MBIA INC
Form 10-Q
August 06, 2014
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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 June 30, 2014

or

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

For the transition period from to

Commission File Number 1-9583

MBIA INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

As of July 31, 2014, 193,195,022 shares of Common Stock, par value $1 per share, were outstanding.

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FORWARD-LOOKING AND CAUTIONARY STATEMENTS

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

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

- increased credit losses or impairments on public finance obligations we insure issued by state, local and territorial governments and finance authorities that are experiencing unprecedented fiscal stress;
- the possibility that MBIA Corp. will have inadequate liquidity to pay expected claims as a result of increased losses on certain structured finance transactions, in particular residential mortgage-backed securities transactions that include a substantial number of ineligible mortgage loans, or a delay or failure in collecting expected recoveries;
- the possibility that loss reserve estimates are not adequate to cover potential claims;
- a disruption in the cash flow from our subsidiaries or an inability to access capital and our exposure to significant fluctuations in liquidity and asset values within the global credit markets as a result of collateral posting requirements;
- our ability to fully implement our strategic plan, including our ability to maintain high stable ratings for National Public Finance Guarantee Corporation and generate investor demand for our financial guarantees;
- deterioration in the economic environment and financial markets in the United States (U.S.) or abroad, and adverse developments in European sovereign credit performance, real estate market performance, credit spreads, interest rates and foreign currency levels;
- the effects of governmental regulation, including insurance laws, securities laws, tax laws, legal precedents and accounting rules; and
- uncertainties that have not been identified at this time.

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

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PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions except share and per share amounts)

	June 30, 2014	December 31, 2013
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $5,235 and $5,064)	$ 5,340	$ 4,987
Investments carried at fair value	244	204
Investments pledged as collateral, at fair value (amortized cost $370 and $483)	341	424
Short-term investments held as available-for-sale, at fair value (amortized cost $1,218 and $1,203)	1,219	1,204
Other investments (includes investments at fair value of $13 and $11)	17	16
Total investments	7,161	6,835
Cash and cash equivalents	534	1,161
Premiums receivable	975	1,051
Deferred acquisition costs	243	260
Insurance loss recoverable	624	694
Assets held for sale	29	29
Deferred income taxes, net	986	1,109
Other assets	243	222
Assets of consolidated variable interest entities:		
Cash	66	97
Investments held-to-maturity, at amortized cost (fair value $2,780 and $2,651)	2,787	2,801
Investments held as available-for-sale, at fair value (amortized cost $0 and $136)	-	136
Fixed-maturity securities at fair value	474	587
Loans receivable at fair value	1,539	1,612
Loan repurchase commitments	363	359
Total assets	**$ 16,024**	**$ 16,953**
Liabilities and Equity		
Liabilities:		
Unearned premium revenue	$ 2,251	$ 2,441
Loss and loss adjustment expense reserves	554	641
Investment agreements	660	700
Medium-term notes (includes financial instruments carried at fair value of $217 and $203)	1,286	1,427
Long-term debt	1,755	1,702
Derivative liabilities	449	1,152
Other liabilities	313	294
Liabilities of consolidated variable interest entities:		
Variable interest entity notes (includes financial instruments carried at fair value of $2,150 and $2,356)	4,937	5,286
Derivative liabilities	11	11

Total liabilities	**12,216**	**13,654**
Commitments and contingencies (See Note 13)		
Equity:		
Preferred stock, par value $1 per share; authorized shares 10,000,000; issued and outstanding none	-	-
Common stock, par value $1 per share; authorized shares 400,000,000; issued shares 281,359,451 and 277,812,430	281	278
Additional paid-in capital	3,118	3,115
Retained earnings	2,665	2,289
Accumulated other comprehensive income (loss), net of tax of $20 and $54	56	(86)
Treasury stock, at cost 86,924,313 and 85,562,546 shares	(2,333)	(2,318)
Total shareholders equity of MBIA Inc.	3,787	3,278
Preferred stock of subsidiary and noncontrolling interest	21	21
Total equity	**3,808**	**3,299**
Total liabilities and equity	**$ 16,024**	**$ 16,953**

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In millions except share and per share amounts)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Revenues:				
Premiums earned:				
Scheduled premiums earned	$ 63	$ 77	$ 132	$ 156
Refunding premiums earned	26	47	45	88
Premiums earned (net of ceded premiums of $2, $2, $5 and $5)	89	124	177	244
Net investment income	42	38	92	76
Fees and reimbursements	4	6	8	12
Change in fair value of insured derivatives:				
Realized gains (losses) and other settlements on insured derivatives	(24)	(1,532)	(393)	(1,520)
Unrealized gains (losses) on insured derivatives	(23)	1,350	815	1,277
Net change in fair value of insured derivatives	(47)	(182)	422	(243)
Net gains (losses) on financial instruments at fair value and foreign exchange	61	(6)	6	57
Net gains (losses) on extinguishment of debt	2	39	3	43
Other net realized gains (losses)	-	-	1	-
Revenues of consolidated variable interest entities:				
Net investment income	13	14	25	30
Net gains (losses) on financial instruments at fair value and foreign exchange	23	78	26	111
Net gains (losses) on extinguishment of debt	-	-	4	-
Other net realized gains (losses)	-	1	-	1
Total revenues	187	112	764	331
Expenses:				
Losses and loss adjustment	12	188	62	(6)
Amortization of deferred acquisition costs	8	11	18	27
Operating	49	103	95	209
Interest	52	60	106	120
Expenses of consolidated variable interest entities:				
Operating	1	2	4	6
Interest	10	12	20	24
Total expenses	132	376	305	380
Income (loss) before income taxes	55	(264)	459	(49)
Provision (benefit) for income taxes	(65)	(86)	83	(35)
Net income (loss)	**$ 120**	**$ (178)**	**$ 376**	**$ (14)**
Net income (loss) per common share:				
Basic	$ 0.61	$ (0.94)	$ 1.93	$ (0.07)
Diluted	$ 0.45	$ (0.94)	$ 1.83	$ (0.07)

Weighted average number of common shares outstanding:				
Basic	189,169,042	189,163,527	189,101,884	189,135,587
Diluted	192,906,871	189,163,527	193,051,436	189,135,587

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

(In millions)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net income (loss)	$ 120	$ (178)	$ 376	$ (14)
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses) arising during the period	79	(153)	184	(140)
Provision (benefit) for income taxes	26	(53)	64	(49)
Total	53	(100)	120	(91)
Reclassification adjustments for (gains) losses included in net income (loss)	13	6	15	(19)
Provision (benefit) for income taxes	5	2	6	(7)
Total	8	4	9	(12)
Available-for-sale securities with other-than-temporary impairments:				
Other-than-temporary impairments and unrealized gains (losses) arising during the period	(4)	2	(1)	7
Provision (benefit) for income taxes	(1)	2	(1)	4
Total	(3)	-	-	3
Reclassification adjustments for (gains) losses included in net income (loss)	7	(4)	7	(4)
Provision (benefit) for income taxes	2	(1)	2	(1)
Total	5	(3)	5	(3)
Foreign currency translation:				
Foreign currency translation gains (losses)	9	4	7	(39)
Provision (benefit) for income taxes	3	-	3	-
Total	6	4	4	(39)
Reclassification adjustments for (gains) losses included in net income (loss)	-	-	4	-
Total other comprehensive income (loss)	69	(95)	142	(142)
Comprehensive income (loss)	**$ 189**	**$ (273)**	**$ 518**	**$ (156)**

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 Six Months Ended June 30, 2014

(In millions except share amounts)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total Shareholders Equity of MBIA Inc.	Preferred Stock of Subsidiary and Noncontrolling Interest		Total Equity
	Shares	Amount				Shares	Amount		Shares	Amount	
Balance, December 31, 2013	**277,812,430**	**$ 278**	**$ 3,115**	**$ 2,289**	**$ (86)**	**(85,562,546)**	**$ (2,318)**	**$ 3,278**	**1,315**	**$ 21**	**$ 3,299**
Net income (loss)	-	-	-	376	-	-	-	376	-	-	376
Other comprehensive income (loss)	-	-	-	-	142	-	-	142	-	-	142
Share-based compensation net of tax of $2	3,547,021	3	3	-	-	(519,695)	(6)	-	-	-	-
Treasury shares acquired under share repurchase program	-	-	-	-	-	(842,072)	(9)	(9)	-	-	(9)
Balance, June 30, 2014	**281,359,451**	**$ 281**	**$ 3,118**	**$ 2,665**	**$ 56**	**(86,924,313)**	**$ (2,333)**	**$ 3,787**	**1,315**	**$ 21**	**$ 3,808**

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In millions)

	Six Months Ended June 30, 2014	2013
Cash flows from operating activities:		
Premiums, fees and reimbursements received	$ 72	$ 107
Investment income received	214	223
Insured derivative commutations and losses paid	(371)	(419)
Financial guarantee losses and loss adjustment expenses paid	(139)	(227)
Proceeds from recoveries and reinsurance	60	1,781
Operating and employee related expenses paid	(142)	(176)
Interest paid, net of interest converted to principal	(95)	(118)
Income taxes (paid) received	5	-
Net cash provided (used) by operating activities	(396)	1,171
Cash flows from investing activities:		
Purchases of available-for-sale investments	(975)	(928)
Sales of available-for-sale investments	463	1,301
Paydowns and maturities of available-for-sale investments	255	377
Purchases of investments at fair value	(259)	(245)
Sales, paydowns and maturities of investments at fair value	343	338
Sales, paydowns and maturities (purchases) of short-term investments, net	309	(1,242)
Sales, paydowns and maturities of held-to-maturity investments	14	12
Paydowns and maturities of loans	112	137
Consolidation (deconsolidation) of variable interest entities, net	(1)	(26)
(Payments) proceeds for derivative settlements	(15)	(39)
Collateral (to) from swap counterparty	81	63
Capital expenditures	(3)	(1)
Net cash provided (used) by investing activities	324	(253)
Cash flows from financing activities:		
Proceeds from investment agreements	11	15
Principal paydowns of investment agreements	(57)	(190)
Principal paydowns of medium-term notes	(166)	(40)
Principal paydowns of variable interest entity notes	(377)	(685)
Payments for retirement of debt	-	(2)
Net cash provided (used) by financing activities	(589)	(902)
Effect of exchange rate changes on cash and cash equivalents	3	-
Net increase (decrease) in cash and cash equivalents	(658)	16
Cash and cash equivalents beginning of period	1,258	990
Cash and cash equivalents end of period	$ 600	$ 1,006
Reconciliation of net income (loss) to net cash provided (used) by operating activities:		
Net income (loss)	$ 376	$ (14)

Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Change in:		
Premiums receivable	83	91
Deferred acquisition costs	17	24
Unearned premium revenue	(204)	(265)
Loss and loss adjustment expense reserves	(87)	(79)
Insurance loss recoverable	70	2,754
Accrued interest payable	51	56
Accrued expenses	(27)	39
Realized (gains) losses and other settlements on insured derivatives	30	-
Unrealized (gains) losses on insured derivatives	(815)	(1,277)
Net (gains) losses on financial instruments at fair value and foreign exchange	(32)	(168)
Deferred income tax provision (benefit)	76	(37)
(Gains) losses on extinguishment of debt	(7)	(43)
Interest on variable interest entities, net	37	49
Other operating	36	41
Total adjustments to net income (loss)	(772)	1,185
Net cash provided (used) by operating activities	$ (396)	$ 1,171

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 and Risks and Uncertainties

Summary

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

Business Developments

National Ratings and New Business Opportunities

National s ability to write new business and compete with other financial guarantors is largely dependent on the financial strength ratings assigned to National by major rating agencies. During the first six months of 2014, Standard & Poor s Financial Services LLC (S&P) upgraded National to a rating of AA- with a stable outlook, Moody s Investors Service, Inc. (Moody s) upgraded National to a rating of A3 with a stable outlook, and subsequent to June 30, 2014, Moody s affirmed National s A3 rating and changed the outlook to negative. In addition, Kroll Bond Rating Agency assigned National a AA+ insurer financial strength rating with a stable outlook.

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

MBIA Corp. Strategic Initiatives

During the six months ended June 30, 2014, the Company continued to focus on the collection of excess spread and put-back recoveries and the mitigation of MBIA Corp. s high risk insurance exposure, primarily through terminations of insurance policies. During the six months ended June 30, 2014, MBIA Corp. commuted $3.9 billion of gross par exposure, primarily comprising structured commercial mortgage-backed securities (CMBS) pools, commercial real estate (CRE) collateralized debt obligations (CDOs), and first-lien residential mortgage-backed securities (RMBS). The difference between the fair values of the Company s derivative liabilities for the commuted policies and the aggregate cost of the commutation was reflected in earnings for the six months ended June 30, 2014.

Risks and Uncertainties

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

U.S. Public Finance Market Conditions

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

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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

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

MBIA Inc. Liquidity

As of June 30, 2014, the liquidity position of MBIA Inc., which consists of the liquidity positions of its corporate and asset/liability products segments, was $365 million, and comprised cash and liquid assets of $317 million available for general liquidity purposes and $48 million not pledged directly as collateral for its asset/liability products segment. As of December 31, 2013, MBIA Inc. had $359 million of cash and liquid assets comprising $307 million available for general corporate liquidity purposes and $52 million not pledged directly as collateral for its asset/liability products segment. During the six months ended June 30, 2014, $202 million was released to MBIA Inc. under the MBIA group s tax sharing agreement (the Tax Escrow Account). While MBIA Inc. s liquidity position slightly improved during the six months ended June 30, 2014 due to this release, MBIA Inc. continues to have liquidity risk. If invested asset performance deteriorates or the flow of dividends from subsidiaries is interrupted and/or access to the capital markets is impaired, its liquidity position could be eroded over time. While the Company expects that MBIA Inc. will generate sufficient cash to satisfy its debt obligations and its general corporate needs over time from distributions from its operating subsidiaries and payments under the Tax Escrow Account once the payments become unrestricted, there can be no assurance that such sources will generate sufficient cash. In addition, a failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp.

MBIA Corp. Recoveries and Insured Portfolio

The amount and timing of projected collections from excess spread and put-back recoverable from Credit Suisse Securities (USA) LLC, DLJ Mortgage Capital, Inc., and Select Portfolio Servicing Inc. (collectively, Credit Suisse) and the potential of claims from MBIA Corp. s remaining insured CMBS pools and second-lien RMBS are uncertain. Further, the remaining insured portfolio, aside from these exposures, could deteriorate and result in additional significant loss reserves and claim payments. Management s expected liquidity and capital forecasts for MBIA Corp., which include expected excess spread recoveries and put-back recoveries from Credit Suisse, reflect adequate resources to pay claims when due. However, if MBIA Corp. experiences higher than expected claim payments or is unable to terminate the remaining exposures that represent substantial risk to the Company, MBIA Corp. may ultimately have insufficient resources to continue to pay claims, which could cause the New York State Department of Financial Services (NYSDFS) to put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding. Such a proceeding could have an adverse impact on MBIA Inc. and would result in material adverse consequences for MBIA Corp., including the termination of insured credit default swaps (CDS) contracts for which counterparties may assert market-based claims, the acceleration of debt obligations issued by affiliates and insured by MBIA Corp., the loss of control of MBIA Insurance Corporation to a rehabilitator or liquidator, and unplanned costs.

Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about MBIA Corp. s loss reserves and recoveries.

Management does not believe that a rehabilitation or liquidation proceeding of MBIA Insurance Corporation by the NYSDFS will have any significant long-term liquidity impact on MBIA Inc. or result in a liquidation or similar proceeding of MBIA UK Insurance Limited.

Note 2: Significant Accounting Policies

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 2: Significant Accounting Policies (continued)

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America (GAAP) for annual periods. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2013. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the Company s consolidated financial position and results of operations. All material intercompany balances and transactions have been eliminated.

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

The results of operations for the three and six months ended June 30, 2014 may not be indicative of the results that may be expected for the year ending December 31, 2014. The December 31, 2013 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. Certain amounts have been reclassified in the prior year s financial statements to conform to the current presentation. Such reclassifications had no impact on total revenues, expenses, assets, liabilities, shareholders equity, operating cash flows, investing cash flows, or financing cash flows for all periods presented.

Note 3: Recent Accounting Pronouncements

Recently Adopted Accounting Standards

Income Taxes (Topic 740) Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (ASU 2013-11)

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

The Company has not adopted any other new accounting pronouncements that had a material impact on its consolidated financial statements.

Recent Accounting Developments

Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity

In April of 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360)-Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. ASU 2014-08 changes the criteria for determining whether a disposal of a component or group of components of an entity qualifies for discontinued operations presentation and requires new disclosures. ASU 2014-08 amends the definition of discontinued operation to a disposal of components of an entity that represent strategic shifts that have, or will have, a major effect on an entity s operations and financial results. ASU 2014-08 is effective for interim and annual periods beginning January 1, 2015 with early adoption permitted. The adoption of ASU 2014-08 is not expected to materially impact the Company s consolidated financial statements.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 3: Recent Accounting Pronouncements (continued)

Revenue from Contracts with Customers (Topic 606) (ASU 2014-09)

In May of 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 amends the accounting guidance for recognizing revenue for the transfer of goods or services from contracts with customers unless those contracts are within the scope of other accounting standards. ASU 2014-09 is effective for interim and annual periods beginning January 1, 2017, and is applied on a retrospective or modified retrospective basis. The Company is evaluating the impact of adopting ASU 2014-09.

Transfers and Servicing (Topic 860) Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures (ASU 2014-11)

In June of 2014, the FASB issued ASU 2014-11, Transfers and Servicing (Topic 860)-Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. The repurchase agreements and similar transactions guidance is amended by ASU 2014-11 to change the accounting for i.) repurchase-to-maturity transactions to secured borrowing accounting and ii.) linked repurchase financing transactions to secured borrowing accounting. ASU 2014-11 amends disclosure requirements for transfers accounted for as sales, and for repurchase transactions accounted for as secured borrowings. ASU 2014-11 is effective for interim and annual periods beginning January 1, 2015, and is applied on a prospective basis. The adoption of ASU 2014-11 is not expected to materially impact the Company s consolidated financial statements.

Compensation-Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (A Consensus of the FASB Emerging Issues Task Force) (ASU 2014-12)

In June of 2014, the FASB issued ASU 2014-12, Compensation-Stock Compensation (Topic 718)-Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. ASU 2014-12 requires that a performance target that affects vesting of share-based payment awards and that could be achieved after an employee s requisite service period be accounted for as a performance condition. ASU 2014-12 is effective for interim and annual periods beginning January 1, 2016 with early adoption permitted, and is applied on a prospective basis or retrospective basis. The adoption of ASU 2014-12 is not expected to materially impact the Company s consolidated financial statements.

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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 (AFS). The Company evaluates issuer-sponsored SPEs to determine if the entity is a VIE. For all entities determined to be VIEs, the Company evaluates whether its investment is determined to have both of the characteristics of a controlling financial interest in the VIE. The Company performs an ongoing reassessment of controlling financial interests in issuer-sponsored VIEs based on investments held. MBIA s wind-down operations do not have a controlling financial interest in any issuer-sponsored VIEs and are not the primary beneficiary of any issuer-sponsored VIEs.

In the conduit segment, the Company has managed and administered a conduit that invested primarily in debt securities and was funded through the issuance of VIE notes. The Company consolidated the conduit as a primary beneficiary. In 2014, all outstanding VIE notes were repaid by the conduit, and the conduit was subsequently dissolved. The Company no longer provides any related credit protection.

Nonconsolidated VIEs

Insurance

The following tables present the total assets of nonconsolidated VIEs in which the Company holds a variable interest as of June 30, 2014 and December 31, 2013, through its insurance operations. The following tables also present the Company s maximum exposure to loss for nonconsolidated VIEs and carrying values of the assets and liabilities for its interests in these VIEs as of June 30, 2014 and December 31, 2013. The Company has aggregated nonconsolidated VIEs based on the underlying credit exposure of the insured obligation. The nature of the Company s variable interests in nonconsolidated VIEs is related to financial guarantees, insured CDS contracts and any investments in obligations issued by nonconsolidated VIEs.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

			June 30, 2014					
			Carrying Value of Assets			Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Investments(1)	Premiums Receivable(2)	Insurance Loss Recoverable(3)	Unearned Premium Revenue(4)	Loss and Loss Adjustment Expense Reserves(5)	Derivative Liabilities(6)
Insurance:								
Global structured finance:								
Collateralized debt obligations	$ 8,399	$ 6,267	$ 117	$ 30	$ -	$ 25	$ 8	$ 96
Mortgage-backed residential	15,622	8,274	9	48	587	46	322	5
Mortgage-backed commercial	617	322	-	1	-	1	-	-
Consumer asset-backed	6,372	2,450	-	18	-	16	10	-
Corporate asset-backed	10,414	6,414	1	62	18	75	-	-
Total global structured finance	41,424	23,727	127	159	605	163	340	101
Global public finance	56,176	20,609	-	203	-	243	5	-
Total insurance(7)	$ 97,600	$ 44,336	$ 127	$ 362	$ 605	$ 406	$ 345	$ 101

(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.

(7) - In addition, the Company holds a $4 million variable interest in a non-insurance VIE that invested in loans that totaled $179 million.

December 31, 2013

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

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

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

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

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

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

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

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

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 $5.2 billion and $4.9 billion, respectively, as of June 30, 2014, and $5.6 billion and $5.3 billion, respectively, as of December 31, 2013. The carrying amounts of assets and liabilities are presented separately in Assets of consolidated variable interest entities and Liabilities of consolidated variable interest entities on the Company s consolidated balance sheets. Additional VIEs are consolidated or deconsolidated based on an ongoing reassessment of controlling financial interest, when events occur or circumstances arise, and whether the ability to exercise rights that constitute power to direct activities of any VIEs are present according to the design and characteristics of these entities. No additional VIEs were consolidated during the six months ended June 30, 2014 and 2013. There was an immaterial amount of net realized gains recorded for the three and six months ended June 30, 2014 and net realized gains related to the deconsolidation of VIEs were $1 million for the three and six months ended June 30, 2013.

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.

Note 5: Loss and Loss Adjustment Expense Reserves

Loss and Loss Adjustment Expense Process

U.S. Public Finance

U.S. public finance insured transactions consist of municipal bonds, including tax-exempt and taxable indebtedness of U.S. political subdivisions, as well as utility districts, airports, health care institutions, higher educational facilities, student loan issuers, housing authorities and other similar agencies and obligations issued by private entities that finance projects that serve a substantial public purpose. The Company estimates future losses by using probability-weighted scenarios that are customized to each insured transaction. Future loss estimates consider debt service due for each insured transaction, which includes par outstanding and interest due.

As of June 30, 2014 and December 31, 2013, the Company established loss and loss adjustment expense (LAE) reserves totaling $70 million and $87 million, respectively, and insurance loss recoverable of $14 million and $13 million, respectively, related to U.S. public finance issues. For the six months ended June 30, 2014, losses and LAE incurred of $3 million primarily related to Puerto Rico exposures, partially offset by decreases in reserves from certain general obligation bonds.

Certain local governments remain under financial and budgetary stress and a few have filed for protection under the United States Bankruptcy Code, or have entered into state statutory proceedings established to assist municipalities in managing through periods of severe fiscal stress. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments on a greater number of the Company s insured transactions. The Company monitors and analyzes these situations closely, however, the overall extent and duration of such events are uncertain and the filing for protection under the United States Bankruptcy Code or entering state statutory proceedings does not result in a default or indicate that an ultimate loss will occur. As of June 30, 2014 and December 31, 2013, the Company had $113.2 billion and $124.9 billion, respectively, of gross par outstanding on general obligations, of which $154 million and $161 million, respectively, were reflected on the Company s Classified List. Capital appreciation bonds are reported at the par amount at the time of issuance of the insurance policy.

Structured Finance and International

As of June 30, 2014, the majority of the structured finance and international insurance segment s case basis reserves and insurance loss recoveries recorded in accordance with GAAP were related to insured second and first-lien RMBS transactions. These reserves and recoveries do not include estimates for policies insuring credit derivatives or losses and recoveries on financial guarantee VIEs that are eliminated in consolidation. Policies insuring credit derivative contracts are accounted for as derivatives and carried at fair value under GAAP. The fair values of insured derivative contracts are influenced by a variety of market and transaction-specific factors that may be unrelated to potential future claim payments under the Company s insurance policies. In the absence of credit impairments on insured derivative contracts or the early termination of such contracts at a loss, the cumulative unrealized losses recorded from these contracts should reverse before or at the maturity of the contracts.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Notwithstanding the difference in accounting under GAAP for financial guarantee policies and the Company s insured derivatives, insured derivatives have similar terms, conditions, risks, and economic profiles to financial guarantee insurance policies, and therefore, are evaluated by the Company for loss (referred to as credit impairment herein) and 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 5.09%, the same rate it used to calculate its statutory loss reserves as of June 30, 2014. MBIA UK used a rate of 2.50% to discount its expected future claim payments and statutory loss reserves. These credit impairments, calculated in accordance with statutory accounting principles (U.S. STAT) differ from the fair values recorded in the Company s consolidated financial statements. The Company considers its credit impairment estimates as critical information for investors as it provides information about loss payments the Company expects to make on insured derivative contracts. As a result, the following loss and LAE process discussion includes information about loss and LAE activity recorded in accordance with GAAP for financial guarantee insurance policies and credit impairments estimated in accordance with U.S. STAT for insured derivative contracts. Refer to Note 6: Fair Value of Financial Instruments included herein for additional information about the Company s insured credit derivative contracts.

RMBS Case Basis Reserves and Recoveries (Financial Guarantees)

The Company s RMBS reserves and recoveries relate to financial guarantee insurance policies. The Company calculated RMBS case basis reserves as of June 30, 2014 for both second and first-lien RMBS transactions using a process called the Roll Rate Methodology. The Roll Rate Methodology is a multi-step process using a database of loan level information, a proprietary internal cash flow model, and a commercially available model to estimate losses on insured bonds. Roll Rate is defined as the probability that current loans become delinquent and that loans in the delinquent pipeline are charged-off or liquidated. Generally, Roll Rates are calculated for the previous three months and averaged. The loss reserve estimates are based on a probability-weighted average of three scenarios of loan losses (base case, stress case, and an additional stress case).

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

<u>Second-lien RMBS Reserves</u>

The Company s second-lien RMBS case basis reserves as of June 30, 2014 relate to RMBS backed by home equity lines of credit (HELOC) and closed-end second mortgages (CES).

The Roll Rates for 30-59 day delinquent loans and 60-89 day delinquent loans are calculated on a transaction-specific basis. The Company assumes that the Roll Rate for 90+ day delinquent loans, excluding foreclosures and Real Estate Owned (REO) is 95%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of May 31, 2014 to estimate future losses from loans that are delinquent as of the current reporting period.

Roll Rates for loans that are current as of May 31, 2014 (Current Roll to Loss) are also calculated on a transaction-specific basis. A proportion of loans reported current as of May 31, 2014 is assumed to become delinquent every month, at a Current Roll to Loss rate that persists at a high level for a time and subsequently starts to decline. A key assumption in the model is the period of time in which the Company projects high levels of Current Roll to Loss to persist. The Company runs multiple scenarios, each with varying periods of time, for which the high levels of Current Roll to Loss rates persist. Loss reserves are calculated by using a weighted average of these scenarios, with the majority of the probability assigned to stressful scenarios where the high levels of Current Roll to Loss rates persist for six or twenty four months before reverting to historic levels. For example, in the base case scenario, the Company assumes that the Current Roll to Loss begins to decline immediately and continues to decline over the next six months to 25% of their levels as of May 31, 2014. If the amount of current loans which become 30-59 days delinquent is 10%, and recent performance suggests that 30% of those loans will be charged-off, the Current Roll to Loss for the transaction is 3%. In the base case, the Current Roll to Loss will then reduce linearly to 25% of its original value over the next six months (i.e., 3% will linearly reduce to 0.75% over the six months from June 2014 to November 2014). After that six-month period, the Company further reduces the Current Roll to Loss to 0% by early 2015 with the expectation that the performing seasoned loans will eventually result in loan performance reverting to lower levels of default consistent with history. In developing multiple loss scenarios, stress is applied by elongating the Current Roll to Loss rate for various periods, simulating a slower improvement in the transaction performance.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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

As of June 30, 2014 and December 31, 2013, the Company established loss and LAE reserves totaling $118 million and $126 million, respectively, related to second-lien RMBS issues after the elimination of $18 million and $43 million, respectively, as a result of consolidating VIEs. For the six months ended June 30, 2014, the Company incurred $72 million of losses and LAE recorded in earnings related to second-lien RMBS issues after the elimination of a $1 million benefit as a result of consolidating VIEs.

The Company monitors portfolio performance on a monthly basis against projected performance, reviewing delinquencies, Roll Rates, and prepayment rates (including voluntary and involuntary). However, loan performance remains difficult to predict and losses may exceed expectations. In the event of a material deviation in actual performance from projected performance, the Company would increase or decrease the case basis reserves accordingly. If actual performance were to remain at the peak levels for six additional months compared to the probability-weighted outcome currently used by the Company, the addition to the case basis reserves would be approximately $60 million.

Second-lien RMBS Recoveries

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

Excess Spread

As of June 30, 2014 and December 31, 2013, the Company recorded estimated recoveries of $577 million and $681 million, respectively, for the reimbursement of past and future expected claims through excess spread in insured second-lien RMBS transactions after the elimination of $173 million and $190 million, respectively, as a result of consolidating VIEs. As of June 30, 2014, $569 million and $8 million were included in Insurance loss recoverable and Loss and loss adjustment expense reserves on the Company s consolidated balance sheets, respectively, after the elimination of $168 million and $5 million, respectively, as a result of consolidating VIEs. As of December 31, 2013, $647 million and $34 million were included in Insurance loss recoverable and Loss and loss adjustment expense reserves on the Company s consolidated balance sheets, respectively, after the elimination of $183 million and $7 million, respectively, as a result of consolidating VIEs.

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

Ineligible Mortgage Loans

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

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

As of June 30, 2014 and December 31, 2013, the Company recorded estimated recoveries of $363 million and $359 million, respectively, related to second-lien RMBS put-back claims on ineligible mortgage loans, reflected in Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company s consolidated balance sheets.

The Company believes that it will prevail in enforcing its contractual put-back rights against Credit Suisse. Based on the Company s assessment of the strength of these claims, the Company believes it is entitled to collect the full amount of its incurred losses, which totaled $424 million through June 30, 2014. The Company is entitled to collect interest on amounts paid. However, uncertainty remains with respect to the ultimate outcome of the litigation with Credit Suisse, which is contemplated in the scenario based-modeling the Company uses. The Credit Suisse recovery scenarios are based on the amount of incurred losses measured against certain probabilities of ultimate resolution of the dispute with Credit Suisse over the inclusion of ineligible mortgage loans in the HEMT securitization. Most of the probability weight is assigned to partial recovery scenarios and are discounted using the current risk-free discount rates associated with the underlying transaction s cash flows.

The Company frequently reviews the approach and assumptions it applies to calculate put-back recoveries. Refer to Note 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, 2013, for the Company s assessment of the remaining unsettled recoveries related to insured Credit Suisse second-lien RMBS.

First-lien RMBS Reserves

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

The Company estimates future losses by using three different probability-weighted scenarios: base; stress; and additional stress. The three scenarios differ in the Roll Rates to loss of 90+ day delinquent loans. In the base scenario, the Company uses deal-specific Roll Rates obtained from historic loan level Roll Rate data for 90+ day delinquent loans. In the stress scenario, the Company assumes a 90% Roll Rate for all 90+ day delinquent loans. In the additional stress scenario, the Roll Rates for each deal are an average of the deal-specific Roll Rate used in the base scenario and the 90% rate. The Roll Rates are applied to the amounts in each deal s respective 90+ delinquency bucket based on delinquencies as of May 31, 2014 in order to estimate future losses from loans that are delinquent as of June 30, 2014.

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

As of June 30, 2014, the Company established loss and LAE reserves totaling $237 million related to first-lien RMBS issues. As of December 31, 2013, the Company established loss and LAE reserves totaling $241 million related to first-lien RMBS issues after the elimination of $2 million as a result of consolidating VIEs. For the six months ended June 30, 2014, the Company incurred $27 million of losses and LAE recorded in earnings related to first-lien RMBS issues after the elimination of a $1 million benefit as a result of consolidating VIEs.

ABS CDOs (Financial Guarantees and Insured Derivatives)

MBIA s insured asset-backed securities (ABS) CDOs are transactions that include a variety of collateral ranging from corporate bonds to structured finance assets (which includes but are not limited to RMBS related collateral, ABS CDOs, corporate CDOs and collateralized loan obligations). These transactions were insured as either financial guarantee insurance policies or credit derivatives with the majority currently insured in the form of financial guarantees. Since the fourth quarter of 2007, MBIA s insured par exposure within the ABS CDO portfolio has been substantially reduced through a combination of terminations and commutations. Accordingly, as of June 30, 2014, the insured par exposure of the ABS CDO financial guarantee insurance policies and credit derivatives portfolio has declined by approximately 97% of the insured amount as of December 31, 2007.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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

As of June 30, 2014 and December 31, 2013, the Company established loss and LAE reserves totaling $92 million and $115 million, respectively, related to ABS CDO financial guarantee insurance policies after the elimination of $235 million and $226 million, respectively, as a result of consolidating VIEs. For the six months ended June 30, 2014, the Company had a benefit of $17 million of losses and LAE recorded in earnings related to ABS CDO financial guarantee insurance policies after the elimination of a $9 million expense as a result of consolidating VIEs. In the event of further deteriorating performance of the collateral referenced or held in ABS CDO transactions, the amount of losses estimated by the Company could increase substantially.

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

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

The Company considers several factors when developing the range of potential outcomes in the CRE market and their impact on MBIA. The following approaches require substantial judgments about the future performance of the underlying loans:

1. Each transaction is evaluated for its commutation potential, which is customized by counterparty and considers historical commutation prices, the level of dialogue with the counterparty and the credit quality and payment profile of the underlying exposure.

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

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

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

For the six months ended June 30, 2014, additional credit impairments and LAE for insured derivatives on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be $82 million as a result of additional delinquencies and loan level liquidations, as well as MBIA s continued assessment of various commutation possibilities. Since 2013, the Company has been paying claims on a CMBS pool transaction that had experienced deterioration such that all remaining deductible was eliminated.

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 and Non-Consolidated VIEs)

The Company s financial guarantee insurance losses and LAE for the six months ended June 30, 2014 are presented in the following table:

	Six Months Ended June 30, 2014			
In millions	**Second-lien RMBS**	**First-lien RMBS**	**Other[1]**	**Total**
Losses and LAE related to expected payments	$ 19	$ 33	$ (50)	$ 2
Recoveries of expected payments	53	(6)	13	60
Gross losses incurred	72	27	(37)	62
Reinsurance	-	-	-	-
Losses and LAE	$ 72	$ 27	$ (37)	$ 62

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

The losses and LAE related to expected payments in the preceding table primarily related to increases in previously established reserves on insured first and second-lien RMBS transactions, partially offset by a decrease in previously established reserves on an international road transaction and ABS CDOs. The recoveries of expected payments primarily related to decreases in projected collections from excess spread within the insured second-lien RMBS securitizations.

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of June 30, 2014:

	Surveillance Categories				
$ in millions	**Caution List Low**	**Caution List Medium**	**Caution List High**	**Classified List**	**Total**
Number of policies	81	110	5	201	397
Number of issues[1]	24	12	4	131	171
Remaining weighted average contract period (in years)	10.9	10.9	8.3	8.8	9.7
Gross insured contractual payments outstanding:[2]					
Principal	$ 5,025	$ 1,869	$ 43	$ 8,658	$ 15,595
Interest	3,642	1,018	21	4,592	9,273

Total	$ 8,667	$ 2,887	$ 64	$ 13,250	$ 24,868
Gross Claim Liability	$ -	$ -	$ -	$ 984	$ 984
Less:					
Gross Potential Recoveries	-	-	-	950	950
Discount, net[(3)]	-	-	-	122	122
Net claim liability (recoverable)	$ -	$ -	$ -	$ (88)	$ (88)
Unearned premium revenue	$ 99	$ 35	$ -	$ 104	$ 238

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

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

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

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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, 2013:

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

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

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

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

The gross claim liability in the preceding tables represents the Company s estimate of undiscounted probability-weighted future claim payments. As of June 30, 2014 and December 31, 2013, the gross claim liability primarily related to insured first and second-lien RMBS issues, ABS CDOs and an international road transaction.

The gross potential recoveries represent the Company s estimate of undiscounted probability-weighted recoveries of actual claim payments and recoveries of estimated future claim payments. As of June 30, 2014 and December 31, 2013, the gross potential recoveries principally related to insured second-lien RMBS and U.S. public finance issues. The Company s recoveries have been, and remain based on either salvage rights, the rights conferred to MBIA through the transactional documents (inclusive of the insurance agreement), or subrogation rights embedded within financial guarantee insurance policies. Expected salvage and subrogation recoveries, as well as recoveries from other remediation efforts, reduce the Company s claim liability. Once a claim payment has been made, the claim liability has been satisfied and MBIA s right to recovery is no longer considered an offset to future expected claim payments, it is recorded as a salvage asset. The amount of recoveries recorded by the Company is limited to paid claims plus the present value of projected future claim payments. As claim payments are made, the recorded amount of potential recoveries may exceed the remaining amount of the claim liability for a given policy. The gross claim liability and gross potential recoveries reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by the Company.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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 June 30, 2014 and December 31, 2013 for insured obligations within MBIA s Classified List. The loss reserves (claim liability) and insurance claim loss recoverable included in the following table represent the present value of the probability-weighted future claim payments and recoveries reported in the preceding tables.

In millions	As of June 30, 2014	As of December 31, 2013
Loss reserves (claim liability)	$ 482	$ 580
LAE reserves	72	61
Loss and LAE reserves	$ 554	$ 641
Insurance claim loss recoverable	$ (619)	$ (694)
LAE insurance loss recoverable	(5)	-
Insurance loss recoverable	$ (624)	$ (694)
Reinsurance recoverable on unpaid losses	$ 6	$ 7
Reinsurance recoverable on unpaid LAE reserves	1	1
Reinsurance recoverable on paid and unpaid losses	$ 7	$ 8

As of June 30, 2014, loss and LAE reserves include $713 million of reserves for expected future payments offset by expected recoveries of such future payments of $159 million. As of December 31, 2013, loss and LAE reserves included $847 million of reserves for expected future payments offset by expected recoveries of such future payments of $206 million. As of June 30, 2014 and December 31, 2013, the insurance loss recoverable primarily related to expected future recoveries on second-lien RMBS transactions resulting from excess spread generated by performing loans in such transactions.

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

The following table presents the amounts of the Company s second-lien RMBS exposure, gross undiscounted claim liability and potential recoveries related to non-consolidated VIEs and consolidated VIEs, included in the Company s Classified List, as of June 30, 2014:

Second-lien RMBS Exposure $ in billions	Issues	Outstanding	Gross Undiscounted

		Gross Principal	Gross Interest	Claim Liability	Potential Recoveries
Non-consolidated VIEs	24	$ 3.2	$ 1.1	$ 0.1	$ 0.6
Consolidated VIEs	11	$ 1.6	$ 0.6	$ -	$ 0.6

The following table presents changes in the Company s loss and LAE reserves for the six months ended June 30, 2014. Changes in the loss and LAE reserves attributable to the accretion of the claim liability discount, changes in discount rates, changes in amount and timing of estimated payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations. As of June 30, 2014, the weighted average risk-free rate used to discount the Company s loss reserves (claim liability) was 2.01%. 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 Six Months Ended June 30, 2014**

Gross Loss and LAE Reserves as of December 31, 2013	Loss Payments for Cases with Reserves	Accretion of Claim Liability Discount	Changes in Discount Rates	Changes in Assumptions	Changes in Unearned Premium Revenue	Changes in LAE Reserves	Other[1]	Gross Loss and LAE Reserves as of June 30, 2014
$ 641	$ (108)	$ 8	$ 37	$ (37)	$ 10	$ 11	$ (8)	$ 554

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

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

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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 tables present changes in the Company s insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company s claim liability for the six months ended June 30, 2014. Changes in insurance loss recoverable attributable to the accretion of the discount on the recoverable, changes in discount rates, changes in amount and timing of estimated collections, changes in assumptions and changes in LAE recoveries are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations.

Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses for the Six Months Ended June 30, 2014

In millions	As of December 31, 2013	Collections for Cases with Recoveries	Accretion of Recoveries	Changes in Discount Rates	Changes in Assumptions	Changes in LAE Recoveries	Other(1)	As of June 30, 2014
Insurance loss recoverable	$ 694	$ (55)	$ 7	$ 10	$ (45)	$ 5	$ 8	$ 624
Recoveries on unpaid losses	206	-	2	11	(60)	-	-	159
Total	$ 900	$ (55)	$ 9	$ 21	$ (105)	$ 5	$ 8	$ 783

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

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

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

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

In millions	Six Months Ended June 30, 2014	2013
Loss adjustment expense incurred, gross	$ 34	$ 33

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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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

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

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

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

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

Financial Assets (excluding derivative assets)

Financial assets, excluding derivative assets, held by the Company primarily consist of investments in debt securities. Substantially all of the Company s investments are priced by independent third parties, including pricing services and brokers. Typically, the Company receives one pricing service value or broker quote for each instrument, which represents a non-binding indication of value. The Company reviews the assumptions, inputs and methodologies used by pricing services and brokers to obtain reasonable assurance that the prices used in its valuations reflect fair value. When the Company believes a third-party quotation differs significantly from its internally developed expectation of fair value, whether higher or lower, the Company reviews its data or assumptions with the provider. This review includes comparing significant assumptions such as prepayment speeds, default ratios, forward yield curves, credit spreads and other significant quantitative inputs to internal assumptions, and working with the price provider to reconcile the differences. The price provider may subsequently provide an updated price. In the event that the price provider does not update its price, and the Company still does not agree with the price provided, the Company will obtain a price from another third-party provider, such as a broker, or use an internally developed price which it believes represents the fair value of the investment. The fair values of investments for which internal prices were used were not significant to the aggregate fair value of the Company s investment portfolio as of June 30, 2014 or December 31, 2013. All challenges to third-party prices are reviewed by staff of the Company with relevant expertise to ensure reasonableness of assumptions.

Financial Liabilities (excluding derivative liabilities)

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Derivative Liabilities

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

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

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

Internal Review Process

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

Valuation Techniques

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

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

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

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

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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

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

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

Loans Receivable at Fair Value

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

Loan Repurchase Commitments

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

- 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 timing and amount of 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 certain 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 these 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 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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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.

Variable Interest Entity Derivatives

The VIEs have entered into derivative transactions consisting of cross currency swaps and interest rate caps. Fair values of over-the-counter (OTC) derivatives are determined using valuation models based on observable and/or unobservable inputs. These observable and market-based inputs include interest rates 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.

Long-term Debt

Long-term debt consists of notes, debentures, surplus notes and accrued interest on this debt. 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 of the accrued interest expense on the surplus notes due 2033 is determined based on the scheduled interest payments discounted by the market s perception of the credit risk related to the repayment of the surplus notes. The credit risk related to the repayment of the surplus notes is based on recent trades of the surplus notes. The deferred interest payment will be due on the first business day on or after which the Company obtains approval to make such payment.

The carrying amounts of accrued interest expense on all other long-term debt approximate fair value due to the short-term nature of these instruments. Long-term debt is categorized as Level 2 of the fair value hierarchy.

Derivatives Asset/Liability Products

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

The Company has policies and procedures in place regarding counterparties, including review and approval of the counterparty and the Company s exposure limit, collateral posting requirements, collateral monitoring and margin calls on collateral. The Company manages counterparty credit risk on an individual counterparty basis through master netting arrangements covering derivative transactions in the asset/liability products segment as of June 30, 2014. 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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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. The valuation models are consistently applied from period to period, with refinements to the fair value estimation approach being applied as and when the information becomes available. Negotiated settlements are also considered when determining fair value to provide the best estimate of how another market participant would evaluate fair value.

Approximately 93% of the balance sheet fair value of insured credit derivatives as of June 30, 2014 was valued based on the Binomial Expansion Technique (BET) Model. Approximately 7% of the balance sheet fair value of insured credit derivatives as of June 30, 2014 was valued based on the internally developed Direct Price Model and the Dual Default model. The valuation of insured derivatives includes the impact of its 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.

The Company has also entered into a derivative contract as a result of a commutation. The fair value of the derivative is determined using a discounted cash flow model. Key inputs include unobservable cash flows projected over the expected term of the derivative, discounted using observable discount rates and CDS spreads.

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.

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.

Additional structural assumptions of the BET Model are:

Default probabilities are determined by three factors: MBIA Corp. s credit spread, MBIA Corp. s 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; and

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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

2. BET Model Inputs

a. Credit spreads

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

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

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; and
- 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 June 30, 2014, sector-specific spreads were used in 6% of the transactions valued using the BET Model. Corporate spreads were used in 50% of the transactions and spreads benchmarked from the most relevant spread source were used for 44% 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 spreads, corporate spreads and some benchmarked spreads are based on WARF. WARF-sourced and/or ratings-sourced credit spreads were used for 72% of the transactions.

Over time, the data inputs change as new sources become available, existing sources are discontinued or are no longer considered to be reliable or the most appropriate. It is always the Company s objective to use more observable spread inputs 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.

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 MBIA Corp. 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 Corp. s CDS spreads as of June 30, 2014. 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 MBIA Corp. s recovery derivative price multiplied by the unadjusted derivative liability.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Overall Model Results

As of June 30, 2014 and December 31, 2013, the Company s net insured CDS derivative liability was $332 million and $1.2 billion, respectively, based on the results of the aforementioned models. A significant driver of changes in fair value is MBIA Corp. s nonperformance risk. In aggregate, the nonperformance calculation resulted in a pre-tax net insured derivative liability that was $84 million and $394 million lower than the net liability that would have been estimated if MBIA Corp. excluded nonperformance risk in its valuation as of June 30, 2014 and December 31, 2013, respectively. Nonperformance risk is a fair value concept and does not contradict MBIA Corp. s internal view, based on fundamental credit analysis of MBIA Corp. s economic condition, that MBIA Corp. will be able to pay all claims when due.

Warrants

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

Financial Guarantees

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 bond 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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Significant Unobservable Inputs

The following tables provide 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 June 30, 2014 and December 31, 2013. These tables exclude 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 June 30, 2014	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	$ 1,539	Market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee	0% - 9% (2%)
Loan repurchase commitments	363	Discounted cash flow	Recovery rates[1]	
			Breach rates[1]	
Liabilities of consolidated VIEs:				
Variable interest entity notes	802	Market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 32% (14%)
Credit derivative liabilities, net:				
CMBS	277	BET Model	Recovery rates	25% - 90% (74%)
			Nonperformance risk	4% - 19% (17%)
			Weighted average life (in years)	0.7 - 3.1 (2.7)
			CMBS spreads	0% - 35% (10%)
Multi-sector CDO	12	Direct Price Model	Nonperformance risk	54% - 54% (54%)
Other	43	BET Model and Dual Default	Recovery rates	42% - 45% (45%)
			Nonperformance risk	7% - 46% (22%)
			Weighted average life (in years)	0.7 - 8.3 (2.0)
Other derivative liabilities	33	Discounted cash flow	Cash flows	$ 0 - $83 ($42)[2]

(1) - Recovery rates and breach rates include estimates about potential variations in the outcome of litigation with a counterparty.

(2) - Midpoint of cash flows are used for the weighted average.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

In millions	Fair Value as of December 31, 2013	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	$ 1,612	Market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee	0% - 17% (3%)
Loan repurchase commitments	359	Discounted cash flow	Recovery rates(1)	
			Breach rates(1)	
Liabilities of consolidated VIEs:				
Variable interest entity notes	940	Market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 25% (12%)
Credit derivative liabilities, net:				
CMBS	1,050	BET Model	Recovery rates	25% - 90% (60%)
			Nonperformance risk	8% - 57% (25%)
			Weighted average life (in years)	1.1 - 28.0 (3.3)
			CMBS spreads	1% - 29% (13%)
Multi-sector CDO	12	Direct Price Model	Nonperformance risk	57% - 57% (57%)
Other	85	BET Model and Dual Default	Recovery rates	42% - 90% (45%)
			Nonperformance risk	13% - 54% (25%)
			Weighted average life (in years)	0.2 - 8.7 (2.3)

(1) - Recovery rates and breach rates include estimates about potential variations in the outcome of litigation with a counterparty.

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 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/servicers. 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 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.

The significant unobservable input used in the fair value measurement of the Company s VIE 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.

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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 inputs used in the fair value measurement of MBIA Corp. 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 MBIA Corp. s own ability to pay and whether MBIA Corp. 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 would result in an increase or decrease in the fair value of the derivative liability, respectively. A significant increase in weighted average life can result in an increase or decrease in the fair value of the derivative liability, depending on the discount rate and the timing of significant losses. Any significant increase or decrease in recovery rates, or MBIA Corp. 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 MBIA Corp. s multi-sector CDO credit derivatives, which are valued using the Direct Price Model, is nonperformance risk. The nonperformance risk is an assumption of MBIA Corp. s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Any significant increase or decrease in MBIA Corp. 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 MBIA Corp. s other credit derivatives, which are valued using the BET Model and Dual Default, 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 MBIA Corp. s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Weighted average life is based on MBIA Corp. s estimate of when the principal of the underlying collateral will be repaid. A significant increase in weighted average life can result in an increase or decrease in the fair value of the derivative liability, depending on the discount rate and the timing of significant losses. Any significant increase or decrease in recovery rates or MBIA Corp. 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.

The significant unobservable input used in the fair value measurement of MBIA Corp. s other derivatives, which are valued using a discounted cash flow model, is the estimates of future cash flows discounted using market rates and CDS spreads. Any significant increase or decrease in future cash flows would result in an increase or decrease in the fair value of the derivative liability, respectively.

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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 June 30, 2014 and December 31, 2013:

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of June 30, 2014**
Assets:					
Fixed-maturity investments:					
U.S. Treasury and government agency	$ 486	$ 114	$ -	$ -	$ 600
State and municipal bonds	-	1,682	57(1)	-	1,739
Foreign governments	225	83	5(1)	-	313
Corporate obligations	-	2,373	34(1)	-	2,407
Mortgage-backed securities:					
Residential mortgage-backed agency	-	1,184	8(1)	-	1,192
Residential mortgage-backed non-agency	-	59	-	-	59
Commercial mortgage-backed	-	30	1(1)	-	31
Asset-backed securities:					
Collateralized debt obligations	-	11	95(1)	-	106
Other asset-backed	-	168	82(1)	-	250
Total fixed-maturity investments	711	5,704	282	-	6,697
Money market securities	392	-	-	-	392
Perpetual debt and equity securities	27	28	13(1)	-	68
Cash and cash equivalents	534	-	-	-	534
Derivative assets:					
Non-insured derivative assets:					
Interest rate derivatives	-	66	-	(62)	4

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of June 30, 2014**
Assets of consolidated VIEs:					
Corporate obligations	-	24	62[1]	-	86
Mortgage-backed securities:					
Residential mortgage-backed non-agency	-	205	4[1]	-	209
Commercial mortgage-backed	-	91	-	-	91
Asset-backed securities:					
Collateralized debt obligations	-	10	6[1]	-	16
Other asset-backed	-	46	26[1]	-	72
Cash	66	-	-	-	66
Loans receivable	-	-	1,539	-	1,539
Loan repurchase commitments	-	-	363	-	363
Total assets	$ 1,730	$ 6,174	$ 2,295	$ (62)	$ 10,137
Liabilities:					
Medium-term notes	$ -	$ -	$ 217[1]	$ -	$ 217
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	3	332	-	335
Non-insured derivatives:					
Interest rate derivatives	-	208	-	(127)	81
Other	-	-	33	-	33
Other liabilities:					
Warrants	-	42	-	-	42
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,348	802	-	2,150
Derivative liabilities:					
Currency derivatives	-	-	11[1]	-	11
Total liabilities	$ -	$ 1,601	$ 1,395	$ (127)	$ 2,869

(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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of December 31, 2013**
Assets:					
Fixed-maturity investments:					
U.S. Treasury and government agency	$ 397	$ 156	$ -	$ -	$ 553
State and municipal bonds	-	1,765	19[(1)]	-	1,784
Foreign governments	112	65	12[(1)]	-	189
Corporate obligations	-	1,776	48[(1)]	-	1,824
Mortgage-backed securities:					
Residential mortgage-backed agency	-	1,173	-	-	1,173
Residential mortgage-backed non-agency	-	86	6[(1)]	-	92
Commercial mortgage-backed	-	25	14[(1)]	-	39
Asset-backed securities:					
Collateralized debt obligations	-	72	82[(1)]	-	154
Other asset-backed	-	130	58[(1)]	-	188
Total fixed-maturity investments	509	5,248	239	-	5,996
Money market securities	783	-	-	-	783
Perpetual debt and equity securities	27	13	11[(1)]	-	51
Cash and cash equivalents	1,161	-	-	-	1,161
Derivative assets:					
Non-insured derivative assets:					
Interest rate derivatives	-	46	-	(42)	4

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 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of December 31, 2013
Assets of consolidated VIEs:					
Corporate obligations	-	41	48(1)	-	89
Mortgage-backed securities:					
Residential mortgage-backed non-agency	-	255	4(1)	-	259
Commercial mortgage-backed	-	102	3(1)	-	105
Asset-backed securities:					
Collateralized debt obligations	-	14	22(1)	-	36
Other asset-backed	-	44	54(1)	-	98
Money market securities	136	-	-	-	136
Cash	97	-	-	-	97
Loans receivable	-	-	1,612	-	1,612
Loan repurchase commitments	-	-	359	-	359
Total assets	$ 2,713	$ 5,763	$ 2,352	$ (42)	$ 10,786
Liabilities:					
Medium-term notes	$ -	$ -	$ 203(1)	$ -	$ 203
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	5	1,147	-	1,152
Non-insured derivatives:					
Interest rate derivatives	-	165	-	(165)	-
Other liabilities:					
Warrants	-	59	-	-	59
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,416	940	-	2,356
Derivative liabilities:					
Currency derivatives	-	-	11(1)	-	11
Total liabilities	$ -	$ 1,645	$ 2,301	$ (165)	$ 3,781

(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.

Level 3 assets at fair value as of June 30, 2014 and December 31, 2013 represented approximately 23% and 22%, respectively, of total assets measured at fair value. Level 3 liabilities at fair value as of June 30, 2014 and December 31, 2013 represented approximately 49% and 61%, respectively, of total liabilities measured at fair value.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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 June 30, 2014 and December 31, 2013:

In millions	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Balance as of June 30, 2014	Carry Value Balance as of June 30, 2014
Assets:					
Other investments	$ -	$ -	$ 4	$ 4	$ 4
Accrued investment income[(1)]	-	51	-	51	51
Receivable for investments sold[(1)]	-	75	-	75	75
Assets of consolidated VIEs:					
Investments held-to-maturity	-	-	2,780	2,780	2,787
Total assets	$ -	$ 126	$ 2,784	$ 2,910	$ 2,917
Liabilities:					
Investment agreements	$ -	$ -	$ 801	$ 801	$ 660
Medium-term notes	-	-	832	832	1,069
Long-term debt	-	1,516	-	1,516	1,755
Payable for investments purchased[(2)]	-	34	-	34	34
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	-	2,780	2,780	2,787
Total liabilities	$ -	$ 1,550	$ 4,413	$ 5,963	$ 6,305
Financial Guarantees:					
Gross	$ -	$ -	$ 4,487	$ 4,487	$ 2,181
Ceded	-	-	116	116	72

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

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

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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: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Balance as of December 31, 2013	Carry Value Balance as of December 31, 2013
Assets:					
Other investments	$ -	$ -	$ 4	$ 4	$ 5
Accrued investment income[1]	-	52	-	52	52
Receivable for investments sold[1]	-	22	-	22	22
Net cash collateral pledged[1]	24	-	-	24	24
Assets of consolidated VIEs:					
Investments held-to-maturity	-	-	2,651	2,651	2,801
Total assets	$ 24	$ 74	$ 2,655	$ 2,753	$ 2,904
Liabilities:					
Investment agreements	$ -	$ -	$ 814	$ 814	$ 700
Medium-term notes	-	-	927	927	1,224
Long-term debt	-	1,412	-	1,412	1,702
Payable for investments purchased[2]	-	31	-	31	31
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	-	2,751	2,751	2,930
Total liabilities	$ -	$ 1,443	$ 4,492	$ 5,935	$ 6,587
Financial Guarantees:					
Gross	$ -	$ -	$ 2,843	$ 2,843	$ 2,388
Ceded	-	-	71	71	76

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

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

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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 June 30, 2014 and 2013:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended June 30, 2014

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(1)	Transfers out of Level 3(1)	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of June 30, 2014
Assets:													
Foreign governments	$ 7	$ -	$ -	$ -	$ -	$ -	$ -	$ (4)	$ -	$ 2	$ -	$ 5	$ -
Corporate obligations	30	4	2	(3)	-	6	-	-	(4)	-	(1)	34	2
Residential mortgage-backed agency	29	-	-	-	-	-	-	-	-	8	(29)	8	-
Commercial mortgage-backed	14	-	-	-	-	-	-	(12)	-	-	(1)	1	-
Collateralized debt obligations	115	(2)	1	24	-	-	-	(3)	(41)	2	(1)	95	-
Other asset-backed	85	-	-	3	-	11	-	(2)	(1)	6	(20)	82	-
State and municipal bonds	62	-	-	1	-	-	-	-	(4)	-	(2)	57	-
Perpetual debt and equity securities	15	-	2	-	-	-	-	-	-	-	(4)	13	2
Assets of consolidated VIEs:													

Corporate obligations	64	-	-	-	-	-	-	(2)	-	-	-	62	-
Residential mortgage- backed non-agency	5	-	(1)	-	-	-	-	(1)	-	1	-	4	-
Commercial mortgage-backed	3	-	(3)	-	-	-	-	-	-	-	-	-	-
Collateralized debt obligations	14	-	(7)	-	-	-	-	(2)	-	1	-	6	-
Other asset-backed	42	-	(4)	-	-	-	-	(2)	-	-	(10)	26	-
Loans receivable	1,557	-	37	-	-	-	-	(55)	-	-	-	1,539	37
Loan repurchase commitments	364	-	(1)	-	-	-	-	-	-	-	-	363	(1)
Total assets	$ 2,406	$ 2	$ 26	$ 25	$ -	$ 17	$ -	$ (83)	$ (50)	$ 20	$ (68)	$ 2,295	$ 40

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(1)	Transfers out of Level 3(1)	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of June 30, 2014
Liabilities:													
Medium-term notes	$ 215	$ -	$ 3	$ -	$ (1)	$ -	$ -	$ -	$ -	$ -	$ -	$ 217	$ 2
Credit derivatives, net	309	23	23	-	-	-	-	(23)	-	-	-	332	24
Other derivatives	31	-	2	-	-	-	-	-	-	-	-	33	2
Liabilities of consolidated VIEs:													
VIE notes	812	-	18	-	-	-	3	(31)	-	-			