

MBIA INC  
Form 10-Q  
November 07, 2012  
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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 quarterly period ended September 30, 2012

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

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

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

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

As of November 1, 2012, 193,731,768 shares of Common Stock, par value \$1 per share, were outstanding.

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**Table of Contents****PART 1 FINANCIAL INFORMATION****Item 1. Financial Statements****MBIA INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS (Unaudited)**

(In millions except share and per share amounts)

	September 30, 2012	December 31, 2011
<b>Assets</b>		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$4,412 and \$6,259)	\$ 4,634	\$ 6,177
Fixed-maturity securities at fair value	237	295
Investments pledged as collateral, at fair value (amortized cost \$424 and \$642)	350	543
Short-term investments held as available-for-sale, at fair value (amortized cost \$1,440 and \$1,577)	1,445	1,571
Other investments (includes investments at fair value of \$16 and \$96)	27	107
Total investments	6,693	8,693
Cash and cash equivalents	298	473
Premiums receivable	1,280	1,360
Deferred acquisition costs	317	351
Insurance loss recoverable	3,316	3,046
Property and equipment, at cost (less accumulated depreciation of \$144 and \$139)	69	69
Deferred income taxes, net	1,446	1,745
Other assets	414	243
Assets of consolidated variable interest entities:		
Cash	143	160
Investments held-to-maturity, at amortized cost (fair value \$2,867 and \$3,489)	3,015	3,843
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$461 and \$473)	442	432
Fixed-maturity securities at fair value	1,754	2,884
Loans receivable at fair value	1,892	2,046
Loan repurchase commitments	1,051	1,077
Derivative assets	-	450
Other assets	2	1
<b>Total assets</b>	<b>\$ 22,132</b>	<b>\$ 26,873</b>
<b>Liabilities and Equity</b>		
Liabilities:		
Unearned premium revenue	\$ 3,091	\$ 3,515
Loss and loss adjustment expense reserves	945	836
Investment agreements	993	1,578
Medium-term notes (includes financial instruments carried at fair value of \$168 and \$165)	1,606	1,656
Securities sold under agreements to repurchase	-	287
Long-term debt	1,836	1,840
Derivative liabilities	3,332	5,164
Other liabilities	467	391
Liabilities of consolidated variable interest entities:		

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Variable interest entity notes (includes financial instruments carried at fair value of \$3,626 and \$4,754)	7,094	8,697
Long-term debt	-	360
Derivative liabilities	180	825
Other liabilities	1	1
<b>Total liabilities</b>	<b>19,545</b>	<b>25,150</b>
Commitments and contingencies (See Note 13)		
Equity:		
Preferred stock, par value \$1 per share; authorized shares 10,000,000; issued and outstanding none	-	-
Common stock, par value \$1 per share; authorized shares 400,000,000; issued shares 275,455,099 and 274,896,162	275	275
Additional paid-in capital	3,072	3,072
Retained earnings	1,403	805
Accumulated other comprehensive income (loss), net of deferred tax of \$24 and \$105	90	(176)
Treasury stock, at cost 81,729,792 and 81,752,966 shares	(2,275)	(2,276)
Total shareholders' equity of MBIA Inc.	2,565	1,700
Preferred stock of subsidiary and noncontrolling interest	22	23
<b>Total equity</b>	<b>2,587</b>	<b>1,723</b>
<b>Total liabilities and equity</b>	<b>\$ 22,132</b>	<b>\$ 26,873</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 millions except share and per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>Revenues:</b>				
Premiums earned:				
Scheduled premiums earned	\$ 85	\$ 111	\$ 291	\$ 354
Refunding premiums earned	70	65	173	108
Premiums earned (net of ceded premiums of \$3, \$3, \$12 and \$9)	155	176	464	462
Net investment income	50	92	172	299
Fees and reimbursements	20	16	47	41
Change in fair value of insured derivatives:				
Realized gains (losses) and other settlements on insured derivatives	12	(53)	(420)	(599)
Unrealized gains (losses) on insured derivatives	(33)	776	1,473	(531)
Net change in fair value of insured derivatives	(21)	723	1,053	(1,130)
Net gains (losses) on financial instruments at fair value and foreign exchange	7	13	(18)	(114)
Investment losses related to other-than-temporary impairments:				
Investment losses related to other-than-temporary impairments	(3)	(12)	(58)	(25)
Other-than-temporary impairments recognized in accumulated other comprehensive income (loss)	(5)	1	(47)	(19)
Net investment losses related to other-than-temporary impairments	(8)	(11)	(105)	(44)
Net gains (losses) on extinguishment of debt	-	-	-	26
Other net realized gains (losses)	1	1	7	6
Revenues of consolidated variable interest entities:				
Net investment income	17	17	51	53
Net gains (losses) on financial instruments at fair value and foreign exchange	44	88	(17)	3
Net gains (losses) on extinguishment of debt	16	-	49	-
Other net realized gains (losses)	-	5	-	8
Total revenues	281	1,120	1,703	(390)
<b>Expenses:</b>				
Losses and loss adjustment	171	190	330	204
Amortization of deferred acquisition costs	8	12	36	51
Operating	72	76	307	226
Interest	69	75	214	225
Expenses of consolidated variable interest entities:				
Operating	5	7	14	24
Interest	13	15	43	45
Total expenses	338	375	944	775
Income (loss) before income taxes	(57)	745	759	(1,165)
Provision (benefit) for income taxes	(64)	301	161	(472)

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Net income (loss)	\$	7	\$	444	\$	598	\$	(693)
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**Net income (loss) per common share:**

Basic	\$	0.04	\$	2.27	\$	3.09	\$	(3.50)
Diluted	\$	0.04	\$	2.26	\$	3.07	\$	(3.50)

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

Basic	193,879,994	195,612,615	193,760,654	198,262,715
Diluted	194,977,642	196,347,502	194,835,537	198,262,715

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

**Table of Contents****MBIA INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)**

(In millions)

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net income (loss)	\$ 7	\$ 444	\$ 598	\$ (693)
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses) arising during the period, net of tax of \$17, \$39, \$69 and \$131	55	70	164	285
Less: Reclassification adjustments for (gains) losses included in net income (loss), net of tax of \$3, \$14, \$20 and \$19	(6)	(26)	38	(36)
Unrealized gains (losses) on available-for-sale securities, net	49	44	202	249
Other-than-temporary impairments on available-for-sale securities:				
Other-than-temporary impairments arising during the period, net of tax of \$1, \$2, \$14 and \$10	1	(3)	26	18
Less: Reclassification adjustments for other-than-temporary impairments included in net income (loss), net of tax of \$2, \$3, \$18 and \$10	4	4	34	19
Other-than-temporary impairments on available-for-sale securities, net	5	1	60	37
Unrealized gains (losses) on derivative instruments:				
Unrealized gains (losses) on derivative instruments arising during the period, net of tax of \$1, \$4, \$1 and \$1	2	(7)	2	(3)
Less: Reclassification adjustments for (gains) losses included in net income (loss), net of tax of \$0, \$3, \$9 and \$4	1	6	17	8
Unrealized gains (losses) on derivative instruments, net	3	(1)	19	5
Foreign currency translation, net of tax of \$4, \$3, \$3 and \$0	(3)	3	(15)	(33)
Total other comprehensive income (loss)	54	47	266	258
<b>Comprehensive income (loss)</b>	<b>\$ 61</b>	<b>\$ 491</b>	<b>\$ 864</b>	<b>\$ (435)</b>

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, 2012

(In millions except share amounts)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated	Treasury Stock		Total Shareholders Equity of MBIA Inc.	Preferred Stock of Subsidiary and Noncontrolling Interest		Total Equity
	Shares	Amount			Other Comprehensive Income (Loss)	Shares	Amount		Shares	Amount	
<b>Balance, December 31, 2011</b>	<b>274,896,162</b>	<b>\$ 275</b>	<b>\$ 3,072</b>	<b>\$ 805</b>	<b>\$ (176)</b>	<b>(81,752,966)</b>	<b>\$ (2,276)</b>	<b>\$ 1,700</b>	<b>1,315</b>	<b>\$ 23</b>	<b>\$ 1,723</b>
Net income	-	-	-	598	-	-	-	598	-	-	598
Other comprehensive income	-	-	-	-	266	-	-	266	-	-	266
Share-based compensation net of tax of \$6	558,937	-	-	-	-	23,174	1	1	-	-	1
Change in noncontrolling interest in subsidiary	-	-	-	-	-	-	-	-	-	(1)	(1)
<b>Balance, September 30, 2012</b>	<b>275,455,099</b>	<b>\$ 275</b>	<b>\$ 3,072</b>	<b>\$ 1,403</b>	<b>\$ 90</b>	<b>(81,729,792)</b>	<b>\$ (2,275)</b>	<b>\$ 2,565</b>	<b>1,315</b>	<b>\$ 22</b>	<b>\$ 2,587</b>

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

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

(In millions)

	<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities:</b>		
Premiums, fees and reimbursements received	\$ 223	\$ 278
Investment income received	459	499
Insured derivative losses and commutations paid	(463)	(683)
Financial guarantee losses and loss adjustment expenses paid	(620)	(778)
Proceeds from reinsurance and recoveries	131	144
Operating and employee related expenses paid	(300)	(244)
Interest paid	(377)	(470)
Income taxes (paid) received	(8)	54
<b>Net cash provided (used) by operating activities</b>	<b>(955)</b>	<b>(1,200)</b>
<b>Cash flows from investing activities:</b>		
Purchase of fixed-maturity securities	(2,032)	(5,590)
Sale and redemption of fixed-maturity securities	4,283	7,096
Proceeds from paydowns on variable interest entity loans	203	223
Redemptions of held-to-maturity investments	828	153
Sale (purchase) of short-term investments, net	335	968
Sale (purchase) of other investments, net	109	26
Consolidation (deconsolidation) of variable interest entities, net	(51)	(16)
(Payments) proceeds for derivative settlements	(266)	(66)
Collateral (to) from swap counterparty	(298)	-
Capital expenditures	(5)	(3)
<b>Net cash provided (used) by investing activities</b>	<b>3,106</b>	<b>2,791</b>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of investment agreements	52	89
Payments for drawdowns of investment agreements	(629)	(453)
Issuance of medium-term notes	18	17
Principal paydowns of medium-term notes	(74)	(107)
Principal paydowns of variable interest entity notes	(1,059)	(829)
Payments for securities sold under agreements to repurchase	(287)	(84)
Payments for retirement of debt	(364)	(72)
Purchase of treasury stock	-	(50)
Contribution from noncontrolling interest and redemption of subsidiary preferred stock, net	(1)	9
Restricted stock awards settlements, net	1	(2)
<b>Net cash provided (used) by financing activities</b>	<b>(2,343)</b>	<b>(1,482)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(192)</b>	<b>109</b>
Cash and cash equivalents beginning of period	633	1,130
<b>Cash and cash equivalents end of period</b>	<b>\$ 441</b>	<b>\$ 1,239</b>

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Reconciliation of net income (loss) to net cash provided (used) by operating activities:		
Net income (loss)	\$ 598	\$ (693)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Change in:		
Premiums receivable	98	182
Deferred acquisition costs	35	48
Unearned premium revenue	(443)	(495)
Loss and loss adjustment expense reserves	109	(198)
Insurance loss recoverable	(270)	(239)
Current income taxes	(11)	74
Net investment losses related to other-than-temporary impairments	105	44
Unrealized (gains) losses on insured derivatives	(1,473)	531
Net (gains) losses on financial instruments at fair value and foreign exchange	35	111
Deferred income tax provision (benefit)	163	(497)
(Gains) losses on extinguishment of debt	(49)	(26)
Other operating	148	(42)
Total adjustments to net income (loss)	(1,553)	(507)
Net cash provided (used) by operating activities	\$ (955)	\$ (1,200)

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

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 1: Business Developments, Risks and Uncertainties, and Liquidity**

###### ***Summary***

MBIA Inc., together with its consolidated subsidiaries, (collectively, MBIA or the Company) operates one of the largest financial guarantee insurance businesses in the industry and is a provider of asset management advisory services. These activities are managed through three business segments: United States ( U.S. ) public finance insurance, structured finance and international insurance, and advisory services. The Company's U.S. public finance insurance business is primarily operated through National Public Finance Guarantee Corporation and its subsidiaries ( National ), its structured finance and international insurance business is primarily operated through MBIA Insurance Corporation and its subsidiaries ( MBIA Corp. ), and its asset management advisory services business is primarily operated through Cutwater Holdings, LLC and its subsidiaries ( Cutwater ). The holding company, MBIA Inc., and certain of its subsidiaries also manage certain other business activities, the results of which are reported in its corporate, asset/liability products, and conduit segments. The corporate segment includes revenues and expenses that arise from general corporate activities. While the asset/liability products and conduit businesses represent separate business segments, they may be referred to collectively as wind-down operations as the funding programs managed through those businesses are in wind-down. Refer to Note 11: Business Segments for further information about the Company's reporting segments.

###### ***Business Developments***

As a result of insured losses and realized investment losses during the period from 2007 through September 30, 2012, the Company has seen ratings downgrades, a near cessation of new insurance business written by the Company, and increasing liquidity pressure. The Company has been unable to write meaningful amounts of new insurance business since 2008 and does not expect to write significant new insurance business prior to an upgrade of the credit ratings of its insurance subsidiaries. As of September 30, 2012, National was rated BBB with a developing outlook by Standard & Poor's Financial Services LLC ( S&P ) and Baa2 with a negative outlook by Moody's Investors Service, Inc. ( Moody's ). As of September 30, 2012, MBIA Insurance Corporation was rated B with a negative outlook by S&P and B3 with a review for a possible downgrade by Moody's.

As of September 30, 2012, the liquidity position of MBIA Inc., which consists of the liquidity positions of its corporate and asset/liability products activities, was \$432 million and comprised cash and liquid assets of \$335 million available for general corporate liquidity purposes, excluding the amounts held in escrow under its tax sharing agreement, and \$97 million not pledged directly as collateral for its asset/liability products activities. As of December 31, 2011, MBIA Inc. had \$386 million of cash and liquid assets comprising \$226 million available for general corporate liquidity purposes, excluding the amounts held in escrow under its tax sharing agreement, and \$160 million not pledged directly as collateral for its asset/liability products activities. The Company believes this liquidity position provides MBIA Inc. with sufficient funds to cover expected obligations at least through the next twelve months.

During the nine months ended September 30, 2012, MBIA Corp. continued to seek to reduce both the absolute amount and the volatility of its obligations and potential future claim payments through the execution of commutations of insurance policies. The combination of payments to reduce liabilities, claims payments and the failure of certain mortgage originators to honor contractual obligations to repurchase ineligible mortgage loans from securitizations the Company insured has increased liquidity pressure on MBIA Corp. As of September 30, 2012 and December 31, 2011, MBIA Corp.'s cash and liquid assets were \$386 million and \$534 million, respectively. During the nine months ended September 30, 2012, MBIA Corp. made \$1.0 billion in gross claim payments, and commuted \$13.0 billion of gross insured exposure, primarily comprising structured commercial mortgage-backed securities ( CMBS ) pools, commercial real estate ( CRE ) collateralized debt obligations ( CDOs ), investment grade corporate CDOs, asset-backed securities ( ABS ) CDOs, and subprime residential mortgage-backed securities ( RMBS ) transactions, of which \$12.8 billion was previously disclosed in earlier MBIA Inc.'s Securities and Exchange Commission ( SEC ) filings. Claims payments primarily resulted from the failure of certain mortgage-backed securities ( MBS ) sponsors to honor contractual obligations to repurchase ineligible mortgage loans. The Company's ability to commute insured transactions may be limited by available liquidity as determined based on management's assessment. The Company currently evaluates different methodologies to mitigate liquidity stress, including intercompany lending arrangements and the monetization of illiquid assets.

The reference herein to ineligible mortgage loans refers to those mortgage loans that the Company believes failed to comply with the representations and warranties made by the sellers/servicers of the securitizations to which those mortgage loans were sold (including mortgage loans that failed to comply with the related underwriting criteria), based on the Company's assessment of such mortgage loans' compliance with such representations and warranties, which included information provided by third-party review firms. The Company's assessment of the

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ineligibility of individual mortgage loans could be challenged by the sellers/servicers of the securitizations in litigation and there is no assurance that the Company's determinations will prevail.

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)***Risks and Uncertainties*

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

Significant risks and uncertainties that could affect amounts reported in the Company's financial statements in future periods include, but are not limited to, the following:

MBIA Corp.'s efforts to recover losses from the second-lien securitization originators could be delayed, settled at amounts below its contractual claims or potentially settled at amounts below those recorded on its balance sheets prepared under accounting principles generally accepted in the United States of America (GAAP) and statutory accounting principles (U.S. STAT). As of September 30, 2012 and December 31, 2011, the Company's estimated recoveries after income taxes calculated at the federal statutory rate of 35%, were \$2.1 billion and \$2.0 billion, respectively, which was 82% and 119% of the consolidated total shareholders' equity of MBIA, excluding preferred stock of subsidiaries and noncontrolling interests. As of September 30, 2012 and December 31, 2011, the related measures calculated under U.S. STAT were 144% and 89%, respectively, of the statutory capital of MBIA Corp. On May 14, 2012, Residential Capital, LLC (ResCap), and its wholly-owned subsidiary companies, Residential Funding Company, LLC (RFC) and GMAC Mortgage LLC (GMAC) each filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code. MBIA has recorded put-back claims associated with RFC and GMAC. Accordingly, MBIA's put-back claims are now subject to the ResCap bankruptcy proceeding. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about the Company's second-lien RMBS loss recoveries.

MBIA Inc. may not have sufficient liquidity to make all payments due on its liabilities and to meet other financial requirements, such as posting collateral, primarily as a result of a deficit of invested assets to debt issued to third parties and affiliates and the lack of dividends from its principal operating subsidiaries. During the nine months ended September 30, 2012, MBIA Inc.'s deficit increased as it realized losses from the sale and impairment of invested assets. In addition, it does not expect to receive dividends from its regulated insurance subsidiaries in the near term. If MBIA Inc. were required to continue to sell invested assets at their current market values in order to settle liabilities or to meet minimum required collateral amounts against liabilities, the deficit would increase further. In order to meet liquidity requirements, MBIA Inc. may also finance unencumbered assets through intercompany or third-party facilities, or use free cash or other assets, in some cases with New York State Department of Financial Services (NYSDFS) approval, although there can be no assurance that these strategies will be available or adequate. A failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp. The Company's ability to resolve the deficit will depend on its ability to receive distributions from its operating subsidiaries and/or raise third-party capital, and there can be no assurance that the Company will be successful in eliminating the deficit through these means, or that they will provide adequate liquidity. Refer to the following Liquidity section for additional information about MBIA Inc.'s liquidity position.

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)**

While MBIA Corp. has commuted most of its higher risk CMBS pool exposures, a single counterparty Bank of America and its subsidiary Merrill Lynch holds a significant amount of MBIA Corp.'s remaining CMBS pool exposures, including a substantial majority of MBIA Corp.'s CMBS pools originally insured in 2006 and 2007 primarily referencing BBB and lower rated collateral. MBIA Corp. has also recorded its largest put-back asset against Bank of America and certain of its subsidiaries, including Countrywide Home Loans, Inc. (Countrywide). While MBIA Corp. has estimated credit impairments or recorded loss reserves for the CMBS exposures, no material claims have been made to date. Bank of America/Merrill Lynch is also one of the two remaining plaintiffs in the litigation challenging the establishment of National (Transformation Litigation) (for a discussion of the Transformation Litigation, see Note 13: Commitments and Contingencies). As a result, the amount MBIA Corp. may ultimately collect from Bank of America/Countrywide on their put-back obligations in any litigation settlement could be impacted by potential commutation payments on these CMBS exposures and developments in the Transformation Litigation. Likewise, MBIA Corp.'s ability to commute these CMBS exposures may be impacted by developments in the put-back litigation with these entities and the Transformation Litigation. There can be no assurance that any such settlement or commutation will occur or that any such settlement or commutation, if it occurred, would be consummated within the estimates of expected recoveries or loss payments associated with these exposures that are recorded in the Company's consolidated financial statements. In addition, due to the deterioration in MBIA Corp.'s CMBS exposures, primarily in those exposures held by Bank of America/Merrill Lynch, there is an increased likelihood that MBIA Corp. will experience claims on those exposures, which could be substantial. Depending on the amount of such claims and the amounts of claims on other policies issued by MBIA Corp., MBIA Corp. may not have sufficient liquid assets to pay such claims in the absence of a settlement with Bank of America/Merrill Lynch and the commutation of the CMBS exposures held by Bank of America/Merrill Lynch or in the absence of the collection of other substantial put-back recoverables.

If commercial real estate servicer behavior does not continue to mitigate potential or actual credit losses in line with current trends, MBIA Corp. could incur substantial losses in that sector, primarily on the Bank of America/Merrill Lynch CMBS exposures described above. As of September 30, 2012, MBIA Corp. had CMBS pool and CRE CDO insured par exposure of approximately \$15.7 billion and \$2.2 billion, respectively, excluding approximately \$2.8 billion of CRE loan pools, primarily comprising European assets. Since the end of 2007 through September 30, 2012, MBIA Corp.'s CMBS pool and CRE CDO gross par exposure has decreased by approximately \$36.1 billion, of which \$33.1 billion resulted from negotiated commutations and early settlements. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about the Company's estimate of CMBS credit impairments.

Incurred losses from insured RMBS have declined from their peaks. However, due to the large percentage of ineligible mortgage loans included within MBIA Corp.'s insured second-lien portfolio, performance remains difficult to predict and losses could ultimately be in excess of MBIA Corp.'s current estimated loss reserves. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about MBIA Corp.'s RMBS loss reserves.

While MBIA Corp. has settled a substantial portion of its insured ABS CDO exposure at levels, on average, within MBIA Corp.'s previously established statutory loss reserves related to those exposures, further economic stress might cause increases in MBIA Corp.'s loss estimates on its remaining exposure. As of September 30, 2012, MBIA Corp.'s ABS CDO gross par outstanding was approximately \$4.4 billion, and had decreased approximately \$32.9 billion since 2007.

In recent years, key components of the Company's strategy have included commuting volatile insured exposures, purchasing instruments issued or guaranteed by the Company in order to reduce future expected economic losses and managing the liquidity requirements and risk in MBIA Inc. In order to implement this strategy, the Company put in place intercompany agreements that allocate liquidity resources among its entities in order to fund commutations and provide liquidity, where needed. The intercompany

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agreements with the Company's insurance subsidiaries have required the approval of the NYSDFS. The Company's ability to continue to draw on intercompany financing, provide other intercompany liquidity and capital support, obtain permission for contingency reserve releases, and the ability of its insurance subsidiaries to pay dividends to MBIA Inc. will in most cases require further approvals from the NYSDFS, and there can be no assurance that the Company will be able to obtain such approvals. In addition, in connection with providing such approvals, the NYSDFS may require the Company or its insurance subsidiaries to agree to take, or refrain from taking, certain actions.

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

Litigation over the NYSDFS approval of National's creation or additional hurdles to achieving high stable ratings may impede National's ability to resume writing municipal bond insurance for some time, reducing its long-term ability to generate capital and cash from operations.



**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)**

Municipal and state fiscal distress in the U.S. could adversely affect the Company's operations if it results in larger-than-expected incurred insurance losses. Additionally, the sovereign debt crisis in the Eurozone could have an adverse impact on insured European exposures and/or cause a global slowdown in growth, thereby adversely affecting U.S. insured exposures.

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

As of September 30, 2012, the Company had \$2.6 billion of shareholders' equity and MBIA Insurance Corporation and National had \$1.5 billion and \$3.1 billion, respectively, of statutory capital. Statutory capital, defined as policyholders' surplus and contingency reserves, is a key measure of an insurance company's financial condition under insurance laws and regulations. Failure to maintain adequate levels of statutory surplus and total statutory capital could lead to intervention by the Company's insurance regulators in its operations and constitute an event of default under certain of the Company's contracts, thereby materially and adversely affecting the Company's financial condition and results of operations. Pursuant to approval granted by the NYSDFS in accordance with New York Insurance Law (NYIL), as of September 30, 2012, MBIA Insurance Corporation released to surplus an aggregate of \$196 million of excessive contingency reserves. As of September 30, 2012, MBIA Insurance Corporation had a deficit of \$97 million of qualifying assets required to support its contingency reserves. The deficit was caused by MBIA Insurance Corporation's sale of liquid assets in order to make claim payments and the failure of certain mortgage originators, particularly Bank of America, to honor their contractual obligations to repurchase ineligible mortgage loans from securitizations the Company insured. The deficit is expected to grow as additional commutation and claim payments are made in the future. The Company has reported the deficit to the NYSDFS. MBIA Insurance Corporation has requested approval from the NYSDFS to release \$97 million of contingency reserves as of September 30, 2012, but to date has not received approval. For risks associated with MBIA Insurance Corporation's failure to meet its contingency reserve requirement, see Item 1A. Risk Factors Liquidity and Market Related Risk Factors. If the Company's insurance subsidiaries fail to meet regulatory capital requirements they may become subject to regulatory action in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

As of September 30, 2012, MBIA Insurance Corporation exceeded its aggregate risk limits under the NYIL by \$47 million. MBIA Insurance Corporation will notify the NYSDFS of the overage and will submit a plan to achieve compliance with the limits in accordance with the NYIL. If MBIA Insurance Corporation is not in compliance with its aggregate risk limits, the NYSDFS may prevent MBIA Insurance Corporation from transacting any new financial guarantee insurance business until it no longer exceeds the limitations.

***Liquidity***

As a financial services company, MBIA has been materially adversely affected by conditions in global financial markets. Current conditions and events in these markets, in addition to the failure by the originators of RMBS to repurchase the ineligible mortgage loans in securitizations that the Company has insured, have put substantial stress on the Company's liquidity resources.

The Company has utilized a liquidity risk management framework, the primary objectives of which are to monitor liquidity positions and projections in its legal entities and guide the matching of liquidity resources to needs. The Company monitors its cash and liquid asset resources using stress-scenario testing. Members of MBIA's senior management meet regularly to review liquidity metrics, discuss contingency plans and establish target liquidity cushions on an enterprise-wide basis. As part of the Company's liquidity risk management framework, the Company evaluates and manages liquidity on a legal-entity basis to take into account the legal, regulatory and other limitations on available liquidity resources within the enterprise.



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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)**

The majority of the Company's liquidity management efforts focus on:

The liquidity resources of MBIA Inc., which are subject to: uncertainty in the timing and amount of cash inflows from dividends paid by National and MBIA Corp.; the necessity of having to support the liquidity needs of the asset/liability products business; and potential cross-defaults of holding company debt with other obligations in the consolidated group. The asset/liability products business of MBIA Inc. is subject to ongoing negative cash flow and has a deficit of invested assets to liabilities. In addition, the liquidity resources of MBIA Inc. are subject to collateralization requirements in connection with the liabilities it has issued to third parties and affiliates and in connection with third-party derivative contracts.

The liquidity resources of MBIA Corp. which are subject to: an increased likelihood that MBIA Corp. will experience claims on its CMBS exposures, primarily in those exposures held by Bank of America/Merrill Lynch, due to the deterioration in such exposures; delays in the collection of recoveries related to ineligible mortgage loans in certain insured RMBS transactions; payments to counterparties in consideration for the commutation of insured transactions; and payments on insured exposures that in some cases may be large bullet payments. MBIA Corp. is currently subject to negative cash flow as a result of these payments and delays in collecting recoveries.

In order to address these liquidity risks and efficiently manage liquidity across the entire enterprise, certain of the Company's subsidiaries which are less liquidity constrained have entered into intercompany agreements that provide resources to subsidiaries that are more liquidity constrained. These resources include intercompany agreements described further below between the Company's primary insurance subsidiaries and between these insurance subsidiaries and the asset/liability products business (through MBIA Inc.), which in each case were approved by the NYSDFS and are subject to ongoing monitoring by the NYSDFS. The Company monitors the liquidity resources of National, for which the Company has not observed material liquidity risk to date, in order to ensure it maintains sufficient liquidity to pay claims and satisfy its other obligations. National's liquidity resources are subject to unexpected loss payments on its insured transactions, negative cash flow, and liquidity support arrangements with its affiliates.

***Key Intercompany Lending Agreements*****National Secured Loan**

National provided a \$1.1 billion secured loan to MBIA Insurance Corporation ( National Secured Loan ) in order to enable MBIA Insurance Corporation to fund settlements and commutations of its insurance policies. This loan was approved by the NYSDFS as well as by the boards of directors of MBIA Inc., MBIA Insurance Corporation and National. The National Secured Loan has a fixed annual interest rate of 7% and a maturity date of December 2016. MBIA Insurance Corporation has the option to defer payments of interest when due by capitalizing interest amounts to the loan balance, subject to the collateral value exceeding certain thresholds. MBIA Insurance Corporation has elected to defer the interest payments due under the loan. MBIA Insurance Corporation's obligation to repay the loan is secured by a pledge of collateral having an estimated value in excess of the notional amount of the loan as of September 30, 2012, which collateral comprised the following future receivables of MBIA Corp.: (i) its right to receive put-back recoveries related to ineligible mortgage loans included in its insured second-lien RMBS transactions; (ii) future recoveries on defaulted insured second-lien RMBS transactions resulting from expected excess spread generated by performing loans in such transactions; and (iii) future installment premiums. During the nine months ended September 30, 2012, MBIA Insurance Corporation borrowed an additional \$443 million under the National Secured Loan with the approval of the NYSDFS at the same terms as the original loan to fund additional commutations of its insurance policies. As of September 30, 2012, the outstanding principal amount under this loan was \$1.6 billion. MBIA Insurance Corporation may seek to borrow additional amounts under the loan in the future. Any such increase or other amendment to the terms of the loan would be subject to regulatory approval by the NYSDFS.

Asset Swap

National maintained simultaneous repurchase and reverse repurchase agreements ( Asset Swap ) with MBIA Inc. for up to \$2.0 billion based on the fair value of securities borrowed. The Asset Swap provides MBIA Inc. with eligible assets to pledge under investment agreements and derivative contracts in the asset/liability products business. As of September 30, 2012, the notional amount utilized under each of these agreements was \$522 million and the fair value of collateral pledged by National and MBIA Inc. under these agreements was \$535 million and \$558 million, respectively. The net average interest rate on these transactions was 0.56% and 0.34% for the nine months ended September 30, 2012 and 2011, respectively. The NYSDFS approved the Asset Swap in connection with the re-domestication of National to New York. National has committed to the NYSDFS to use commercially reasonable efforts to reduce the amount of the Asset Swap over time.

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)****MBIA Corp. Secured Loan**

MBIA Corp., as lender, maintained a master repurchase agreement with MBIA Inc. ( MBIA Corp. Secured Loan ) for the benefit of MBIA Inc.'s asset/liability products business, which totaled \$2.0 billion at inception and was scheduled to mature in May 2012, as amended. This loan was repaid in May 2012 and there have been no further draws. During 2012, the average interest rate on the MBIA Corp. Secured Loan was 2.51% through the repayment in May 2012. Also in May 2012, the NYSDFS approved the maturity extension of the MBIA Corp. Secured Loan to May 2013 with a maximum outstanding amount of \$450 million, subject to MBIA Corp. obtaining prior regulatory approval from the NYSDFS for any draws under the facility.

**Conduit Repurchase Agreement**

MBIA Inc. maintained a repurchase agreement with Meridian Funding Company, LLC ( Conduit Repurchase Agreement ), with a maximum funded amount of \$1.0 billion, subject to a pledge of collateral. The Conduit Repurchase Agreement had an average interest rate during the nine months ended September 30, 2012 of 2.48%. As of September 30, 2012, the amount drawn by MBIA Inc. under this agreement and the fair value of the collateral pledged by MBIA Inc. was \$51 million and \$63 million, respectively.

**MBIA Inc. Liquidity**

MBIA Inc.'s liquidity resources support the Company's corporate and asset/liability products segments. The activities of MBIA Inc. consist of holding and managing investments, servicing outstanding corporate debt instruments, investment agreements and medium-term notes ( MTNs ) issued by the asset/liability products and conduit segments, posting collateral under financing and hedging arrangements and investment agreements, making payments and collateral postings related to interest rate and foreign exchange swaps, and paying operating expenses. The primary sources of cash within MBIA Inc. used to meet its liquidity needs include available cash and liquid assets not subject to collateral posting requirements, scheduled principal and interest on assets held in its investment portfolio, dividends from subsidiaries, payments under tax sharing agreements with these subsidiaries (once the payments become unrestricted) and the ability to issue debt and equity. There can be no assurance as to the amount and timing of any such dividends or payments under the tax sharing agreements. MBIA Inc.'s corporate debt, investment agreements, MTNs, and derivatives may be accelerated by the holders of such instruments upon the occurrence of certain events, such as a breach of covenant or representation, a bankruptcy of MBIA Inc. or the filing of an insolvency proceeding with respect to MBIA Corp. MBIA Inc.'s obligations under its loans from MBIA Global Funding, LLC ( GFL ) may be accelerated only upon the occurrence of a bankruptcy or liquidation of MBIA Inc. Refer to Note 11: Business Segments for a description of the GFL loans. In the event of any acceleration of the Company's obligations, including under its corporate debt, investment agreements, MTNs, or derivatives, the Company likely would not have sufficient liquid resources to pay amounts due with respect to its corporate debt and other obligations.

During the nine months ended September 30, 2012, pursuant to the tax sharing agreement, National settled with MBIA Inc. its taxes related to the 2010 and 2011 tax years of \$1 million and \$11 million, respectively. In addition, National paid to MBIA Inc. estimated 2012 taxes of \$95 million. Consistent with the tax sharing agreement, these amounts were placed in an escrow account until the expiration of National's two-year net operating loss ( NOL ) carry-back period under U.S. tax rules. At the expiration of National's carry-back period, any funds remaining after any reimbursement to National in respect of any NOL carry-backs would be available for general corporate purposes, including to satisfy any other obligations under the tax sharing agreement. As of September 30, 2012, \$365 million remained in escrow for the 2010 through 2012 tax years.

MBIA Inc. is subject to material liquidity risks and uncertainties. To mitigate these risks, the Company seeks to maintain cash and liquidity resources that are expected to be sufficient to make all payments due on its obligations and to meet other financial requirements, such as posting collateral, at least through the next twelve months.

Liquidity risk within MBIA Inc. is primarily a result of the following factors:

MBIA Inc. s asset/liability products segment had a deficit of invested assets to liabilities issued to third parties and affiliates of \$980 million as of September 30, 2012, which increased from \$591 million as of December 31, 2011. This deficit is a result of selling investments and terminating interest rate swaps at losses, and may further increase as a result of selling investments and terminating interest rates swaps at losses in the future. In addition, this deficit is expected to increase as a result of ongoing expected operating losses. This deficit will need to be reversed prior to the maturity of the liabilities in order to ensure that there are sufficient funds available to fully retire the liabilities. The Company expects that MBIA Inc. will be able to eliminate the deficit prior to the maturity of the related liabilities from distributions from its operating subsidiaries and by raising third-party capital, although there can be no assurance that MBIA Inc. will be able to eliminate the deficit through such means.

Uncertainty of the timing and amount of cash inflows from dividends paid by MBIA s principal operating subsidiaries.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)**

Currently, the majority of the cash and securities of MBIA Inc. is pledged against investment agreement liabilities, intercompany financing arrangements and derivatives, which limit its ability to raise liquidity through asset sales. In addition, if the market value or rating eligibility of the assets which are pledged against these obligations were to decline, the Company would be required to pledge additional eligible assets in order to meet minimum required collateral amounts against these liabilities. In such event, the Company may sell additional assets, potentially with substantial losses, finance unencumbered assets through intercompany facilities, or use free cash or other assets, in some cases with NYSDFS approval, although there can be no assurance that these strategies will be available or adequate to meet liquidity requirements.

Because the majority of MBIA Inc.'s assets is pledged against the obligations described above, the widening of credit spreads would have an adverse impact on the market value of these assets and increase collateralization requirements for the portfolio. The following table presents the estimated pre-tax change in fair value of the asset/liability products business assets as of September 30, 2012 from instantaneous shifts in credit spread curves. This table assumes that all credit spreads move by the same amount; however, it is more likely that the actual changes in credit spreads will vary by investment sector and individual security. The table presents hypothetical increases and decreases in credit spreads of 50 and 200 basis points. Because downward movements of these amounts in some cases would result in negative spreads, a floor was assumed for minimum spreads.

In millions	Change in Credit Spreads (Asset/Liability Products Business)			
	200 Basis Point	50 Basis Point	50 Basis Point	200 Basis Point
	Decrease	Decrease	Increase	Increase
Estimated change in fair value	\$ 149	\$ 41	\$ (37)	\$ (130)

During the nine months ended September 30, 2012, MBIA Inc. maintained three intercompany financing facilities to provide it with additional resources to meet its liquidity requirements within the asset/liability products business: the Asset Swap, the MBIA Corp. Secured Loan and the Conduit Repurchase Agreement. Refer to the preceding Key Intercompany Lending Agreements section for a description of these facilities.

Stressed credit market conditions could cause MBIA Inc. to have insufficient resources to cover collateral and/or other liquidity requirements. Management has identified certain actions to mitigate this risk. These contingent actions include: (1) additional sales of other invested assets exposed to credit spread stress risk, which may occur at losses and increase the deficit of invested assets to liabilities; (2) termination and settlement of interest rate swap agreements; and (3) other available advances from subsidiaries. These actions, if taken, are expected to result in either additional liquidity or reduced exposure to adverse credit spread movements. There can be no assurance that these actions will be sufficient to fully mitigate this risk. In the event that the Company cannot implement the contingent actions identified above to raise liquidity, or eliminate the deficit, it may have insufficient assets to make all payments on its obligations as they come due, which could result in a default by MBIA Inc. on its obligations and the potential for MBIA Corp., as guarantor of the investment agreements and GFL MTNs, to be called upon to satisfy obligations on those instruments as they come due.

As of September 30, 2012, the liquidity position of MBIA Inc., which consists of the liquidity positions of its corporate and asset/liability products activities, was \$432 million and comprised cash and liquid assets of \$335 million available for general corporate liquidity purposes, excluding the amounts held in escrow under its tax sharing agreement, and \$97 million not pledged directly as collateral for its asset/liability products activities. As of December 31, 2011, MBIA Inc. had \$386 million of cash and liquid assets comprising \$226 million available for general corporate liquidity purposes, excluding the amounts held in escrow under its tax sharing agreement, and \$160 million not pledged directly as collateral for its asset/liability products activities. This liquidity position provides MBIA Inc. with sufficient funds to cover expected obligations at least through the next twelve months.

**MBIA Corp. Liquidity**

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Liquidity available in the structured finance and international insurance segment is affected by the Company's ability to collect on receivables associated with loss payments, the payment of claims on insured exposures, payments made to commute insured exposures, the repayment of the National Secured Loan, a reduction in investment income, any unanticipated expenses, or the impairment or a significant decline in the fair value of invested assets. The Company may also experience liquidity constraints as a result of NYIL requirements that the Company maintain specified, high quality assets to back the Company's reserves and surplus.



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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)**

The Company's current liquidity position of MBIA Corp. is adequate to make expected future claims payments and it expects to settle its insured CMBS exposures with no cash payments. However, the liquidity position of MBIA Corp. has been stressed due to the failure of the sellers/servicers of RMBS transactions insured by MBIA Corp. to repurchase ineligible mortgage loans in certain insured transactions and payments to counterparties in consideration for the commutation of insured transactions, which have resulted in a substantial reduction of exposure and potential loss volatility. While MBIA Corp. has made and may in the future make payments to counterparties in consideration for the commutation of insured transactions, MBIA Corp.'s ability to commute insured transactions will depend on management's assessment of available liquidity. In addition, due to the deterioration in MBIA Corp.'s CMBS exposures, primarily in those exposures held by Bank of America/Merrill Lynch, there is an increased likelihood that MBIA Corp. will experience claims on those exposures, which claims could be substantial. Depending on the amount of such claims and the amounts of claims on other policies issued by MBIA Corp., MBIA Corp. may not have sufficient liquid assets to pay such claims in the absence of a settlement with Bank of America/Merrill Lynch and the commutation of the CMBS exposures held by Bank of America/Merrill Lynch or in the absence of the collection of other substantial put-back recoverables.

Payment requirements for the structured finance and international financial guarantee contracts fall into three categories: (i) timely interest and ultimate principal; (ii) ultimate principal only at final maturity; and (iii) payments upon settlement of individual collateral losses as they occur after any deductible or subordination has been exhausted, which payments are unscheduled and therefore more difficult to predict, and which category applies to most of the transactions on which the Company has recorded loss reserves. Insured transactions that require payment in full of the principal insured at maturity could present liquidity risks for MBIA Corp. since payment of the principal is due at maturity but any salvage could be recovered over time after payment of the principal amount. MBIA Corp. is generally required to satisfy claims within one to three business days, and as a result seeks to identify potential claims in advance through the Company's monitoring process. While MBIA Corp.'s financial guarantee policies generally cannot be accelerated, thereby mitigating liquidity risk, the insurance of credit default swap (CDS) contracts may, in certain events, including the insolvency or payment default of the insurer or the issuer of the CDS, be subject to termination by the counterparty, triggering a claim for the fair value of the contract. In order to monitor liquidity risk and maintain appropriate liquidity resources, the Company uses the same methodology as it uses to monitor credit quality and losses within its insured portfolio, including stress scenarios. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for a discussion of the Company's loss and loss adjustment expense (LAE) process.

The Company's structured finance and international insurance segment also requires cash for the payment of operating expenses, as well as principal and interest related to its surplus notes. Pursuant to Section 1307 of the NYIL and the Fiscal Agency Agreement governing MBIA Corp.'s surplus notes, any payment on the notes may be made only with the prior approval of the Superintendent of the NYSDFS whenever, in his judgment, the financial condition of [MBIA Corp.] warrants and payment may be made only out of MBIA Corp.'s free and divisible surplus. If these conditions are not met, MBIA Corp. would not be obligated to make any applicable interest payment and no default or event of default would occur under the Fiscal Agency Agreement or any of the Company's other agreements. While the NYSDFS has approved the note interest payments in the past, its approval of the most recent note interest payment on July 16, 2012 was not received until after the date on which the Fiscal Agency Agreement required MBIA Corp. to notify the registered holders of the notes and the Fiscal Agent of the failure to obtain such approval, as the Company disclosed on a Form 8-K filed on July 10, 2012. There can be no assurance that the NYSDFS will approve the next scheduled note interest payment on January 15, 2013 or any subsequent payments, or that it will approve any payment by the scheduled interest payment date or by the date on which the notice is required to be delivered to the registered holders and the Fiscal Agent, nor can there be any assurance that the NYSDFS will approve any optional redemption payment that MBIA Corp. may seek to make on or after January 15, 2013.

Since the fourth quarter of 2007 through September 30, 2012, MBIA Corp. has made \$11.6 billion of cash payments, before reinsurance and collections and excluding LAE (including payments made to debt holders of consolidated variable interest entities (VIEs)), associated with second-lien RMBS securitizations and with commutations and claim payments relating to CDS contracts. These cash payments include loss payments of \$893 million made on behalf of MBIA Corp.'s consolidated VIEs. Of the \$11.6 billion, MBIA Corp. has paid \$6.6 billion of gross claims (before reinsurance and collections and excluding LAE) on policies insuring second-lien RMBS securitizations, driven primarily by an extensive number of ineligible mortgage loans being placed in the securitizations in breach of the representations and warranties of the sellers/servicers. In addition, MBIA Corp. has paid \$5.0 billion of gross settlement and claim payments (before reinsurance and collections and excluding LAE) on insured credit derivatives. Also, since the fourth quarter of 2007 through September 30, 2012, MBIA Corp. has collected

\$185 million on excess spread before reinsurance.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)**

MBIA Corp. is seeking to enforce its rights to have mortgage sellers/servicers cure, replace or repurchase ineligible mortgage loans from securitizations and has recorded a total of \$3.2 billion of related expected recoveries on its consolidated balance sheets as of September 30, 2012, including expected recoveries recorded in the Company's consolidated VIEs. These put-back claims have been disputed by the loan sellers/servicers and are the subject of certain litigations discussed more fully in Note 13: Commitments and Contingencies. On May 14, 2012, ResCap and its wholly-owned subsidiary companies, RFC and GMAC each filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code. Additionally, there is some risk that the sellers/servicers or other responsible parties might not be able to fully satisfy any judgment the Company secures in litigation and ResCap's bankruptcy filing. Further, there can be no assurance that the Company will be successful or that the Company will not be delayed in realizing these recoveries. Such risks are contemplated in the scenarios the Company utilizes to calculate these recoveries, which are recognized on the Company's consolidated balance sheets. The Company believes that it has adequate liquidity resources to provide for anticipated cash outflows; however, if the Company does not realize or is delayed in realizing these expected recoveries, the Company may not have adequate liquidity to fully execute the strategy to reduce future potential economic losses by commuting policies and purchasing instruments issued or guaranteed by the Company, or to repay any intercompany borrowings.

A portion of the commutation payments made since the fourth quarter of 2011 were financed through the National Secured Loan. MBIA Insurance Corporation's ability to repay the loan and any accrued interest will be primarily predicated on MBIA Corp.'s ability to collect on its future receivables, including its ability to successfully enforce its rights to have the mortgage sellers/servicers cure, replace or repurchase ineligible mortgage loans from insured securitizations.

MBIA Corp. also insures third-party holders of the Company's asset/liability products segment's obligations. If the Company was unable to meet payment or collateral requirements associated with these obligations, the holders thereof could make claims under the MBIA Corp. insurance policies. In 2008, to provide additional liquidity to the asset/liability products business, MBIA Corp. lent \$2.0 billion to the segment on a secured basis under the MBIA Corp. Secured Loan. As of September 30, 2012, the outstanding balance of the MBIA Corp. Secured Loan was repaid in full. In May 2012, the NYSDFS approved the maturity extension of the MBIA Corp. Secured Loan to May 2013 with a maximum outstanding amount of \$450 million, subject to MBIA Corp. obtaining prior regulatory approval from the NYSDFS for any draws under the facility.

As of September 30, 2012, MBIA Corp. held cash and available-for-sale investments of \$1.4 billion, of which \$386 million comprised cash and highly liquid assets. As of December 31, 2011, MBIA Corp. held cash and available-for-sale investments of \$1.5 billion, of which \$534 million comprised cash and highly liquid assets. The Company believes that MBIA Corp.'s liquidity resources, including expected cash inflows, will adequately provide for anticipated cash outflows. In the event of unexpected liquidity requirements, the Company may have insufficient resources to meet its obligations or insufficient qualifying assets to support its surplus and reserves, and may seek to increase its cash holdings position by selling or financing assets, or raising external capital, and there can be no assurance that the Company will be able to draw on these additional sources of liquidity.

***National Liquidity***

Despite continued adverse macroeconomic conditions in the U.S., the incidence of default among U.S. public finance issuers remains extremely low and the Company believes that the liquidity position of its U.S. public finance insurance segment is sufficient to meet cash requirements in the ordinary course of business.

Liquidity risk arises in the Company's U.S. public finance insurance segment primarily from the following:

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The insurance policies issued or reinsured by National, the entity from which the Company conducts its U.S. public finance insurance business, provide unconditional and irrevocable guarantees of payments of the principal of, and interest or other amounts owing on, insured obligations when due or, in the event that the insurance company has the right, at its discretion, to accelerate insured obligations upon default or otherwise, upon the insurance company's election to accelerate. In the event of a default in payment of principal, interest or other insured amounts by an issuer, National generally promises to make funds available in the insured amount within one to three business days following notification. In some cases, the amount due can be substantial, particularly if the default occurs on a transaction to which National has a large notional exposure or on a transaction structured with large, bullet-type principal maturities. The fact that the U.S. public finance insurance segment's financial guarantee contracts generally cannot be accelerated by a party other than the insurer helps to mitigate liquidity risk in this segment.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 1: Business Developments, Risks and Uncertainties, and Liquidity (continued)**

National has entered into certain intercompany transactions to support the liquidity needs of its affiliates. These transactions include the National Secured Loan to MBIA Insurance Corporation and the Asset Swap through which National provides liquid assets to the Company's asset/liability products business. As a result of these transactions, National is subject to repayment risk, which may adversely affect its liquidity. The repayment of the National Secured Loan will primarily be predicated on MBIA Corp.'s ability to successfully enforce its rights to have mortgage sellers/servicers cure, replace or repurchase ineligible mortgage loans from securitizations it insured. In addition, changes in the market value of securities sold to National under its Asset Swap with the asset/liability products business may adversely affect its liquidity position if the asset/liability business were unable to pledge additional eligible assets in order to meet minimum required collateral amounts.

National held cash and short-term investments of \$356 million as of September 30, 2012, of which \$318 million was highly liquid and consisted predominantly of highly rated municipal, U.S. agency and corporate bonds. As of December 31, 2011, National held cash and short-term investments of \$771 million, of which \$703 million was highly liquid and consisted predominantly of highly rated municipal, U.S. agency and corporate bonds. With the exception of its loan to MBIA Insurance Corporation, most of National's investments, including those encumbered by the Asset Swap, are liquid and highly rated.

**Note 2: Significant Accounting Policies**

The Company has disclosed its significant accounting policies in Note 2: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. The following significant accounting policies provide an update to those included in the Company's Annual Report on Form 10-K.

***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, do not include all of the information and disclosures required by GAAP for annual periods. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2011. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the Company's consolidated financial position and results of operations. All material intercompany balances and transactions have been eliminated.

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

The results of operations for the three and nine months ended September 30, 2012 may not be indicative of the results that may be expected for the year ending December 31, 2012. The December 31, 2011 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. Certain amounts have been reclassified in comparison to prior years' financial statements to conform to the current presentation. Such reclassifications had no impact on total revenues, expenses, assets, liabilities, or shareholders' equity for all periods presented.

***Statements of Cash Flows***

Previously, the Company reported its consolidated statements of cash flows using the indirect method. The indirect method uses accrual accounting information to present the cash flows from operations. Effective January 1, 2012, the Company elected to present its consolidated

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statements of cash flows using the direct method. The direct method uses actual cash flow information from the Company's operations, rather than using accrual accounting values. Using either the direct or indirect method, total cash flows from operations are consistent. In addition, the presentation of cash flows from investing and financing activities using either the direct or indirect method are consistent. The change to the direct method for calculating and presenting cash flows from operations was implemented retroactively for all statements of cash flows presented herein. Use of the direct method requires a reconciliation of net income to cash flows from operations. This reconciliation is provided as a supplement directly beneath the statements of cash flows.

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 3: Recent Accounting Pronouncements*****Recently Adopted Accounting Standards******Presentation of Comprehensive Income (ASU 2011-05)***

In June 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income. This amendment eliminates the current option to report other comprehensive income and its components in the statements of changes in equity except for the presentation of reclassification adjustments for which adoption has been deferred by the FASB. The amendment does not change what currently constitutes net income and other comprehensive income. The new guidance is effective for the Company beginning January 1, 2012. In December 2011, the FASB issued ASU 2011-12 Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05, which defers certain aspects of ASU 2011-05 related to the presentation of reclassification adjustments. The Company adopted this standard effective January 1, 2012. The standard only affected the Company's presentation of comprehensive income and did not affect the Company's consolidated balance sheets, results of operations, or cash flows.

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

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

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

In October 2010, the FASB issued ASU 2010-26, Financial Services Insurance (Topic 944) Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. This amendment specifies which costs incurred in the acquisition of new and renewal insurance contracts should be capitalized. The Company adopted this standard on a prospective basis effective January 1, 2012. As the Company is currently not writing any significant new business, the adoption of this standard did not have a material effect on the Company's consolidated balance sheets, results of operations, or cash flows. The difference between the amount of acquisition costs capitalized during the first nine months of 2012 compared with the amount of acquisition costs that would have been capitalized during the period if the Company's previous policy had been applied during that period is not material because the Company did not write any significant new insurance business during the first nine months of 2012.

***Recent Accounting Developments******Disclosures about Offsetting Assets and Liabilities (ASU 2011-11)***

In December 2011, the FASB issued ASU 2011-11, Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. ASU 2011-11 creates new disclosure requirements about the nature of the Company's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. This amendment does not change the existing offsetting eligibility criteria or the permitted balance sheet presentation for those instruments that meet the eligibility criteria. The disclosure requirements are effective for the Company beginning in the first quarter of 2013. This standard will only affect the Company's disclosures and will not affect the Company's consolidated balance sheets, results of operations, or cash flows.

Refer to the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further information regarding the effects of recently adopted accounting standards on prior year financial statements.





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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 4: Variable Interest Entities*****Structured Finance and International Insurance***

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

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

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

***Wind-down Operations***

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

In the conduit segment, the Company has managed and administered two conduits that invested primarily in debt securities and were funded through the issuance of VIE notes and long-term debt. MBIA Corp. insures the debt obligations of the conduits, and provides credit protection on certain assets held by the conduits. The conduits are VIEs and are consolidated by the Company as primary beneficiary. In 2012, all debt securities held by one of the conduits were entirely repaid, and the proceeds were used to repay all outstanding long-term debt of this conduit. The Company subsequently dissolved this conduit, and no longer provides any related credit protection.

***Nonconsolidated VIEs***

The following tables present the total assets of nonconsolidated VIEs in which the Company holds a variable interest as of September 30, 2012 and December 31, 2011. The following tables also present the Company's maximum exposure to loss for nonconsolidated VIEs and carrying

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values of the assets and liabilities for its interests in these VIEs as of September 30, 2012 and December 31, 2011. The Company has aggregated nonconsolidated VIEs based on the underlying credit exposure of the insured obligation. The nature of the Company's variable interests in nonconsolidated VIEs is related to financial guarantees, insured CDS contracts and any investments in obligations issued by nonconsolidated VIEs.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 4: Variable Interest Entities (continued)**

In millions	September 30, 2012 Carrying Value of Assets					Carrying Value of Liabilities Loss and Loss Adjustment		
	VIE Assets	Maximum Exposure to Loss	Investments <sup>(1)</sup>	Premiums Receivable <sup>(2)</sup>	Insurance Loss Recoverable <sup>(3)</sup>	Unearned Premium Revenue <sup>(4)</sup>	Expense Reserves <sup>(5)</sup>	Derivative Liabilities <sup>(6)</sup>
Insurance:								
Global structured finance:								
Collateralized debt obligations	\$ 17,552	\$ 11,053	\$ -	\$ 67	\$ 3	\$ 59	\$ 78	\$ 85
Mortgage-backed residential	36,464	13,578	9	75	2,967	73	485	4
Mortgage-backed commercial	4,751	2,456	-	2	-	2	-	-
Consumer asset-backed	6,372	3,390	11	20	-	20	16	-
Corporate asset-backed	22,006	11,261	-	144	21	159	-	1
Total global structured finance	87,145	41,738	20	308	2,991	313	579	90
Global public finance	46,795	21,578	-	216	-	268	-	-
Total insurance	\$ 133,940	\$ 63,316	\$ 20	\$ 524	\$ 2,991	\$ 581	\$ 579	\$ 90

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

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

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

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

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

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

In millions	December 31, 2011 Carrying Value of Assets					Carrying Value of Liabilities Loss and Loss Adjustment		
	VIE Assets	Maximum Exposure to Loss	Investments <sup>(1)</sup>	Premiums Receivable <sup>(2)</sup>	Insurance Loss Recoverable <sup>(3)</sup>	Unearned Premium Revenue <sup>(4)</sup>	Expense Reserves <sup>(5)</sup>	Derivative Liabilities <sup>(6)</sup>
Insurance:								
Global structured finance:								
Collateralized debt obligations	\$ 26,507	\$ 15,466	\$ 42	\$ 67	\$ -	\$ 58	\$ 3	\$ 113
Mortgage-backed residential	47,669	16,379	25	87	2,773	86	428	5
Mortgage-backed commercial	5,001	2,644	-	2	-	2	-	-

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Consumer asset-backed	8,015	4,563	16	26	-	25	23	-
Corporate asset-backed	29,855	15,577	241	192	22	205	-	1
<b>Total global structured finance</b>	<b>117,047</b>	<b>54,629</b>	<b>324</b>	<b>374</b>	<b>2,795</b>	<b>376</b>	<b>454</b>	<b>119</b>
<b>Global public finance</b>	<b>42,106</b>	<b>21,774</b>	<b>-</b>	<b>215</b>	<b>-</b>	<b>270</b>	<b>-</b>	<b>-</b>
Total insurance	\$ 159,153	\$ 76,403	\$ 324	\$ 589	\$ 2,795	\$ 646	\$ 454	\$ 119

- (1) - Reported within Investments on MBIA's consolidated balance sheets.
- (2) - Reported within Premiums receivable on MBIA's consolidated balance sheets.
- (3) - Reported within Insurance loss recoverable on MBIA's consolidated balance sheets.
- (4) - Reported within Unearned premium revenue on MBIA's consolidated balance sheets.
- (5) - Reported within Loss and loss adjustment expense reserves on MBIA's consolidated balance sheets.
- (6) - Reported within Derivative liabilities on MBIA's consolidated balance sheets.

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

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 4: Variable Interest Entities (continued)***Consolidated VIEs*

The carrying amounts of assets and liabilities of consolidated VIEs were \$8.2 billion and \$7.2 billion, respectively, as of September 30, 2012, and \$10.9 billion and \$9.9 billion, respectively, as of December 31, 2011. The carrying amounts of assets and liabilities are presented separately in *Assets of consolidated variable interest entities* and *Liabilities of consolidated variable interest entities* on the Company's consolidated balance sheets. Additional VIEs are consolidated or deconsolidated based on an ongoing reassessment of controlling financial interest, when events occur or circumstances arise, and whether the ability to exercise rights that constitute power to direct activities of any VIEs are present according to the design and characteristics of these entities. No additional VIEs were consolidated during the nine months ended September 30, 2012 and 2011. No gains or losses were recognized on the VIEs that were deconsolidated during the nine months ended September 30, 2012 and net realized gains related to the deconsolidation of VIEs were immaterial for the nine months ended September 30, 2011.

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

**Note 5: Loss and Loss Adjustment Expense Reserves***Loss and Loss Adjustment Expense Process*

As of September 30, 2012, the majority of the Company's case basis reserves and insurance loss recoveries recorded in accordance with GAAP were related to insured second-lien and first-lien RMBS transactions. These reserves and recoveries do not include estimates for policies insuring credit derivatives. Policies insuring credit derivative contracts are accounted for as derivatives and carried at fair value under GAAP. The fair values of insured derivative contracts are influenced by a variety of market and transaction-specific factors that may be unrelated to potential future claim payments under the Company's insurance policies. In the absence of credit impairments on insured derivative contracts or the early termination of such contracts at a loss, the cumulative unrealized losses recorded from fair valuing these contracts should reverse before or at the maturity of the contracts.

Notwithstanding the difference in accounting under GAAP for financial guarantee policies and the Company's insured derivatives, insured derivatives have similar terms, conditions, risks, and economic profiles to financial guarantee insurance policies, and, therefore, are evaluated by the Company for loss (referred to as credit impairment herein) and LAE periodically in a manner similar to the way that loss and LAE reserves are estimated for financial guarantee insurance policies. Credit impairments represent actual payments and collections plus the present value of estimated expected future claim payments, net of recoveries. MBIA Insurance Corporation's expected future claim payments for insured derivatives were discounted using a rate of 5.59%, the same rate it used to calculate its statutory loss reserves as of September 30, 2012. These credit impairments, calculated in accordance with U.S. STAT, differ from the fair values recorded in the Company's consolidated financial statements. The Company considers its credit impairment estimates as critical information for investors as it provides information about loss payments the Company expects to make on insured derivative contracts. As a result, the following loss and LAE process discussion includes information about loss and LAE activity recorded in accordance with GAAP for financial guarantee insurance policies and credit impairments estimated in accordance with U.S. STAT for insured derivative contracts. Refer to *Note 6: Loss and Loss Adjustment Expense Reserves* in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for information about the Company's monitoring of outstanding insured obligations and for additional information about its loss reserving process. Refer to *Note 6: Fair Value of Financial Instruments* included herein for additional information about the Company's insured credit derivative contracts.

*RMBS Case Basis Reserves and Recoveries (Financial Guarantees)*

The Company's RMBS reserves and recoveries relate to financial guarantee insurance policies. The Company calculated RMBS case basis reserves as of September 30, 2012 for both second-lien and first-lien RMBS transactions using a process called the Roll Rate Methodology. The Roll Rate Methodology is a multi-step process using a database of loan level information, a proprietary internal cash flow model, and a commercially available model to estimate expected ultimate cumulative losses on insured bonds. Roll Rate is defined as the probability that current loans become delinquent and that loans in the delinquent pipeline are charged-off or liquidated. Generally, Roll Rates are calculated for the previous three months and averaged. The loss reserve estimates are based on a probability-weighted average of three scenarios of loan losses (base case, stress case, and an additional stress case).

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

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

**Second-lien RMBS Reserves**

The Company's second-lien RMBS case basis reserves as of September 30, 2012 relate to RMBS backed by home equity lines of credit ( HELOC ) and closed-end second mortgages ( CES ).

The Roll Rates for 30-59 day delinquent loans and 60-89 day delinquent loans are calculated on a transaction-specific basis. The Company assumes that the Roll Rate for 90+ day delinquent loans, excluding foreclosures, Real Estate Owned ( REO ) and bankruptcies, is 95%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of August 31, 2012 to estimate future losses from loans that are delinquent as of the current reporting period.

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

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

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

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in the probability-weighted outcome, the addition to the Company's second-lien RMBS case basis reserves before considering potential recoveries would be approximately \$125 million.



**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**Second-lien RMBS Recoveries

As of September 30, 2012, the Company recorded estimated recoveries of \$3.2 billion, gross of income taxes, related to second-lien RMBS put-back claims on ineligible mortgage loans, consisting of \$2.1 billion included in Insurance loss recoverable and \$1.1 billion included in Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company's consolidated balance sheets. As of September 30, 2012 and December 31, 2011, the Company's estimated recoveries after income taxes calculated at the federal statutory rate of 35%, were \$2.1 billion and \$2.0 billion, respectively, which was 82% and 119% of the consolidated total shareholders' equity of MBIA, excluding preferred stock of subsidiaries and noncontrolling interests. These estimated recoveries relate to the Company's put-back claims of ineligible mortgage loans, which have been disputed by the loan sellers/servicers and are currently subject to litigation initiated by the Company to pursue recoveries. While the Company believes that it will prevail in enforcing its contractual rights, there is uncertainty with respect to the ultimate outcome. Furthermore, there is a risk that sellers/servicers or other responsible parties might not be able to satisfy their put-back obligations. Such risks are contemplated in the scenarios the Company utilizes to calculate recoveries.

The Company assesses the financial abilities of the sellers/servicers using external credit ratings and other factors. The impact of such factors on cash flows related to expected recoveries is incorporated into the Company's probability-weighted scenarios. Accordingly, the Company has not recognized any recoveries related to its IndyMac Bank, F.S.B. insured exposures and has subsequent to the ResCap bankruptcy filing reviewed the indicative scenarios and related probabilities assigned to each scenario to develop a distribution of possible outcomes. The Company's expected recoveries may be discounted in the future based on additional reviews of the creditworthiness of other sellers/servicers.

On May 14, 2012, ResCap, and its wholly-owned subsidiary companies, RFC and GMAC, each filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code. The Company believes that the claims against RFC and GMAC are stronger and better defined than most other unsecured creditor claims due to the following reasons:

the direct contractual relationship between MBIA, GMAC and RFC related to the Company's second-lien RMBS put-back claims on ineligible mortgage loans that were improperly included in the MBIA-insured transactions;

MBIA's legal claims against RFC and GMAC based on breach of contract and fraud have withstood motions to dismiss; and

expert reports submitted in the RFC litigation which established a substantial breach rate in MBIA insured securitizations, and MBIA's damages as a result thereof.

The Company has modeled scenario-based recoveries which are founded upon the strength of these claims as well as a range of estimated assets available to unsecured creditors of the ResCap companies. These outcomes are based upon information that was available to the Company as of the filing date.

The Company continues to maintain the same probability-weighted scenarios for its non-GMAC and non-RFC exposures (non-ResCap exposures), which are primarily based on the percentage of incurred losses the Company would collect. The non-ResCap recovery estimates incorporate five scenarios that include full recovery of its incurred losses and limited/reduced recoveries due to litigation delays and risks and/or potential financial distress of the sellers/servicers. Probabilities were assigned across these scenarios, with most of the probability weight on partial recovery scenarios. The sum of the probabilities assigned to all scenarios is 100%. Expected cash inflows from recoveries are discounted using the current risk-free discount rates associated with the underlying transaction's cash flows, which ranged from 0.7% to 1.6%, depending upon the transaction's expected average life. However, based on the Company's assessment of the strength of its contract claims, the Company

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believes it is entitled to collect and/or assert a claim for the full amount of its incurred losses on these transactions, which totaled \$5.0 billion through September 30, 2012.

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

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

To date, sellers/servicers have not substituted loans which MBIA has put-back, and the amount of loans repurchased has been insignificant. The unsatisfactory resolution of these put-backs led MBIA to initiate litigation against five of the sellers/servicers to enforce their obligations. The Company has alleged several causes of action in its complaints, including breach of contract, fraudulent inducement and indemnification. MBIA's aggregate \$3.2 billion of estimated potential recoveries do not include damages from causes of action other than breach of contract. Irrespective of amounts recorded in its financial statements, MBIA is seeking to recover and/or assert claims for the full amount of its incurred losses and other damages on these transactions. MBIA has not collected any material amounts of cash related to these recoveries. Additional information on the status of these litigations can be found in the Recovery Litigation discussion within Note 13: Commitments and Contingencies.

MBIA has received five decisions with regard to the respective defendants' motions to dismiss the Company's claims. In each instance, the respective court denied the motion, allowing MBIA to proceed on, at minimum, its fraud and breach of contract claims. In December 2011, MBIA reached an agreement with one of the five sellers/servicers with whom it had initiated litigation and that litigation has been dismissed.

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

1. the strength of the Company's existing contract claims related to ineligible mortgage loan substitution/repurchase obligations;
2. the settlement of Assured Guaranty's and Syncora's put-back related claims with Bank of America;
3. the improvement in the financial strength of certain sellers/servicers due to mergers and acquisitions and/or government assistance, which should facilitate the ability of these sellers/servicers and their successors to comply with required loan repurchase/substitution obligations. The Company is not aware of any provisions that explicitly preclude or limit successors' obligations to honor the obligations of original sellers/servicers. The Company's assessment of any credit risk associated with sellers/servicers (or their successors) is reflected in the Company's probability-weighted potential recovery scenarios;
4. evidence of ineligible mortgage loan repurchase/substitution by sellers/servicers for put-back requests made by other harmed parties; this factor is further enhanced by (i) Bank of America's disclosure that it has resolved \$8.0 billion of repurchase requests in the fourth quarter of 2010; (ii) the Fannie Mae settlements with Ally Bank announced on December 23, 2010 and with Bank of America (which also involved Freddie Mac) announced on December 31, 2010, and (iii) the Company's settlement agreements entered into on July 16, 2010 and December 13, 2011 respectively, between MBIA Corp. and sponsors of certain MBIA Corp.-insured mortgage loan securitizations in which the Company received consideration in exchange for a release relating to its representation and warranty claims against the sponsors. These settlements resolved all of MBIA's representation and warranty claims against the sponsors on mutually beneficial terms and in aggregate were slightly more than the recoveries previously recorded by the Company related to these exposures;
5. the defendants' failure to win dismissals of MBIA's put-back litigations discussed above, allowing MBIA to continue to pursue its contract and fraud claims;

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6. Countrywide's unsuccessful appeal of its failure to win dismissal of MBIA's fraud claims in the Countrywide litigation, allowing MBIA to pursue its fraud claims;
7. MBIA's successful motion in the Countrywide litigation allowing MBIA to present evidence of liability and damages through the introduction of statistically valid random samples of loans rather than on a loan-by-loan basis and subsequent decisions consistent with that ruling;
8. Bank of America's failure to win dismissal of MBIA's claims for successor liability in the Countrywide litigation, as well as the completion of discovery relating to MBIA's successor liability claims against Bank of America;
9. MBIA's successful motion regarding causation and the right to rescissory damages in the Countrywide litigation, which provides that MBIA is not required to establish a direct causal link between Countrywide's misrepresentations and MBIA's claims payments made pursuant to the insurance policies at issue, and that MBIA may seek damages equal to the amount that it has been and will be required to pay under the relevant policies, less premiums received;
10. Syncora's and Assured Guaranty's successful motions regarding causation in their Federal court put-back litigations with JP Morgan Chase and Flagstar Bank, respectively, which support the ruling on causation in MBIA's litigation against Countrywide; and
11. other loan repurchase reserves and/or settlements which have been publicly disclosed by certain sellers/servicers.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

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

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

**First-lien RMBS Reserves**

The Company's first-lien RMBS case basis reserves as of September 30, 2012, which primarily relate to RMBS backed by alternative A-paper (Alt-A) and subprime mortgage loans were determined using the Roll Rate Methodology. The Company assumes that the Roll Rate for loans in foreclosure, REO and bankruptcy are 90%, 90% and 75%, respectively. Roll Rates for current, 30-59 day delinquent loans, 60-89 day delinquent loans and 90+ day delinquent loans are calculated on a transaction-specific basis. The Current Roll to Loss stay at the August 31, 2012 level for two months before declining to 25% of this level over a 24-month period. Additionally, the Company runs scenarios where the 90+ day roll rate to loss is set at 90%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of August 31, 2012 to estimate future losses from loans that are delinquent as of the current reporting period.

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

***ABS CDOs (Financial Guarantees and Insured Derivatives)***

MBIA's insured ABS CDOs are transactions that include a variety of collateral ranging from corporate bonds to structured finance assets (which includes but are not limited to RMBS related collateral, ABS CDOs, corporate CDOs and collateralized loan obligations). These transactions were insured as either financial guarantee insurance policies or credit derivatives with the majority insured in the form of credit derivatives. Since the fourth quarter of 2007, MBIA's insured par exposure within the ABS CDO portfolio has been substantially reduced through a combination of terminations and commutations. Accordingly, as of September 30, 2012, the insured par exposure of the ABS CDO financial guarantee insurance policies and credit derivatives portfolio has declined by approximately 88% of the insured amount as of December 31, 2007.

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

The primary factor in estimating reserves on insured ABS CDO policies written as financial guarantee insurance policies and in estimating impairments on insured ABS CDO credit derivatives is the losses associated with the underlying collateral in the transactions. MBIA's approach to establishing reserves or impairments in this portfolio employs a methodology which is similar to other structured finance asset classes insured

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by MBIA. The Company uses a total of four probability-weighted scenarios in order to estimate its reserves or impairments for ABS CDOs.

As of September 30, 2012, the Company had loss and LAE reserves totaling \$171 million related to ABS CDO financial guarantee insurance policies after the elimination of \$242 million as a result of consolidating VIEs. For the nine months ended September 30, 2012, the Company incurred \$6 million of losses and LAE recorded in earnings related to ABS CDO financial guarantee insurance policies after the elimination of an \$18 million benefit as a result of consolidating VIEs. In the event of further deteriorating performance of the collateral referenced or held in ABS CDO transactions, the amount of losses estimated by the Company could increase materially.

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)***Credit Impairments Related to Structured CMBS Pools, CRE CDOs and CRE Loan Pools (Financial Guarantees and Insured Derivatives)*

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

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

The first approach considers the range of commutation agreements achieved and agreed to since 2010, which included 66 structured CMBS pools, CRE CDOs and CRE loan pool policies totaling \$33.1 billion of gross insured exposure. The Company considers the range of commutations achieved over the past several years with multiple counterparties. This approach results in an estimated price to commute the remaining policies with price estimates, based on this experience. It is customized by counterparty and is dependent on the level of dialogue with the counterparty and the credit quality and payment profile of the underlying exposure.

The second approach considers current delinquency rates and uses current and projected net operating income (NOI) and capitalization rates (Cap Rates) to project losses under two scenarios. Loans are stratified by size with larger loans being valued utilizing lower Cap Rates than for smaller loans. These scenarios also assume that Cap Rates and NOIs remain flat for the near term and then begin to improve gradually. Additionally, in these scenarios, any loan with a balance greater than \$75 million with a debt service coverage ratio (DSCR) less than 1.0x or that was reported as being in any stage of delinquency, was reviewed individually so that performance and loss severity could be more accurately determined. Specific loan level assumptions for this large loan subset were then incorporated into these scenarios, as well as specific assumptions regarding certain smaller loans when there appeared to be a material change in the asset's financial or delinquency performance over the preceding six months. As the Company continues to increase the level of granularity in its individual loan assessments, it analyzes and adjusts assumptions for loans with certain mitigating attributes, such as no lifetime delinquency, recent appraisals indicating sufficient value and large capital reserve levels. These scenarios project different levels of additional defaults with respect to loans that are current. This approach makes use of the most recent financial statements available at the property level.

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

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The fourth approach is based on a proprietary model developed by reviewing performance data on over 80,000 securitized CRE loans originated between 1992 and 2011. The time period covered during the performance review includes the years 2006 through 2011. The Company believes that these five years represent an appropriate time period in which to conduct a performance review because they encompass a period of extreme stress in the economy and the CRE market.

Based on a review of the data, the Company found property type and the DSCR to be the most significant determinants of a loan's default probability, with other credit characteristics less influential. As a result, the Company developed a model in which the loans were divided into 168 representative cohorts based on their DSCR and property type. For each of these cohorts, the Company calculated the average annual probability of default, and then ran Monte Carlo simulations to estimate the timing of defaults. In addition, the model incorporated the following logic:

NOI and Cap Rates were assumed to remain at current levels for loans in the Company's classified portfolio, resulting in no modifications or extensions under the model, other than as described in the next bullet point, to reflect the possibility that the U.S. economy and CRE market could experience no growth for the foreseeable future.



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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

Any valuation estimates obtained by special servicers since a loan's origination as well as the Company's individual large loan level analysis for loans with balances greater than \$75 million were incorporated as described in the second approach. However, in the fourth approach no adjustments were made for loans lower than \$75 million regardless of any mitigating factors.

The loss severities projected by these scenarios vary widely, from moderate to substantial losses, with the majority of projected losses relating to a subset of transactions with a single counterparty. The Company previously incorporated an additional actuarial based approach, which has been eliminated as it did not reflect the best current market observations. Actual losses will be a function of the proportion of loans in the pools that are foreclosed and liquidated and the loss severities associated with those liquidations. If the deductibles in the Company's insured transactions and underlying referenced CMBS transactions are fully eroded, additional property level losses upon foreclosures and liquidations could result in substantial losses for MBIA. Since foreclosures and liquidations have only begun to take place during this economic cycle, particularly for larger properties, ultimate loss rates remain uncertain. Whether CMBS collateral is included in a structured pool or in a CRE CDO, the Company believes the modeling related to the underlying bond should be the same. However, adjustments may be needed for structural or legal reasons. The Company assigns a wide range of probabilities to these scenarios, with lower severity scenarios being weighted more heavily than higher severity scenarios. This reflects the view that liquidations will continue to be mitigated by loan extensions and modifications, and that property values and NOIs have bottomed for many sectors and markets in the U.S. The weightings are customized to each counterparty. If macroeconomic stress were to increase or the U.S. goes into a recession, higher delinquencies, liquidations and/or higher severities of loss upon liquidation may result and the Company may incur substantial additional losses. The foreclosure and REO pipelines are still relatively robust, with several restructurings and liquidations yet to occur, so the range of possible outcomes is wider than those for the Company's exposures to ABS CDOs and second-lien RMBS.

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

For the nine months ended September 30, 2012, the Company incurred \$87 million of losses and LAE recorded in earnings related to CRE CDO financial guarantee insurance policies. For the nine months ended September 30, 2012, additional credit impairments and LAE on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be \$502 million as a result of additional delinquencies and loan level liquidations, as well as continued refinements of MBIA's assessment of various commutation possibilities. The majority of the increase relates to a subset of transactions with a single counterparty. The cumulative credit impairments and LAE on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be \$3.3 billion through September 30, 2012. Although the pace of increases in the delinquency rate has slowed and many loans are being modified, liquidations have taken place. Some loans were liquidated with minimal losses of 1% to 2%, others experienced near complete losses, and in some cases severities exceeded 100%. These liquidations have led to losses in the CMBS market, and in many cases, have resulted in reductions of enhancement to the individual CMBS bonds referenced by the insured structured CMBS pools. In certain insured transactions, these losses have resulted in deductible erosion. Bond level enhancement and pool level deductibles are structural features intended to mitigate losses to the Company. However, some of the transactions reference similar rated subordinate tranches of CMBS bonds. When there are broad-based declines in property performance, this leverage can result in rapid deterioration in pool performance.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)***Loss and LAE Activity*Financial Guarantee Insurance Losses (Non-Derivative)

The Company's financial guarantee insurance losses and LAE for the nine months ended September 30, 2012 are presented in the following table:

Losses and LAE In millions	Nine Months Ended September 30, 2012		
	Second-lien RMBS	Other <sup>(1)</sup>	Total
Losses and LAE related to actual and expected payments	\$ 180	\$ 273	\$ 453
Recoveries of actual and expected payments	(74)	(49)	(123)
Gross losses incurred	106	224	330
Reinsurance	-	-	-
Losses and LAE	\$ 106	\$ 224	\$ 330

(1) - Primarily first-lien RMBS and financial guarantee CMBS.

The second-lien RMBS losses and LAE related to actual and expected payments included in the preceding table comprise net increases of previously established reserves. The second-lien RMBS recoveries of actual and expected payments comprise \$154 million in recoveries resulting from ineligible mortgage loans included in insured exposures that are subject to contractual obligations by sellers/servicers to repurchase or replace such mortgages, offset by an \$80 million reduction in excess spread. Other losses and LAE expense primarily resulted from credit deterioration within first-lien RMBS and CMBS transactions.

The following table provides information about the financial guarantees and related claim liability included in each of MBIA's surveillance categories as of September 30, 2012:

\$ in millions	Surveillance Categories				Total
	Caution List Low	Caution List Medium	Caution List High	Classified List	
Number of policies	49	24	11	209	293
Number of issues <sup>(1)</sup>	27	14	10	137	188

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Remaining weighted average contract period (in years)	8.7	4.6	7.8	9.4	8.7
Gross insured contractual payments outstanding <sup>(2)</sup> :					
Principal	\$ 3,747	\$ 1,409	\$ 360	\$ 9,671	\$ 15,187
Interest	2,690	334	115	5,387	8,526
<b>Total</b>	<b>\$ 6,437</b>	<b>\$ 1,743</b>	<b>\$ 475</b>	<b>\$ 15,058</b>	<b>\$ 23,713</b>
Gross claim liability	\$ -	\$ -	\$ -	\$ 1,670	\$ 1,670
Less:					
Gross potential recoveries	-	-	-	3,844	3,844
Discount, net	-	-	-	178	178
Net claim liability (recoverable)	\$ -	\$ -	\$ -	\$ (2,352)	\$ (2,352)
Unearned premium revenue	\$ 130	\$ 17	\$ 3	\$ 119	\$ 269

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

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

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

The following table provides information about the financial guarantees and related claim liability included in each of MBIA's surveillance categories as of December 31, 2011:

\$ in millions	Surveillance Categories				Total
	Caution List Low	Caution List Medium	Caution List High	Classified List	
Number of policies	54	28	14	200	296
Number of issues <sup>(1)</sup>	32	18	11	130	191
Remaining weighted average contract period (in years)	8.2	5.6	6.0	9.6	8.8
Gross insured contractual payments outstanding <sup>(2)</sup> :					
Principal	\$ 4,310	\$ 1,213	\$ 561	\$ 10,420	\$ 16,504
Interest	2,653	351	144	5,836	8,984
<b>Total</b>	<b>\$ 6,963</b>	<b>\$ 1,564</b>	<b>\$ 705</b>	<b>\$ 16,256</b>	<b>\$ 25,488</b>
Gross claim liability	\$ -	\$ -	\$ -	\$ 1,812	\$ 1,812
Less:					
Gross potential recoveries	-	-	-	3,813	3,813
Discount, net	-	-	-	177	177
Net claim liability (recoverable)	\$ -	\$ -	\$ -	\$ (2,178)	\$ (2,178)
Unearned premium revenue	\$ 155	\$ 16	\$ 3	\$ 134	\$ 308

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

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

The gross claim liability as of September 30, 2012 and December 31, 2011 in the preceding tables represents the Company's estimate of undiscounted probability-weighted future claim payments, which principally relate to insured first-lien and second-lien RMBS transactions and U.S. public finance transactions. The gross potential recoveries represent the Company's estimate of undiscounted probability-weighted recoveries of actual claim payments and recoveries of estimated future claim payments, and principally relate to insured second-lien RMBS transactions. Both amounts reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by the Company.

The following table presents the components of the Company's loss and LAE reserves and insurance loss recoverable as reported on the Company's consolidated balance sheets as of September 30, 2012 and December 31, 2011 for insured obligations within MBIA's Classified List. The loss reserves (claim liability) and insurance claim loss recoverable included in the following table represent the present value of the probability-weighted future claim payments and recoveries reported in the preceding tables.

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<b>In millions</b>	<b>As of September 30, 2012</b>	<b>As of December 31, 2011</b>
Loss reserves (claim liability)	\$ 862	\$ 781
LAE reserves	83	55
<b>Loss and LAE reserves</b>	<b>\$ 945</b>	<b>\$ 836</b>
Insurance claim loss recoverable	\$ (3,281)	\$ (3,032)
LAE insurance loss recoverable	(35)	(14)
<b>Insurance loss recoverable</b>	<b>\$ (3,316)</b>	<b>\$ (3,046)</b>
Reinsurance recoverable on unpaid losses	\$ 13	\$ 15
Reinsurance recoverable on paid losses	2	1
<b>Reinsurance recoverable on paid and unpaid losses</b>	<b>\$ 15</b>	<b>\$ 16</b>

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

As of September 30, 2012, loss and LAE reserves include \$1.3 billion of reserves for expected future payments offset by expected recoveries of such future payments of \$395 million. As of December 31, 2011, loss and LAE reserves included \$1.4 billion of reserves for expected future payments offset by expected recoveries of such future payments of \$562 million. As of September 30, 2012 and December 31, 2011, the insurance loss recoverable primarily related to estimated recoveries of payments made by the Company resulting from ineligible mortgage loans in certain insured second-lien residential mortgage loan securitizations that are subject to a contractual obligation by the sellers/servicers to repurchase or replace the ineligible mortgage loans and expected future recoveries on second-lien RMBS transactions resulting from expected excess spread generated by performing loans in such transactions. The Company expects to be reimbursed for the majority of its potential recoveries related to ineligible mortgage loans by the second quarter of 2013.

Total paid losses and LAE, net of reinsurance and collections, for the nine months ended September 30, 2012 was \$489 million, including \$330 million related to insured second-lien RMBS transactions. For the nine months ended September 30, 2012, the increase in insurance loss recoverable related to paid losses totaled \$270 million, and primarily related to insured second-lien RMBS transactions.

The following table presents the Company's second-lien RMBS exposure, gross undiscounted claim liability and potential recoveries for amounts excluding consolidated VIEs and amounts related to consolidated VIEs, as of September 30, 2012. All insured transactions with potential recoveries are included within the Classified List.

Second-lien RMBS Exposure \$ in billions	Issues	Outstanding		Gross Undiscounted		
		Gross Principal	Gross Interest	Claim Liability	Potential Recoveries	
<b>Excluding Consolidated VIEs:</b>						
Insured issues designated as Classified List	22	\$ 4.2	\$ 1.7	\$ 0.3	\$ 3.2	
Insured issues reviewed with potential recoveries	15	\$ 3.9	\$ 1.6	\$ 0.2	\$ 3.1	
<b>Consolidated VIEs:</b>						
Insured issues designated as Classified List	12	\$ 2.3	\$ 0.9	\$ 0.1	\$ 1.4	
Insured issues reviewed with potential recoveries	11	\$ 2.2	\$ 0.8	\$ 0.1	\$ 1.4	

The Company has performed reviews on 29 of the 34 total insured issues designated as Classified List and recorded potential recoveries on 26 of those 29 issues, primarily related to four issuers (Countrywide, RFC, GMAC and Credit Suisse). In addition, the Company has received consideration on two transactions, including one Alt-A transaction, which have been excluded in the preceding table.

The following table presents changes in the Company's loss and LAE reserves for the nine months ended September 30, 2012. Changes in the loss and LAE reserves attributable to the accretion of the claim liability discount, changes in discount rates, changes in the timing and amounts of estimated payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in Losses and loss adjustment expenses in the Company's consolidated statements of operations. As of September 30, 2012, the weighted average risk-free rate used to discount the Company's loss reserves (claim liability) was 1.26%. LAE reserves are expected to be settled within a one-year period and are not discounted.

In  
millions

Changes in Loss and LAE Reserves for the Nine Months Ended September 30, 2012

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Gross Loss and LAE Reserves as of December 31, 2011	Loss Payments for Cases with Reserves	Accretion of Claim Liability Discount	Changes in Discount Rates	Changes in Timing of Payments	Changes in Amount of Net Payments	Changes in Assumptions	Changes in Unearned Premium Revenue	Changes in LAE Reserves	Gross Loss and LAE Reserves as of September 30, 2012
\$ 836	\$ (283)	\$ 9	\$ 26	\$ 52	\$ 3	\$ 267	\$ 7	\$ 28	\$ 945

The increase in the Company's gross loss and LAE reserves reflected in the preceding table was primarily due to changes in assumptions, timing of payments, and changes in LAE reserves, offset by decreases in reserves related to loss payments on insured first-lien and second-lien RMBS issues outstanding as of December 31, 2011.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

Current period changes in the Company's estimate of potential recoveries may be recorded as an insurance loss recoverable asset, netted against the gross loss and LAE reserve liability, or both. The following table presents changes in the Company's insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company's claim liability for the nine months ended September 30, 2012. Changes in insurance loss recoverable attributable to the accretion of the discount on the recoverable, changes in discount rates, changes in the timing and amounts of estimated collections, changes in assumptions and changes in LAE recoveries are recorded in Losses and loss adjustment expenses in the Company's consolidated statements of operations.

**Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses  
for the Nine Months Ended September 30, 2012**

In millions	Gross Reserve as of December 31, 2011	Collections for Cases with Recoveries	Accretion of Recoveries	Changes in Discount Rates	Changes in Timing of Collections	Changes in Amount of Collections	Changes in Assumptions	Changes in LAE Recoveries	Gross Reserve as of September 30, 2012
Insurance loss recoverable	\$ 3,046	\$ (6)	\$ 30	\$ 8	\$ -	\$ (149)	\$ 366	\$ 21	\$ 3,316
Recoveries on unpaid losses	562	-	6	19	-	-	(185)	(7)	395
<b>Total</b>	<b>\$ 3,608</b>	<b>\$ (6)</b>	<b>\$ 36</b>	<b>\$ 27</b>	<b>\$ -</b>	<b>\$ (149)</b>	<b>\$ 181</b>	<b>\$ 14</b>	<b>\$ 3,711</b>

The Company's insurance loss recoverable increased during 2012 primarily due to changes in assumptions associated with issues outstanding as of December 31, 2011, which related to increases in excess spread and ineligible mortgage loans included in insured second-lien residential mortgage securitization exposures that are subject to contractual obligations by sellers/servicers to repurchase or replace such mortgages, partially offset by changes in the amount of collections. Recoveries on unpaid losses decreased primarily due to changes in assumptions as a result of a reduction of excess spread related to first-lien and second-lien RMBS transactions offset by changes in discount rates.

The following table presents the Company's total estimated recoveries from ineligible mortgage loans included in certain insured second-lien mortgage loan securitizations as of September 30, 2012. The total estimated recoveries from ineligible mortgage loans of \$3.2 billion include \$2.1 billion recorded as Insurance loss recoverable and \$1.1 billion recorded as Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company's consolidated balance sheets.

In millions	Total Estimated Recoveries from Ineligible Mortgage Loans as of	Accretion of Future Collections	Changes in Discount Rates	Recoveries (Collections)	Changes in Amount of Collections	Changes in Assumptions	Total Estimated Recoveries from Ineligible Mortgage Loans as of September 30, 2012



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December 31,

2011						
\$ 3,119	\$ 34	\$ 2	\$ -	\$ -	\$ 92	\$ 3,247

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

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

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

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

In millions	Nine Months Ended September 30,	
	2012	2011
Loss adjustment expense incurred, gross	\$ 113	\$ 76

**Note 6: Fair Value of Financial Instruments*****Fair Value Measurement***

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

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

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company can access. 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.

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.

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

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

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)***1. Financial Assets (excluding derivative assets)*

Financial assets, excluding derivative assets, held by the Company primarily consist of investments in debt securities. Substantially all of the Company's investments are priced by independent third parties, including pricing services and brokers. Typically the Company receives one pricing service value or broker quote for each instrument, which represents a non-binding indication of value. The Company reviews the assumptions, inputs and methodologies used by pricing services to obtain reasonable assurance that the prices used in its valuations reflect fair value. When the Company believes a third-party quotation differs significantly from its internally developed expectation of fair value, whether higher or lower, the Company reviews its data or assumptions with the provider. This review includes comparing significant assumptions such as prepayment speeds, default ratios, forward yield curves, credit spreads and other significant quantitative inputs to internal assumptions, and working with the price provider to reconcile the differences. The price provider may subsequently provide an updated price. In the event that the price provider does not update their price, and the Company still does not agree with the price provided, the Company will try to obtain a price from another third-party provider, such as a broker, or use an internally developed price which it believes represents the fair value of the investment. The fair values of investments for which internal prices were used were not significant to the aggregate fair value of the Company's investment portfolio as of September 30, 2012 or December 31, 2011. All challenges to third-party prices are reviewed by staff of the Company with relevant expertise to ensure reasonableness of assumptions.

In addition to challenging pricing assumptions, the Company obtains reports from the independent accountants for significant third-party pricing services attesting to the effectiveness of the controls over data provided to the Company. These reports are obtained annually and are reviewed by the Company to ensure key controls are applied by the pricing services, and that appropriate user controls are in place at the Company to ensure proper measurement of the fair values of its investments. In the event that any controls in these reports are deemed as ineffective by independent accountants, the Company will take the necessary actions to ensure that internal user controls are in place to mitigate the control risks. No deficiencies were noted for significant third-party pricing services used.

*2. Financial Liabilities (excluding derivative liabilities)*

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

*3. Derivative Assets and Liabilities*

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

The Company's insured credit derivative contracts are non-traded structured credit derivative transactions. Since insured derivatives are highly customized and there is generally no observable market for these derivatives, the Company estimates their fair values in a hypothetical market based on internal and third-party models simulating what a similar company would charge to assume the Company's position in the transaction at the measurement date. This pricing would be based on the expected loss of the exposure. The Company reviews its valuation model results on a quarterly basis to assess the appropriateness of the assumptions and results in light of current market activity and conditions. This review is performed by internal staff with relevant expertise. If live market spreads or securities prices are observable for similar transactions, those

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spreads are an integral part of the analysis. New insured transactions that resemble existing (previously insured) transactions, if any, would be considered, as well as negotiated settlements of existing transactions.

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

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**MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)***4. Internal Review Process*

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

***Valuation Techniques***

Valuation techniques for financial instruments measured at fair value and included in the tables that follow are described below.

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

Fixed-maturity securities (including short-term investments) held as available-for-sale, fixed-maturity securities at fair value, investments pledged as collateral, and other investments include investments in U.S. Treasury and government agencies, foreign governments, corporate obligations, MBS and ABS (including CMBS and CDOs), state and municipal bonds and equity securities (including perpetual preferred securities and money market mutual funds).

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

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

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

*Cash and Cash Equivalents, Receivable for Investments Sold, and Accrued Investment Income*

The carrying amounts of cash and cash equivalents, receivable for investments sold, and accrued investment income approximate fair values due to the short-term nature and credit worthiness of these instruments.

*Loans Receivable at Fair Value*

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

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

*Loan Repurchase Commitments*

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

breach rates representing the rate at which the sellers/servicers failed to comply with stated representations and warranties;

recovery rates representing the estimates of future cash flows for the asset, including estimates about possible variations in the amount of cash flows expected to be collected;

expectations about possible variations in the timing of collections of the cash flows; and

time value of money, represented by the rate on risk-free monetary assets.

*Investment Agreements*

The fair values of investment agreements are determined using discounted cash flow techniques based on contractual cash flows and observable interest rates currently being offered for similar agreements with comparable maturity dates. Investment agreements contain collateralization and termination agreements that substantially mitigate the nonperformance risk of the Company. As the terms of the notes are private, and the contract cash flows are not observable, these investment agreements are categorized as Level 3 of the fair value hierarchy.

*Medium-Term Notes*

The fair values of MTNs are based on quoted market prices provided by third-party sources, where available. When quoted market prices are not available, the Company applies a matrix pricing grid based on the quoted market prices received and the MTNs' stated maturity and interest rate to determine fair value. Nonperformance risk is included in the quoted market prices and the matrix pricing grid.

The Company has elected to record three MTNs at fair value as they contain embedded derivatives which cannot accurately be separated from the host debt instrument and fair valued separately, therefore, these three MTNs are carried at fair value with changes in fair value reflected in earnings. The remaining MTNs, which are not carried at fair value, do not contain embedded derivatives.

As these MTNs are illiquid and the prices reflect significant unobservable inputs, they are categorized as Level 3 of the fair value hierarchy.



*Variable Interest Entity Notes*

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

*Long-term Debt*

Long-term debt consists of notes, debentures, surplus notes and floating rate liquidity loans. The fair value of long-term notes, debentures and surplus notes are estimated based on quoted prices for the identical or similar securities. The fair value for floating rate liquidity loans are determined using discounted cash flow techniques of the underlying collateral pledged to the specific loans, as these loans are non-recourse and fully backed by a pool of underlying assets. Long-term debt is categorized as Level 2 of the fair value hierarchy.

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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)***Derivatives Asset/Liability Products*

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

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

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

*Derivatives Insurance*

The derivative contracts insured by the Company cannot be legally traded and generally do not have observable market prices. The Company determines the fair values of insured credit derivatives using valuation models.

Approximately 81% of the balance sheet fair value of insured credit derivatives as of September 30, 2012 was valued using the Binomial Expansion Technique ( BET ) Model. Approximately 19% of the balance sheet fair value of insured credit derivatives as of September 30, 2012 was valued using the internally developed Direct Price Model. An immaterial amount of insured credit derivatives were valued using the dual-default model. The valuation of insured derivatives includes the impact of its own credit standing. All of these derivatives are categorized as Level 3 of the fair value hierarchy as their fair value is derived using significant unobservable inputs.

**A. Description of the BET Model****1. Valuation Model Overview**

The BET Model estimates what a bond insurer would charge to guarantee a transaction at the measurement date, based on the market-implied default risk of the underlying collateral and the remaining structural protection in a deductible or subordination.

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

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

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

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

recovery rate for all defaulted collateral.

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

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

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

Additional structural assumptions of the BET Model are:

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

Frequencies of defaults are modeled evenly over time.

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

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

**2. BET Model Inputs**

**a. Credit spreads**

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

The Company uses the spread hierarchy listed below in determining which source of spread information to use, with the rule being to use CDS spreads where available and cash security spreads as the next alternative.

Spread Hierarchy:

Collateral-specific credit spreads when observable.

Sector-specific spread tables by asset class and rating.

Corporate spreads, including Bloomberg spread tables based on rating.

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

There were some transactions where the Company incorporated multiple levels within the hierarchy, including using actual collateral-specific credit spreads in combination with a calculated spread based on an assumed relationship. In those cases, MBIA classified the transaction as being benchmarked from the most relevant spread source even though the majority of the average spread was from actual collateral-specific spreads. As of September 30, 2012, sector-specific spreads were used in 9% of the transactions valued using the BET Model. Corporate spreads were used in 46% of the transactions and spreads benchmarked from the most relevant spread source were used for 45% of the transactions. The spread source can also be identified by whether or not it is based on collateral weighted average rating factor (WARF). No collateral-specific spreads are based on WARF, sector-specific and corporate spreads are based on WARF, and some benchmarked spreads are based on WARF. WARF-sourced and/or ratings-sourced credit spreads were used for 77% of the transactions.

Over time, the data inputs change as new sources become available, existing sources are discontinued or are no longer considered to be reliable or the most appropriate. It is always the Company's objective to use more observable spread hierarchies defined above. However, the Company may on occasion move to less observable spread inputs due to the discontinuation of data sources or due to the Company considering certain spread inputs no longer representative of market spreads.

### b. Diversity Scores

Diversity scores are a means of estimating the diversification in a portfolio. The diversity score estimates the number of uncorrelated assets that are assumed to have the same loss distribution as the actual portfolio of correlated assets. While diversity score is a required input into the BET model, due to current high levels of default within the collateral of the structures, diversity score does not have a significant impact on valuation.

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### **MBIA Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements (Unaudited)**

#### **Note 6: Fair Value of Financial Instruments (continued)**

##### c. Recovery Rate

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

##### d. Nonperformance Risk

The Company's valuation methodology for insured credit derivative liabilities incorporates the Company's own nonperformance risk. The Company calculates the fair value by discounting the market value loss estimated through the BET Model at discount rates which include MBIA CDS spreads as of September 30, 2012. The CDS spreads assigned to each deal are based on the weighted average life of the deal. The Company limits the nonperformance impact so that the derivative liability could not be lower than the Company's recovery derivative price multiplied by the unadjusted derivative liability.

#### B. Description of Direct Price Model

##### 1. Valuation Model Overview

The Direct Price Model uses quoted market prices of financial assets correlated to the underlying collateral of the pool of assets backing the liabilities guaranteed by certain insured derivative liabilities. These quoted market prices are adjusted to reflect the unique characteristics of the liabilities of the entities backed by the correlated assets and unique terms of the insured derivative contracts.

##### 2. Model Inputs

###### Collateral prices

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

###### Interest rates

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

###### Nonperformance risk

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

marked by this model.

#### Overall Model Results

As of September 30, 2012 and December 31, 2011, the Company's net insured derivative liability was \$3.3 billion and \$4.8 billion, respectively, and was primarily related to the fair values of insured credit derivatives, based on the results of the aforementioned pricing models. In the current environment, the most significant driver of changes in fair value is nonperformance risk. In aggregate, the nonperformance calculation resulted in a pre-tax net insured derivative liability that was \$4.4 billion and \$5.7 billion lower than the net liability that would have been estimated if the Company excluded nonperformance risk in its valuation as of September 30, 2012 and December 31, 2011, respectively. Nonperformance risk is a fair value concept and does not contradict the Company's internal view, based on fundamental credit analysis of the Company's economic condition, that the Company will be able to pay all claims when due.

#### *Warrants*

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

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)***Financial Guarantees*

**Gross Financial Guarantees** The fair value of gross financial guarantees is determined using discounted cash flow techniques based on inputs that include (i) assumptions of expected losses on financial guarantee policies where loss reserves have not been recognized, (ii) amount of losses expected on financial guarantee policies where loss reserves have been established, net of expected recoveries, (iii) the cost of capital reserves required to support the financial guarantee liability, (iv) operating expenses, and (v) discount rates. The MBIA Corp. CDS spread and recovery rate are used as the discount rate for MBIA Corp., while the CDS spread and recovery rate of a similar municipal insurance company are used as the discount rate for National, as National does not have a published CDS spread and recovery rate.

The carrying value of the Company's gross financial guarantees consists of unearned premium revenue and loss and LAE reserves, net of the insurance loss recoverable as reported on MBIA's consolidated balance sheets.

**Ceded Financial Guarantees** The fair value of ceded financial guarantees is determined by applying the percentage ceded to reinsurers to the related fair value of the gross financial guarantees. The carrying value of ceded financial guarantees consists of prepaid reinsurance premiums and reinsurance recoverable on paid and unpaid losses as reported within Other assets on the Company's consolidated balance sheets.

*Significant Unobservable Inputs*

The following table provides quantitative information regarding the significant unobservable inputs used by the Company for assets and liabilities measured at fair value on a recurring basis as of September 30, 2012. This table excludes inputs used to measure fair value that are not developed by the Company, such as broker prices and other third-party pricing service valuations.

In millions	Fair Value as of September 30, 2012	Valuation Techniques	Unobservable Input	Range (Weighted Average)
<b>Assets of consolidated VIEs:</b>				
Loans receivable at fair value	\$ 1,892	Quoted market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee	0% - 22% (4%)
Loan repurchase commitments	1,051	Discounted cash flow	Recovery rates	9% - 96% (43%)
			Breach rates	65% - 94% (78%)
<b>Liabilities of consolidated VIEs:</b>				
Variable interest entity notes	1,885	Quoted market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 20% (6%)
<b>Credit derivative liabilities, net:</b>				
CMBS	1,533	BET Model	Recovery rates	20% - 90% (51%)
			Nonperformance risk	8% - 62% (57%)
			Weighted average life (in years)	0.3 - 5.9 (4.6)
			CMBS spreads	1% - 22% (12%)



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Multi-sector CDO	628	Direct Price Model	Nonperformance risk	63% - 63% (63%)
Other	1,156	BET Model	Recovery rates	42% - 75% (47%)
			Nonperformance risk	8% - 63% (50%)
			Weighted average life (in years)	0.2 - 19.0 (3.1)

### *Sensitivity of Significant Unobservable Inputs*

The significant unobservable input used in the fair value measurement of the Company's loans receivable at fair value of consolidated VIEs is the impact of the financial guarantee. The fair value of loans receivable is calculated by subtracting the value of the financial guarantee from the market value of VIE liabilities. The value of a financial guarantee is estimated by the Company as the present value of expected cash payments under the policy. As expected cash payments provided by the Company under the insurance policy increase, there is a lower expected cash flow on the underlying loans receivable of the VIE. This results in a lower fair value of the loans receivable in relation to the obligations of the VIE.

The significant unobservable inputs used in the fair value measurement of the Company's loan repurchase commitments of consolidated VIEs are the recovery rates and the breach rates. Recovery rates reflect the estimates of future cash flows reduced for litigation delays and risks and/or potential financial distress of the sellers/services. The estimated recoveries of the loan repurchase commitments may differ from the actual recoveries that may be received in the future. Breach rates represent the rate at which the mortgages fail to comply with stated representations and warranties of the sellers/servicers. Significant increases or decreases in the recovery rates and the breach rates would result in significantly higher or lower fair values of the loan repurchase commitments, respectively. Additionally, changes in the legal environment and the ability of the counterparties to pay would impact the recovery rate assumptions, which could significantly impact the fair value measurement. Any significant challenges by the counterparties to the Company's determination of breaches of representations and warranties could significantly adversely impact the fair value measurement. Recovery rates and breach rates are determined independently. Changes in one input will not necessarily have any impact on the other input.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

The significant unobservable input used in the fair value measurement of the Company's variable interest entity notes of consolidated VIEs is the impact of the financial guarantee. The fair value of VIE notes is calculated by adding the value of the financial guarantee to the market value of VIE assets. The value of a financial guarantee is estimated by the Company as the present value of expected cash payments under the policy. As the value of the guarantee provided by the Company to the obligations issued by the VIE increases, the credit support adds value to the liabilities of the VIE. This results in an increase in the fair value of the liabilities of the VIE.

The significant unobservable inputs used in the fair value measurement of the Company's CMBS credit derivatives, which are valued using the BET Model, are CMBS spreads, recovery rates, nonperformance risk and weighted average life. The CMBS spread is an indicator of credit risk of the collateral securities. The recovery rate represents the percentage of notional expected to be recovered after an asset defaults, indicating the severity of a potential loss. The nonperformance risk is an assumption of the Company's own ability to pay and whether the Company will have the necessary resources to pay the obligations as they come due. Weighted average life is based on the Company's estimate of when the principal of the underlying collateral of the CMBS structure will be repaid. A significant increase or decrease in CMBS spreads or weighted average life would result in an increase or decrease in the fair value of the derivative liabilities, respectively. Any significant increase or decrease in recovery rates or the Company's nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively. CMBS spreads, recovery rates, nonperformance risk and weighted average lives are determined independently. Changes in one input will not necessarily have any impact on the other inputs.

The significant unobservable input used in the fair value measurement of the Company's multi-sector CDO credit derivatives, which are valued using the Direct Price Model, is nonperformance risk. The nonperformance risk is an assumption of the Company's own ability to pay and whether the Company will have the necessary resources to pay the obligations as they come due. Any significant increase or decrease in the Company's nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively.

The significant unobservable inputs used in the fair value measurement of the Company's other credit derivatives, which are valued using the BET Model, are recovery rates, nonperformance risk and weighted average life. The recovery rate represents the percentage of notional expected to be recovered after an asset defaults, indicating the severity of a potential loss. The nonperformance risk is an assumption of the Company's own ability to pay and whether the Company will have the necessary resources to pay the obligations as they come due. Weighted average life is based on the Company's estimate of when the principal of the underlying collateral will be repaid. Any significant increase or decrease in weighted average life would result in an increase or decrease in the fair value of the derivative liabilities, respectively. Any significant increase or decrease in recovery rates or the Company's nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively. Recovery rates, nonperformance risk and weighted average lives are determined independently. Changes in one input will not necessarily have any impact on the other inputs.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)***Fair Value Measurements*

The following tables present the fair value of the Company's assets (including short-term investments) and liabilities measured and reported at fair value on a recurring basis as of September 30, 2012 and December 31, 2011:

In millions	Fair Value Measurements at Reporting Date Using				Balance as of September 30, 2012
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	
<b>Assets:</b>					
<b>Investments:</b>					
<b>Fixed-maturity investments:</b>					
<b>Taxable bonds:</b>					
U.S. Treasury and government agency	\$ 860	\$ 101	\$ -	\$ -	\$ 961
Foreign governments	257	72	12 <sup>(1)</sup>	-	341
Corporate obligations	1	1,136	91 <sup>(1)</sup>	-	1,228
<b>Mortgage-backed securities:</b>					
Residential mortgage-backed agency	-	1,073	-	-	1,073
Residential mortgage-backed non-agency	-	169	7 <sup>(1)</sup>	-	176
Commercial mortgage-backed	-	19	30 <sup>(1)</sup>	-	49
<b>Asset-backed securities:</b>					
Collateralized debt obligations	-	64	30 <sup>(1)</sup>	-	94
Other asset-backed	-	116	73 <sup>(1)</sup>	-	189
State and municipal bonds	-	888	71 <sup>(1)</sup>	-	959
<b>Total taxable bonds</b>	<b>1,118</b>	<b>3,638</b>	<b>314</b>	<b>-</b>	<b>5,070</b>
<b>Tax-exempt bonds:</b>					
State and municipal bonds	-	925	23 <sup>(1)</sup>	-	948
Other fixed-maturity investments	-	10	-	-	10
<b>Total fixed-maturity investments</b>	<b>1,118</b>	<b>4,573</b>	<b>337</b>	<b>-</b>	<b>6,028</b>
Money market securities	593	-	-	-	593
Perpetual preferred securities	-	28	3 <sup>(1)</sup>	-	31
Other	20	-	11 <sup>(1)</sup>	-	31
<b>Total investments</b>	<b>1,731</b>	<b>4,601</b>	<b>351</b>	<b>-</b>	<b>6,683</b>
Cash and cash equivalents	298	-	-	-	298
<b>Derivative assets:</b>					
<b>Insured derivative assets:</b>					
Credit derivatives	-	-	1	-	1
<b>Non-insured derivative assets:</b>					

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Interest rate derivatives	-	95	4 <sup>(1)</sup>	(96)	3
Total derivative assets	-	95	5	(96)	4

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

In millions	Fair Value Measurements at Reporting Date Using				Balance as of September 30, 2012
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	
Assets of consolidated VIEs:					
Fixed-maturity investments:					
Corporate obligations	-	219	83 <sup>(1)</sup>	-	302
Mortgage-backed securities:					
Residential mortgage-backed non-agency	-	852	8 <sup>(1)</sup>	-	860
Commercial mortgage-backed	-	409	13 <sup>(1)</sup>	-	422
Asset-backed securities:					
Collateralized debt obligations	-	191	173 <sup>(1)</sup>	-	364
Other asset-backed	-	126	66 <sup>(1)</sup>	-	192
State and municipal taxable bonds	-	41	-	-	41
Money market securities	15	-	-	-	15
Total fixed-maturity investments	15	1,838	343	-	2,196
Cash	143	-	-	-	143
Loans receivable	-	-	1,892	-	1,892
Loan repurchase commitments	-	-	1,051	-	1,051
Total assets	\$ 2,187	\$ 6,534	\$ 3,642	\$ (96)	\$ 12,267
Liabilities:					
Medium-term notes	\$ -	\$ -	\$ 168 <sup>(1)</sup>	\$ -	\$ 168
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	14	3,318	-	3,332
Non-insured derivatives:					
Interest rate derivatives	-	305	4 <sup>(1)</sup>	(311)	(2)
Currency derivatives	-	1	1 <sup>(1)</sup>	-	2
Other liabilities:					
Warrants	-	18	-	-	18
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,741	1,885	-	3,626
Derivative liabilities:					
Interest rate derivatives	-	157	-	-	157
Currency derivatives	-	-	23 <sup>(1)</sup>	-	23
Total liabilities	\$ -	\$ 2,236	\$ 5,399	\$ (311)	\$ 7,324

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(1) - Unobservable inputs are either not developed by the Company or do not significantly impact the overall fair values of the aggregate financial assets and liabilities.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

In millions	Fair Value Measurements at Reporting Date Using				Balance as of December 31, 2011
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	
Assets:					
Investments:					
Fixed-maturity investments:					
Taxable bonds:					
U.S. Treasury and government agency	\$ 1,038	\$ 103	\$ -	\$ -	\$ 1,141
Foreign governments	277	62	11	-	350
Corporate obligations	1	1,531	207	-	1,739
Mortgage-backed securities:					
Residential mortgage-backed agency	-	1,276	8	-	1,284
Residential mortgage-backed non-agency	-	350	17	-	367
Commercial mortgage-backed	-	34	24	-	58
Asset-backed securities:					
Collateralized debt obligations	-	78	60	-	138
Other asset-backed	-	130	317	-	447
State and municipal bonds	-	924	-	-	924
Total taxable bonds	1,316	4,488	644	-	6,448
Tax-exempt bonds:					
State and municipal bonds	-	1,137	28	-	1,165
Other fixed-maturity investments	-	15	-	-	15
Total fixed-maturity investments	1,316	5,640	672	-	7,628
Money market securities	912	-	-	-	912
Perpetual preferred securities	-	106	1	-	107
Other	25	-	10	-	35
Total investments	2,253	5,746	683	-	8,682
Cash and cash equivalents	473	-	-	-	473
Derivative assets:					
Non-insured derivative assets:					
Credit derivatives	-	1	-	-	1
Interest rate derivatives	-	91	3	-	94
Other	-	-	-	(93)	(93)
Total derivative assets	-	92	3	(93)	2

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

In millions	Fair Value Measurements at Reporting Date Using				Balance as of December 31, 2011
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	
Assets of consolidated VIEs:					
Fixed-maturity investments:					
Corporate obligations	-	170	69	-	239
Mortgage-backed securities:					
Residential mortgage-backed agency	-	3	-	-	3
Residential mortgage-backed non-agency	-	1,437	21	-	1,458
Commercial mortgage-backed	-	559	22	-	581
Asset-backed securities:					
Collateralized debt obligations	-	330	203	-	533
Other asset-backed	-	236	67	-	303
Money market securities	199	-	-	-	199
Total fixed-maturity investments	199	2,735	382	-	3,316
Cash	160	-	-	-	160
Loans receivable	-	-	2,046	-	2,046
Loan repurchase commitments	-	-	1,077	-	1,077
Derivative assets:					
Credit derivatives	-	-	447	-	447
Interest rate derivatives	-	3	-	-	3
Total assets	\$ 3,085	\$ 8,576	\$ 4,638	\$ (93)	\$ 16,206
Liabilities:					
Medium-term notes	\$ -	\$ -	\$ 165	\$ -	\$ 165
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	18	4,790	-	4,808
Non-insured derivatives:					
Interest rate derivatives	-	445	-	-	445
Currency derivatives	-	4	-	-	4
Other	-	-	-	(93)	(93)
Other liabilities:					
Warrants	-	38	-	-	38
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,865	2,889	-	4,754
Derivative liabilities:					
Credit derivatives	-	-	527	-	527
Interest rate derivatives	-	281	-	-	281
Currency derivatives	-	-	17	-	17



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Total liabilities	\$	-	\$	2,651	\$	8,388	\$	(93)	\$	10,946
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**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

Level 3 assets at fair value, as of September 30, 2012 and December 31, 2011 represented approximately 30% and 29%, respectively, of total assets measured at fair value. Level 3 liabilities at fair value, as of September 30, 2012 and December 31, 2011 represented approximately 74% and 77%, respectively, of total liabilities measured at fair value.

The following tables present the fair values and carrying values of the Company's assets and liabilities that are disclosed at fair value but not reported at fair value on the Company's consolidated balance sheets as of September 30, 2012 and December 31, 2011:

In millions	Fair Value Measurements at Reporting Date			Fair Value Balance as of September 30, 2012	Carry Value Balance as of September 30, 2012
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<b>Assets:</b>					
Other investments	\$ -	\$ -	\$ 9	\$ 9	\$ 9
Accrued investment income <sup>(1)</sup>	51	-	-	51	51
Receivable for investments sold <sup>(1)</sup>	159	-	-	159	159
<b>Assets of consolidated VIEs:</b>					
Investments held-to-maturity	-	-	2,867	2,867	3,015
<b>Total assets</b>	<b>\$ 210</b>	<b>\$ -</b>	<b>\$ 2,876</b>	<b>\$ 3,086</b>	<b>\$ 3,234</b>
<b>Liabilities:</b>					
Investment agreements	\$ -	\$ -	\$ 1,254	\$ 1,254	\$ 993
Medium-term notes	-	-	1,068	1,068	1,438
Long-term debt	-	1,109	-	1,109	1,836
Payable for investments purchased <sup>(2)</sup>	150	-	-	150	150
<b>Liabilities of consolidated VIEs:</b>					
Variable interest entity notes	-	-	3,166	3,166	3,468
<b>Total liabilities</b>	<b>\$ 150</b>	<b>\$ 1,109</b>	<b>\$ 5,488</b>	<b>\$ 6,747</b>	<b>\$ 7,885</b>
<b>Financial Guarantees:</b>					
Gross	\$ -	\$ -	\$ 866	\$ 866	\$ 720
Ceded	-	-	88	88	94

(1) - Reported within Other assets on MBIA's consolidated balance sheets.

(2) - Reported within Other liabilities on MBIA's consolidated balance sheets.



**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

In millions	Fair Value Measurements at Reporting Date Using			Fair Value Balance as of December 31, 2011	Carry Value Balance as of December 31, 2011
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<b>Assets:</b>					
Other investments	\$ -	\$ -	\$ 11	\$ 11	\$ 11
Accrued investment income <sup>(1)</sup>	63	-	-	63	63
Receivable for investments sold <sup>(1)</sup>	32	-	-	32	32
<b>Assets of consolidated VIEs:</b>					
Investments held-to-maturity	-	-	3,489	3,489	3,843
<b>Total assets</b>	<b>\$ 95</b>	<b>\$ -</b>	<b>\$ 3,500</b>	<b>\$ 3,595</b>	<b>\$ 3,949</b>
<b>Liabilities:</b>					
Investment agreements	\$ -	\$ -	\$ 1,853	\$ 1,853	\$ 1,578
Medium-term notes	-	-	1,187	1,187	1,491
Securities sold under agreements to repurchase	-	286	-	286	287
Long-term debt	-	1,117	-	1,117	1,840
Payable for investments purchased <sup>(2)</sup>	3	-	-	3	3
<b>Liabilities of consolidated VIEs:</b>					
Variable interest entity notes	-	-	3,297	3,297	3,943
Long-term debt	-	-	368	368	360
<b>Total liabilities</b>	<b>\$ 3</b>	<b>\$ 1,403</b>	<b>\$ 6,705</b>	<b>\$ 8,111</b>	<b>\$ 9,502</b>
<b>Financial Guarantees:</b>					
Gross	\$ -	\$ -	\$ 1,451	\$ 1,451	\$ 1,305
Ceded	-	-	94	94	104

(1) - Reported within Other assets on MBIA's consolidated balance sheets.

(2) - Reported within Other liabilities on MBIA's consolidated balance sheets.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the three months ended September 30, 2012 and 2011:

**Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended September 30, 2012**

In millions	Balance, Beginning of Period	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 <sup>(1)</sup>	Transfers out of Level 3 <sup>(1)</sup>	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of
													September 30, 2012
Assets:													
Foreign governments	\$ 12	\$ -	\$ -	\$ -	\$ 1	\$ 9	\$ -	\$ (10)	\$ -	\$ -	\$ -	\$ 12	\$ -
Corporate obligations	98	-	4	(2)	-	2	-	(13)	-	10	(8)	91	3
Residential mortgage- backed agency	4	-	-	-	-	-	-	(1)	-	-	(3)	-	-
Residential mortgage- backed non-agency	33	(1)	-	2	-	-	-	(5)	-	1	(23)	7	-
Commercial mortgage-backed	27	-	-	1	-	1	-	-	-	1	-	30	-
Collateralized debt obligations	29	(4)	-	9	-	-	-	(4)	-	4	(4)	30	-
Other asset-backed	69	(2)	-	2	-	1	-	(1)	-	4	-	73	-
State and municipal taxable bonds	-	-	-	-	-	-	-	-	-	71	-	71	-
State and municipal tax-exempt bonds	25	-	-	-	-	-	-	(2)	-	-	-	23	-
Perpetual preferred securities	3	-	-	-	-	-	-	-	-	-	-	3	-

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Other investments	10	-	1	-	-	-	-	-	-	-	-	11	-
Assets of consolidated VIEs:													
Corporate obligations	95	-	(10)	-	-	-	-	(2)	-	3	(3)	83	1
Residential mortgage-backed non-agency	10	-	-	-	-	-	-	(1)	-	2	(3)	8	-
Commercial mortgage-backed	12	-	1	-	-	-	-	-	-	-	-	13	1
Collateralized debt obligations	140	-	(5)	2	-	-	-	(1)	-	37	-	173	(2)
Other asset-backed	42	-	(1)	-	-	-	-	(5)	-	30	-	66	1
Loans receivable	1,903	-	61	-	-	-	-	(72)	-	-	-	1,892	61
Loan repurchase commitments	1,032	-	19	-	-	-	-	-	-	-	-	1,051	19
<b>Total assets</b>	<b>\$ 3,544</b>	<b>\$ (7)</b>	<b>\$ 70</b>	<b>\$ 14</b>	<b>\$ 1</b>	<b>\$ 13</b>	<b>\$ -</b>	<b>\$ (117)</b>	<b>\$ -</b>	<b>\$ 163</b>	<b>\$ (44)</b>	<b>\$ 3,637</b>	<b>\$ 84</b>

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

In millions	Balance, Beginning of Period	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 <sup>(1)</sup>	Transfers out of Level 3 <sup>(1)</sup>	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of September 30,
													2012
<b>Liabilities:</b>													
Medium-term notes	\$ 151	\$ -	\$ 14	\$ -	\$ 3	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 168	\$ 14
Credit derivatives, net	3,285	-	32	-	-	-	-	-	-	-	-	3,317	33
Interest rate derivatives, net	(4)	-	-	-	-	-	-	-	-	4	-	-	5
Currency derivatives, net	-	-	-	-	-	-	-	-	-	1	-	1	-
<b>Liabilities of consolidated VIEs:</b>													
VIE notes	1,867	-	128	-	-	-	-	(110)	-	-	-	1,885	128
Currency derivatives, net	21	-	2	-	-	-	-	-	-	-	-	23	2
<b>Total liabilities</b>	<b>\$ 5,320</b>	<b>\$ -</b>	<b>\$ 176</b>	<b>\$ -</b>	<b>\$ 3</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (110)</b>	<b>\$ -</b>	<b>\$ 5</b>	<b>\$ -</b>	<b>\$ 5,394</b>	<b>\$ 182</b>

(1) - Transferred in and out at the end of the period.

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Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended September 30, 2011

In millions	Balance, Beginning of Period	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 <sup>(1)</sup>	Transfers out of Level 3 <sup>(1)</sup>	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of September 30, 2011
Assets:													
Foreign governments	\$ 13	\$ -	\$ -	\$ -	\$ (2)	\$ 3	\$ -	\$ (3)	\$ -	\$ -	\$ -	\$ 11	\$ -
Corporate obligations	294	(1)	-	(10)	(5)	19	-	(32)	(38)	115	-	342	-
Residential mortgage- backed agency	-	-	-	-	-	1	-	-	-	-	-	1	-
Residential mortgage- backed non-agency	28	(1)	-	1	-	4	-	(4)	-	1	(2)	27	-
Commercial mortgage-backed	50	(2)	-	-	-	-	-	(3)	(13)	-	-	32	-
Collateralized debt obligations	162	(2)	-	(3)	-	39	2	(79)	(28)	1	(25)	67	-
Other asset-backed	331	-	-	(27)	-	-	-	(9)	-	3	(28)	270	-
State and municipal taxable bonds	13	1	-	1	-	-	-	(15)	-	-	-	-	-
State and municipal tax-exempt bonds	32	-	-	-	-	-	-	(2)	-	-	-	30	-
Perpetual preferred securities	-	-	-	-	-	-	-	-	-	1	-	1	-
Assets of consolidated VIEs:													
Corporate obligations	62	-	(5)	-	-	-	-	(1)	-	7	-	63	(2)
Residential mortgage- backed non-agency	17	-	3	-	-	-	-	(1)	(6)	2	-	15	1
Commercial mortgage-backed	27	-	(1)	-	-	-	-	-	(11)	2	-	17	(2)
Collateralized debt obligations	201	-	(17)	(7)	-	60	-	(1)	(21)	12	(21)	206	(14)
Other asset-backed	73	-	5	-	-	-	-	-	(6)	-	(1)	71	5
Loans receivable	2,320	-	(36)	-	-	-	-	(66)	-	-	-	2,218	(36)
Loan repurchase commitments	905	-	33	-	-	-	-	-	-	-	-	938	33



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Total assets      \$ 4,528      \$ (5)      \$ (18)      \$ (45)      \$ (7)      \$ 126      \$ 2      \$ (216)      \$ (123)      \$ 144      \$ (77)      \$ 4,309      \$ (15)

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

In millions	Balance, Beginning of Period	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 <sup>(1)</sup>	Transfers out of Level 3 <sup>(1)</sup>	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of
													September 30, 2011
Liabilities:													
Medium-term notes	\$ 206	\$ -	\$ (69)	\$ -	\$ (9)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 128	\$ (69)
Credit derivatives, net	5,657	78	(777)	-	-	-	-	(78)	-	-	-	4,880	(388)
Interest rate derivatives, net	(4)	-	1	-	-	-	-	-	-	-	-	(3)	5
Liabilities of consolidated VIEs:													
VIE notes	4,513	-	(194)	-	-	-	-	(207)	(981)	-	-	3,131	(194)
Credit derivatives, net	920	-	(154)	-	-	-	-	(1)	-	-	-	765	(154)
Currency derivatives, net	16	-	2	-	-	-	-	-	-	-	-	18	2
<b>Total liabilities</b>	<b>\$ 11,308</b>	<b>\$ 78</b>	<b>\$ (1,191)</b>	<b>\$ -</b>	<b>\$ (9)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (286)</b>	<b>\$ (981)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 8,919</b>	<b>\$ (798)</b>

(1) - Transferred in and out at the end of the period.

Transfers into and out of Level 3 were \$168 million and \$44 million, respectively, for the three months ended September 30, 2012. Transfers into and out of Level 2 were \$44 million and \$168 million, respectively, for the three months ended September 30, 2012. Transfers into Level 3 were principally for state and municipal taxable bonds, CDOs, other asset-backed and corporate obligations where inputs, which are significant

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to their valuation, became unobservable during the year. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. Residential mortgage-backed non-agency and corporate obligations comprised the majority of the transferred instruments out of Level 3. There were no transfers into or out of Level 1.

Transfers into and out of Level 3 were \$144 million and \$77 million, respectively, for the three months ended September 30, 2011. Transfers into and out of Level 2 were \$77 million and \$144 million, respectively, for the three months ended September 30, 2011. These transfers were principally for available-for-sale securities where inputs, which are significant to their valuation, became observable or unobservable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. Corporate obligations, CDOs and other asset-backed comprised the majority of the transferred instruments. There were no transfers into or out of Level 1.

All Level 1, 2 and 3 designations are made at the end of each accounting period.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the nine months ended September 30, 2012 and 2011:

**Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months Ended September 30, 2012**

In millions	Balance, Beginning of Year	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 <sup>(1)</sup>	Transfers out of Level 3 <sup>(1)</sup>	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of September 30, 2012
<b>Assets:</b>													
Foreign governments	\$ 11	\$ -	\$ -	\$ -	\$ 1	\$ 22	\$ -	\$ (19)	\$ (3)	\$ -	\$ -	\$ 12	\$ -
Corporate obligations	207	(15)	9	24	-	18	-	(29)	(140)	25	(8)	91	8
Residential mortgage-backed agency	8	-	-	1	-	-	-	(1)	-	4	(12)	-	-
Residential mortgage-backed non-agency	17	(1)	-	(1)	-	-	-	(11)	(3)	31	(25)	7	-
Commercial mortgage-backed collateralized debt obligations	24	-	-	5	-	1	-	-	-	1	(1)	30	-
Other asset-backed	60	(9)	-	18	-	-	-	(12)	(10)	14	(31)	30	-
State and municipal taxable bonds	317	(58)	-	71	-	5	-	(11)	(250)	5	(6)	73	-
State and municipal tax-exempt bonds	-	-	-	-	-	-	-	-	-	71	-	71	-
Perpetual preferred	28	-	-	-	-	-	-	(5)	-	-	-	23	-
	1	-	-	1	-	-	-	-	-	4	(3)	3	-

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securities													
Other investments	10	-	1	-	-	-	-	-	-	-	-	11	-
Assets of consolidated VIEs:													
Corporate obligations	69	-	(15)	(6)	-	28	-	(5)	-	15	(3)	83	3
Residential mortgage- backed non-agency	21	-	6	-	-	-	-	(5)	(15)	5	(4)	8	3
Commercial mortgage-backed Collateralized debt obligations	22	-	3	-	-	-	-	(3)	(8)	5	(6)	13	2
Other asset-backed	67	-	4	-	-	4	-	(8)	(35)	34	-	66	5
Loans receivable	2,046	-	52	-	-	-	-	(204)	(2)	-	-	1,892	52
Loan repurchase commitments	1,077	-	(26)	-	-	-	-	-	-	-	-	1,051	(26)
<b>Total assets</b>	<b>\$ 4,188</b>	<b>\$ (83)</b>	<b>\$ 29</b>	<b>\$ 112</b>	<b>\$ 1</b>	<b>\$ 78</b>	<b>\$ -</b>	<b>\$ (314)</b>	<b>\$ (540)</b>	<b>\$ 265</b>	<b>\$ (99)</b>	<b>\$ 3,637</b>	<b>\$ 52</b>

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

In millions	Balance, Beginning of Year	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 <sup>(1)</sup>	Transfers out of Level 3 <sup>(1)</sup>	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of
													September 30, 2012
<b>Liabilities:</b>													
Medium-term notes	\$ 165	\$ -	\$ 3	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 168	\$ 4
Credit derivatives, net	4,790	463	(1,473)	-	-	-	-	(463)	-	-	-	3,317	(538)
Interest rate derivatives, net	(3)	-	(1)	-	-	-	-	-	-	4	-	-	12
Interest rate derivatives, net	-	-	-	-	-	-	-	-	-	1	-	1	-
<b>Liabilities of consolidated VIEs:</b>													
VIE notes	2,889	-	348	-	-	-	-	(369)	(983)	-	-	1,885	292
Credit derivatives, net	80	-	2	-	-	-	-	-	(82)	-	-	-	-
Currency derivatives, net	17	-	6	-	-	-	-	-	-	-	-	23	6
<b>Total liabilities</b>	<b>\$ 7,938</b>	<b>\$ 463</b>	<b>\$(1,115)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$(832)</b>	<b>\$(1,065)</b>	<b>\$ 5</b>	<b>\$ -</b>	<b>\$ 5,394</b>	<b>\$(224)</b>

(1) - Transferred in and out at the end of the period.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)****Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months Ended September 30, 2011**

In millions	Balance, Beginning of Year	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 <sup>(1)</sup>	Transfers out of Level 3 <sup>(1)</sup>	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of September 30, 2011
<b>Assets:</b>													
Foreign governments	\$ 11	\$ -	\$ -	\$ -	\$ (1)	\$ 9	\$ -	\$ (8)	\$ -	\$ 7	\$ (7)	\$ 11	\$ -
Corporate obligations	246	(1)	-	(3)	(2)	30	-	(65)	(50)	202	(15)	342	-
Residential mortgage- backed agency	41	-	-	1	-	2	-	(1)	(1)	-	(41)	1	-
Residential mortgage- backed non-agency	48	(2)	-	11	(1)	15	-	(14)	(19)	9	(20)	27	-
Commercial mortgage-backed	41	(2)	-	2	1	8	-	(3)	(14)	-	(1)	32	-
Collateralized debt obligations	192	(4)	-	25	-	46	3	(112)	(36)	49	(96)	67	-
Other asset-backed	349	-	-	(26)	-	10	-	(20)	(2)	16	(57)	270	-
State and municipal taxable bonds	14	1	-	-	-	-	-	(15)	-	-	-	-	-
State and municipal tax-exempt bonds	36	-	-	-	-	2	-	(7)	(1)	-	-	30	-
Perpetual preferred securities	-	-	-	-	-	-	-	-	-	1	-	1	-

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Assets of consolidated VIEs:														
Corporate obligations	82	-	(18)	-	-	-	-	(5)	-	11	(7)	63	(2)	
Residential mortgage- backed non-agency	40	-	2	3	-	-	-	(6)	(6)	2	(20)	15	2	
Commercial mortgage-backed	23	-	6	-	-	-	-	(2)	(12)	2	-	17	3	
Collateralized debt obligations	245	-	(27)	(7)	-	60	-	(3)	(21)	48	(89)	206	1	
Other asset-backed	81	-	(3)	-	-	-	-	(2)	(6)	2	(1)	71	2	
Loans receivable	2,183	-	260	-	-	-	-	(223)	(2)	-	-	2,218	260	
Loan repurchase commitments	835	-	91	-	-	-	12	-	-	-	-	938	91	
Total assets	\$ 4,467	\$ (8)	\$ 311	\$ 6	\$ (3)	\$ 182	\$ 15	\$ (486)	\$ (170)	\$ 349	\$ (354)	\$ 4,309	\$ 357	



In millions	Balance, Beginning of Year	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 <sup>(1)</sup>	Transfers out of Level 3 <sup>(1)</sup>	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included In Earnings for Liabilities still held as of
													September 30, 2011
<b>Liabilities:</b>													
Medium-term notes	\$ 116	\$ -	\$ 9	\$ -	\$ 3	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 128	\$ 9
Credit derivatives, net	4,350	683	530	-	-	-	-	(683)	-	-	-	4,880	2,160
Interest rate derivatives, net	(5)	-	1	-	-	-	-	-	-	1	-	(3)	6
<b>Liabilities of consolidated VIEs:</b>													
VIE notes	4,673	-	75	-	-	-	-	(456)	(1,161)	-	-	3,131	75
Credit derivatives, net	768	-	(3)	-	-	-	-	-	-	-	-	765	(3)
Currency derivatives, net	14	-	4	-	-	-	-	-	-	-	-	18	4
<b>Total liabilities</b>	<b>\$ 9,916</b>	<b>\$ 683</b>	<b>\$ 616</b>	<b>\$ -</b>	<b>\$ 3</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (1,139)</b>	<b>\$ (1,161)</b>	<b>\$ 1</b>	<b>\$ -</b>	<b>\$ 8,919</b>	<b>\$ 2,251</b>

(1) - Transferred in and out at the end of the period.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

Transfers into and out of Level 3 were \$270 million and \$99 million, respectively, for the nine months ended September 30, 2012. Transfers into and out of Level 2 were \$99 million and \$270 million, respectively, for the nine months ended September 30, 2012. Transfers into Level 3 were principally related to state and municipal taxable bonds, CDOs, other asset-backed, residential mortgage-backed non-agency and corporate obligations where inputs, which are significant to their valuation, became unobservable during the year. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. CDOs, residential mortgage-backed non-agency, residential mortgage-backed agency and corporate obligations comprised the majority of the transferred instruments out of Level 3. There were no transfers into or out of Level 1.

Transfers into and out of Level 3 were \$350 million and \$354 million, respectively, for the nine months ended September 30, 2011. Transfers into and out of Level 2 were \$354 million and \$350 million, respectively, for the nine months ended September 30, 2011. These transfers were principally related to available-for-sale securities where inputs, which are significant to their valuation, became observable or unobservable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. Corporate obligations, CDOs, residential mortgage-backed non-agency and other asset-backed comprised the majority of the transferred instruments. There were no transfers into or out of Level 1.

All Level 1, 2 and 3 designations are made at the end of each accounting period.

Gains and losses (realized and unrealized) included in earnings relating to Level 3 assets and liabilities for the three months ended September 30, 2012 and 2011 are reported on the Company's consolidated statements of operations as follows:

In millions	Three Months Ended September 30, 2012			Consolidated VIEs Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange
	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	\$ (32)	\$ (7)	\$ (9)	\$ (65)
Change in unrealized gains (losses) for the period included in earnings for assets and liabilities still held as of September 30, 2012	\$ (33)	\$ -	\$ (16)	\$ (49)

In millions	Three Months Ended September 30, 2011			Consolidated VIEs
	Unrealized Gains (Losses) on Insured Derivatives	Net Realized Gains (Losses)	Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	

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	<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>	<b>Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange</b>
Total gains (losses) included in earnings	\$ 777	\$ (83)	\$ 68	\$ 328
Change in unrealized gains (losses) for the period included in earnings for assets and liabilities still held as of September 30, 2011	\$ 388	\$ -	\$ 64	\$ 331

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

Gains and losses (realized and unrealized) included in earnings relating to Level 3 assets and liabilities for the nine months ended September 30, 2012 and 2011 are reported on the Company's consolidated statements of operations as follows:

	Nine Months Ended September 30, 2012			
	Unrealized Gains (Losses) on Insured Derivatives	Net Realized Gains (Losses)	Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	Consolidated VIEs Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange
<b>In millions</b>				
Total gains (losses) included in earnings	\$ 1,473	\$ (546)	\$ 8	\$ (337)
Change in unrealized gains (losses) for the period included in earnings for assets and liabilities still held as of September 30, 2012	\$ 538	\$ -	\$ (8)	\$ (254)

	Nine Months Ended September 30, 2011			
	Unrealized Gains (Losses) on Insured Derivatives	Net Realized Gains (Losses)	Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	Consolidated VIEs Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange
<b>In millions</b>				
Total gains (losses) included in earnings	\$ (530)	\$ (691)	\$ (10)	\$ 235
Change in unrealized gains (losses) for the period included in earnings for assets and liabilities still held as of September 30, 2011	\$ (2,160)	\$ -	\$ (15)	\$ 281

**Fair Value Option**

The Company elected to record at fair value certain financial instruments of VIEs that have been consolidated in connection with the adoption of the accounting guidance for consolidation of VIEs, among others.

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The following table presents the changes in fair value included in the Company's consolidated statements of operations for the three and nine months ended September 30, 2012 and 2011 for all financial instruments for which the fair value option was elected:

In millions	Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange			
	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Fixed-maturity securities held at fair value	\$ 21	\$ (286)	\$ (36)	\$ (338)
Loans receivable at fair value:				
Residential mortgage loans	(4)	(65)	(103)	65
Other loans	(7)	(37)	(48)	(30)
Loan repurchase commitments	19	33	62	103
Other assets	-	(162)	-	(184)
Long-term debt	12	481	140	367

Substantially all gains and losses included in earnings during the nine months ended September 30, 2012 on loans receivable and VIE notes reported in the preceding table are attributable to credit risk. This is primarily due to the high rate of defaults on loans and the collateral supporting the VIE notes, resulting in depressed pricing of the financial instruments.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)**

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding as of September 30, 2012 and December 31, 2011 for loans and VIE notes for which the fair value option was elected:

In millions	As of September 30, 2012			As of December 31, 2011		
	Contractual Outstanding Principal	Fair Value	Difference	Contractual Outstanding Principal	Fair Value	Difference
Loans receivable at fair value:						
Residential mortgage loans	\$ 2,430	\$ 1,746	\$ 684	\$ 2,769	\$ 1,895	\$ 874
Residential mortgage loans (90 days or more past due)	241	46	195	259	-	259
Other loans	39	16	23	129	43	86
Other loans (90 days or more past due)	206	84	122	324	108	216
Total loans receivable at fair value	\$ 2,916	\$ 1,892	\$ 1,024	\$ 3,481	\$ 2,046	\$ 1,435
Variable interest entity notes	\$ 9,015	\$ 3,626	\$ 5,389	\$ 13,583	\$ 4,754	\$ 8,829

**Note 7: Investments**

The Company's fixed-maturity portfolio consists of high-quality (average rating Aa) taxable and tax-exempt investments of diversified maturities. Other investments primarily comprise equity investments, including those accounted for under the equity method, highly rated perpetual securities and loan receivables that bear interest.

**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 7: Investments (continued)**

The following tables present the amortized cost, fair value and other-than-temporary impairments of fixed-maturity investments and other investments designated as available-for-sale in the consolidated investment portfolio of the Company as of September 30, 2012 and December 31, 2011:

In millions	Amortized Cost	Gross Unrealized Gains	September 30, 2012		Other-Than-Temporary Impairments <sup>(1)</sup>
			Gross Unrealized Losses	Fair Value	
Fixed-maturity investments:					
Taxable bonds:					
U.S. Treasury and government agency	\$ 896	\$ 44	\$ (1)	\$ 939	\$ -
Foreign governments	318	22	-	340	-
Corporate obligations	1,068	59	(21)	1,106	3
Mortgage-backed securities:					
Residential mortgage-backed agency	988	48	-	1,036	-
Residential mortgage-backed non-agency	187	16	(36)	167	(24)
Commercial mortgage-backed	46	1	(4)	43	-
Asset-backed securities:					
Collateralized debt obligations	165	-	(74)	91	(26)
Other asset-backed	195	3	(14)	184	-
State and municipal bonds	895	73	(11)	957	-
Total taxable bonds	4,758	266	(161)	4,863	(47)
Tax-exempt bonds:					
State and municipal bonds	886	60	-	946	-
Total fixed-maturity investments	5,644	326	(161)	5,809	(47)
Other investments:					
Perpetual preferred securities	31	-	-	31	-
Other investments	10	-	-	10	-
Money market securities	583	-	-	583	-
Total other investments	624	-	-	624	-
Assets of consolidated VIEs:					
Corporate obligations	177	7	(7)	177	-
Mortgage-backed securities:					
Residential mortgage-backed non-agency	99	-	(12)	87	-
Asset-backed securities:					
Collateralized debt obligations	108	-	(11)	97	-
Other asset-backed	25	1	-	26	-
State and municipal bonds	37	3	-	40	-
Other investments:					
Money market securities	15	-	-	15	-

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Total available-for-sale investments	\$ 6,729	\$ 337	\$ (191)	\$ 6,875	\$ (47)
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(1) - Represents unrealized gains or losses on other than temporarily impaired securities recognized in accumulated other comprehensive income (loss), which includes the non-credit component of impairments, as well as all subsequent changes in fair value of such impaired securities.



**Table of Contents****MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 7: Investments (continued)**

In millions	Amortized Cost	Gross Unrealized Gains	December 31, 2011		Other-Than- Temporary Impairments <sup>(1)</sup>
			Gross Unrealized Losses	Fair Value	
Fixed-maturity investments:					
Taxable bonds:					
U.S. Treasury and government agency	\$ 1,091	\$ 39	\$ -	\$ 1,130	\$ -
Foreign governments	326	23	-	349	-
Corporate obligations	1,698	43	(106)	1,635	(2)
Mortgage-backed securities:					
Residential mortgage-backed agency	1,198	47	-	1,245	-
Residential mortgage-backed non-agency	325	31	(83)	273	(57)
Commercial mortgage-backed	58	1	(10)	49	-
Asset-backed securities:					
Collateralized debt obligations	251	-	(118)	133	(43)
Other asset-backed	520	2	(82)	440	(37)
State and municipal bonds	903	35	(17)	921	-
Total taxable bonds	6,370	221	(416)	6,175	(139)
Tax-exempt bonds:					
State and municipal bonds	1,122	41	(2)	1,161	-
Total fixed-maturity investments	7,492	262	(418)	7,336	(139)
Other investments:					
Perpetual preferred securities	127	-	(19)	108	-
Other investments	22	1	-	23	-
Money market securities	911	-	-	911	-
Total other investments	1,060	1	(19)	1,042	-
Assets of consolidated VIEs:					
Corporate obligations	2	-	-	2	-
Mortgage-backed securities:					
Residential mortgage-backed non-agency	119	-	(26)	93	-
Asset-backed securities:					
Collateralized debt obligations	112	-	(15)	97	-