorded on the Company's balance sheet at fair value. The fair value of derivative instruments is determined as the amount that would be received to sell the derivative when in an asset position (when the Company would be owed money under the derivative in a termination) or transfer the derivative when in a liability position (when the Company would owe money under the derivative in a termination). Changes in the fair value of derivatives, exclusive of insured derivatives, are recorded each period in current earnings within Net gains (losses) on financial instruments at fair value and foreign exchange or in shareholders' equity within Accumulated other comprehensive loss, depending on whether the derivative is designated as a hedge, and if so designated, the type of hedge.

*Insured Derivatives*

The majority of the Company's notional derivative exposure arises from credit derivative instruments insured by MBIA Corp. As part of our core financial guarantee business until February 2008, MBIA Corp. insured CDSs entered into by LaCrosse Financial Products LLC (LaCrosse), an entity that is consolidated into MBIA's GAAP financial statements under the FIN 46(R), Consolidation of Variable Interest Entities an interpretation of ARB No. 51, criteria. In February 2008, we decided to cease insuring credit derivative instruments except in transactions related to the reduction of our existing insured derivative exposure.

In most cases, our insured credit derivatives must be stated at fair value as they do not qualify for the financial guarantee scope exception under SFAS 133. Because they are highly customized, as described further below, there is generally no observable market for these derivatives. In the absence of such a market, we estimate the value of these derivatives in a hypothetical market based on internal and third-party models that simulate what a bond insurer would charge to guarantee the transaction. Such a price would be based on the expected loss for our exposure based on the value of the underlying collateral within the transaction.

Description of MBIA's Insured Credit Derivatives

MBIA's insured credit derivatives referenced primarily structured pools of cash securities and CDSs. We generally provided CDS protection on the most senior liabilities of structured finance transactions, and at inception of the contract our exposure generally had more subordination than needed to achieve triple-A ratings from credit rating agencies (referred to as Super Triple-A exposure). The collateral for the insured derivatives was cash securities and CDSs referencing primarily corporate, asset-backed, residential mortgage-backed, commercial mortgage-backed and collateralized debt obligation securities.

MBIA also issued guarantees under principal protection fund programs, which are also accounted for as derivatives. Under these programs, MBIA's insurance operations guaranteed the return of principal to investors. Structurally, MBIA is protected by a portion of the portfolio that is rebalanced daily to match the present value of MBIA's guarantee. As of September 30, 2008, the maximum amount of future payments that the Company would be required to make under these guarantees was \$147 million. The Company has not made any payments to date relating to these guarantees and the mark-to-market gains (losses) on these derivatives for the years ended 2005, 2006 and 2007 were \$0, reflecting the extremely remote likelihood that MBIA will incur a loss.

A portion of MBIA's insured CDS contracts require that MBIA make payments for losses of the principal outstanding under the contracts only once losses on the underlying referenced collateral exceed a predetermined deductible. The total notional amount and MBIA's maximum payment obligation under these contracts as of September 30, 2008 was \$79.2 billion. The underlying referenced collateral for contracts executed in this manner largely consist of investment grade corporate debt collateralized debt obligations (CDOs), structured commercial mortgage-backed securities (CMBS) pools and, to a lesser extent, multi-sector CDO-squared transactions.

The total changes in fair value of the insured derivatives are recorded in Net change in fair value of insured derivatives. Realized gains (losses) and other settlements on insured derivatives include (i) net premiums received and receivable on written CDS contracts, (ii) net premiums paid and payable to reinsurers in respect of CDS contracts, (iii) losses paid and payable to CDS contract counterparties due to the occurrence of a credit event, (iv) losses recovered and recoverable on purchased CDS contracts due to the occurrence of a credit event and (v) fees relating to CDS contracts. Losses paid and payable and losses recovered and recoverable reported in Realized gains and other settlements on insured

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derivatives include claims and estimated recoveries thereof, respectively, only after a credit event has occurred that would require a payment under contract terms. The Unrealized gains (losses) on insured derivatives include all other changes in fair value of the derivative contracts.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Lack of an Observable Market for Our Insured Credit Derivatives**

In determining fair value, we use various valuation methods with priority given to observable market prices when they are available. Market prices are generally available for traded securities and market standard CDSs but are less available or unavailable for highly-customized CDSs. Most of the derivative contracts we insure are structured credit derivative transactions that are not traded and do not have observable market prices. Typical market CDSs are standardized, liquid instruments that reference tradable securities such as corporate bonds that also have observable prices. These market standard CDSs also involve collateral posting, and upon a default of the reference bond, can be settled in cash.

In contrast, our insured CDS contracts do not contain the typical CDS market standard features as described above but have been customized to replicate our financial guarantee insurance policies. Our insured derivative instruments provide protection on a specified or managed pool of securities or CDS with a stated deductible or with subordination beneath the MBIA-insured tranche. We are not required to post collateral. Under the insured CDS contract, payment is not due unless there is a default of an underlying reference obligation and then only after and to the extent that the aggregate amount of losses with respect to defaults of underlying reference obligations exceed the deductible or subordination in the transaction. Some contracts also provide for further deferrals of payment at our option. In the event of the insolvency of or payment default by MBIA Insurance Corporation, the contracts give the counterparty the right to terminate and settle the contract.

Our payment obligations after a default on the underlying reference obligation vary by deal and by insurance type. There are three primary types of policy payment requirements:

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

Our insured credit derivative policies are structured to prevent large one-time claims upon an event of default and to allow for payments over time (i.e. pay-as-you-go basis) or at final maturity. Also, each insured CDS we enter into is governed by a single transaction International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement relating only to that particular transaction/insurance policy. There is no requirement for mark-to-market termination payments, under most monoline standard termination provisions, upon the early termination of the insured CDS. However, these contracts generally have mark-to-market termination payments for termination events related to MBIA Corp.'s failure to pay or insolvency and some have other mark-to-market termination payments for events within our control, such as the sale of all or substantially all of the assets of MBIA Corp. An additional difference between our CDS and the typical market standard CDS is that there is no acceleration of the payment to be made under our insured CDS contract in the ordinary course of business unless we elect to accelerate at our option. Furthermore, MBIA's policies are unconditional and irrevocable and cannot be transferred to most other capital market participants as they are not licensed to write financial guarantee insurance policies. As the insured CDS contracts are accounted for as derivatives under SFAS 133, the Company does not defer the charges associated with underwriting the CDS policies and expenses them immediately.

Through reinsurance, MBIA has transferred some of the risk of loss on these contracts to other financial guarantee insurance and reinsurance companies. The fair value of the transfer under the reinsurance contract with the reinsurers is accounted for as a derivative asset. These derivative assets are valued consistently with our SFAS 157 valuation policies as described in Note 2: Significant Accounting Policies. The fair value measurement for these derivative assets assumes an in-exchange premise for valuation as defined by SFAS 157 as the highest and best use by market participants. When the Company enters into a reinsurance agreement on an insured credit derivative, the Company receives a ceding commission. Ceding commissions are retained by the Company, as the primary insurer, from the ceded premium as compensation for placing the business with the reinsurer and to cover the acquisition expenses incurred by the Company to issue the CDS. Ceding commissions are calculated based on a fixed percentage of the ceded premium to the reinsurer, and the reinsurer receives the net ceded premium (total ceded premium less the ceding commission). The fixed percentage of the ceding commission is determined at the beginning of a reinsurance treaty agreement. Currently, the Company recognizes ceding commissions as a contra-expense to the Company's deferred acquisition cost amortization.

Our Valuation Technique for Insured Credit Derivatives

As a result of the differences between market standard CDS contracts and the CDS contracts insured by MBIA as described above, we believe there are no relevant third-party exit value market observations for our insured credit derivative contracts. Accordingly, there is no principal market for such highly structured insured credit derivatives as described in SFAS 157. In the absence of a principal market, we value these insured credit derivatives in a hypothetical market where the market participants include other comparably-rated primary financial guarantors. Since there are no active market transactions in our exposures, we generally use internal and third-party models, depending on the type and structure of the contract, to estimate the fair value of our derivative contracts.

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Our insured CDS valuation model simulates what a bond insurer would charge to guarantee the transactions at the measurement date, based on the market-implied default risk of the underlying collateral and the remaining deductible or subordination. Implicit in this approach is the notion that bond insurers would be willing to accept these contracts from us at a price equal to what they could issue them for in the current market. While the fee charged by financial guarantors is not an input into our model, the model does estimate the amount a financial guarantor would charge to assume an insured derivative obligation at the measurement date. The estimate of the cost to transfer an obligation increases as the probability of default increases, as reflected by any combination of increased underlying credit spreads, negative credit migration, lower assumed recovery rates, lower diversity, and erosion of the deductible or subordination.

#### Model Overview

Approximately 96% of the balance sheet fair value of insurance derivatives as of September 30, 2008 is valued using a probabilistic approach to determine the price that a bond insurer would charge to assume the risk associated with our exposure on the credit derivative contract. For each transaction, we apply a Binomial Expansion Technique ( BET ) based model to the insured obligation to derive a probabilistic measure of expected loss for our exposure using market pricing on the underlying referenced collateral within the transaction. The BET was developed and published by Moody's to estimate a probability distribution of losses on a diverse pool of assets. The main modifications we have made to the BET model developed by Moody's are that a) we use market credit spreads, when available and reliable, to determine default probability instead of using historical loss experience, and b) for collateral pools where the spread distribution is characterized by extremes, we model each segment of the pool individually instead of using an overall pool average.

#### The BET-based model

Calculates expected losses on a collateral pool within an insured credit derivative transaction by reference to the following (each described in further detail under Assumptions and Inputs below):

Credit spreads of the underlying collateral, based on actual spreads or spreads on similar collateral with similar ratings,

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

recovery rate for all defaulted collateral.

Allocates the expected losses for each tranche of the transaction according to its subordination level within the transaction structure.

For example, if the expected total collateral pool loss is 4% and the transaction has equity and three progressively more senior C, B, and A tranches with corresponding underlying subordination levels of 0%, 3%, 5% and 10%, then the 4% loss will have the greatest impact on the equity tranche, a lower, but significant impact on the C tranche and progressively lower impacts on the B and A tranches. MBIA usually insures the super senior tranche which has strong structural protection and the lowest exposure to collateral losses due to the underlying subordination.

At any point in time, the mark-to-market gain or loss on a transaction is the difference between the original price of the risk (the original market-implied expected loss) and the current price of the risk based on the assumed expected losses derived from the model.

The Company reports the net premiums received and receivable on written insured CDS transactions in Realized gains and other settlements on insured derivatives. Other changes in fair value of the derivative contracts are reported in the Unrealized gains (losses) on insured derivatives. See Note 2: Significant Accounting Policies for further information.



Strengths and Weaknesses

The primary strengths of our insured CDS modeling techniques are:

- 1) The model takes account of transaction structure and the key drivers of market value. The transaction structure includes par insured, weighted average life, level of deductible or subordination and composition of collateral.
  
- 2) The model is a well-documented, consistent approach to marking positions that minimizes the level of subjectivity since it was originally developed by Moody's and has been modified by MBIA. The model structure, inputs and operation are well-documented so we believe there are strong controls around the execution of the model. MBIA has also developed a hierarchy for market-based spread inputs that helps reduce the level of subjectivity, especially during periods of high illiquidity.

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- 3) The model uses market inputs whenever they are available. The key inputs to the BET model for any transactions are market-based spreads for the underlying referenced collateral, assumed recovery rates specific to the type and rating of the referenced collateral, and the diversity score of the collateral pool. These are viewed by MBIA to be the key parameters that affect the fair value of the transaction and, to the extent practicable, the inputs are market-based inputs.

The primary weaknesses of our insured CDS modeling techniques are:

- 1) There is no market in which to verify the fair values developed by our model, and at September 30, 2008, the markets for the inputs to the model were highly illiquid, which impacts their reliability.
- 2) There is diversity of approach to estimating the fair value of these transactions among the financial guarantee insurance companies.
- 3) The averaging of spreads in our model and use of a single diversity factor rather than using specific spreads for each piece of underlying collateral and collateral-specific correlation assumptions may distort results. Neither the data nor the analytical tools exist today to be more specific in our calculation of fair value.

MBIA uses the approach described above to value almost all of the insured CDSs on tranching portfolios of credits ( portfolio CDS ) or on senior tranches of CDOs of the insured portfolio. Listed below are the key inputs and assumptions used within this approach.

**Assumptions**

The assumed credit quality, the assumed credit spread for credit risk exclusive of funding costs and the appropriate reference credit index or price source are significant assumptions that, if changed, could result in materially different fair values. Accordingly, market perceptions of credit deterioration would result in an increase in the expected price at which a bond insurer would assume the risk from MBIA due to wider credit spreads.

The key assumptions of the BET model include:

Collateral default probabilities are determined by spreads which are based on market data when available. The BET model uses the average spread of the collateral as a key input and it is assumed that market spreads reflect the market's assessment of default probability for each piece of collateral. The average spread is calculated differently depending on whether MBIA uses collateral-specific credit spreads as an input or generic spreads.

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

If collateral-specific credit spreads are not available, the next alternative is to use generic spread tables based on asset class and rating. When this is done, we use the spread table that matches the average rating of the collateral portfolio. To determine the average credit rating for the collateral, we identify a weighted average rating factor ( WARF ) for the collateral portfolio as described below, and then use that average rating to choose an appropriate spread.

The WARF is based on a 10,000 point scale designed by Moody's. On the WARF scale, lower numbers indicate better credit quality and ratings are not spaced equally on this scale (because, for example, the difference in default probability between AA1 and AA2 is much less than between B1 and B2). The WARF is obtained from the most recent trustee's

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report or calculated by us based on the credit ratings of the collateral in the transaction. To accomplish this calculation, MBIA first identifies the credit ratings of each piece of collateral (using, in order of preference as available, Moody's, S&P or Fitch ratings), then converts that credit rating into a rating factor on the WARF scale, averages those factors (weighted by par) to create a portfolio WARF, and then converts the portfolio WARF into an average credit rating for the pool. MBIA then uses a market index that is based on collateral type and average rating to determine the generic spread for the pool, which is input into the BET model.

These approaches have been used for most of the insured CDS transactions in MBIA's portfolio. There have been a few cases where modified approaches have been used if either there was high dispersion of ratings within an asset class or no collateral-specific or ratings-based generic spreads were available. When ratings dispersion is high, the collateral within an asset class has been segmented into different rating buckets and each bucket is used in calculating the overall average.

When spreads have not been available on either a collateral-specific basis or ratings-based generic basis, MBIA has used its hierarchy of spread sources (see Inputs below) to identify the most appropriate spread for that asset class and that spread is used to calculate the average spread.

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The default probability is calculated using a standard model as an appropriate way to do this calculation. The model assumes that the default probability is determined by three factors: credit spread, recovery rate after default and the time period under risk.

Collateral in the portfolio is generally considered on an average basis instead of modeling each piece of collateral separately.

Correlation is modeled using a diversity score, which is calculated based on rules regarding industry or sector concentrations.

Defaults are modeled such that they are spaced evenly over time.

Recovery rates are based on historical averages and updated as market evidence warrants.

#### Inputs

The specific model inputs we use are listed below, including how we derive inputs for market credit spreads on the underlying transaction collateral, how we determine credit quality (WARF), how we determine diversity estimation, and how we determine recovery rates.

Credit spreads These are obtained from market data sources published by third parties (e.g. dealer spread tables for the collateral similar to collateralized or referenced assets within our transactions) as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market data is used that most closely resembles the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. This data is obtained from recognized sources and is reviewed on an ongoing basis for reasonableness and applicability to our derivative portfolio.

We use the spread hierarchy listed below in determining which source of spread information to use, with the rule being to use CDS spreads where available. Within each category below, if CDS spreads are not available, we use cash security spreads. Cash spreads reflect trading activity in funded fixed-income instruments while CDS spreads reflect trading levels for derivative instruments that do not require actual funding. While both markets are driven in part by an assessment of the credit quality of the referenced security, there are some factors which can create significant differences in these two markets. In particular, CDS spreads can be driven at times more by speculative activity since the CDS market facilitates both long and short positions and allows for significant leverage.

Spread Hierarchy:

- 1) Actual collateral-specific credit spreads (if up-to-date and reliable market-based spreads are available, they are used).
- 2) Sector-specific spreads (JP Morgan and Citigroup spread tables by asset class and rating).
- 3) Corporate spreads (Bloomberg and Risk Metrics spread tables based on rating).
- 4) Benchmark from most relevant spread source (if no specific spreads are available and corporate spreads are not directly relevant, an assumed relationship will be used between corporate spreads or sector-specific spreads and collateral spreads).

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For example, if current market based spreads are not available then we utilize sector-specific spreads from spread tables provided by dealers or corporate cash spread tables. The generic spread utilized is based on the nature of the underlying collateral in the deal. Deals with corporate collateral use the corporate spread table. Deals with asset-backed collateral use one or more of the dealer asset-backed tables as discussed below. If there are no observable market spreads for the specific collateral, and sector-specific and corporate spread tables are not appropriate to estimate the spread of a given type of collateral, we use the fourth alternative in our hierarchy. An example is tranching corporate collateral, in which case we use corporate spreads as an input and estimate the spread on the tranching position. In each case the priority is to use information for CDS spreads if available, and cash spreads as a second priority.

As of September 30, 2008, actual collateral credit spreads were used in one transaction. Sector-specific spreads were used in 24% of the transactions. Corporate spreads were used in 26% of the transactions and spreads benchmarked from the most relevant spread source (number 4 above) were used for 50% of the transactions. When determining the percentages above, there were some transactions where MBIA incorporated multiple levels within the hierarchy. For example, for some transactions MBIA used actual collateral-specific credit spreads (number 1 above) in combination with a calculated spread based on an assumed relationship (number 4 above). In those cases, MBIA classified the transaction as being benchmarked from the most relevant spread source (number 4 above) even though the majority of the average spread was from actual collateral-specific spreads. WARF was used to determine the credit rating which was used to determine the appropriate spread for 95% of the transactions.

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Over time the data inputs can change as new sources become available or existing sources are discontinued or are no longer considered to be the most appropriate. It is the objective of the Company to move to higher levels on the hierarchy whenever possible, but it is sometimes necessary to move to lower priority inputs because of discontinued data sources or assessments that the higher priority inputs are no longer considered to be representative of market spreads for a given type of collateral. This can happen, for example, if transaction volume changes such that a previously used spread index is no longer viewed as being reflective of current market levels. The Company believes such a circumstance existed for CMBS collateral in insured CDSs during the first nine months of 2008. See section Impact of Current Market Conditions on Data Inputs for CMBS Transactions below.

Our process provides for a monthly update of the proportion of each type of collateral in each deal from the respective trustees. Using the most recent monthly applicable market spread data based on the hierarchy above, we then calculate a weighted average spread to be used in the valuation process (i.e., the spread for each component of collateral is weighted by its percentage of total collateral to calculate the weighted average spread). If collateral-specific spreads are not available, the WARF is used to determine the credit rating which is used to determine the appropriate spread.

**Diversity Scores** The diversity score estimates the number of uncorrelated assets that are assumed to have the same loss distribution as the actual portfolio of correlated assets. For example, if a portfolio of 100 assets had a diversity score of 50, this means that the 100 correlated assets are assumed to have the same loss distribution as 50 uncorrelated assets. A lower diversity score will generally negatively impact the valuation for our senior tranche since a low diversity score represents higher assumed correlation, increasing the chances of a large number of defaults, and thereby increasing the risk of loss in the senior tranche. The calculation methodology for a diversity score takes into account the extent to which a portfolio is diversified by industry. The diversity of industry or asset class is calculated internally, if not reported by the trustee on a regular basis. The diversity score is calculated at the inception of the deal and refined as necessary as the portfolio statistics change over time. MBIA calculates the diversity score on a periodic basis for deals that do not require the trustee to provide this measure. The internally developed model used to calculate the diversity score is based on Moody's methodology and uses MBIA's internal assumptions on default correlation. Inputs such as underlying collateral rating, notional amount, asset type and remaining life are used in the model. The diversity score is a measure to estimate the diversification in a portfolio, specifically in the context of a collateralized debt obligation (CDO).

**Recovery Rate** The recovery rate represents the percentage of par expected to be recovered after an asset defaults. MBIA generally uses rating agency recovery assumptions. These assumptions may be adjusted to account for differences in the characteristics and performance of the collateral used by the rating agencies in determining their recovery rate assumptions and the actual collateral in MBIA-insured transactions. The Company may also adjust rating agency assumptions based on the performance of the collateral manager. The Company periodically reviews recovery rate assumptions in light of new market information and rating agency reports, and makes changes to these assumptions as necessary. For example, in the first quarter of this year, we received a new S&P publication showing that the agency was lowering its recovery rate assumptions for securities backed by ALT-A and subprime real estate collateral. Although the collateral that backs MBIA's transactions is on average of better quality than that referred to in the S&P report, we used this report in conjunction with the significantly wider trading spreads for these assets as an indication that recovery rates for MBS collateral warranted a change. Therefore, MBIA decided to lower recovery rate assumptions for MBS collateral by approximately 10 percentage points. Since there are differences in recovery rate assumptions among the rating agencies themselves, the Company is required to make a judgment as to the most appropriate recovery assumption to use. There were no changes to recovery rates in the second or third quarter of 2008.

**Net Par Outstanding and Net Unrealized Gains (Losses) on Insured Derivatives**

The following table presents the net par outstanding as of September 30, 2008 and net unrealized gains (losses) on insured derivatives for the nine months ended September 30, 2008 by fair value technique of all insured credit derivatives within our insurance portfolio.

In millions	% of Net Par Outstanding	Net Par Outstanding	Net Unrealized Gains (Losses)
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Binomial expansion valuation model	85.0%	\$ 122,032	\$ (54)
Specific dealer quotes	0.3	427	(104)
Other	14.7	21,099	10
Total	100.0%	\$ 143,558	\$ (148)

The Company's investment management services operations and corporate operations enter into over-the-counter derivatives, such as interest rate swaps, currency swaps, credit default swaps and total return swaps, which predominately trade in liquid markets. The fair values for these derivatives are either based on specific dealer quotes or estimated using valuation models that combine observable market prices and market data inputs. For further information regarding our derivative portfolio, see the "Market Risk" section included herein.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Impact of Current Market Conditions on Data Inputs for CMBS Transactions**

Approximately \$37 billion of the gross par of insured derivative transactions subject to fair value accounting under SFAS 133 include substantial amounts of CMBS and commercial mortgage collateral. In 2007, the spreads implied by the pricing on the CMBX indices had been used as an input for the spreads on the underlying referenced collateral in these transactions. In light of the current market conditions, we believe that there was a significant disconnect in the first nine months of the year between cumulative loss expectations of MBIA and market analysts on underlying commercial mortgages and the loss expectations implied by the CMBX index or the CMBS spread tables we had been using. During this period, commercial mortgage securities were experiencing historically low default and loss rates. The underlying mortgage collateral in the insured transactions in MBIA's portfolio have performed in line with general commercial mortgage performance and continue to be rated AAA by Moody's or S&P.

Transaction volume in CMBS and trading activity in the CMBX were both at dramatically lower levels during the first nine months of the year than they had been in prior periods, and the implied loss rates on underlying mortgages in MBIA's spread sources of these markets were far higher than that forecast by fundamental researchers and MBIA's internal analysis. In addition, the implied illiquidity premium on the index, in the context of MBIA's model, suggested that monoline insurers would capture 100% of the changes in spread on the underlying collateral, which has not been the case in other periods of market illiquidity (since monoline insurers have buy and hold portfolios, spread changes that reflect illiquidity versus changes in perceived credit fundamentals typically are not reflected in pricing). As a result, the unadjusted CMBX indices and the CMBS spread tables were deemed to be unreliable model inputs for the purpose of estimating fair value in our hypothetical market among monoline insurers.

In the first quarter of 2008, MBIA modified the spread input in the BET model to reflect a combination of market pricing levels and fundamental analysis of CMBS credit, as determined by parties independent to MBIA. Our revised model input combines the expectations for CMBS credit performance as forecasted by the average of two investment banks' research departments with the illiquidity premium implied by the CMBX indices. The illiquidity premium that we used for CMBS collateral was the CMBS index for the senior triple-A tranche. The CMBX index is issued in series representing vintages of CMBS origination. We match our collateral to the CMBX series appropriate to the vintage of the collateral since these spreads differ across the various CMBX series. For example, for collateral that was originated in the second half of 2006, the illiquidity premium was set as the CMBX series 1, triple-A index. The sum of the illiquidity premium plus the derived credit spread based on the average of the two investment banks' research department loss estimates is the analog index that is used as an alternative input in our BET-based approach.

MBIA believes that it is important to apply consistently its valuation techniques. However, the Company may consider making enhancements to its valuation technique if they result in a measurement that is more representative of fair value in the circumstances. Additionally, it is the Company's policy to use observable inputs (Level 2 inputs) whenever possible. To calculate the spread for CMBS tranches, the Company divides a Wall Street research estimate of cumulative net losses (CNL) by an estimated average life of the tranche. The Company's preferred approach would be to use an average life that is known to be consistent with the CNL assumption. Unfortunately the research departments that published CNL assumptions have not provided corresponding average life assumptions. During prior quarters, the Company estimated average life as tranche duration, as published by independent sources. At the time it was thought that this would be the most consistent and appropriate approach. During the third quarter of 2008, as a result of continued widening of published credit spreads, it became clear that these tranche duration assumptions were not compatible with the expectations of future losses that a market participant would use in determining the fair value of our insured CDS contracts. Therefore, during the third quarter of 2008, the Company determined a better estimate of average life would be an internally developed tranche weighted average life of the Company's CMBS transactions that is more consistent with other model assumptions. Management believes that this change results in a measurement that is more representative of fair value for its insured CDS portfolio. Management will continue to assess the reasonableness of observable market information in determining fair value of its insured CDS portfolio and may make further adjustments to the estimate based on what we believe a market participant would use in considering fair value. The impact of this change in the estimated fair value of its insured CDS portfolio was to reduce the liability by approximately \$901 million (pre-tax) as of September 30, 2008.

**Nonperformance Risk Adjustment**

In compliance with requirements of SFAS 157, effective January 1, 2008, the Company updated its valuation methodology for insured credit derivative liabilities to incorporate the Company's own nonperformance risk. This was calculated by discounting at MBIA Corp.'s CDS spreads the estimated market value loss on insured CDSs at September 30, 2008. This resulted in a pre-tax \$7.1 billion reduction in the fair value of the derivative liability. Nonperformance risk is a fair value concept and does not contradict the Company's internal view, based on fundamental credit analysis, that the Company will be able to pay all claims when due.



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Prior to the third quarter of 2008, the difference between the MBIA credit adjusted value of certain portions of the derivative liability and the non-MBIA credit adjusted value of those same portions of the derivative liability was immaterial relative to the Company's unrealized gains (losses) on insured derivatives reported on the Company's income statement. As a result, the Company made no nonperformance risk adjustment for this portion of the derivative liability. During the third quarter of 2008, the magnitude of the difference between the MBIA credit adjusted value of this portion of the derivative liability and the non-MBIA credit adjusted value of the same portion of the derivative liability was material relative to the Company's unrealized gains (losses) on insured derivatives reported on the Company's income statement. Therefore, the Company determined that other market participants would recognize that these liabilities should be treated as long-term because the Company has the option to pay these liabilities over time. Therefore, the Company adjusted its estimate of nonperformance risk to reflect the longer exposure period for this portion of the liability. Absent this valuation refinement, the estimated fair value liability of the insured CDS portfolio would have been higher by approximately \$683 million (pre-tax) as of September 30, 2008.

Effective January 1, 2008, for its ceded insured credit derivatives portfolio, the Company also made credit valuation adjustments by incorporating the nonperformance risk of the reinsurer.

### ***Fair Value Hierarchy Level 3***

SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The objective of a fair value measurement is to determine the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

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Instruments that trade infrequently and therefore have little or no price transparency are classified within Level 3 of the fair value hierarchy. Also included in Level 3 are financial instruments that have significant unobservable inputs that are deemed significant to the instrument's overall fair value. The Company performs a detailed review process of the inputs used to derive fair value of its financial instruments to determine which instruments are classified within Level 3. This process is performed by personnel, independent of the insurance and investment operating functions, who corroborate valuations to external market data (e.g., quoted market prices, broker or dealer quotations, third-party pricing vendors, recent trading activity and comparative analyses to similar instruments).

With respect to investments, all pricing is provided by third-party providers, who use their own data sources and models to arrive at fair value pricing for each security. On a quarterly basis, the Company performs an analysis of the reasonableness of third-party valuations using a variety of methods, including comparison of asset valuations for similar quality and maturity investments, internal modeling of implied credit spreads by sector and quality and comparison to published spread estimates, and assessment relative to comparable dealer offerings or actual transactions, if any, from a recent time period. If the Company believes a third-party quotation differs significantly from its internal assessment, the Company will review its findings with the provider with respect to data sources or assumptions used and the price provider may subsequently provide a revised price. This approach is followed whether we believe the price provided is significantly higher or lower than our internal assessment.

The following table presents the fair values of assets and liabilities recorded on our balance sheet that are classified as Level 3 within the fair value hierarchy, along with a brief description of the valuation technique for each type of asset and liability:

**Level 3 Financial Assets and Liabilities at Fair Value as of September, 2008**

In millions	September 30, 2008	Valuation Technique
<b>Investments:</b>		
Foreign governments	\$ 81.6	Quoted prices for which the inputs are unobservable
Corporate obligations	1,066.6	Quoted prices for which the inputs are unobservable
Mortgage-backed	426.7	Quoted prices for which the inputs are unobservable
Asset-backed	1,361.6	Quoted prices for which the inputs are unobservable
State and municipal bonds	22.5	Quoted prices for which the inputs are unobservable
Other investments	77.0	Valuation models with significant unobservable inputs
Derivative assets	799.5	Valuation models with significant unobservable inputs
<b>Total Level 3 assets at fair value</b>	<b>\$ 3,835.5</b>	
Medium-term notes	\$ 284.6	Quoted prices or cash flow model for which the inputs are unobservable
Derivative liabilities	4,625.3	Valuation models with significant unobservable inputs
<b>Total Level 3 liabilities at fair value</b>	<b>\$ 4,909.9</b>	

Level 3 assets were \$3.8 billion as of September 30, 2008, and represented approximately 14.3% of total assets measured at fair value. Level 3 liabilities were \$4.9 billion as of September 30, 2008, and represented approximately 90.2% of total liabilities measured at fair value.

Net transfers into Level 3 were \$197 million and \$110 million for the three and nine months ended September 30, 2008, respectively. These net transfers were principally for available-for-sale securities where inputs, which are significant to their valuation, became unobservable or observable during the quarter. Foreign governments, corporate obligations, mortgage-backed securities and asset-backed securities (ABS) constituted the majority of the affected instruments. The net unrealized loss related to the transfers in (out) of Level 3 as of September 30, 2008 was \$114.4 million.

**Fair Value Control Processes**

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A control infrastructure, independent of the insurance and investment functions, is fundamental to ensuring that our financial instruments are appropriately valued at market-clearing levels (i.e., exit prices) and that fair value measurements are reliable.

The Company employs control processes to validate the fair value of its financial instruments, including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to assure that the valuation approach utilized is appropriate and consistently applied and that the assumptions are reasonable. These control processes include reviews of the pricing model's theoretical soundness and appropriateness by Company personnel with relevant expertise who are independent from the insurance and investment operating groups. Additionally, groups within the Market Risk department who are

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independent from the operating groups participate in the review and validation of the fair values generated from pricing models, as appropriate. Where a pricing model is used to determine fair value, recently executed comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model.

The Company maintains an ongoing review of its valuation models and has formal procedures for the approval and control of data inputs. The Company employs an oversight structure that includes appropriate segregation of duties. Senior management, independent of the insurance and investment functions, is responsible for the oversight of control and valuation policies and for reporting the results of these policies to our Audit Committee. See **Market Risk** below for a further discussion of how the Company manages the risks inherent in valuing financial instruments.

#### ***Goodwill***

Under SFAS 142, **Goodwill and Other Intangible Assets**, goodwill and intangible assets with indefinite lives are tested for impairment at least annually. This test includes a two-step process aimed at determining the amount, if any, by which the carrying value of a reporting unit exceeds its fair value and should be charged as an expense through net income.

The Company had goodwill totaling \$79.4 million as of December 31, 2007 and September 30, 2008, of which \$76.9 million was within our insurance operations and \$2.5 million was within our investment management services operations.

MBIA's insurance operations are principally conducted through MBIA Corp. The Company defines its insurance operations as both a reporting unit and an operating segment. The carrying amount and estimated fair value of the Company's insurance operations were \$4.5 billion and \$9.4 billion as of December 31, 2007, respectively, and \$4.4 billion and \$9.3 billion as of September 30, 2008, respectively.

The fair value of the Company's insurance operations is estimated by increasing book value calculated under U.S. generally accepted accounting principles (shareholders' equity) for the after-tax effects of net deferred premium revenue and the present value of future installment premiums less the after-tax effects of deferred acquisition costs and a provision for losses, and by excluding the after-tax effects of cumulative unrealized net gains or losses, net of credit impairments, to arrive at adjusted book value. In the third quarter of 2008, the Company refined its calculation of adjusted book value to exclude the after-tax effects of all cumulative unrealized gains or losses, net of credit impairments, instead of only excluding those related to insured derivatives. The above estimated fair value of the Company's insurance operations as of December 31, 2007 has been adjusted to reflect this refinement. Adjusted book value is a measure commonly provided by financial guarantee companies, which we believe provides a comprehensive measure of the value of the Company since we expect that the adjustments to book value will affect future results and, in general, do not require any additional future performance on the part of the Company. The assumptions used to estimate the fair value of the insurance operations are (i) its statutory income tax rate of 35%, (ii) the pre-tax yield of its investment portfolio of 4.50% and an estimate of future installment premiums to arrive at the present value of future installment premiums, (iii) its 14.5% loss factor to arrive at the provision for losses, and (iv) an estimate of the present value of payments under insured derivatives.

MBIA's investment management services operations are primarily conducted by MBIA Inc. and certain of its wholly owned subsidiaries. The Company defines its investment management services operations as a reporting unit consisting of three reporting unit components or reportable segments (asset/liability products, advisory services, and conduits).

Goodwill allocated to the advisory services segment is related to MBIA Municipal Investors Service Corporation ( **MBIA-MISC** ) and totaled \$2.5 million as of December 31, 2007 and September 30, 2008. As of December 31, 2007, MBIA-MISC's carrying amount and estimated fair value were \$40.6 million and \$73.6 million, respectively, and as of September 30, 2008, MBIA-MISC's carrying amount and estimated fair value were \$47.8 million and \$64.2 million, respectively.

MBIA-MISC's fair value is estimated by using a multiple of its earnings before income tax, depreciation and amortization ( **EBITDA** ), which is a common method used to value investment management companies. The assumption used to arrive at MBIA-MISC's fair value was a multiple of ten times EBITDA as of December 31, 2007 and eight times EBITDA as of September 30, 2008. The change in the earnings multiple is based on current market conditions for investment management companies.

We performed our annual impairment testing of goodwill as of January 1, 2008. As a result of our impairment testing, we determined that the fair values of the reporting segments exceeded their carrying values indicating that goodwill was not impaired. Alternate valuation methods would have likely produced different fair values. However, we believe that the valuation methods used provided the best estimates of fair value.

**RECENT ACCOUNTING PRONOUNCEMENTS**

*Recently Adopted Accounting Standards*

In October 2008, the FASB issued FASB Staff Position ( FSP ) No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active: An Amendment of FASB Statement No. 157. FSP No. FAS 157-3 applies to financial assets within the scope of SFAS 157 for which other accounting pronouncements require or permit fair value measurements. FSP No. FAS 157-3 clarifies the application of SFAS 157 in an inactive market and provides an illustrative example to demonstrate how the

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fair value of a financial asset is determined when the market for that financial asset is not active. The provisions are effective upon issuance, including prior periods for which financial statements have not been issued. The provisions of this FSP need not be applied to immaterial items. Since FSP No. FAS 157-3 only illustrates additional guidance in determining the fair value of a financial asset when the market for that financial asset is not active, FSP No. FAS 157-3 is not material to the Company's financial statements and will not affect the Company's financial condition, results of operations or cash flows.

In May 2008, the FASB issued SFAS 163, *Accounting for Financial Guarantee Insurance Contracts*—an interpretation of FASB Statement No. 60. SFAS 163 requires financial guarantee insurance (and reinsurance) contracts issued by reporting entities considered insurance enterprises under SFAS No. 60, *Accounting and Reporting by Insurance Enterprises* to recognize and measure premium revenue based on the amount of insurance protection provided and the period in which it is provided and to recognize and measure claim liabilities based on the present value of expected net cash outflows to be paid, using a risk-free rate, in excess of the unearned premium revenue. SFAS 163 does not apply to financial guarantee insurance contracts accounted for as derivative instruments within the scope of SFAS 133. SFAS 163 is effective for the Company prospectively as of January 1, 2009, except for the presentation and disclosure requirements related to claim liabilities effective for financial statements prepared as of September 30, 2008 as presented and disclosed in Note 8: Loss and Loss Adjustment Expense Reserves (LAE) in the Notes to Consolidated Financial Statements. The cumulative effect of initially applying SFAS 163 is required to be recognized as an adjustment to the opening balance of retained earnings for the fiscal year beginning January 1, 2009. The Company is currently evaluating the potential impact of adopting SFAS 163.

The Company adopted the provisions of SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, effective January 1, 2008. SFAS 159 provides entities the option to measure certain financial assets and financial liabilities at fair value with changes in fair value recognized in earnings each period. SFAS 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The Company applies the disclosure requirements of SFAS 159 for certain eligible instruments which it previously elected to fair value under SFAS 155, *Accounting for Certain Hybrid Financial Instruments*. These instruments included medium-term notes and available-for-sale securities which contained embedded derivatives requiring bifurcation. The Company did not elect the fair value option under SFAS 159 for any eligible financial instruments.

The Company adopted the provisions of SFAS 157, excluding non-financial assets and liabilities per FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157*, beginning January 1, 2008. SFAS 157 defines fair value as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. SFAS 157 requires that fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available. Assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model. SFAS 157 also clarifies that an issuer's credit standing should be considered when measuring liabilities at fair value. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurements). SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FSP No. FAS 157-2, which delayed the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). A transition adjustment to opening retained earnings was not required.

In April 2007, the FASB issued FSP FIN 39-1, *Amendment of FASB Interpretation No. 39*. FSP FIN 39-1 permits a reporting entity that is a party to a master netting agreement to offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments that have been offset under the same master netting agreement. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007 and is required to be applied retrospectively for all financial statements presented unless it is impracticable to do so. The Company adopted the provisions of the FSP beginning January 1, 2008 and elected not to offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral under a master netting agreement against fair value amounts recognized for derivative instruments that have been offset under the same master netting agreement. The Company may reevaluate in the future its election to not offset the fair value amounts recognized for derivative contracts executed with the same counterparty under a master netting agreement.

***Recent Accounting Developments***

In September 2008, the FASB issued FSP No. FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*. FSP No. FAS 133-1 and FIN 45-4 requires enhanced disclosures about credit derivatives and guarantees and amends FIN 45, *Guarantors*

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Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others to exclude derivative instruments accounted for at fair value under SFAS No. 133. The Company will adopt

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FSP No. FAS 133-1 and FIN 45-4 for financial statements prepared as of December 31, 2008. Since FSP No. FAS 133-1 and FIN 45-4 only requires additional disclosures concerning credit derivatives and guarantees, adoption of FSP No. FAS 133-1 and FIN 45-4 will not affect the Company's financial condition, results of operations or cash flows.

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities*, an amendment of FASB Statement No. 133. SFAS 161 expands the disclosure requirements about an entity's derivative instruments and hedging activities. The disclosure provisions of SFAS 161 apply to all entities with derivative instruments subject to SFAS 133 and its related interpretations. The provisions also apply to related hedged items, bifurcated derivatives, and non-derivative instruments that are designated and qualify as hedging instruments. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. MBIA will adopt the disclosure provisions of SFAS 161 on January 1, 2009. Since SFAS 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS 161 will not affect our financial condition, results of operations or cash flows.

In February 2008, the FASB issued FSP No. FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*. FSP No. FAS 140-3 requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with or in contemplation of the initial transfer to be evaluated as a linked transaction under SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* unless certain criteria are met. FSP No. FAS 140-3 is effective for fiscal years beginning after November 15, 2008, and will be applied to new transactions entered into after the date of adoption. Early adoption is prohibited. We are currently evaluating the potential impact of adopting FSP No. FAS 140-3.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of Accounting Research Bulletin No. 51. SFAS 160 requires reporting entities to present noncontrolling (minority) interest as equity (as opposed to liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 and earlier adoption is prohibited. MBIA is currently evaluating the provisions of SFAS 160 and their potential impact on the Company's financial statements.

**RESULTS OF OPERATIONS***Summary of Consolidated Results*

The following table presents highlights of our consolidated financial results for the three and nine months ended September 30, 2008 and 2007.

In millions except per share amounts	3 <sup>rd</sup> Quarter		Year-to-date	
	2008	2007	2008	2007
<b>Revenues:</b>				
Insurance	\$ 561	\$ 25	\$ 1,289	\$ 782
Investment management services	(141)	414	(474)	1,163
Corporate	(91)	0	(64)	12
Eliminations	(9)	(8)	(19)	(21)
Total revenues	320	431	732	1,936
<b>Expenses:</b>				
Insurance	1,118	88	1,648	274
Investment management services	227	407	832	1,112
Corporate	30	27	82	84
Eliminations	(9)	(8)	(19)	(21)
Total expenses	1,366	514	2,543	1,449
Provision (benefit) for income taxes	(240)	(46)	(298)	113



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Net income (loss)	\$ (806)	\$ (37)	\$ (1,513)	\$ 374
Net income (loss) per diluted share	\$ (3.48)	\$ (0.30)	\$ (6.97)	\$ 2.84

Consolidated revenues for the three months ended September 30, 2008 decreased 26% to \$320 million from \$431 million for the same period of 2007. The increase in insurance revenues for the third quarter resulted from a \$105 million unrealized gain on insured derivatives, which primarily resulted from favorable changes in the fair value of the Company's insurance credit derivative portfolio, compared with a \$341 million unrealized loss in the third quarter of 2007. The decrease in investment management services revenues for the third quarter resulted from realized losses from security sales and other-than-temporary impairments of available-for-sale securities and a decrease in interest income within our asset/liability products segment partially offset by net gains related to debt

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repurchases. The decrease in corporate revenues for the third quarter of 2008 principally resulted from net losses related to changes in the fair value of warrants issued as part of our capital strengthening plan. Gains from repurchasing MBIA-issued debt obligations at a discount and from terminated investment agreements are presented within revenues and, in the third quarter of 2008, totaled \$10 million in our insurance operations, \$205 million in our investment management services operations, and \$25 million in our corporate operations. See "Securities Repurchases" in the "Capital Resources" section included herein for additional information regarding repurchases of MBIA-issued debt obligations.

Consolidated expenses for the three months ended September 30, 2008 increased 166% to \$1.4 billion from \$514 million for the same period of 2007. The increase in insurance expenses for the third quarter of 2008 primarily resulted from additional loss and LAE incurred of \$961 million related to our insured second-lien RMBS exposure. Investment management services' expenses declined for the third quarter of 2008 due to a decrease in interest expense resulting from withdrawals and terminations of investment agreements and maturities and repurchases of MTNs. Corporate expenses increased slightly due to an increase in legal costs.

We reported a net loss for the three months ended September 30, 2008 of \$806 million compared with a \$37 million net loss for the same period of 2007. Our net loss per diluted share was \$3.48 for the three months ended September 30, 2008 compared with a net loss per diluted share of \$0.30 for the same period of 2007. For the third quarter of 2008, diluted weighted average shares outstanding of 232 million were 108 million greater than the third quarter of 2007 as a result of shares issued in the beginning of 2008 in connection with our capital strengthening plan.

Consolidated revenues for the nine months ended September 30, 2008 decreased 62% to \$732 million from \$1.9 billion for the same period of 2007. The increase in insurance revenues principally resulted from a decrease in net losses on insured derivatives, an increase in net gains on financial instruments at fair value and foreign exchange and an increase in premiums earned principally due to greater refunding activity. Refer to the discussion under "Net Change in Fair Value of Insured Credit Derivatives" for the Company's estimate of credit impairments on insured derivatives. The decrease in investment management services operations' revenues resulted from realized losses from security sales and other-than-temporary impairments of available-for-sale securities and a decrease in interest income within our asset/liability products segment net of gains related to debt repurchases. The decrease in corporate revenues principally resulted from net losses related to changes in the fair value of warrants issued as part of our capital strengthening plan. Corporate revenues for the first nine months of 2007 included insurance recoveries of \$6.4 million, representing the reimbursement of a portion of expenses incurred in connection with the regulatory investigations of the Company and related litigation. Gains from repurchasing MBIA-issued debt obligations at a discount totaled \$10 million in our insurance operations, \$284 million in our investment management services operations, and \$25 million in our corporate operations in the nine months ended September 30, 2008.

Consolidated expenses for the nine months ended September 30, 2008 increased 76% to \$2.5 billion from \$1.4 billion for the same period of 2007. The increase in consolidated expenses was principally due to additional loss and LAE incurred in the first quarter and third quarter of 2008 related to our insured second-lien RMBS exposure and interest expense on surplus notes issued in the first quarter of 2008 in our insurance operations. The increase in insurance expenses was partially offset by a decrease in interest expense within our investment management services operations from investment agreement withdrawals and repurchases of MTNs. Corporate expenses were consistent with the same period of 2007.

For the nine months ended September 30, 2008, we reported a net loss of \$1.5 billion compared with net income of \$374 million for the nine months ended September 30, 2007. Our net loss per diluted share for the nine months ended September 30, 2008 was \$6.97 compared with net income per diluted share of \$2.84 for the same period in 2007. For the nine months ended September 30, 2008, diluted weighted average shares outstanding of 217 million were 86 million greater than the same period of 2007 as a result of shares issued in the beginning of 2008 in connection with our capital strengthening plan.

The Company's book value as of September 30, 2008 was \$11.37 per share, down 61% from \$29.16 per share as of December 31, 2007. The decrease was principally driven by an increase in common shares outstanding, which resulted from the issuance of common stock in the first quarter of 2008. The increase in shareholders' equity from proceeds of the issuance of common stock was partially offset by losses from the Company's insured derivatives and financial guarantee portfolios and available-for-sale investment portfolio during 2008.

In addition to book value per share, we also analyze adjusted book value per share (ABV) when evaluating the value of the Company. ABV is a non-GAAP measure of book value inclusive of items that are expected to impact shareholders' equity in future periods and, in general, do not require any additional future performance obligation on the Company's part. Additionally, ABV excludes gains and losses due to market value changes that have not been realized through sales or impairments of assets or extinguishment of liabilities. While ABV is not a substitute for GAAP book value, we believe it provides a comprehensive measure of the value of the Company and is meaningful to investors and analysts when viewed in conjunction with GAAP book value. As of September 30, 2008, ABV per share was \$37.55, down 52% from \$77.89 as of

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December 31, 2007. The following provides a reconciliation of book value per share to ABV per share:

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	September 30, 2008	December 31, 2007
Book value	\$ 11.37	\$ 29.16
Adjustments (after-tax):		
Net deferred premium revenue	9.19	14.58
Deferred acquisition costs	(1.56)	(2.45)
Present value of future installment premiums	6.92	13.68
Asset/liability products present value of net spread adjustment	(0.54)	4.17
Loss provision	(1.93)	(3.39)
Cumulative unrealized mark-to-market losses <sup>(1)</sup>	14.10	22.14
<b>Total adjustments</b>	<b>26.18</b>	<b>48.73</b>
Adjusted book value	\$ 37.55	\$ 77.89

(1) Net of cumulative estimated impairments on insured derivatives of \$3.09 and \$1.04 as of September 30, 2008 and December 31, 2007, respectively.

**Insurance Operations**

The Company's insurance segment principally comprises the activities of MBIA Corp. MBIA Corp.'s guarantees insure municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, bonds backed by publicly or privately funded public-purpose projects, bonds issued by sovereign and sub-sovereign entities, obligations collateralized by diverse pools of corporate loans and pools of corporate and asset-backed bonds, and bonds backed by other revenue sources such as corporate franchise revenues. Additionally, MBIA Corp. has insured CDSs primarily on pools of collateral, which it previously considered part of its core financial guarantee business. The pools of collateral are primarily made up of corporate obligations, but also include commercial and residential mortgage-backed securities. The financial guarantees issued by MBIA Corp. provide unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due. MBIA Corp. may have the right, at its discretion, to accelerate insured obligations upon default or otherwise. Certain guaranteed investment contracts written by MBIA Inc. are terminable upon ratings downgrades, and if MBIA Inc. were to have insufficient assets to pay the termination payments, MBIA Corp. would make such payments.

The municipal obligations that MBIA Corp. insures include tax-exempt and taxable indebtedness of states, counties, cities, utility districts and other political subdivisions, as well as airports, higher education and healthcare facilities and similar authorities and obligations issued by private entities that finance projects which serve a substantial public purpose. The asset-backed and structured finance obligations insured by MBIA Corp. typically consist of securities that are payable from or which are tied to the performance of a specified pool of assets that have an expected cash flow. Securities of this type include collateral consisting of residential and commercial mortgages, a variety of consumer loans, corporate loans and bonds, trade and export receivables, aircraft, equipment and real property leases, and infrastructure projects.

In certain cases, the Company may be required to consolidate entities established as part of securitizations when it insures the assets or liabilities of those entities. These entities typically meet the definition of a variable interest entity ( "VIE" ) under FIN 46(R). We do not believe there is any difference in the risks and profitability of financial guarantees provided to VIEs compared with other financial guarantees written by the Company. Additional information relating to VIEs is contained in the "Variable Interest Entities" section included herein.

In the third quarter of 2008, we closed a reinsurance transaction between MBIA Corp. and Financial Guaranty Insurance Company ( "FGIC" ) in which MBIA assumed a significant portion of FGIC's U.S. public finance insurance portfolio. As of the closing date, the reinsured portfolio consisted exclusively of investment grade credits, primarily in the general obligation, water and sewer, tax-backed and transportation sectors, and did not contain any CDS contracts, below investment grade credits or other credits that were inconsistent with our credit underwriting standards. The reinsurance was provided on a "cut-through" basis, which enables FGIC's policyholders to receive the benefit of MBIA's reinsurance by allowing them to present claims directly to MBIA.

Under the FGIC reinsurance transaction, MBIA assumed a total net par of approximately \$159.1 billion and received upfront unearned premiums, net of a ceding commission paid to FGIC, of approximately \$639 million. As required by the NYSID in connection with its approval of the reinsurance transaction, the funds have been placed in a trust and will be released to MBIA upon the earlier of its removal from ratings review with its current ratings or nine months from the closing date of the transaction. Additionally, under the terms of the trust, the funds will

be released to MBIA as the premiums are earned and can be used to pay claims o