

MBIA INC
Form 10-Q
May 09, 2013
Table of Contents

United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2013

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)

Edgar Filing: MBIA INC - Form 10-Q

Connecticut
(State of incorporation)

06-1185706
(I.R.S. Employer

Identification No.)

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

10504
(Zip Code)

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check mark whether the Registrant is shell company (as defined in Rule 12b-2 of the Act). Yes No

As of May 2, 2013, 192,964,835 shares of Common Stock, par value \$1 per share, were outstanding.

Table of Contents

	PAGE
<u>PART I FINANCIAL INFORMATION</u>	
Item 1. Financial Statements MBIA Inc. and Subsidiaries (Unaudited)	
<u>Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012 (Unaudited)</u>	1
<u>Consolidated Statements of Operations for the three months ended March 31, 2013 and 2012 (Unaudited)</u>	2
<u>Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2013 and 2012 (Unaudited)</u>	3
<u>Consolidated Statement of Changes in Shareholders' Equity for the three months ended March 31, 2013 (Unaudited)</u>	4
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012 (Unaudited)</u>	5
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	68
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	116
Item 4. <u>Controls and Procedures</u>	119
<u>PART II OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	120
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	120
Item 5. <u>Other Information</u>	120
Item 6. <u>Exhibits</u>	121
<u>SIGNATURES</u>	122

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

(In millions except share and per share amounts)

	March 31, 2013	December 31, 2012
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$4,101 and \$4,347)	\$ 4,215	\$ 4,485
Fixed-maturity securities at fair value	243	244
Investments pledged as collateral, at fair value (amortized cost \$374 and \$489)	333	443
Short-term investments held as available-for-sale, at fair value (amortized cost \$859 and \$662)	866	669
Other investments (includes investments at fair value of \$13 and \$12)	22	21
Total investments	5,679	5,862
Cash and cash equivalents	862	814
Premiums receivable	1,161	1,228
Deferred acquisition costs	290	302
Insurance loss recoverable	3,877	3,648
Property and equipment, at cost (less accumulated depreciation of \$144 and \$146)	68	69
Deferred income taxes, net	1,146	1,199
Other assets	238	268
Assets of consolidated variable interest entities:		
Cash	72	176
Investments held-to-maturity, at amortized cost (fair value \$2,759 and \$2,674)	2,826	2,829
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$628 and \$637)	623	625
Fixed-maturity securities at fair value	1,753	1,735
Loans receivable at fair value	1,819	1,881
Loan repurchase commitments	1,176	1,086
Other assets	2	2
Total assets	\$ 21,592	\$ 21,724
Liabilities and Equity		
Liabilities:		
Unearned premium revenue	\$ 2,774	\$ 2,938
Loss and loss adjustment expense reserves	785	853
Investment agreements	915	944
Medium-term notes (includes financial instruments carried at fair value of \$181 and \$165)	1,577	1,598
Long-term debt	1,661	1,662
Derivative liabilities	3,006	2,934
Other liabilities	377	315
Liabilities of consolidated variable interest entities:		
Variable interest entity notes (includes financial instruments carried at fair value of \$3,578 and \$3,659)	7,039	7,124
Derivative liabilities	149	162
Total liabilities	18,283	18,530

Commitments and contingencies (See Note 13)

Equity:

Edgar Filing: MBIA INC - Form 10-Q

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 277,793,696 and 277,405,039	278	277
Additional paid-in capital	3,107	3,076
Retained earnings	2,203	2,039
Accumulated other comprehensive income (loss), net of tax of \$18 and \$21	9	56
Treasury stock, at cost 84,836,010 and 81,733,530 shares	(2,309)	(2,275)
Total shareholders' equity of MBIA Inc.	3,288	3,173
Preferred stock of subsidiary and noncontrolling interest	21	21
Total equity	3,309	3,194
Total liabilities and equity	\$ 21,592	\$ 21,724

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

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

(In millions except share and per share amounts)

	Three Months Ended March 31,	
	2013	2012
Revenues:		
Premiums earned:		
Scheduled premiums earned	\$ 79	\$ 96
Refunding premiums earned	41	41
Premiums earned (net of ceded premiums of \$2 and \$3)	120	137
Net investment income	38	62
Fees and reimbursements	6	7
Change in fair value of insured derivatives:		
Realized gains (losses) and other settlements on insured derivatives	12	(4)
Unrealized gains (losses) on insured derivatives	(73)	303
Net change in fair value of insured derivatives	(61)	299
Net gains (losses) on financial instruments at fair value and foreign exchange	63	(19)
Investment losses related to other-than-temporary impairments:		
Investment losses related to other-than-temporary impairments	-	(53)
Other-than-temporary impairments recognized in accumulated other comprehensive income (loss)	-	(41)
Net investment losses related to other-than-temporary impairments	-	(94)
Net gains (losses) on extinguishment of debt	4	-
Other net realized gains (losses)	-	1
Revenues of consolidated variable interest entities:		
Net investment income	16	17
Net gains (losses) on financial instruments at fair value and foreign exchange	33	(27)
Total revenues	219	383
Expenses:		
Losses and loss adjustment	(194)	97
Amortization of deferred acquisition costs	16	13
Operating	106	158
Interest	60	73
Expenses of consolidated variable interest entities:		
Operating	4	6
Interest	12	15
Total expenses	4	362
Income (loss) before income taxes	215	21
Provision (benefit) for income taxes	51	11
Net income (loss)	\$ 164	\$ 10
Net income (loss) per common share:		
Basic	\$ 0.84	\$ 0.05

Edgar Filing: MBIA INC - Form 10-Q

Diluted	\$	0.84	\$	0.05
Weighted average number of common shares outstanding:				
Basic		194,523,933		193,489,424
Diluted		195,631,960		194,594,974

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

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

(In millions)

	Three Months Ended March 31,	
	2013	2012
Net income (loss)	\$ 164	\$ 10
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities:		
Unrealized gains (losses) arising during the period	13	47
Provision (benefit) for income taxes	4	6
Total	9	41
Reclassification adjustments for (gains) losses included in net income (loss)	(25)	135
Provision (benefit) for income taxes	(9)	47
Total	(16)	88
Other-than-temporary impairments on available-for-sale securities:		
Other-than-temporary impairments arising during the period	5	11
Provision (benefit) for income taxes	2	4
Total	3	7
Reclassification adjustments for (gains) losses included in net income (loss)	-	41
Provision (benefit) for income taxes	-	15
Total	-	26
Net foreign currency translation gains (losses)	(43)	(12)
Total other comprehensive income (loss)	(47)	150
Comprehensive income (loss)	\$ 117	\$ 160

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

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

For The Three Months Ended March 31, 2013

(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, 2012	277,405,039	\$ 277	\$ 3,076	\$ 2,039	\$ 56	(81,733,530)	\$ (2,275)	\$ 3,173	1,315	\$ 21	\$ 3,194
Net income	-	-	-	164	-	-	-	164	-	-	164
Other comprehensive income (loss)	-	-	-	-	(47)	-	-	(47)	-	-	(47)
Share-based compensation net of tax of \$5	388,657	1	31	-	-	(3,102,480)	(34)	(2)	-	-	(2)
Balance, March 31, 2013	277,793,696	\$ 278	\$ 3,107	\$ 2,203	\$ 9	(84,836,010)	\$ (2,309)	\$ 3,288	1,315	\$ 21	\$ 3,309

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

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

(In millions)

	Three Months Ended March 31,	
	2013	2012
Cash flows from operating activities:		
Premiums, fees and reimbursements received	\$ 54	\$ 53
Investment income received	115	162
Insured derivative losses and commutations paid	-	(20)
Financial guarantee losses and loss adjustment expenses paid	(115)	(172)
Proceeds from reinsurance and recoveries	13	16
Operating and employee related expenses paid	(84)	(120)
Interest paid, net of interest converted to principal	(61)	(149)
Income taxes (paid) received	-	(3)
Net cash provided (used) by operating activities	(78)	(233)
Cash flows from investing activities:		
Purchase of fixed-maturity securities	(673)	(938)
Sale and redemption of fixed-maturity securities	1,062	1,440
Proceeds from paydowns on variable interest entity loans	69	60
Redemptions of held-to-maturity investments	4	750
Sale (purchase) of short-term investments, net	(130)	(115)
Sale (purchase) of other investments, net	(1)	65
(Payments) proceeds for derivative settlements	(31)	(51)
Collateral (to) from swap counterparty	23	-
Capital expenditures	-	(1)
Net cash provided (used) by investing activities	323	1,210
Cash flows from financing activities:		
Proceeds from investment agreements	8	16
Payments for drawdowns of investment agreements	(39)	(18)
Issuance of medium-term notes	-	8
Principal paydowns of medium-term notes	(23)	-
Principal paydowns of variable interest entity notes	(246)	(262)
Payments for securities sold under agreements to repurchase	-	(138)
Payments for retirement of debt	(1)	(361)
Net cash provided (used) by financing activities	(301)	(755)
Net increase (decrease) in cash and cash equivalents	(56)	222
Cash and cash equivalents beginning of period	990	633
Cash and cash equivalents end of period	\$ 934	\$ 855
Reconciliation of net income (loss) to net cash provided (used) by operating activities:		
Net income (loss)	\$ 164	\$ 10
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Change in:		

Edgar Filing: MBIA INC - Form 10-Q

Premiums receivable	44	37
Deferred acquisition costs	12	11
Unearned premium revenue	(130)	(149)
Loss and loss adjustment expense reserves	(68)	31
Insurance loss recoverable	(229)	(91)
Current income taxes	(1)	(24)
Net investment losses related to other-than-temporary impairments	-	94
Unrealized (gains) losses on insured derivatives	73	(303)
Net (gains) losses on financial instruments at fair value and foreign exchange	(96)	46
Deferred income tax provision (benefit)	53	32
(Gains) losses on extinguishment of debt	(4)	-
Other operating	104	73
Total adjustments to net income (loss)	(242)	(243)
Net cash provided (used) by operating activities	\$ (78)	\$ (233)

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Business Developments and Risks and Uncertainties

Summary

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

Business Developments

As a result of insured losses and realized investment losses during the period from 2007 through March 31, 2013, the Company has seen ratings downgrades, a near cessation of new insurance business, and increasing liquidity pressure. The Company has been unable to write meaningful amounts of new insurance business since 2008 and does not expect to write significant new insurance business prior to an upgrade of the credit ratings of National. As of March 31, 2013, National was rated BB with a developing outlook by Standard & Poor's Financial Services LLC (S&P) and Baa2 with a review for downgrade by Moody's Investors Service, Inc. (Moody's). In May of 2013, S&P upgraded National's rating to BBB with a credit watch positive outlook. In addition, in May of 2013, S&P upgraded MBIA Inc.'s rating to B- with a credit watch positive from B- with a negative outlook and upgraded MBIA Insurance Corporation's rating to B with a stable outlook from CCC with a negative outlook.

Bank of America Settlement

In May of 2013, MBIA Inc., together with its subsidiaries MBIA Corp. and National, entered into a comprehensive settlement agreement and related agreements (the BofA Settlement Agreement) with Bank of America Corporation and certain of its subsidiaries (collectively, Bank of America). Under the terms of the BofA Settlement Agreement, MBIA Corp. received a payment of approximately \$1.7 billion, consisting of \$1.6 billion in cash and \$136 million principal amount of MBIA Inc.'s 5.70% Senior Notes due 2034. In exchange for such payment, MBIA Corp. agreed to dismiss the litigation commenced in September 2008 against Countrywide Home Loans, Inc. (Countrywide), among other parties, and later amended to include claims against Bank of America, relating to breaches of representations and warranties on certain MBIA-insured securitizations sponsored by Countrywide. Bank of America and MBIA have also agreed to the commutation of all of the MBIA Corp. policies held by Bank of America, which have a notional insured amount of approximately \$7.4 billion, and of which \$6.1 billion are policies insuring credit default swaps (CDS) held by Bank of America referencing commercial real estate exposures. MBIA Corp. will have no further payment obligations under the commuted policies. The New York State Department of Financial Services (NYSDFS) advised MBIA Corp. that the NYSDFS did not object to the BofA Settlement Agreement.

Under the terms of the BofA Settlement Agreement, Bank of America received a five-year warrant to purchase 9.94 million shares of MBIA common stock at a price of \$9.59 per share. Bank of America has also agreed to dismiss the pending litigation between the parties concerning the restructuring transactions announced by MBIA on February 18, 2009 (the Transformation) and the pending litigation between the parties concerning the senior debt Consent Solicitation completed by MBIA in the fourth quarter of 2012. In addition, Bank of America agreed to withdraw the purported notice of default it sent in connection with such Consent Solicitation.

Under the terms of the BofA Settlement Agreement, the dismissals of the litigations referenced above are initially being filed on a without prejudice basis. The parties will refile such dismissals on a with prejudice basis provided that, within the one-year period following execution of the BofA Settlement Agreement, none of the claims released pursuant to the BofA Settlement Agreement are reinstated and neither party is required to make a payment on any such released claims. The Company views the likelihood of such an event as remote, and thus expects that the litigation dismissals will be filed on a with prejudice basis at the expiration of such one-year period.

Edgar Filing: MBIA INC - Form 10-Q

MBIA Corp. s policies insuring the residential mortgage-backed securities (RMBS) securitizations originated by Countrywide will continue to be in full force and effect, and MBIA Corp. will continue to make timely payments of principal and interest when due under such policies. Bank of America will have no further representation and warranty liability with respect to the origination of the mortgage loans in the MBIA-insured Countrywide and certain other securitizations.

In addition, MBIA Corp. has entered into a \$500 million three-year secured revolving credit agreement with Blue Ridge Investments, L.L.C., an affiliate of Bank of America (the BofA Secured Loan). Borrowings may be used for general corporate purposes and will be secured by a pledge of collateral consisting of the following: (i) MBIA Corp. s right to receive put-back recoveries related to ineligible mortgage loans included in its insured RMBS transactions; (ii) MBIA Corp. s future recoveries on defaulted insured RMBS transactions resulting from expected excess spread generated by performing loans in such transactions; (iii) MBIA Corp. s future installment premiums; and (iv) 65% of the voting capital stock in MBIA Corp. s wholly-owned subsidiary, MBIA UK (Holdings) Limited. The BofA Secured Loan includes a number of provisions that govern MBIA Corp. s ability to draw on the loan and use the proceeds from the borrowings, limit the amount MBIA Corp. can use to fund commutations without the consent of Bank of America, and require it to prepay borrowings. The loan also includes customary representations and warranties and customary affirmative, negative and financial covenants, including a requirement that MBIA Corp. maintain at least \$750 million of statutory capital (defined as policyholders surplus plus contingency reserves).

The payment from Bank of America, including the MBIA Inc. bonds, was used to repay the remaining outstanding balance and accrued interest on MBIA Corp. s secured loan from National (the National Secured Loan) in accordance with its terms. The National Secured Loan balance of \$1.7 billion as of March 31, 2013 was reduced to approximately \$1.6 billion prior to the Bank of America settlement as a result of the receipt of \$110 million in settlement of Flagstar Bank s put-back obligation.

The value of the settlement is consistent with amounts recorded on MBIA Corp. s statutory balance sheet as of December 31, 2012. MBIA Corp. s liquidity and capital risk profile has substantially improved as a result of the settlement. While the Company has updated its estimates to reflect the BofA Settlement Agreement in its financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as of and for the three months ended March 31, 2013, certain of the agreements will be accounted for in the second quarter of 2013 as of the settlement date.

Pursuant to the anti-dilution provisions of warrants that were issued by MBIA to Warburg Pincus Private Equity X, L.P. and certain of its affiliates (Warburg Pincus) pursuant to an Investment Agreement, dated as of December 10, 2007, as amended and restated as of February 6, 2008, by and between MBIA and Warburg Pincus, the strike price under such warrants will be decreased and the aggregate number of shares of MBIA common stock to be issued upon exercise of such warrants will be increased, in each case as a result of the issuance of the warrant to Bank of America. The adjustments to the strike price and number of such underlying shares are not expected to have a material dilutive effect on the MBIA common stock.

Societe Generale Settlement

In May of 2013, the Company entered into an agreement with Societe Generale pursuant to which MBIA commuted \$4.2 billion of gross insured exposure comprising asset-backed securities (ABS) collateralized debt obligations (CDOs), structured commercial mortgage-backed securities (CMBS) pools and commercial real estate (CRE) CDOs. The amount MBIA paid to Societe Generale in consideration of commuting its insured exposure was consistent with MBIA Corp. s aggregate statutory loss reserves for the exposures commuted. Also, pursuant to the agreement, Societe Generale agreed to dismiss the pending litigation between the parties concerning the Transformation, which includes any appeals of the decision denying the Article 78 petition and the plenary case.

Transformation Litigation Resolution

As a result of the Bank of America settlement and the Societe Generale settlement, all litigation brought originally by the group of eighteen domestic and international financial institutions, relating to the establishment of National, has been resolved.

Other

As of March 31, 2013, the liquidity position of MBIA, which consists of the liquidity positions of the Company s corporate segment and asset/liability products segment, was \$373 million compared with \$239 million as of December 31, 2012. During the three months ended March 31, 2013, \$115 million was released from an escrow account under the MBIA group s tax sharing agreement (the Tax Escrow Account), which resulted in an increase to MBIA s liquidity position. Management believes that MBIA can support its operating needs for the foreseeable future primarily from additional anticipated releases of assets from the Tax Escrow Account, which releases are subject to the risk of National incurring net tax losses in the future and declines in the value of the assets held in the Tax Escrow Account.

MBIA Corp. continues to seek to reduce both the absolute amount and the volatility of its obligations and potential future claim payments through the execution of commutations of insurance policies. The combination of the failure of certain mortgage originators to honor contractual obligations to repurchase ineligible mortgage loans from securitizations the Company insured, commutation payments to reduce liabilities and

Edgar Filing: MBIA INC - Form 10-Q

claim payments have placed liquidity pressure on MBIA Corp. The failure of certain mortgage originators to repurchase ineligible mortgages from securitizations the Company insured represents significant breaches of their contractual obligations. As of March 31, 2013 and December 31, 2012, MBIA Corp. s cash and liquid assets were \$258 million and \$345 million, respectively. The Company believes MBIA Corp. s current liquidity position, together with future cash inflows and amounts available under a lending facility, is adequate to make expected future claim payments.

During the three months ended March 31, 2013, MBIA Corp. made \$139 million in gross claim payments, and commuted \$2.1 billion of gross insured exposure, primarily comprising investment grade corporate CDOs. Subsequent to March 31, 2013, MBIA Corp. agreed to commute an additional \$13.4 billion of gross insured exposure, primarily comprising structured CMBS pools, first-lien subprime RMBS, high yield corporate CDOs, CRE CDOs, structured insurance securities, ABS CDOs and first-lien alternative-A RMBS, including the aggregate notional amount of \$7.4 billion described above in the Bank of America Settlement discussion and the aggregate notional amount of \$4.2 billion described above in the Societe Generale Settlement discussion.

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

The reference herein to ineligible mortgage loans refers to those mortgage loans that the Company believes failed to comply with the representations and warranties made by the sellers/servicers of the securitizations to which those mortgage loans were sold (including mortgage loans that failed to comply with the related underwriting criteria), based on the Company's assessment of such mortgage loans' compliance with such representations and warranties, which included information provided by third-party review firms. The sellers/servicers have contractual obligations to cure, repurchase or replace such ineligible mortgage loans. These expected recoveries are generally referred to as put-backs, and are calculated based on the Company's assessment of a range of possible collection outcomes. The Company's assessment of the ineligibility of individual mortgage loans has been challenged by the sellers/servicers of the securitizations in litigation and there is no assurance that the Company's determinations will prevail.

Risks and Uncertainties

The Company's financial statements include estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The outcome of certain significant risks and uncertainties could cause the Company to revise its estimates and assumptions or could cause actual results to differ from the Company's estimates. While the Company believes it continues to have sufficient capital and liquidity to meet all of its expected obligations, if one or more possible adverse outcomes were to be realized, its statutory capital, financial position, results of operations and cash flows could be materially and adversely affected. Significant risks and uncertainties that could affect amounts reported in the Company's financial statements in future periods include, but are not limited to, the following:

Management's expected liquidity and capital forecasts for MBIA Corp. for 2013 reflect adequate resources to pay expected claims. In addition, MBIA Corp. can borrow under the BofA Secured Loan to pay claims. However, there is risk to the liquidity forecast as the Company's second-lien RMBS and remaining insured CMBS pools are potentially volatile. There are risks to the capital forecast due to those potential liabilities, potential volatility in the collection of put-back recoverables and potential volatility associated with remaining ABS CDO exposures. Further, the remaining insured portfolio, aside from these exposures, could deteriorate and result in loss reserves and claim payments. Management believes it will have adequate resources to pay expected claims. However, if MBIA Corp. experiences higher than expected claims payments or is unable to commute exposures that represent substantial risk to the Company, MBIA Corp. may ultimately have insufficient resources to continue paying claims, which could also cause the NYSDFS to commence a rehabilitation or liquidation proceeding, as per Article 74 of the New York Insurance Law (NYIL), against MBIA Insurance Corporation (an MBIA Corp. Proceeding). As a result of the BofA Settlement Agreement, the risk of an MBIA Corp. Proceeding has been significantly reduced.

Management believes that MBIA Inc. has sufficient liquidity resources to meet all of its obligations for the foreseeable future. However, MBIA Inc. may not have sufficient liquidity to make all payments due on its liabilities and to meet other financial requirements, such as posting collateral, primarily as a result of invested asset performance and a potential inadequacy of dividends from its principal operating subsidiaries. In order to meet liquidity requirements, MBIA Inc. may finance unencumbered assets through intercompany or third-party facilities, in some cases with NYSDFS approval, or use free cash or other assets, although there can be no assurance that these strategies will be available or adequate. A failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp.

Incurred losses from insured RMBS have declined from their peaks. However, due to the large percentage of ineligible mortgage loans included within the MBIA Corp. insured second-lien portfolio, performance remains difficult to predict and losses could ultimately be in excess of MBIA Corp.'s current estimated loss reserves. In addition, MBIA Corp.'s efforts to recover losses from second-lien RMBS originators could be delayed, settled at amounts below its contractual claims or potentially settled at amounts

Edgar Filing: MBIA INC - Form 10-Q

below those recorded in its financial statements. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about MBIA Corp.'s RMBS reserves and recoveries.

Further economic stress might cause increases in MBIA Corp.'s loss estimates on its remaining exposure, particularly within its higher risk structured CMBS pool, ABS CDO and RMBS exposures. As of March 31, 2013, MBIA Corp.'s CMBS pools and CRE CDOs gross par outstanding, including approximately \$6.1 billion of exposure held by Bank of America that was commuted subsequent to March 31, 2013, and ABS CDO gross par outstanding was approximately \$17.6 billion and \$4.1 billion, respectively. The Company's primary strategy for managing its CMBS pool and ABS CDO exposures has been commutations. The Company's ability to commute insured transactions is limited by available liquidity, including the availability of the BofA Secured Loan, intercompany loans and the use of other available financing structures and liquidity, some of which could be subject to regulatory approval by the NYSDFS. The BofA Secured Loan includes a number of provisions that govern MBIA Corp.'s ability to draw on the loan and use the proceeds from the borrowings, limit the amount MBIA Corp. can use to fund commutations without the consent of Bank of America, and require it to prepay borrowings. The loan also includes customary representations and warranties and customary affirmative and restricted covenants, including a requirement that MBIA Corp. maintain at least \$750 million of statutory capital (defined as policyholders' surplus plus contingency reserves). There can be no assurance that the Company will be able to fund further commutations through borrowings or otherwise. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about the Company's estimate of losses on its exposures.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

As of March 31, 2013, MBIA Insurance Corporation was not in compliance with a requirement under NYIL to hold qualifying assets in an amount necessary to satisfy its contingency reserves. MBIA Insurance Corporation has reported the deficit and has requested approval from the NYSDFS, to release a portion of its contingency reserves as of September 30, 2012, December 31, 2012 and March 31, 2013, but to date has not received approval. In addition, as of March 31, 2013, MBIA Insurance Corporation exceeded its aggregate risk limits under NYIL. MBIA Insurance Corporation previously filed a formal notification with the NYSDFS regarding the overage and submitted a plan to achieve compliance with its limits. While the NYSDFS has not taken action against MBIA Insurance Corporation, the NYSDFS may restrict MBIA Insurance Corporation from making commutation or other payments or may impose other remedial actions for failing to meet these requirements.

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

As a result of the BofA Settlement Agreement, the risk of an MBIA Corp. Proceeding has been significantly reduced. While the Company believes MBIA Corp. will have adequate resources to pay expected claims, in the event it does not have adequate resources in the future and the NYSDFS were to commence an MBIA Corp. Proceeding, the Company would be subject to the following:

Medium-term notes (MTNs) issued by MBIA's subsidiaries MBIA Global Funding, LLC (GFL) and Meridian Funding, LLC (Meridian), which are insured by MBIA Corp., would accelerate. To the extent GFL failed to pay the accelerated amounts under the GFL MTNs or the collateral securing the Meridian MTNs was deemed insufficient to pay the accelerated amounts under the Meridian MTNs, the MTN holders would have policy claims against MBIA Corp. for scheduled payments of interest and principal;

An MBIA Corp. Proceeding may accelerate certain investment agreements issued by MBIA Inc., including, in some cases, with make-whole payments. While the investment agreements are fully collateralized with high quality collateral, the settlements of these amounts could reduce MBIA Inc.'s liquidity resources, and to the extent MBIA fails to pay the accelerated amounts under these investment agreements or the collateral securing these investment agreements is deemed insufficient to pay the accelerated amounts due, the holders of the investment agreements would have policy claims against MBIA Corp.;

CDS counterparties may seek to terminate CDS contracts insured by MBIA Corp. and make market-based damage claims (irrespective of whether actual credit-related losses are expected under the underlying exposure). The Company believes that such an acceleration would likely eliminate any residual value in MBIA Corp.;

The Company may be unable to carry out its tax planning strategies as a result of an MBIA Corp. Proceeding. This may cause the Company to record additional allowances against a portion or all of its deferred tax assets. Refer to Note 9: Income Taxes for information about the Company's deferred tax assets. In addition, the Company currently files a consolidated tax return. An MBIA Corp. Proceeding could result in challenges to the tax sharing arrangement among the MBIA affiliates that might adversely affect the Company's ability to manage taxes efficiently;

Edgar Filing: MBIA INC - Form 10-Q

The rehabilitator or liquidator would replace the Board of Directors of MBIA Insurance Corporation and take control of the operations and assets of MBIA Insurance Corporation, which would result in MBIA Inc. losing control of MBIA Insurance Corporation and possible changes to MBIA Insurance Corporation's strategies and management;

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

An MBIA Corp. Proceeding would be an event of default under the BofA Secured Loan and, as a result, the loan could be accelerated and Bank of America would have rights to the loan's collateral; and

An MBIA Corp. Proceeding may impose unplanned costs on MBIA Inc. In addition, MBIA Corp. would be subject to significant additional expenses arising from the appointment of a rehabilitator or liquidator, as receiver, and payment of the fees and expenses of the advisors to such rehabilitator or liquidator.

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, 2012. The following significant accounting policies provide an update to those included in the Company's Annual Report on Form 10-K.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, do not include all of the information and disclosures required by GAAP for annual periods. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2012. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the Company's consolidated financial position and results of operations. All material intercompany balances and transactions have been eliminated.

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

The results of operations for the three months ended March 31, 2013 may not be indicative of the results that may be expected for the year ending December 31, 2013. The December 31, 2012 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. Certain amounts have been reclassified in comparison to prior years' financial statements to conform to the current presentation. Such reclassifications had no impact on total revenues, expenses, assets, liabilities, 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

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02)

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02, **Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income** that requires an entity to present information about the amounts reclassified out of accumulated other comprehensive income (AOCI) by component and to present significant amounts reclassified out of AOCI by the respective line items of net income. The amendment only affects the Company's disclosures and does

Edgar Filing: MBIA INC - Form 10-Q

not affect the Company's consolidated balance sheets, results of operations, or cash flows. The Company adopted this standard in the first quarter of 2013.

Table of Contents**MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 3: Recent Accounting Pronouncements (continued)***Disclosures about Offsetting Assets and Liabilities (ASU 2011-11)*

In December 2011, the FASB issued ASU 2011-11, Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. ASU 2011-11 creates new disclosure requirements about the nature of the Company's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. This amendment does not change the existing offsetting eligibility criteria or the permitted balance sheet presentation for those instruments that meet the eligibility criteria. The disclosure requirements are effective for the Company beginning in the first quarter of 2013. In January 2013, the FASB issued ASU 2013-01, Balance Sheet (Topic 210) Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. ASU 2013-01 clarifies that ASU 2011-11 applies only to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in the FASB Accounting Standards Codification or subject to a master netting arrangement or similar agreement. These standards only affect the Company's disclosures and do not affect the Company's consolidated balance sheets, results of operations, or cash flows. The Company adopted this standard in the first quarter of 2013.

Note 4: Variable Interest Entities*Structured Finance and International Insurance*

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

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

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.

Table of Contents**MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 4: Variable Interest Entities (continued)***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 two conduits that invested primarily in debt securities and were funded through the issuance of VIE notes and long-term debt. MBIA Corp. insures the debt obligations of the conduits, and provides credit protection on certain assets held by the conduits. The conduits are VIEs and are consolidated by the Company as primary beneficiary. In 2012, all debt securities held by one of the conduits were entirely repaid, and the proceeds were used to repay all outstanding long-term debt of this conduit. The Company subsequently dissolved this conduit, and no longer provides any related credit protection.

*Nonconsolidated VIEs**Insurance*

The following tables present the total assets of nonconsolidated VIEs in which the Company holds a variable interest as of March 31, 2013 and December 31, 2012, through its insurance operations. The following tables also present the Company's maximum exposure to loss for nonconsolidated VIEs and carrying values of the assets and liabilities for its interests in these VIEs as of March 31, 2013 and December 31, 2012. 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.

In millions	March 31, 2013					March 31, 2013		
	VIE Assets	Maximum Exposure to Loss	Investments ⁽¹⁾	Premiums Receivable ⁽²⁾	Insurance Loss Recoverable ⁽³⁾	Carrying Value of Assets	Carrying Value of Liabilities Loss and Loss	
						Unearned Premium Revenue ⁽⁴⁾	Adjustment Expense Reserves ⁽⁵⁾	Derivative Liabilities ⁽⁶⁾
Insurance:								
Global structured finance:								
Collateralized debt obligations	\$ 15,031	\$ 10,796	\$ -	\$ 60	\$ 4	\$ 53	\$ 35	\$ 66
Mortgage-backed residential	32,210	12,505	10	72	3,502	70	389	5
Mortgage-backed commercial	4,646	2,328	-	2	-	2	-	-
Consumer asset-backed	5,605	2,990	10	18	-	18	21	-
Corporate asset-backed	18,799	9,309	-	111	13	128	-	-
Total global structured finance	76,291	37,928	20	263	3,519	271	445	71
Global public finance	45,298	20,242	-	202	-	248	4	-
Total insurance	\$ 121,589	\$ 58,170	\$ 20	\$ 465	\$ 3,519	\$ 519	\$ 449	\$ 71

Edgar Filing: MBIA INC - Form 10-Q

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

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

In millions	December 31, 2012 Carrying Value of Assets					Carrying Value of Liabilities Loss and Loss		
	VIE Assets	Maximum Exposure to Loss	Investments ⁽¹⁾	Premiums Receivable ⁽²⁾	Insurance Loss Recoverable ⁽³⁾	Unearned Premium Revenue ⁽⁴⁾	Adjustment Expense Reserves ⁽⁵⁾	Derivative Liabilities ⁽⁶⁾
Insurance:								
Global structured finance:								
Collateralized debt obligations	\$ 16,925	\$ 10,873	\$ -	\$ 62	\$ 5	\$ 55	\$ 37	\$ 74
Mortgage-backed residential	34,061	13,075	11	77	3,278	75	440	4
Mortgage-backed commercial	4,801	2,432	-	2	-	2	-	-
Consumer asset-backed	5,820	3,086	10	19	-	19	21	-
Corporate asset-backed	19,980	9,981	-	123	13	140	-	-
Total global structured finance	81,587	39,447	21	283	3,296	291	498	78
Global public finance	39,259	21,346	-	220	-	267	4	-
Total insurance	\$ 120,846	\$ 60,793	\$ 21	\$ 503	\$ 3,296	\$ 558	\$ 502	\$ 78

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

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

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

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

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

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

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

Other

During the first quarter of 2013, the Company began managing a VIE that issues notes for the purpose of funding loans to the United Kingdom (U.K.) social housing sector. Assets of the VIE totaled approximately \$135 million as of March 31, 2013. MBIA holds de minimis variable

interests in the VIE, has no obligation or commitment to provide the financial support or liquidity to the VIE, and is not the primary beneficiary.

Consolidated VIEs

The carrying amounts of assets and liabilities of consolidated VIEs were \$8.3 billion and \$7.2 billion, respectively, as of March 31, 2013, and \$8.3 billion and \$7.3 billion, respectively, as of December 31, 2012. 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 or deconsolidated during the three months ended March 31, 2013 and 2012.

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

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

As of March 31, 2013, the majority of the Company's case basis reserves and insurance loss recoveries recorded in accordance with GAAP were related to insured second-lien and first-lien RMBS transactions. These reserves and recoveries do not include estimates for policies insuring credit derivatives. Policies insuring credit derivative contracts are accounted for as derivatives and carried at fair value under GAAP. The fair values of insured derivative contracts are influenced by a variety of market and transaction-specific factors that may be unrelated to potential future claim payments under the Company's insurance policies. In the absence of credit impairments on insured derivative contracts or the early termination of such contracts at a loss, the cumulative unrealized losses recorded from fair valuing these contracts should reverse before or at the maturity of the contracts.

Notwithstanding the difference in accounting under GAAP for financial guarantee policies and the Company's insured derivatives, insured derivatives have similar terms, conditions, risks, and economic profiles to financial guarantee insurance policies, and, therefore, are evaluated by the Company for loss (referred to as credit impairment herein) and loss adjustment expense (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 5.72%, the same rate it used to calculate its statutory loss reserves as of March 31, 2013. These credit impairments, calculated in accordance with statutory accounting principles (U.S. STAT), differ from the fair values recorded in the Company's consolidated financial statements. The Company considers its credit impairment estimates as critical information for investors as it provides information about loss payments the Company expects to make on insured derivative contracts. As a result, the following loss and LAE process discussion includes information about loss and LAE activity recorded in accordance with GAAP for financial guarantee insurance policies and credit impairments estimated in accordance with U.S. STAT for insured derivative contracts. Refer to Note 6: Fair Value of Financial Instruments included herein for additional information about the Company's insured credit derivative contracts.

RMBS Case Basis Reserves and Recoveries (Financial Guarantees)

The Company's RMBS reserves and recoveries relate to financial guarantee insurance policies. The Company calculated RMBS case basis reserves as of March 31, 2013 for both second-lien and first-lien RMBS transactions using a process called the Roll Rate Methodology. The Roll Rate Methodology is a multi-step process using a database of loan level information, a proprietary internal cash flow model, and a commercially available model to estimate expected ultimate cumulative losses on insured bonds. Roll Rate is defined as the probability that current loans become delinquent and that loans in the delinquent pipeline are charged-off or liquidated. Generally, Roll Rates are calculated for the previous three months and averaged. The loss reserve estimates are based on a probability-weighted average of three scenarios of loan losses (base case, stress case, and an additional stress case).

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

Second-lien RMBS Reserves

The Company's second-lien RMBS case basis reserves as of March 31, 2013 relate to RMBS backed by home equity lines of credit (HELOC) and closed-end second mortgages (CES).

The Roll Rates for 30-59 day delinquent loans and 60-89 day delinquent loans are calculated on a transaction-specific basis. The Company assumes that the Roll Rate for 90+ day delinquent loans, excluding foreclosures and Real Estate Owned (REO) is 95%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of February 28, 2013 to estimate future losses from loans that are delinquent as of the current reporting period.

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

Roll Rates for loans that are current as of February 28, 2013 (Current Roll to Loss) are also calculated on a transaction-specific basis. A proportion of loans reported current as of February 28, 2013 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 (stress case and additional stress case), where the high levels of Current Roll to Loss rates persist for six or twenty four months before reverting to historic levels. In the base case scenario, the Company assumes that the Current Roll to Loss begins to decline immediately and continues to decline over the next six months to 25% of their levels as of February 28, 2013. For example, in the base case, as of February 28, 2013, if the amount of current loans which become 30-59 days delinquent is 10%, and recent performance suggests that 30% of those loans will be charged-off, the Current Roll to Loss for the transaction is 3%. In the base case, it is then assumed that the Current Roll to Loss will reduce linearly to 25% of its original value over the next six months (i.e., 3% will linearly reduce to 0.75% over the six months from March 2013 to August 2013). After that six-month period, the Company further reduces the Current Roll to Loss to 0% by early 2014 with the expectation that the performing seasoned loans will eventually result in loan performance reverting to historically low levels of default.

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

The Company monitors portfolio performance on a monthly basis against projected performance, reviewing delinquencies, Roll Rates, and prepayment rates (including voluntary and involuntary). However, given the large percentage of mortgage loans that were not underwritten by the sellers/servicers in accordance with applicable underwriting guidelines, performance remains difficult to predict and losses may exceed expectations. In the event of a material deviation in actual performance from projected performance, the Company would increase or decrease the case basis reserves accordingly. If actual performance were to remain at the peak levels the Company is modeling for six months longer than in the probability-weighted outcome, the addition to the Company's second-lien RMBS case basis reserves before considering potential recoveries would be approximately \$80 million.

Second-lien RMBS Recoveries

As of March 31, 2013, the Company recorded estimated recoveries of \$4.0 billion, gross of income taxes, related to second-lien RMBS put-back claims on ineligible mortgage loans, consisting of \$2.8 billion included in Insurance loss recoverable and \$1.2 billion included in Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company's consolidated balance sheets. As of March 31, 2013 and December 31, 2012, the Company's estimated recoveries after income taxes calculated at the federal statutory rate of 35%, were \$2.6 billion and \$2.3 billion, respectively, which was 78% and 73% of the consolidated total shareholders' equity of MBIA, excluding preferred stock of subsidiaries and noncontrolling interests. These estimated recoveries relate to the Company's put-back claims of ineligible mortgage loans, including put-back claims settled in May of 2013 as part of the Bank of America and Flagstar Bank settlements and put-back claims being disputed by the loan sellers/servicers that are currently subject to litigation initiated by the Company to pursue recoveries. While the Company believes that it will prevail in enforcing its contractual rights against sellers/servicers with which it has not settled, there is

Edgar Filing: MBIA INC - Form 10-Q

uncertainty with respect to the ultimate outcome. Furthermore, there is a risk that sellers/servicers or other responsible parties might not be able to satisfy their put-back obligations. Such risks are contemplated in the scenarios the Company utilizes to calculate recoveries.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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

The Company utilizes probability-weighted scenarios primarily based on the percentage of incurred losses for all sellers/servicers in order to estimate recoveries of ineligible mortgage loans.

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

MBIA's direct contractual relationship between GMAC and RFC related to the Company's second-lien RMBS put-back claims on ineligible mortgage loans;

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

MBIA expert reports submitted in the RFC litigation and subsequent decisions in other cases which have affirmed MBIA's claims. The Company has modeled scenario-based recoveries which are founded upon the strength of these claims as well as a range of estimated assets available to unsecured creditors of the ResCap companies. As of March 31, 2013, the auction of the servicing platform and specific loans of the ResCap bankruptcy estate, as well as the corresponding sales associated with the auctions, have concluded and closed. However, an actual distribution of proceeds will not occur until a plan detailing the distribution of assets has been approved by the bankruptcy court. Consequently, the outcomes utilized by the Company continue to be based upon information that was available to the Company as of the filing date.

As of March 31, 2013, the Company continues to maintain the same probability-weighted scenarios for its non-GMAC and non-RFC exposures (non-ResCap exposures), which are primarily based on the percentage of incurred losses the Company would collect. The non-ResCap recovery estimates incorporate five scenarios that include full recovery of its incurred losses and limited/reduced recoveries due to litigation delays and risks and/or potential financial distress of the sellers/servicers. Probabilities were assigned across these scenarios, with most of the probability weight on partial recovery scenarios.

The sum of the probabilities assigned to all scenarios, both ResCap and non-ResCap is 100%. Expected cash inflows from recoveries are discounted using the current risk-free discount rates associated with the underlying transaction's cash flows. Excluding Bank of America and Flagstar Bank, this ranged from 0.9% to 2.0%, depending upon the transaction's expected average life, which ranged from 5.5 years to 11.1 years. However, based on the Company's assessment of the strength of its contract claims, the Company believes it is entitled to collect and/or assert a claim for the full amount of its incurred losses on these transactions, which totaled \$2.1 billion through March 31, 2013, excluding incurred losses related to claims against Bank of America and Flagstar Bank that were settled in May of 2013. The Company is entitled to collect interest on amounts paid.

Edgar Filing: MBIA INC - Form 10-Q

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

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

The Company consistently reviews the approach and assumptions it applies to calculate put-back recoveries. As previously indicated, the relevant transactional documents afford the Company the contractual right to put-back ineligible loans. The same transactional documents also provide that the Company is entitled to reimbursement of interest on paid claims at a prescribed interest rate. Following Judge Jed Rakoff's decision on February 7, 2013 in the Assured Guaranty v. Flagstar case (Assured Guaranty Municipal Corp. v. Flagstar Bank, 11-cv-02375, U.S. District Court, Southern District of New York (Manhattan)), in which he confirmed Assured Guaranty's analogous right to recover contractual interest in addition to claims paid, the Company has refined its put-back recovery assumptions to increase the probability that it will be reimbursed for contractual interest owed on paid claims. Consistent with the Company's probability based put-back recovery calculations it has determined the interest owed contemplating litigation risk, and repayment risk, as well as the potential value in the context of a settlement. The Company continues to maintain that in the context of its put-back litigation, the Company is entitled to receive interest at the New York State statutory rate, however, it currently calculates its put-back recoveries using the contractual interest rate, which is lower than the New York State statutory rate.

As of March 31, 2013, sellers/servicers have not substituted loans which MBIA has put-back, and the amount of loans repurchased has been insignificant. The unsatisfactory resolution of these put-backs led MBIA to initiate litigation against six of the sellers/servicers to enforce their obligations. The Company has alleged several causes of action in its complaints, including breach of contract, fraudulent inducement and indemnification. MBIA's aggregate \$4.0 billion of estimated potential recoveries do not include damages from causes of action other than breach of contract. Irrespective of amounts recorded in its financial statements, MBIA is seeking to recover and/or assert claims for the full amount of its incurred losses and other damages on these transactions. As of March 31, 2013, MBIA has not collected any material amounts of cash related to these recoveries. Subsequent to March 31, 2013, MBIA settled its put-back claims against Bank of America and Flagstar Bank. Refer to Note 1: Business Developments and Risks and Uncertainties included herein for a description of the BofA Settlement Agreement. Additional information on the status of litigation against other sellers/servicers can be found in the Recovery Litigation discussion within Note 13: Commitments and Contingencies.

MBIA has initiated litigation against six sellers/servicers (most recent filing was January 11, 2013) related to loan put-backs. MBIA has received five decisions with regard to the respective defendants' motions to dismiss the Company's claims. In each instance, the respective court denied the motion, allowing MBIA to proceed on, at minimum, its fraud and breach of contract claims. In December 2011, MBIA reached an agreement with one of the six sellers/servicers with whom it had initiated litigation and that litigation has been dismissed.

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

1. the strength of the Company's existing contract claims related to ineligible mortgage loan substitution/repurchase obligations;
2. the settlement of the Company's put-back related claims with Bank of America and Flagstar Bank in May of 2013 and the settlement of Assured Guaranty's and Syncora's put-back related claims with Bank of America;
3. the improvement in the financial strength of certain sellers/servicers due to mergers and acquisitions and/or government assistance, which should facilitate the ability of these sellers/servicers and their successors to comply with required loan repurchase/substitution obligations. The Company is not aware of any provisions that explicitly preclude or limit successors' obligations to honor the obligations of original sellers/servicers. The Company's assessment of any credit risk associated with sellers/servicers (or their successors) is reflected in the Company's probability-weighted potential recovery scenarios;

Edgar Filing: MBIA INC - Form 10-Q

4. evidence of ineligible mortgage loan repurchase/substitution by sellers/servicers for put-back requests made by other harmed parties; this factor is further enhanced by (i) Bank of America's disclosure that it has resolved \$8.0 billion of repurchase requests in the fourth quarter of 2010; (ii) the Fannie Mae settlements with Ally Bank announced on December 23, 2010 and with Bank of America (which also involved Freddie Mac) announced on December 31, 2010; and (iii) the Bank of America settlement with Fannie Mae announced on January 7, 2013, which settlement substantially resolves Countrywide repurchase related claims between Bank of America and Fannie Mae;
5. the Company's settlement agreements entered into in 2010, 2011 and 2013 between MBIA Corp. and sponsors of certain MBIA Corp.-insured mortgage loan securitizations in which the Company received consideration in exchange for a release relating to its representation and warranty claims against the sponsors. These settlements resolved all of MBIA's representation and warranty claims against the sponsors on mutually beneficial terms and in aggregate were slightly more than the recoveries previously recorded by the Company related to these exposures;
6. Assured Guaranty's favorable court ruling awarding it \$90 million (plus interest, fees and expenses) due to Flagstar Bank's pervasive breach of mortgage representations and warranties;
7. the defendants' failure to win dismissals of MBIA's put-back litigations discussed above, allowing MBIA to continue to pursue its contract and fraud claims;

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

8. MBIA's successful motion in the Countrywide litigation allowing MBIA to present evidence of liability and damages through the introduction of statistically valid random samples of loans rather than on a loan-by-loan basis and subsequent decisions consistent with that ruling;
9. MBIA's successful motion regarding causation in the Countrywide litigation, which provides that MBIA is not required to establish a direct causal link between Countrywide's misrepresentations and MBIA's claims payments made pursuant to the insurance policies at issue, and that MBIA may seek damages equal to the amount that it has been and will be required to pay under the relevant policies, less premiums received;
10. the April 2, 2013 decision in MBIA's Countrywide litigation from the New York State Supreme Court, Appellate Division, First Department, in which the Court endorsed MBIA's position that the repurchase provision in the transactional documents, on which the Company's recoveries are based, does not require the loans be delinquent or defaulted to be eligible for repurchase, and that to prevail on the fraud and contract claims, MBIA need not establish causation tying Countrywide's misrepresentations to the Company's claims payments;
11. Syncora's and Assured Guaranty's successful motions regarding causation in their Federal court put-back litigations with JP Morgan Chase and Flagstar Bank, respectively, which support the ruling on causation in MBIA's litigation against Countrywide; and
12. other loan repurchase reserves and/or settlements which have been publicly disclosed by certain sellers/servicers.

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

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

First-lien RMBS Reserves

The Company's first-lien RMBS case basis reserves as of March 31, 2013, which primarily relate to RMBS backed by alternative A-paper (Alt-A) and subprime mortgage loans, were determined using the Roll Rate Methodology. The Company assumes that the Roll Rate for loans in foreclosure, REO and bankruptcy are 90%, 90% and 75%, respectively. Roll Rates for current, 30-59 day delinquent loans, 60-89 day delinquent loans and 90+ day delinquent loans are calculated on a transaction-specific basis. The Current Roll to Loss rates stay at the February 28, 2013 level for one month before declining to 25% of this level over a 24-month period. Additionally, the Company runs scenarios where the 90+ day roll rate to loss is set at 90%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of February 28, 2013 to estimate future losses from loans that are delinquent as of the current reporting period.

Edgar Filing: MBIA INC - Form 10-Q

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.

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

MBIA's insured ABS CDOs are transactions that include a variety of collateral ranging from corporate bonds to structured finance assets (which includes but are not limited to RMBS related collateral, ABS CDOs, corporate CDOs and collateralized loan obligations). These transactions were insured as either financial guarantee insurance policies or credit derivatives with the majority insured in the form of credit derivatives. Since the fourth quarter of 2007, MBIA's insured par exposure within the ABS CDO portfolio has been substantially reduced through a combination of terminations and commutations. Accordingly, as of March 31, 2013, the insured par exposure of the ABS CDO financial guarantee insurance policies and credit derivatives portfolio has declined by approximately 89% of the insured amount as of December 31, 2007.

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

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

As of March 31, 2013, the Company established loss and LAE reserves totaling \$107 million related to ABS CDO financial guarantee insurance policies after the elimination of \$234 million as a result of consolidating VIEs. For the three months ended March 31, 2013, the Company had a benefit of \$37 million of losses and LAE recorded in earnings related to ABS CDO financial guarantee insurance policies after the elimination of a \$2 million benefit as a result of consolidating VIEs. In the event of further deteriorating performance of the collateral referenced or held in ABS CDO transactions, the amount of losses estimated by the Company could increase materially.

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

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

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

The first approach considers the range of commutation agreements achieved since 2010 through March 31, 2013, which included 66 structured CMBS pools, CRE CDOs and CRE loan pool policies totaling \$33.1 billion of gross insured exposure. The Company considers the range of commutations achieved over the past several years with multiple counterparties. This approach results in an estimated price to commute the remaining policies with price estimates, based on this experience. It is customized by counterparty and is dependent on the level of dialogue with the counterparty and the credit quality and payment profile of the underlying

exposure.

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

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

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

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

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

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

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

any mitigating factors.

The loss severities projected by these scenarios vary widely, from moderate to substantial losses, with the majority of projected losses relating to a subset of transactions with a single counterparty. Actual losses will be a function of the proportion of loans in the pools that are foreclosed and liquidated and the loss severities associated with those liquidations. If the deductibles in the Company's insured transactions and underlying referenced CMBS transactions are fully eroded, additional property level losses upon foreclosures and liquidations could result in substantial losses for MBIA. Since foreclosures and liquidations have only begun to take place during this economic cycle, particularly for larger properties, ultimate loss rates remain uncertain. Whether CMBS collateral is included in a structured pool or in a CRE CDO, the Company believes the modeling related to the underlying bond should be the same. However, adjustments may be needed for structural or legal reasons. The Company assigns a wide range of probabilities to these scenarios, with lower severity scenarios being weighted more heavily than higher severity scenarios. This reflects the view that liquidations will continue to be mitigated by loan extensions and modifications, and that property values and NOIs have bottomed for many sectors and markets in the U.S. The weightings are customized to each counterparty. If macroeconomic stress were to increase or the U.S. goes into a recession, higher delinquencies, liquidations and/or higher severities of loss upon liquidation may result and the Company may incur substantial additional losses. The foreclosure and REO pipelines are still relatively robust, with several restructurings and liquidations yet to occur, so the range of possible outcomes is wider than those for the Company's exposures to ABS CDOs and second-lien RMBS.

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

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

For the three months ended March 31, 2013, the Company had a benefit of \$8 million of losses and LAE recorded in earnings related to CRE CDO financial guarantee insurance policies. For the three months ended March 31, 2013, additional credit impairments and LAE on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be \$290 million as a result of additional delinquencies and loan level liquidations, as well as continued refinements of MBIA's assessment of various commutation possibilities. The majority of the increase relates to a subset of transactions with a single counterparty. The cumulative credit impairments and LAE on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be \$3.9 billion through March 31, 2013. The pace of increases in the delinquency rate has slowed, many loans are being modified and liquidations continue to take place. Some loans were liquidated with minimal losses of 1% to 2%, others experienced near complete losses, and in some cases severities exceeded 100%. These liquidations have led to losses in the CMBS market, and in many cases, have resulted in reductions of enhancement to the individual CMBS bonds referenced by the insured structured CMBS pools. In certain insured transactions, these losses have resulted in deductible erosion. Bond level enhancement and pool level deductibles are structural features intended to mitigate losses to the Company. However, some of the transactions reference similar rated subordinate tranches of CMBS bonds. When there are broad-based declines in property performance, this leverage can result in rapid deterioration in pool performance. Subsequent to March 31, 2013, a CMBS pool transaction experienced deterioration such that all remaining deductible was eliminated and claims for this transaction were presented to the Company.

Loss and LAE Activity**Financial Guarantee Insurance Losses (Non-Derivative)**

The Company's financial guarantee insurance losses and LAE for the three months ended March 31, 2013 are presented in the following table:

Losses and LAE

In millions	Three Months Ended March 31, 2013			
	Second-lien RMBS	First-lien RMBS	Other ⁽¹⁾	Total
Losses and LAE related to actual and expected payments	\$ 67	\$ (12)	\$ (51)	\$ 4
Recoveries of actual and expected payments	(220)	(4)	26	(198)
Gross losses incurred	(153)	(16)	(25)	(194)
Reinsurance	-	-	-	-
Losses and LAE	\$ (153)	\$ (16)	\$ (25)	\$ (194)

(1) - Primarily financial guarantee ABS CDOs.

Edgar Filing: MBIA INC - Form 10-Q

The second-lien RMBS losses and LAE related to actual and expected payments included in the preceding table comprise net increases of previously established reserves. The second-lien RMBS recoveries of actual and expected payments include \$306 million in recoveries resulting from ineligible mortgage loans included in insured exposures that are subject to contractual obligations by sellers/servicers to repurchase or replace such mortgages, partially offset by a \$94 million reduction in excess spread.

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

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

\$ in millions	Surveillance Categories				Total
	Caution List Low	Caution List Medium	Caution List High	Classified List	
Number of policies	54	24	8	209	295
Number of issues ⁽¹⁾	31	15	8	139	193
Remaining weighted average contract period (in years)	7.9	4.9	8.1	9.8	8.8
Gross insured contractual payments outstanding: ⁽²⁾					
Principal	\$ 3,893	\$ 1,466	\$ 232	\$ 9,246	\$ 14,837
Interest	2,526	359	97	5,312	8,294
Total	\$ 6,419	\$ 1,825	\$ 329	\$ 14,558	\$ 23,131
Gross claim liability	\$ -	\$ -	\$ -	\$ 1,459	\$ 1,459
Less:					
Gross potential recoveries	-	-	-	4,276	4,276
Discount, net	-	-	-	234	234
Net claim liability (recoverable)	\$ -	\$ -	\$ -	\$ (3,051)	\$ (3,051)
Unearned premium revenue	\$ 125	\$ 22	\$ 2	\$ 116	\$ 265

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

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

The following table provides information about the financial guarantees and related claim liability included in each of MBIA's surveillance categories as of December 31, 2012:

\$ in millions	Surveillance Categories				Total
	Caution List Low	Caution List Medium	Caution List High	Classified List	
Number of policies	54	25	10	206	295
Number of issues ⁽¹⁾	29	15	10	136	190

Edgar Filing: MBIA INC - Form 10-Q

Remaining weighted average contract period (in years)	8.1	4.0	7.6	9.5	8.7
Gross insured contractual payments outstanding: ⁽²⁾					
Principal	\$ 4,250	\$ 1,176	\$ 373	\$ 9,458	\$ 15,257
Interest	2,721	256	120	5,264	8,361
Total	\$ 6,971	\$ 1,432	\$ 493	\$ 14,722	\$ 23,618
Gross claim liability	\$ -	\$ -	\$ -	\$ 1,589	\$ 1,589
Less:					
Gross potential recoveries	-	-	-	4,109	4,109
Discount, net	-	-	-	229	229
Net claim liability (recoverable)	\$ -	\$ -	\$ -	\$ (2,749)	\$ (2,749)
Unearned premium revenue	\$ 142	\$ 11	\$ 3	\$ 122	\$ 278

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

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

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

The gross claim liability as of March 31, 2013 and December 31, 2012 in the preceding tables represents the Company's estimate of undiscounted probability-weighted future claim payments, which principally relate to insured first-lien and second-lien RMBS transactions and U.S. public finance transactions. The gross potential recoveries represent the Company's estimate of undiscounted probability-weighted recoveries of actual claim payments and recoveries of estimated future claim payments, and principally relate to insured second-lien RMBS transactions. Both amounts reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by the Company.

The following table presents the components of the Company's loss and LAE reserves and insurance loss recoverable as reported on the Company's consolidated balance sheets as of March 31, 2013 and December 31, 2012 for insured obligations within MBIA's Classified List. The loss reserves (claim liability) and insurance claim loss recoverable included in the following table represent the present value of the probability-weighted future claim payments and recoveries reported in the preceding tables.

In millions	As of March 31, 2013	As of December 31, 2012
Loss reserves (claim liability)	\$ 713	\$ 790
LAE reserves	72	63
Loss and LAE reserves	\$ 785	\$ 853
Insurance claim loss recoverable	\$ (3,840)	\$ (3,610)
LAE insurance loss recoverable	(37)	(38)
Insurance loss recoverable	\$ (3,877)	\$ (3,648)
Reinsurance recoverable on unpaid losses	\$ 14	\$ 14
Reinsurance recoverable on paid losses	-	1
Reinsurance recoverable on paid and unpaid losses	\$ 14	\$ 15

As of March 31, 2013, loss and LAE reserves include \$1.1 billion of reserves for expected future payments offset by expected recoveries of such future payments of \$289 million. As of December 31, 2012, loss and LAE reserves included \$1.2 billion of reserves for expected future payments offset by expected recoveries of such future payments of \$332 million. As of March 31, 2013 and December 31, 2012, the insurance loss recoverable principally related to estimated recoveries of payments made by the Company resulting from ineligible mortgage loans in certain insured second-lien residential mortgage loan securitizations that are subject to a contractual obligation by the sellers/servicers to repurchase or replace the ineligible mortgage loans and expected future recoveries on second-lien RMBS transactions resulting from expected excess spread generated by performing loans in such transactions. The Company expects to be reimbursed for the majority of its potential recoveries related to ineligible mortgage loans by the second half of 2013.

Total paid losses and LAE, net of reinsurance and collections, for the three months ended March 31, 2013 was \$102 million, including \$84 million related to insured second-lien RMBS transactions. For the three months ended March 31, 2013, the increase in insurance loss recoverable related to paid losses totaled \$229 million, and principally related to insured second-lien RMBS transactions.

Edgar Filing: MBIA INC - Form 10-Q

The following table presents the Company's second-lien RMBS exposure, gross undiscounted claim liability and potential recoveries for amounts excluding consolidated VIEs and amounts related to consolidated VIEs, as of March 31, 2013. All insured transactions reviewed with potential recoveries are included within the Classified List.

Second-lien RMBS Exposure		Outstanding		Gross Undiscounted	
\$ in billions	Issues	Gross Principal	Gross Interest	Claim Liability	Potential Recoveries
Excluding Consolidated VIEs:					
Insured issues designated as Classified List	23	\$ 4.0	\$ 1.5	\$ 0.2	\$ 3.7
Insured issues reviewed with potential recoveries	16	\$ 3.6	\$ 1.4	\$ 0.2	\$ 3.6
Consolidated VIEs:					
Insured issues designated as Classified List	12	\$ 2.1	\$ 0.8	\$ 0.1	\$ 1.4
Insured issues reviewed with potential recoveries	11	\$ 2.0	\$ 0.8	\$ 0.1	\$ 1.4

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

The Company has performed reviews on 30 of the 35 total insured issues designated as **Classified List** and recorded potential recoveries on 27 of those 30 issues, primarily related to five issuers (Countrywide, RFC, GMAC, Flagstar Bank and Credit Suisse). In addition, the Company has received consideration on two transactions, including one Alt-A transaction, which have been excluded in the preceding table.

The following table presents changes in the Company's loss and LAE reserves for the three months ended March 31, 2013. Changes in the loss and LAE reserves attributable to the accretion of the claim liability discount, changes in discount rates, changes in the timing and amounts of estimated payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in **Losses and loss adjustment expenses** in the Company's consolidated statements of operations. As of March 31, 2013, the weighted average risk-free rate used to discount the Company's loss reserves (claim liability) was 1.50%. LAE reserves are expected to be settled within a one-year period and are not discounted.

In millions									
Changes in Loss and LAE Reserves for the Three Months Ended March 31, 2013									
Gross Loss and LAE Reserves as of December 31, 2012	Loss Payments for Cases with Reserves	Accretion of Claim Liability Discount	Changes in Discount Rates	Changes in Timing of Payments	Changes in Amount of Net Payments	Changes in Assumptions	Changes in Unearned Premium Revenue	Changes in LAE Reserves	Gross Loss and LAE Reserves as of March 31, 2013
\$ 853	\$ (78)	\$ 3	\$ (33)	\$ 11	\$ (1)	\$ 26	\$ (5)	\$ 9	\$ 785

The decrease in the Company's gross loss and LAE reserves reflected in the preceding table was primarily due to a decrease in reserves related to loss payments on insured first-lien and second-lien RMBS issues.

Current period changes in the Company's estimate of potential recoveries may be recorded as an insurance loss recoverable asset, netted against the gross loss and LAE reserve liability, or both. The following table presents changes in the Company's insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company's claim liability for the three months ended March 31, 2013. Changes in insurance loss recoverable attributable to the accretion of the discount on the recoverable, changes in discount rates, changes in the timing and amounts of estimated collections, changes in assumptions and changes in LAE recoveries are recorded in **Losses and loss adjustment expenses** in the Company's consolidated statements of operations.

Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses for the Three Months Ended March 31, 2013									
In millions	Gross Reserve as of December 31, 2012	Collections for Cases with Recoveries	Accretion of Recoveries	Changes in Discount Rates	Changes in Timing of Collections	Changes in Amount of Collections	Changes in Assumptions	Changes in LAE Recoveries	Gross Reserve as of March 31, 2013
Insurance loss recoverable	\$ 3,648	\$ (9)	\$ 11	\$ (4)	\$ -	\$ (53)	\$ 285	\$ (1)	\$ 3,877
Recoveries on unpaid losses	332	-	1	(5)	-	-	(41)	2	289

Edgar Filing: MBIA INC - Form 10-Q

Total	\$ 3,980	\$ (9)	\$ 12	\$ (9)	\$ -	\$ (53)	\$ 244	\$ 1	\$ 4,166
-------	----------	--------	-------	--------	------	---------	--------	------	----------

The Company's insurance loss recoverable increased during 2013 primarily due to changes in assumptions associated with issues outstanding as of December 31, 2012, which related to increases in expected recoveries on ineligible mortgage loans included in insured second-lien residential mortgage securitization exposures that are subject to contractual obligations by sellers/servicers to repurchase or replace such mortgages, partially offset by changes in the amount of collections. Recoveries on unpaid losses decreased primarily due to changes in assumptions.

The following table presents the Company's total estimated recoveries from ineligible mortgage loans included in certain insured second-lien mortgage loan securitizations as of March 31, 2013. The total estimated recoveries from ineligible mortgage loans of \$4.0 billion include \$2.8 billion recorded as Insurance loss recoverable and \$1.2 billion recorded as Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company's consolidated balance sheets.

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

In millions

Total Estimated Recoveries from Ineligible Mortgage Loans as of December 31, 2012	Accretion of Future Collections	Changes in Discount Rates	Recoveries (Collections)	Changes in Amount of Collections	Changes in Assumptions	Total Estimated Recoveries from Ineligible Mortgage Loans as of March 31, 2013
\$ 3,583	\$ 11	\$ (1)	\$ -	\$ -	\$ 374	\$ 3,967

The Company's total estimated recoveries from ineligible mortgage loans in the preceding table increased primarily as a result of the modification of the put-back recovery assumptions which increased the probability that the Company will be reimbursed for contractual interest owed on paid claims as described within the preceding "Second-lien RMBS Recoveries" section.

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

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

In millions	Three Months Ended March 31,	
	2013	2012
Loss adjustment expense incurred, gross	\$ 18	\$ 75

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

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

values.

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

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company can access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail any degree of judgment.

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

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

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.

1. Financial Assets (excluding derivative assets)

Financial assets, excluding derivative assets, held by the Company primarily consist of investments in debt securities. Substantially all of the Company's investments are priced by independent third parties, including pricing services and brokers. Typically the Company receives one pricing service value or broker quote for each instrument, which represents a non-binding indication of value. The Company reviews the assumptions, inputs and methodologies used by pricing services to obtain reasonable assurance that the prices used in its valuations reflect fair value. When the Company believes a third-party quotation differs significantly from its internally developed expectation of fair value, whether higher or lower, the Company reviews its data or assumptions with the provider. This review includes comparing significant assumptions such as prepayment speeds, default ratios, forward yield curves, credit spreads and other significant quantitative inputs to internal assumptions, and working with the price provider to reconcile the differences. The price provider may subsequently provide an updated price. In the event that the price provider does not update their price, and the Company still does not agree with the price provided, the Company will try to obtain a price from another third-party provider, such as a broker, or use an internally developed price which it believes represents the fair value of the investment. The fair values of investments for which internal prices were used were not significant to the aggregate fair value of the Company's investment portfolio as of March 31, 2013 or December 31, 2012. All challenges to third-party prices are reviewed by staff of the Company with relevant expertise to ensure reasonableness of assumptions.

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

2. Financial Liabilities (excluding derivative liabilities)

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

3. Derivative 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

Edgar Filing: MBIA INC - Form 10-Q

subordination than needed to achieve triple-A ratings from credit rating agencies. The types of collateral underlying its insured derivatives consist of cash securities and CDSs referencing primarily corporate, asset-backed, residential mortgage-backed, commercial mortgage-backed, CRE loans, and CDO securities.

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

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.

4. Internal Review Process

All significant financial assets and liabilities, including derivative assets and liabilities, are reviewed by committees created by the Company to ensure compliance with the Company's policies and risk procedures in the development of fair values of financial assets and liabilities. These valuation committees review, among other things, key assumptions used for internally developed prices, significant changes in sources and uses of inputs, including changes in model approaches, and any adjustments from third-party inputs or prices to internally developed inputs or prices. The committees also review any significant impairment or improvements in fair values of the financial instruments from prior periods. From time to time, these committees will reach out to the Company'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 and included in the tables that follow are described below.

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

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

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

Edgar Filing: MBIA INC - Form 10-Q

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

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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

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

Loans Receivable at Fair Value

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

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 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.

Table of Contents**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.

Long-term Debt

Long-term debt consists of notes, debentures and surplus notes. The fair value of long-term notes, debentures and surplus notes are estimated based on quoted prices for the identical or similar securities. 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, cross currency swaps, and CDS contracts. Fair values of over-the-counter derivatives are determined using valuation models based on observable inputs, nonperformance risk of the Company's own credit and nonperformance risk of the counterparties. Observable and market-based inputs include interest rate yields, credit spreads and volatilities. These derivatives are categorized in Level 2 or Level 3 of the fair value hierarchy based on the input that is significant to the fair value measurement in its entirety.

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

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

Derivatives Insurance

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

Edgar Filing: MBIA INC - Form 10-Q

Approximately 80% of the balance sheet fair value of insured credit derivatives as of March 31, 2013 was valued primarily based on the Binomial Expansion Technique (BET) Model. Approximately 20% of the balance sheet fair value of insured credit derivatives as of March 31, 2013 was valued primarily based on the internally developed Direct Price Model. An immaterial amount of insured credit derivatives were valued using the dual-default model. The valuation of insured derivatives includes the impact of its 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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

A. Description of the BET Model

1. Valuation Model Overview

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

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

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: credit spread, recovery rate after default, and the time period under risk.

Frequencies of defaults are modeled evenly over time.

Edgar Filing: MBIA INC - Form 10-Q

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

Collateral asset correlation is modeled using a diversity score which is calculated based on industry or sector concentrations.

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

2. BET Model Inputs

a. Credit spreads

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

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

Spread Hierarchy:

Collateral-specific credit spreads when observable.

Sector-specific spread tables by asset class and rating.

Corporate spreads, including Bloomberg spread tables based on rating.

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

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

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 March 31, 2013, sector-specific spreads were used in 8% of the transactions valued using the BET Model. Corporate spreads were used in 42% of the transactions and spreads benchmarked from the most relevant spread source were used for 50% 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 77% of the transactions.

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

b. Diversity Scores

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

c. Recovery Rate

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

d. Nonperformance Risk

The Company's valuation methodology for insured credit derivative liabilities incorporates the Company's own nonperformance risk. The Company calculates the fair value by discounting the market value loss estimated through the BET Model at discount rates which include MBIA CDS spreads as of March 31, 2013. The CDS spreads assigned to each deal are based on the weighted average life of the deal. The Company limits the nonperformance impact so that the derivative liability could not be lower than the Company's recovery derivative price multiplied by the unadjusted derivative liability.

B. Description of Direct Price Model**1. Valuation Model Overview**

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

2. Model Inputs

Collateral prices

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

Interest rates

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Nonperformance risk

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

Overall Model Results

As of March 31, 2013 and December 31, 2012, the Company's net insured derivative liability was \$3.0 billion and \$2.9 billion, respectively, and was primarily related to the fair values of insured credit derivatives, based on the results of the aforementioned pricing models. In the current environment, the most significant driver of changes in fair value is nonperformance risk. In aggregate, the nonperformance calculation resulted in a pre-tax net insured derivative liability that was \$3.2 billion and \$4.4 billion lower than the net liability that would have been estimated if the Company excluded nonperformance risk in its valuation as of March 31, 2013 and December 31, 2012, respectively. Nonperformance risk is a fair value concept and does not contradict the Company's internal view, based on fundamental credit analysis of the Company's economic condition, that the Company will be able to pay all claims when due.

Warrants

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

Accrued Interest Expense

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.

Financial Guarantees

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

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

Ceded Financial Guarantees The fair value of ceded financial guarantees is determined by applying the percentage ceded to reinsurers to the related fair value of the gross financial guarantees. The carrying value of ceded financial guarantees consists of prepaid reinsurance premiums

and reinsurance recoverable on paid and unpaid losses as reported within Other assets on the Company's consolidated balance sheets.

Table of Contents**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 March 31, 2013 and December 31, 2012. 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 March 31, 2013	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	\$ 1,819	Quoted market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee	0% - 21% (4%)
Loan repurchase commitments	1,176	Discounted cash flow	Recovery rates Breach rates	10% - 75% (46%) 67% - 94% (78%)
Liabilities of consolidated VIEs:				
Variable interest entity notes	1,901	Quoted market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 34% (8%)
Credit derivative liabilities, net:				
CMBS	1,851	BET Model	Recovery rates Nonperformance risk Weighted average life (in years) CMBS spreads	21% - 90% (51%) 20% - 48% (48%) 0.1 - 33.5 (4.3) 0.6% - 23.5% (13.1%)
Multi-sector CDO	594	Direct Price Model	Nonperformance risk	48% - 48% (48%)
Other	549	BET Model	Recovery rates Nonperformance risk Weighted average life (in years)	42% - 70% (47%) 37% - 48% (48%) 0.4 - 19.6 (2.8)

In millions	Fair Value as of December 31, 2012	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	\$ 1,881	Quoted market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee	0% - 14% (3%)
Loan repurchase commitments	1,086	Discounted cash flow	Recovery rates	10% - 75% (47%)

			Breach rates	66% - 94% (78%)
Liabilities of consolidated VIEs:				
Variable interest entity notes	1,932	Quoted market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 23% (6%)
Credit derivative liabilities, net:				
CMBS	1,590	BET Model	Recovery rates	21% - 90% (51%)
			Nonperformance risk	19% - 59% (58%)
			Weighted average life (in years)	0.1 - 5.6 (4.4)
			CMBS spreads	1% - 23% (13%)
Multi-sector CDO	525	Direct Price Model	Nonperformance risk	59% - 59% (59%)
Other	806	BET Model	Recovery rates	42% - 75% (47%)
			Nonperformance risk	42% - 59% (58%)
			Weighted average life (in years)	0.1 - 19.6 (3.0)

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.

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

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

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

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

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

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

The following tables present the fair value of the Company's assets (including short-term investments) and liabilities measured and reported at fair value on a recurring basis as of March 31, 2013 and December 31, 2012:

In millions	Fair Value Measurements at Reporting Date Using				Balance as of March 31, 2013
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	
Assets:					
Fixed-maturity investments:					
U.S. Treasury and government agency	\$ 641	\$ 99	\$ -	\$ -	\$ 740
State and municipal bonds	-	1,504	23 ⁽¹⁾	-	1,527
Foreign governments	110	91	8 ⁽¹⁾	-	209
Corporate obligations	-	1,087	57 ⁽¹⁾	-	1,144
Mortgage-backed securities:					
Residential mortgage-backed agency	-	931	-	-	931
Residential mortgage-backed non-agency	-	89	1 ⁽¹⁾	-	90
Commercial mortgage-backed	-	24	13 ⁽¹⁾	-	37
Asset-backed securities:					
Collateralized debt obligations	-	61	37 ⁽¹⁾	-	98
Other asset-backed	-	78	67 ⁽¹⁾	-	145
Total fixed-maturity investments	751	3,964	206	-	4,921
Money market securities	693	7	-	-	700
Perpetual debt and equity securities	27	12	10 ⁽¹⁾	-	49
Cash and cash equivalents	862	-	-	-	862
Derivative assets:					
Non-insured derivative assets:					
Interest rate derivatives	-	81	4 ⁽¹⁾	(81)	4
Total derivative assets	-	81	4	(81)	4

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

In millions	Fair Value Measurements at Reporting Date Using				Balance as of March 31, 2013
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	
Assets of consolidated VIEs:					
State and municipal bonds	-	37	-	-	37
Corporate obligations	-	209	79 ⁽¹⁾	-	288
Mortgage-backed securities:					
Residential mortgage-backed non-agency	-	893	6 ⁽¹⁾	-	899
Commercial mortgage-backed	-	416	28 ⁽¹⁾	-	444
Asset-backed securities:					
Collateralized debt obligations	-	207	117 ⁽¹⁾	-	324
Other asset-backed	-	117	47 ⁽¹⁾	-	164
Money market securities	220	-	-	-	220
Cash	72	-	-	-	72
Loans receivable	-	-	1,819	-	1,819
Loan repurchase commitments	-	-	1,176	-	1,176
Total assets	\$ 2,625	\$ 5,943	\$ 3,492	\$ (81)	\$ 11,979
Liabilities:					
Medium-term notes	\$ -	\$ -	\$ 181 ⁽¹⁾	\$ -	\$ 181
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	12	2,994	-	3,006
Non-insured derivatives:					
Interest rate derivatives	-	265	3 ⁽¹⁾	(269)	(1)
Currency derivatives	-	-	1 ⁽¹⁾	-	1
Other liabilities:					
Warrants	-	12	-	-	12
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,677	1,901	-	3,578
Derivative liabilities:					
Interest rate derivatives	-	126	-	-	126
Currency derivatives	-	-	23 ⁽¹⁾	-	23
Total liabilities	\$ -	\$ 2,092	\$ 5,103	\$ (269)	\$ 6,926

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

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

In millions	Fair Value Measurements at Reporting Date Using				Balance as of December 31, 2012
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	
Assets:					
Fixed-maturity investments:					
U.S. Treasury and government agency	\$ 784	\$ 100	\$ -	\$ -	\$ 884
State and municipal bonds	-	1,429	103 ⁽¹⁾	-	1,532
Foreign governments	86	107	3 ⁽¹⁾	-	196
Corporate obligations	-	1,140	76 ⁽¹⁾	-	1,216
Mortgage-backed securities:					
Residential mortgage-backed agency	-	988	-	-	988
Residential mortgage-backed non-agency	-	94	4 ⁽¹⁾	-	98
Commercial mortgage-backed	-	20	28 ⁽¹⁾	-	48
Asset-backed securities:					
Collateralized debt obligations	-	65	31 ⁽¹⁾	-	96
Other asset-backed	-	119	26 ⁽¹⁾	-	145
Total fixed-maturity investments	870	4,062	271	-	5,203
Money market securities	585	8	-	-	593
Perpetual debt and equity securities	23	20	14 ⁽¹⁾	-	57
Cash and cash equivalents	814	-	-	-	814
Derivative assets:					
Non-insured derivative assets:					
Interest rate derivatives	-	89	5 ⁽¹⁾	(90)	4
Total derivative assets	-	89	5	(90)	4

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

In millions	Fair Value Measurements at Reporting Date Using				Balance as of December 31, 2012
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	
Assets of consolidated VIEs:					
State and municipal bonds	-	41	-	-	41
Corporate obligations	-	215	78 ⁽¹⁾	-	293
Mortgage-backed securities:					
Residential mortgage-backed non-agency	-	869	6 ⁽¹⁾	-	875
Commercial mortgage-backed	-	410	7 ⁽¹⁾	-	417
Asset-backed securities:					
Collateralized debt obligations	-	215	125 ⁽¹⁾	-	340
Other asset-backed	-	120	64 ⁽¹⁾	-	184
Money market securities	210	-	-	-	210
Cash	176	-	-	-	176
Loans receivable	-	-	1,881	-	1,881
Loan repurchase commitments	-	-	1,086	-	1,086
Total assets	\$ 2,678	\$ 6,049	\$ 3,537	\$ (90)	\$ 12,174
Liabilities:					
Medium-term notes	\$ -	\$ -	\$ 165 ⁽¹⁾	\$ -	\$ 165
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	13	2,921	-	2,934
Non-insured derivatives:					
Interest rate derivatives	-	287	4 ⁽¹⁾	(293)	(2)
Currency derivatives	-	1	1 ⁽¹⁾	-	2
Other liabilities:					
Warrants	-	6	-	-	6
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,727	1,932	-	3,659
Derivative liabilities:					
Interest rate derivatives	-	141	-	-	141
Currency derivatives	-	-	21 ⁽¹⁾	-	21
Total liabilities	\$ -	\$ 2,175	\$ 5,044	\$ (293)	\$ 6,926

(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.

Edgar Filing: MBIA INC - Form 10-Q

Level 3 assets at fair value, as of March 31, 2013 and December 31, 2012 represented approximately 29% of total assets measured at fair value. Level 3 liabilities at fair value, as of March 31, 2013 and December 31, 2012 represented approximately 74% and 73%, respectively, of total liabilities measured at fair value.

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

The following tables present 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 March 31, 2013 and December 31, 2012:

In millions	Fair Value Measurements at Reporting Date Using				Fair Value Balance as of March 31, 2013	Carry Value Balance as of March 31, 2013
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Other Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
Assets:						
Other investments	\$ -	\$ -	\$ -	\$ 9	\$ 9	\$ 9
Accrued investment income ⁽¹⁾	40	-	-	-	40	40
Receivable for investments sold ⁽¹⁾	3	-	-	-	3	3
Net cash collateral pledged ⁽¹⁾	58	-	-	-	58	58
Assets of consolidated VIEs:						
Investments held-to-maturity	-	-	-	2,759	2,759	2,826
Total assets	\$ 101	\$ -	\$ -	\$ 2,768	\$ 2,869	\$ 2,936
Liabilities:						
Investment agreements	\$ -	\$ -	\$ -	1,126	1,126	915
Medium-term notes	-	-	-	944	944	1,396
Long-term debt	-	801	-	-	801	1,661
Payable for investments purchased ⁽²⁾	51	-	-	-	51	51
Accrued interest expense ⁽²⁾	13	21	-	-	34	103
Liabilities of consolidated VIEs:						
Variable interest entity notes	-	-	-	3,253	3,253	3,461
Total liabilities	\$ 64	\$ 822	\$ -	\$ 5,323	\$ 6,209	\$ 7,587
Financial Guarantees:						
Gross	\$ -	\$ -	\$ -	466	466	(318)
Ceded	-	-	-	100	100	87

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

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

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

In millions	Fair Value Measurements at Reporting Date					Fair Value Balance as of December 31, 2011	Carry Value Balance as of December 31, 2012
	Using			Significant Other Inputs	Significant Inputs		
	Quoted Prices in Active Markets for						
	Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Other Inputs	Significant Inputs (Level 3)			
Assets:							
Other investments	\$ -	\$ -		\$ 9	\$ 9	\$ 9	
Accrued investment income ⁽¹⁾	43	-		-	43	43	
Receivable for investments sold ⁽¹⁾	17	-		-	17	17	
Net cash collateral pledged ⁽¹⁾	66	-		-	66	66	
Assets of consolidated VIEs:							
Investments held-to-maturity	-	-		2,674	2,674	2,829	
Total assets	\$ 126	\$ -		\$ 2,683	\$ 2,809	\$ 2,964	
Liabilities:							
Investment agreements	\$ -	\$ -		\$ 1,175	\$ 1,175	\$ 944	
Medium-term notes	-	-		860	860	1,433	
Long-term debt	-	692		-	692	1,662	
Payable for investments purchased ⁽²⁾	50	-		-	50	50	
Accrued interest expense ⁽²⁾	9	10		-	19	70	
Liabilities of consolidated VIEs:							
Variable interest entity notes	-	-		3,147	3,147	3,465	
Total liabilities	\$ 59	\$ 702		\$ 5,182	\$ 5,943	\$ 7,624	
Financial Guarantees:							
Gross	\$ -	\$ -		\$ 650	\$ 650	\$ 143	
Ceded	-	-		97	97	91	

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

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

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

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the three months ended March 31, 2013 and 2012:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended March 31, 2013

In millions	Balance, Beginning of Period	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3 ⁽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 March 31, 2013
													March 31, 2013
Assets:													
Foreign governments													
	\$ 3	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8	\$ (3)	\$ 8	\$ -
Corporate obligations													
	76	2	4	1	(2)	-	-	(1)	(23)	-	-	57	4
Residential mortgage-backed non-agency													
	4	-	-	-	-	-	-	(3)	-	-	-	1	-
Commercial mortgage-backed													
	28	-	-	4	-	-	-	-	(19)	1	(1)	13	-
Collateralized debt obligations													
	31	(1)	-	3	-	-	-	(4)	-	9	(1)	37	-
Other asset-backed													
	26	-	-	1	-	-	-	(2)	-	42	-	67	-
State and municipal bonds													
	103	2	-	-	-	-	-	(1)	(13)	-	(68)	23	-
Perpetual debt and equity securities													
	14	-	-	-	(1)	-	-	-	-	-	(3)	10	-
Assets of consolidated VIEs:													
Corporate obligations													
	78	-	(2)	-	-	-	-	-	-	3	-	79	-
Residential mortgage-backed non-agency													
	6	-	6	-	-	-	-	(6)	-	1	(1)	6	1

Edgar Filing: MBIA INC - Form 10-Q

Commercial mortgage-backed	7	-	1	-	-	-	-	-	-	20	-	28	1
Collateralized debt obligations	125	-	(8)	-	-	-	-	-	-	1	(1)	117	(4)
Other asset-backed	64	-	(14)	-	-	-	-	(3)	-	-	-	47	(9)
Loans receivable	1,881	-	8	-	-	-	-	(70)	-	-	-	1,819	8
Loan repurchase commitments	1,086	-	90	-	-	-	-	-	-	-	-	1,176	90
Total assets	\$ 3,532	\$ 3	\$ 85	\$ 9	\$ (3)	\$ -	\$ -	\$ (90)	\$ (55)	\$ 85	\$ (78)	\$ 3,488	\$ 91

In millions	Balance, Beginning of Period	Realized / 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 March 31, 2013
													March 31, 2013
Liabilities:													
Medium-term notes	\$ 165	\$ -	\$ 21	\$ -	\$ (5)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 181	\$ 16
Credit derivatives, net	2,921	1	73	-	-	-	-	(1)	-	-	-	2,994	131
Interest rate derivatives, net	(1)	-	1	-	(1)	-	-	-	-	-	-	(1)	-
Currency derivatives, net	1	-	1	-	(1)	-	-	-	-	-	-	1	-
Liabilities of consolidated VIEs:													
VIE notes	1,932	-	122	-	-	-	-	(153)	-	-	-	1,901	122
Currency derivatives, net	21	-	(1)	-	3	-	-	-	-	-	-	23	2
Total liabilities	\$ 5,039	\$ 1	\$ 217	\$ -	\$ (4)	\$ -	\$ -	\$ (154)	\$ -	\$ -	\$ -	\$ 5,099	\$ 271

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

Table of Contents**MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 6: Fair Value of Financial Instruments (continued)****Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended March 31, 2012**

In millions	Balance, Beginning of Period	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI 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 March 31, 2012
Assets:													
Foreign governments	\$ 11	\$ -	\$ -	\$ -	\$ 1	\$ 6	\$ -	\$ (6)	\$ -	\$ -	\$ -	\$ 12	\$ -
Corporate obligations	206	(13)	-	17	-	-	-	(1)	(24)	-	-	185	-
Residential mortgage-backed agency	8	-	-	1	-	-	-	-	-	-	-	9	-
Residential mortgage-backed non-agency	17	-	-	1	-	-	-	(1)	-	-	(3)	14	-
Commercial mortgage-backed	24	-	-	2	-	-	-	-	-	-	(1)	25	-
Collateralized debt obligations	60	(3)	-	6	-	-	-	(5)	(2)	6	(27)	35	-
Other asset-backed	318	(116)	-	121	-	1	-	(7)	(202)	2	(2)	115	-
State and municipal bonds	28	-	-	-	-	-	-	(1)	-	-	-	27	-
Perpetual debt and equity securities	11	-	-	1	-	-	-	-	-	-	(2)	10	-
Assets of consolidated VIEs:													
Corporate obligations	69	-	1	-	-	-	-	(1)	-	6	-	75	2
Residential mortgage-backed non-agency	21	-	5	-	-	-	-	(2)	-	2	(1)	25	4
Commercial mortgage-backed	22	-	1	-	-	-	-	(2)	-	-	(6)	15	-
	203	-	3	1	-	-	-	-	-	11	-	218	2

Edgar Filing: MBIA INC - Form 10-Q

Collateralized debt obligations													
Other													
asset-backed	67	-	3	-	-	-	-	-	-	1	-	71	3
Loans receivable	2,046	-	39	-	-	-	-	(60)	-	-	-	2,025	39
Loan repurchase commitments	1,077	-	(1)	-	-	-	-	-	-	-	-	1,076	(1)
Total assets	\$ 4,188	\$ (132)	\$ 51	\$ 150	\$ 1	\$ 7	\$ -	\$ (86)	\$ (228)	\$ 28	\$ (42)	\$ 3,937	\$ 49

In millions	Balance, Beginning of Period	Realized (Gains) / Losses	Unrealized			Foreign Exchange Recognized in OCI	Purchases	Issuances	Settlements	Sales	Transfers		Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of March 31, 2012
			Losses Included in Earnings	(Gains) / Losses Included in OCI	Unrealized (Gains) / Losses Included in OCI						into Level 3 ⁽¹⁾	Transfers out of Level 3 ⁽¹⁾		
Liabilities:														
Medium-term notes														
	\$ 165	\$ -	\$ 5	\$ -	\$ 4	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 174	\$ 5
Credit derivatives, net														
	4,790	20	(303)	-	-	-	-	(20)	-	-	-	-	4,487	(286)
Interest rate derivatives, net														
	(3)	-	(1)	-	-	-	-	-	-	-	-	-	(4)	7
Liabilities of consolidated VIEs:														
VIE notes														
	2,889	-	158	-	-	-	-	(183)	-	-	-	-	2,864	158
Credit derivatives, net														
	80	-	2	-	-	-	-	-	-	-	-	-	82	2
Currency derivatives, net														
	17	-	2	-	-	-	-	-	-	-	-	-	19	2
Total liabilities														
	\$ 7,938	\$ 20	\$ (137)	\$ -	\$ 4	\$ -	\$ -	\$ (203)	\$ -	\$ -	\$ -	\$ -	\$ 7,622	\$ (112)

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

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

Transfers into and out of Level 3 were \$85 million and \$78 million, respectively, for the three months ended March 31, 2013. Transfers into and out of Level 2 were \$78 million and \$85 million, respectively, for the three months ended March 31, 2013. Transfers into Level 3 were principally related to other asset-backed obligations, commercial mortgage-backed obligations and CDOs where inputs, which are significant to their valuation, became unobservable during the quarter. State and municipal bonds comprised the majority of the transferred instruments out of Level 3 where inputs, which are significant to their valuation, became observable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

Transfers into and out of Level 3 were \$28 million and \$42 million, respectively, for the three months ended March 31, 2012. Transfers into and out of Level 2 were \$42 million and \$28 million, respectively, for the three months ended March 31, 2012. Transfers into Level 3 were principally related to CDOs and corporate obligations where inputs, which are significant to their valuation, became unobservable during the quarter. CDOs, commercial mortgage-backed and residential mortgage-backed non-agency comprised the majority of the transferred instruments out of Level 3 where inputs, which are significant to their valuation, became observable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

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

Gains and losses (realized and unrealized) included in earnings related to Level 3 assets and liabilities for the three months ended March 31, 2013 and 2012 are reported on the Company's consolidated statements of operations as follows:

In millions	Three Months Ended March 31, 2013	
	Total Gains (Losses) Included in Earnings	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets and Liabilities still held as of March 31, 2013
Revenues:		
Unrealized gains (losses) on insured derivatives	\$ (73)	\$ (131)
Realized gains (losses) and other settlements on insured derivatives	(1)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	(16)	(12)
Revenues of consolidated VIEs:		
Net gains (losses) on financial instruments at fair value and foreign exchange	(40)	(37)
Total	\$ (130)	\$ (180)

In millions	Three Months Ended March 31, 2012	
	Total Gains (Losses) included	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets

Edgar Filing: MBIA INC - Form 10-Q

	in Earnings	and Liabilities still held as of March 31, 2012
Revenues:		
Net investment income	\$ (5)	\$ -
Unrealized gains (losses) on insured derivatives	303	286
Realized gains (losses) and other settlements on insured derivatives	(20)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	(36)	(12)
Net investment losses related to other-than-temporary impairments	(95)	-
Revenues of consolidated VIEs:		
Net gains (losses) on financial instruments at fair value and foreign exchange	(111)	(113)
Total	\$ 36	\$ 161

Fair Value Option

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

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

The following table presents the changes in fair value included in the Company's consolidated statements of operations for the three months ended March 31, 2013 and 2012 for all financial instruments for which the fair value option was elected:

In millions	Net Gains (Losses) on Financial Instruments	
	at	
	Fair Value and Foreign Exchange Three Months Ended March 31,	
	2013	2012
Fixed-maturity securities held at fair value	\$ 18	\$ (1)
Loans receivable at fair value:		
Residential mortgage loans	(74)	18
Other loans	13	(39)
Loan repurchase commitments	90	-
Long-term debt	81	(7)

Substantially all gains and losses included in earnings during the three months ended March 31, 2013 on loans receivable and VIE notes reported in the preceding table are attributable to credit risk. This is primarily due to the high rate of defaults on loans and the collateral supporting the VIE notes, resulting in depressed pricing of the financial instruments.

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding as of March 31, 2013 and December 31, 2012 for loans and VIE notes for which the fair value option was elected:

In millions	As of March 31, 2013			As of December 31, 2012		
	Contractual	Fair	Difference	Contractual	Fair	Difference
	Outstanding Principal	Value		Outstanding Principal	Value	
Loans receivable at fair value:						
Residential mortgage loans	\$ 2,220	\$ 1,660	\$ 560	\$ 2,307	\$ 1,735	\$ 572
Residential mortgage loans (90 days or more past due)	244	54	190	244	54	190
Other loans	22	11	11	22	22	-
Other loans (90 days or more past due)	196	94	102	197	70	127
Total loans receivable at fair value	\$ 2,682	\$ 1,819	\$ 863	\$ 2,770	\$ 1,881	\$ 889
Variable interest entity notes	\$ 8,813	\$ 3,578	\$ 5,235	\$ 9,021	\$ 3,659	\$ 5,362

Note 7: Investments

Investments, excluding those elected under the fair value option, include debt and equity securities classified as either AFS or HTM. Other invested assets designated as AFS are primarily comprised of money market funds.

The following tables present the amortized cost, fair value, corresponding gross unrealized gains and losses and other-than-temporary impairments (OTTI) for AFS and HTM investments in the Company's consolidated investment portfolio as of March 31, 2013 and December 31,

2012:

43

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

In millions	Amortized Cost	Gross Unrealized Gains	March 31, 2013 Gross Unrealized Losses	Fair Value	Other-Than- Temporary Impairments ⁽¹⁾
AFS Investments					
Fixed-maturity investments:					
U.S. Treasury and government agency	\$ 678	\$ 37	\$ (1)	\$ 714	\$ -
State and municipal bonds	1,457	76	(8)	1,525	-
Foreign governments	198	12	-	210	-
Corporate obligations	994	45	(20)	1,019	4
Mortgage-backed securities:					
Residential mortgage-backed agency	888	16	(3)	901	-
Residential mortgage-backed non-agency	78	11	(7)	82	2
Commercial mortgage-backed	31	1	(1)	31	-
Asset-backed securities:					
Collateralized debt obligations	158	1	(65)	94	(21)
Other asset-backed	141	3	(11)	133	-
Total fixed-maturity investments	4,623	202	(116)	4,709	(15)
Money market securities	688	-	-	688	-
Perpetual debt and equity securities	12	1	-	13	-
Assets of consolidated VIEs:					
State and municipal bonds	33	4	-	37	-
Corporate obligations	175	10	(6)	179	-
Mortgage-backed securities:					
Residential mortgage-backed non-agency	86	-	(7)	79	-
Asset-backed securities:					
Collateralized debt obligations	94	-	(6)	88	-
Other asset-backed	20	-	-	20	-
Money market securities	220	-	-	220	-
Total AFS investments	\$ 5,951	\$ 217	\$ (135)	\$ 6,033	\$ (15)
HTM Investments					
Assets of consolidated VIEs:					
Corporate obligations	\$ 2,826	\$ 26	\$ (93)	\$ 2,759	\$ -
Total HTM investments	\$ 2,826	\$ 26	\$ (93)	\$ 2,759	\$ -

(1) - Represents unrealized gains or losses on other than temporarily impaired securities recognized in AOCI, which includes the non-credit component of impairments, as well as all subsequent changes in fair value of such impaired securities reported in AOCI.

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

In millions	Amortized Cost	Gross Unrealized Gains	December 31, 2012		Other-Than- Temporary Impairments ⁽¹⁾
			Gross Unrealized Losses	Fair Value	
AFS Investments					
Fixed-maturity investments:					
U.S. Treasury and government agency	\$ 819	\$ 40	\$ (1)	\$ 858	\$ -
State and municipal bonds	1,446	97	(12)	1,531	-
Foreign governments	183	13	-	196	-
Corporate obligations	1,058	54	(20)	1,092	5
Mortgage-backed securities:					
Residential mortgage-backed agency	939	19	(1)	957	-
Residential mortgage-backed non-agency	86	11	(8)	89	-
Commercial mortgage-backed	46	-	(4)	42	-
Asset-backed securities:					
Collateralized debt obligations	161	1	(71)	91	(25)
Other asset-backed	145	3	(11)	137	-
Total fixed-maturity investments	4,883	238	(128)	4,993	(20)
Money market securities	580	-	-	580	-
Perpetual debt and equity securities	22	1	-	23	-
Assets of consolidated VIEs:					
State and municipal bonds	38	3	-	41	-
Corporate obligations	177	9	(6)	180	-
Mortgage-backed securities:					
Residential mortgage-backed non-agency	92	-	(10)	82	-
Asset-backed securities:					
Collateralized debt obligations	97	-	(8)	89	-
Other asset-backed	23	-	-	23	-
Money market securities	210	-	-	210	-
Total AFS investments	\$ 6,122	\$ 251	\$ (152)	\$ 6,221	\$ (20)
HTM Investments					
Assets of consolidated VIEs:					
Corporate obligations	\$ 2,829	\$ 2	\$ (157)	\$ 2,674	\$ -
Total HTM investments	\$ 2,829	\$ 2	\$ (157)	\$ 2,674	\$ -

(1) - Represents unrealized gains or losses on other than temporarily impaired securities recognized in AOCI, which includes the non-credit component of impairments, as well as all subsequent changes in fair value of such impaired securities reported in AOCI.

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

The following table presents the distribution by contractual maturity of AFS and HTM fixed-maturity securities at amortized cost and fair value as of March 31, 2013. Contractual maturity may differ from expected maturity as borrowers may have the right to call or prepay obligations.

In millions	AFS Securities				HTM Securities	
	Consolidated VIEs					
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 274	\$ 275	\$ 17	\$ 18	\$ -	\$ -
Due after one year through five years	898	921	107	116	-	-
Due after five years through ten years	794	831	-	-	-	-
Due after ten years through fifteen years	370	398	84	82	-	-
Due after fifteen years	991	1,043	-	-	2,826	2,759
Mortgage-backed and asset-backed	1,296	1,241	200	187	-	-
Total fixed-maturity investments	\$ 4,623	\$ 4,709	\$ 408	\$ 403	\$ 2,826	\$ 2,759

Deposited and Pledged Securities

The fair value of securities on deposit with various regulatory authorities was \$11 million and \$10 million as of March 31, 2013 and December 31, 2012, respectively. These deposits are required to comply with state insurance laws.

The Company enters into securities borrowing and lending contracts in connection with MBIA's collateralized investment agreement activities. Such contracts are only transacted with high-quality dealer firms. It is the Company's policy to take possession of securities borrowed under these contracts. The Company minimizes credit risk from counterparties that might be unable to fulfill their contractual obligations by monitoring customer credit exposure and collateral values and requiring additional collateral to be deposited with the Company when deemed necessary.

Substantially all of the obligations under investment agreements require the Company to pledge securities as collateral. Securities pledged in connection with investment agreement activities may not be repledged by the investment agreement counterparty. As of March 31, 2013 and December 31, 2012, the fair value of securities pledged as collateral for these investment agreements approximated \$804 million and \$820 million, respectively. The Company's collateral as of March 31, 2013 consisted principally of RMBS, U.S. Treasury and government agency bonds and state and municipal bonds, and was primarily held with major U.S. banks. Additionally, the Company pledged cash and money market securities as collateral under investment agreements in the amount of \$122 million and \$144 million as of March 31, 2013 and December 31, 2012, respectively.

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

The following tables present the gross unrealized losses related to AFS and HTM investments as of March 31, 2013 and December 31, 2012:

In millions	Less than 12 Months		March 31, 2013 12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AFS Investments						
Fixed-maturity investments:						
U.S. Treasury and government agency	\$ 70	\$ (1)	\$ -	\$ -	\$ 70	\$ (1)
State and municipal bonds	196	(2)	85	(6)	281	(8)
Foreign governments	32	-	-	-	32	-
Corporate obligations	267	(5)	54	(15)	321	(20)
Mortgage-backed securities:						
Residential mortgage-backed agency	403	(3)	36	-	439	(3)
Residential mortgage-backed non-agency	2	-	27	(7)	29	(7)
Commercial mortgage-backed	3	-	1	(1)	4	(1)
Asset-backed securities:						
Collateralized debt obligations	4	-	74	(65)	78	(65)
Other asset-backed	3	-	63	(11)	66	(11)
Total fixed-maturity investments	980	(11)	340	(105)	1,320	(116)
Perpetual debt and equity securities	1	-	-	-	1	-
Assets of consolidated VIEs:						
Corporate obligations	10	-	21	(6)	31	(6)
Mortgage-backed securities:						
Residential mortgage-backed non-agency	3	-	76	(7)	79	(7)
Asset-backed securities:						
Collateralized debt obligations	-	-	83	(6)	83	(6)
Total AFS investments	\$ 994	\$ (11)	\$ 520	\$ (124)	\$ 1,514	\$ (135)
HTM Investments						
Assets of consolidated VIEs:						
Corporate obligations	\$ 311	\$ (4)	\$ 1,336	\$ (89)	\$ 1,647	\$ (93)
Total HTM investments	\$ 311	\$ (4)	\$ 1,336	\$ (89)	\$ 1,647	\$ (93)

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

In millions	Less than 12 Months		December 31, 2012 12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AFS Investments						
Fixed-maturity investments:						
U.S. Treasury and government agency	\$ 234	\$ (1)	\$ -	\$ -	\$ 234	\$ (1)
State and municipal bonds	69	-	87	(12)	156	(12)
Foreign governments	11	-	1	-	12	-
Corporate obligations	202	(2)	57	(18)	259	(20)
Mortgage-backed securities:						
Residential mortgage-backed agency	173	(1)	38	-	211	(1)
Residential mortgage-backed non-agency	4	-	28	(8)	32	(8)
Commercial mortgage-backed	3	-	27	(4)	30	(4)
Asset-backed securities:						
Collateralized debt obligations	1	-	80	(71)	81	(71)
Other asset-backed	4	-	65	(11)	69	(11)
Total fixed-maturity investments	701	(4)	383	(124)	1,084	(128)
Perpetual debt and equity securities	1	-	1	-	2	-
Assets of consolidated VIEs:						
Corporate obligations	-	-	31	(6)	31	(6)
Mortgage-backed securities:						
Residential mortgage-backed non-agency	-	-	82	(10)	82	(10)
Asset-backed securities:						
Collateralized debt obligations	-	-	85	(8)	85	(8)
Total AFS investments	\$ 702	\$ (4)	\$ 582	\$ (148)	\$ 1,284	\$ (152)
HTM Investments						
Assets of consolidated VIEs:						
Corporate obligations	\$ 297	\$ (19)	\$ 1,287	\$ (138)	\$ 1,584	\$ (157)
Total HTM investments	\$ 297	\$ (19)	\$ 1,287	\$ (138)	\$ 1,584	\$ (157)

Gross unrealized losses on AFS and HTM securities decreased as of March 31, 2013 compared with December 31, 2012 primarily due to market price appreciation.

With the weighting applied on the fair value of each security relative to the total fair value, the weighted average contractual maturity of securities in an unrealized loss position as of March 31, 2013 and December 31, 2012 was 24 and 23 years, respectively. As of March 31, 2013 and December 31, 2012, there were 124 and 153 securities, respectively, that were in an unrealized loss position for a continuous twelve-month period or longer, of which the fair values of 68 and 89 securities, respectively, were below book value by more than 5%.

The following table presents the distribution of securities by percentage of fair value below book value by more than 5%:

Percentage of Fair Value Below Book Value	Number of Securities	Book Value (in millions)	Fair Value (in millions)
> 5% to 15%	18	\$ 741	\$ 641
> 15% to 25%	15	136	110
> 25% to 50%	15	56	40
> 50%	20	80	17
Total	68	\$ 1,013	\$ 808

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

The following table presents the fair values and gross unrealized losses by credit rating category of ABS, MBS and corporate obligations included in the Company's consolidated AFS investment portfolio as of March 31, 2013 for which fair value was less than amortized cost. The credit ratings are based on ratings from Moody's as of March 31, 2013 or an alternate ratings source, such as S&P, when a security is not rated by Moody's. For investments that are insured by various third-party guarantee insurers, the credit rating reflects the higher of the insurer's rating or the underlying bond's rating.

In millions	Aaa		Aa		A		Baa		Below Investment Grade		Not Rated		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
ABS	\$ 25	\$ (1)	\$ 64	\$ (5)	\$ 3	\$ -	\$ 1	\$ -	\$ 134	\$ (76)	\$ -	\$ -	\$ 227	\$ (82)
MBS	439	(4)	4	-	78	(7)	2	-	13	(2)	15	(5)	551	(18)
Corporate obligations	5	-	72	(1)										