MBIA INC
Form 10-Q
August 07, 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 June 30, 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)

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

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

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

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

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

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

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

As of August 1, 2013, 192,971,908 shares of Common Stock, par value $1 per share, were outstanding.

Table of Contents

Table of Contents

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions except share and per share amounts)

	June 30, 2013	December 31, 2012
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $3,999 and $4,347)	$ 3,995	$ 4,485
Fixed-maturity securities at fair value	247	244
Investments pledged as collateral, at fair value (amortized cost $396 and $489)	319	443
Short-term investments held as available-for-sale, at fair value (amortized cost $1,942 and $662)	1,943	669
Other investments (includes investments at fair value of $13 and $12)	22	21
Total investments	6,526	5,862
Cash and cash equivalents	928	814
Premiums receivable	1,106	1,228
Deferred acquisition costs	278	302
Insurance loss recoverable	907	3,648
Property and equipment, at cost (less accumulated depreciation of $145 and $146)	67	69
Deferred income taxes, net	1,287	1,199
Other assets	236	268
Assets of consolidated variable interest entities:		
Cash	78	176
Investments held-to-maturity, at amortized cost (fair value $2,690 and $2,674)	2,818	2,829
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $321 and $637)	321	625
Fixed-maturity securities at fair value	663	1,735
Loans receivable at fair value	1,790	1,881
Loan repurchase commitments	1,115	1,086
Other assets	2	2
Total assets	**$ 18,122**	**$ 21,724**
Liabilities and Equity		
Liabilities:		
Unearned premium revenue	$ 2,640	$ 2,938
Loss and loss adjustment expense reserves	774	853
Investment agreements	775	944
Medium-term notes (includes financial instruments carried at fair value of $188 and $165)	1,561	1,598
Long-term debt	1,524	1,662
Derivative liabilities	1,655	2,934
Other liabilities	431	315
Liabilities of consolidated variable interest entities:		
Variable interest entity notes (includes financial instruments carried at fair value of $2,590 and $3,659)	5,707	7,124
Derivative liabilities	18	162

Total liabilities		**15,085**		**18,530**
Commitments and contingencies (See Note 14)				
Equity:				
Preferred stock, par value $1 per share; authorized shares 10,000,000; issued and outstanding none		-		-
Common stock, par value $1 per share; authorized shares 400,000,000; issued shares 277,804,712 and 277,405,039		278		277
Additional paid-in capital		3,108		3,076
Retained earnings		2,025		2,039
Accumulated other comprehensive income (loss), net of tax of $33 and $21		(86)		56
Treasury stock, at cost 84,837,343 and 81,733,530 shares		(2,309)		(2,275)
Total shareholders equity of MBIA Inc.		3,016		3,173
Preferred stock of subsidiary and noncontrolling interest		21		21
Total equity		**3,037**		**3,194**
Total liabilities and equity	**$**	**18,122**	**$**	**21,724**

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

1

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In millions except share and per share amounts)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Revenues:				
Premiums earned:				
Scheduled premiums earned	$ 77	$ 110	$ 156	$ 206
Refunding premiums earned	47	61	88	103
Premiums earned (net of ceded premiums of $2, $6, $5 and $9)	124	171	244	309
Net investment income	38	60	76	122
Fees and reimbursements	6	20	12	27
Change in fair value of insured derivatives:				
Realized gains (losses) and other settlements on insured derivatives	(1,532)	(428)	(1,520)	(432)
Unrealized gains (losses) on insured derivatives	1,350	1,203	1,277	1,506
Net change in fair value of insured derivatives	(182)	775	(243)	1,074
Net gains (losses) on financial instruments at fair value and foreign exchange	(6)	(6)	57	(25)
Investment losses related to other-than-temporary impairments:				
Investment losses related to other-than-temporary impairments	-	(2)	-	(55)
Other-than-temporary impairments recognized in accumulated other comprehensive income (loss)	-	(1)	-	(42)
Net investment losses related to other-than-temporary impairments	-	(3)	-	(97)
Net gains (losses) on extinguishment of debt	39	-	43	-
Other net realized gains (losses)	-	6	-	6
Revenues of consolidated variable interest entities:				
Net investment income	14	17	30	34
Net gains (losses) on financial instruments at fair value and foreign exchange	78	(34)	111	(61)
Net gains (losses) on extinguishment of debt	-	33	-	33
Other net realized gains (losses)	1	-	1	-
Total revenues	112	1,039	331	1,422
Expenses:				
Losses and loss adjustment	188	62	(6)	159
Amortization of deferred acquisition costs	11	15	27	28
Operating	103	78	209	235
Interest	60	71	120	145
Expenses of consolidated variable interest entities:				
Operating	2	3	6	9
Interest	12	15	24	30
Total expenses	376	244	380	606

Income (loss) before income taxes	(264)	795	(49)	816
Provision (benefit) for income taxes	(86)	214	(35)	225
Net income (loss)	**$ (178)**	**$ 581**	**$ (14)**	**$ 591**
Net income (loss) per common share:				
Basic	$ (0.92)	$ 2.99	$ (0.07)	$ 3.05
Diluted	$ (0.92)	$ 2.98	$ (0.07)	$ 3.03
Weighted average number of common shares outstanding:				
Basic	193,104,610	193,926,953	193,810,351	193,700,328
Diluted	193,104,610	194,941,233	193,810,351	194,763,617

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

2

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

(In millions)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Net income (loss)	$ (178)	$ 581	$ (14)	$ 591
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses) arising during the period	(153)	139	(140)	186
Provision (benefit) for income taxes	(53)	54	(49)	60
Total	(100)	85	(91)	126
Reclassification adjustments for (gains) losses included in net income (loss)	6	(43)	(19)	92
Provision (benefit) for income taxes	2	(15)	(7)	32
Total	4	(28)	(12)	60
Available-for-sale securities with other-than-temporary impairments:				
Other-than-temporary impairments and unrealized gains (losses) arising during the period	2	(2)	7	9
Provision (benefit) for income taxes	2	(1)	4	3
Total	-	(1)	3	6
Reclassification adjustments for (gains) losses included in net income (loss)	(4)	9	(4)	50
Provision (benefit) for income taxes	(1)	3	(1)	18
Total	(3)	6	(3)	32
Foreign currency translation:				
Foreign currency translation gains (losses)	4	-	(39)	(11)
Provision (benefit) for income taxes	-	-	-	1
Total	4	-	(39)	(12)
Total other comprehensive income (loss)	(95)	62	(142)	212
Comprehensive income (loss)	**$ (273)**	**$ 643**	**$ (156)**	**$ 803**

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 Six Months Ended June 30, 2013

(In millions except share amounts)

	Common Stock				Accumulated	Treasury Stock		Total	Preferred Stock of Subsidiary and Noncontrolling Interest		
			Additional		Other			Shareholders			
			Paid-in	Retained	Comprehensive Income			Equity of MBIA			Total
	Shares	Amount	Capital	Earnings	(Loss)	Shares	Amount	Inc.	Shares	Amount	Equity
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 (loss)	-	-	-	(14)	-	-	-	(14)	-	-	(14)
Other comprehensive income (loss)	-	-	-	-	(142)	-	-	(142)	-	-	(142)
Share-based compensation net of tax of $5	399,673	1	32	-	-	(3,103,813)	(34)	(1)	-	-	(1)
Balance, June 30, 2013	**277,804,712**	**$ 278**	**$ 3,108**	**$ 2,025**	**$ (86)**	**(84,837,343)**	**$ (2,309)**	**$ 3,016**	**1,315**	**$ 21**	**$ 3,037**

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

4

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In millions)

	Six Months Ended June 30, 2013	2012
Cash flows from operating activities:		
Premiums, fees and reimbursements received	$ 107	$ 160
Investment income received	223	316
Insured derivative commutations and losses paid	(419)	(463)
Financial guarantee losses and loss adjustment expenses paid	(227)	(363)
Proceeds from recoveries and reinsurance	1,781	38
Operating and employee related expenses paid	(176)	(232)
Interest paid, net of interest converted to principal	(118)	(241)
Income taxes (paid) received	-	(5)
Net cash provided (used) by operating activities	1,171	(790)
Cash flows from investing activities:		
Purchase of fixed-maturity securities	(1,675)	(1,587)
Sale and redemption of fixed-maturity securities	2,544	3,376
Proceeds from paydowns on variable interest entity loans	137	131
Redemptions of held-to-maturity investments	12	792
Sale (purchase) of short-term investments, net	(1,267)	122
Sale (purchase) of other investments, net	(1)	76
Consolidation (deconsolidation) of variable interest entities, net	(26)	(51)
(Payments) proceeds for derivative settlements	(39)	(83)
Collateral (to) from swap counterparty	63	(327)
Capital expenditures	(1)	(4)
Net cash provided (used) by investing activities	(253)	2,445
Cash flows from financing activities:		
Proceeds from investment agreements	15	33
Payments for drawdowns of investment agreements	(190)	(432)
Issuance of medium-term notes	-	13
Principal paydowns of medium-term notes	(40)	(42)
Principal paydowns of variable interest entity notes	(685)	(797)
Payments for securities sold under agreements to repurchase	-	(287)
Payments for retirement of debt	(2)	(363)
Restricted stock awards settlements, net	-	1
Net cash provided (used) by financing activities	(902)	(1,874)
Net increase (decrease) in cash and cash equivalents	16	(219)
Cash and cash equivalents beginning of period	990	633
Cash and cash equivalents end of period	$ 1,006	$ 414
Reconciliation of net income (loss) to net cash provided (used) by operating activities:		
Net income (loss)	$ (14)	$ 591

Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Change in:		
Premiums receivable	91	96
Deferred acquisition costs	24	27
Unearned premium revenue	(265)	(311)
Loss and loss adjustment expense reserves	(79)	(2)
Insurance loss recoverable	2,754	(166)
Accrued expenses	95	5
Net investment losses related to other-than-temporary impairments	-	97
Unrealized (gains) losses on insured derivatives	(1,277)	(1,506)
Net (gains) losses on financial instruments at fair value and foreign exchange	(168)	86
Deferred income tax provision (benefit)	(37)	230
(Gains) losses on extinguishment of debt	(43)	(33)
Other operating	90	96
Total adjustments to net income (loss)	1,185	(1,381)
Net cash provided (used) by operating activities	$ 1,171	$ (790)

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Business Developments and Risks and Uncertainties

Summary

MBIA Inc., together with its consolidated subsidiaries, (collectively, MBIA or the Company) operates one of the largest financial guarantee insurance businesses in the industry and is a provider of asset management and advisory services. These activities are managed through three business segments: United States (U.S.) public finance insurance; structured finance and international insurance; and advisory services. The Company s U.S. public finance insurance business is primarily operated through National Public Finance Guarantee Corporation and its subsidiaries (National), its structured finance and international insurance business is primarily operated through MBIA Insurance Corporation and its subsidiaries (MBIA Corp.), and its asset management and advisory services business is primarily operated through Cutwater Holdings, LLC and its subsidiaries (Cutwater). In addition, the Company s asset management and advisory services business also consists of Trifinium Advisors (UK) Limited (Trifinium). 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 11: Business Segments for further information about the Company s reporting segments.

Business Developments

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), discussed below under Bank of America Settlement . As a result of the BofA Settlement Agreement, the repayment of MBIA Insurance Corporation s secured loan from National (the National Secured Loan) and recent credit ratings upgrades, certain barriers to re-enter the bond insurance market have been removed and the Company is currently evaluating strategies for such re-entry into the U.S. public finance market. As of June 30, 2013, National was rated A with a stable outlook by Standard & Poor s Financial Services LLC (S&P) and Baa1 with a positive outlook by Moody s Investors Service, Inc. (Moody s). As of June 30, 2013, MBIA Insurance Corporation was rated B with a stable outlook by S&P and B3 with a positive outlook by Moody s.

Bank of America Settlement

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 had a notional insured amount of approximately $7.4 billion, of which $6.1 billion were policies insuring credit default swaps (CDS) held by Bank of America referencing commercial real estate (CRE) exposures. MBIA Corp. has 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. The $1.6 billion of cash received in connection with the BofA Settlement Agreement is included in Proceeds from recoveries and reinsurance presented under the heading Cash flows from operating activities on the Company s consolidated statements of cash flows.

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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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 if there are shortfalls 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 Insurance Corporation has entered into a $500 million three-year secured revolving credit agreement with Blue Ridge Investments, L.L.C. (Blue Ridge), an affiliate of Bank of America (the Blue Ridge Secured Loan). Refer to Note 9: Debt for a discussion of the Blue Ridge Secured Loan.

The payment from Bank of America, including the MBIA Inc. notes, was used by MBIA Corp. to repay the remaining outstanding balance and accrued interest on the National Secured Loan. 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.

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 exercise price under such warrants was decreased and the aggregate number of shares of MBIA common stock to be issued upon exercise of such warrants was increased, in each case as a result of the issuance of the warrant to Bank of America. The adjustments to the exercise 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 the Company 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 CRE CDOs. The amount MBIA paid to Societe Generale in consideration of commuting its insured exposure is consistent with MBIA Corp. s December 31, 2012 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.

Residential Capital LLC Agreement

In May of 2013, the Company and the other Consenting Claimants, Residential Capital LLC (ResCap) and Ally Financial Inc. (Ally), agreed to the terms of a comprehensive plan agreement to support ResCap s Chapter 11 plan. The confirmation of ResCap s Chapter 11 plan would resolve MBIA Corp. s claims against the Residential Funding Company, LLC (RFC), GMAC Mortgage LLC (GMAC) and ResCap estates, and Ally. In June of 2013, the bankruptcy court issued a Memorandum Opinion approving the Plan Support Agreement (the Plan). The Plan is now subject to voting by creditors as well as a confirmation hearing by the bankruptcy court. There can be no assurance that the Plan will be confirmed. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for a discussion of the ResCap agreement.

Transformation Litigation

Subsequent to the BofA Settlement Agreement 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 June 30, 2013, the liquidity position of MBIA Inc., which consists of the liquidity positions of the Company s corporate segment and asset/liability products segment, was $327 million compared with $239 million as of December 31, 2012. During the six months ended June 30, 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 its existing liquidity position, expected subsidiary dividends and additional anticipated releases of assets from the Tax Escrow Account, which releases are subject to the risks of National incurring net tax losses in the future and/or declines in the value of the assets held in the Tax Escrow Account. As of June 30, 2013 and December 31, 2012, MBIA Corp. s cash and liquid assets were $92 million and $345 million, respectively. The Company believes MBIA Corp. s current liquidity position, together with future cash inflows and amounts available under the Blue Ridge Secured Loan, is adequate to make expected future claim payments.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

The combination of commutation payments to reduce liabilities and claim payments have placed liquidity pressure on MBIA Corp. 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. During the six months ended June 30, 2013, MBIA Corp. commuted $19.9 billion of gross insured exposure, primarily comprising structured CMBS pools, investment grade CDOs, ABS CDOs, first-lien subprime RMBS, high yield corporate CDOs, CRE CDOs, structured insurance securities, and first-lien alternative A-paper RMBS.

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:

The amount and timing of potential claims from the Company s second-lien RMBS and remaining insured CMBS pools are potentially volatile, as are the projected collections of excess spread and the remaining put-back recoverables. However, management s expected liquidity and capital forecasts for MBIA Corp. for 2013, which include expected availability of draws under the Blue Ridge Secured Loan and expected recoveries from the ResCap agreement, reflect adequate resources to pay expected claims. Further, the remaining insured portfolio, aside from these exposures, could deteriorate and result in loss reserves and claim payments. While management believes MBIA Corp. will have adequate resources to pay expected claims, if MBIA Corp. experiences higher than expected claim payments or is unable to commute the remaining exposures that represent substantial risk to the Company, MBIA Corp. may ultimately have insufficient resources to continue to pay claims, which could cause the NYSDFS to put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about MBIA Corp. s reserves and recoveries.

MBIA Inc. continues to have liquidity risk. If invested asset performance deteriorates, or the flow of dividends from subsidiaries was interrupted, its liquidity position would be eroded over time. However, management believes that MBIA Inc. has sufficient liquidity resources to meet all of its obligations for the foreseeable future. In order to meet its liquidity requirements, MBIA Inc. may use free cash or other assets or use its ability to finance through intercompany or third-party facilities, although there can be no assurance that these strategies will be available or adequate. A failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp.

The Company s ability to commute insured transactions is limited by available liquidity, including the availability of the Blue Ridge Secured Loan, recoveries from the ResCap agreement and the use of other available financing structures and liquidity, some of which could be subject to regulatory approval by the NYSDFS and/or the United Kingdom s Prudential Regulation Authority. The Company s primary strategy for managing its CMBS pool and ABS CDO exposures has been commutations. 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.

As of June 30, 2013, MBIA Insurance Corporation was not in compliance with a requirement under the New York Insurance Law (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, March 31, 2013, and June 30, 2013. All of these requests were disapproved by the NYSDFS. In addition, as of June 30, 2013, MBIA Insurance Corporation reported an overage related to its single risk limits under NYIL. MBIA Insurance Corporation previously filed a formal notification with the NYSDFS regarding this 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.

Changes in fair value of insured credit derivatives can be caused by general market conditions and the volatility in the relationship between MBIA s credit spreads and those underlying collateral assets on insured credit derivatives may cause significant unrealized gains and losses in the Company s reported results of operations. Refer to Note 6: Fair Value of Financial Instruments for information about the Company s valuation of insured credit derivatives.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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 accounting principles generally accepted in the United States of America (GAAP) for annual periods. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 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 and six months ended June 30, 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 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.

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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 3: Recent Accounting Pronouncements (continued)

Recent Accounting Developments

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

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

Note 4: Variable Interest Entities

Structured Finance and International Insurance

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

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

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

Wind-down Operations

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

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 June 30, 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 June 30, 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.

			June 30, 2013				
			Carrying Value of Assets		Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Premiums Receivable(1)	Insurance Loss Recoverable(2)	Unearned Premium Revenue(3)	Loss and Loss Adjustment Expense Reserves(4)	Derivative Liabilities(5)
Insurance:							
Global structured finance:							
Collateralized debt obligations	$ 12,688	$ 8,769	$ 57	$ 5	$ 50	$ 16	$ 95
Mortgage-backed residential	23,812	10,294	59	700	57	351	6
Mortgage-backed commercial	4,628	2,284	1	-	1	-	-
Consumer asset-backed	5,404	2,878	17	-	17	19	-
Corporate asset-backed	15,717	8,914	102	19	119	-	-
Total global structured finance	62,249	33,139	236	724	244	386	101
Global public finance	44,456	19,353	197	-	242	5	-
Total insurance	$ 106,705	$ 52,492	$ 433	$ 724	$ 486	$ 391	$ 101

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

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

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

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

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

			December 31, 2012					
			Carrying Value of Assets			Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Investments(1)	Premiums Receivable(2)	Insurance Loss Recoverable(3)	Unearned Premium Revenue(4)	Loss and Loss Adjustment Expense Reserves(5)	Derivative Liabilities(6)
Insurance:								
Global structured finance:								
Collateralized debt obligations	$ 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, Trifinium 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 June 30, 2013. Trifinium 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 $6.8 billion and $5.7 billion, respectively, as of June 30, 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 during the six months ended June 30, 2013 and 2012. Net realized gains related to the deconsolidation of VIEs were $1 million for the three and six months ended June 30, 2013, and no net realized gains or losses were recognized related to the deconsolidation of VIEs for the same periods in 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.

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 June 30, 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 June 30, 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.

To date, the Company has resolved substantially all of its contract claims (referred to as put-back claims) related to those mortgage loans whose inclusion in insured securitizations failed to comply with representations and warranties (ineligible loans), with the exception of those ineligible loans securitized by Credit Suisse 2007-2 in the home equity mortgage trust (HEMT) securitization. Credit Suisse has challenged the Company s assessment of the ineligibility of individual mortgage loans and the dispute is the subject of litigation for which there is no assurance that the Company will prevail.

RMBS Case Basis Reserves and Recoveries (Financial Guarantees)

The Company s RMBS reserves and recoveries relate to financial guarantee insurance policies. The Company calculated RMBS case basis reserves as of June 30, 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 June 30, 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 May 31, 2013 to estimate future losses from loans that are delinquent as of the current reporting period.

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 May 31, 2013 (Current Roll to Loss) are also calculated on a transaction-specific basis. A proportion of loans reported current as of May 31, 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 May 31, 2013. For example, in the base case, as of May 31, 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 June 2013 to November 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 lower levels of default consistent with history.

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. Due to the current volatility in mortgage prepayment rates, which influence mortgage refinancing and voluntary principal prepayment rates, the Company used historical average mortgage rates to model its loss reserves in the second quarter of 2013. 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, loan performance remains difficult to predict and losses may exceed expectations. In the event of a material deviation in actual performance from projected performance, the Company would increase or decrease the case basis reserves accordingly. When actual performance remains at peak levels, the Company s includes an additional six month period when calculating the probability-weighted outcome. The addition to the Company s second-lien RMBS case basis reserves, before considering potential recoveries, would be approximately $90 million.

Second-lien RMBS Recoveries

As of June 30, 2013, the Company recorded estimated recoveries of $1.1 billion, gross of income taxes, related to second-lien RMBS put-back claims on ineligible mortgage loans, consisting of $18 million included in Insurance loss recoverable and $1.1 billion included in Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company s consolidated balance sheets. As of June 30, 2013 and December 31, 2012, the Company s estimated recoveries after income taxes calculated at the federal statutory rate of 35%, were $736 million and $2.3 billion, respectively, which was 24% and 73% of the consolidated total shareholders equity of MBIA, excluding preferred stock of subsidiaries and noncontrolling interests, respectively. As of June 30, 2013, the remaining estimated recoveries relate to the Company s claims based on ineligible mortgage loans asserted against Credit Suisse and the bankruptcy estates of RFC, GMAC and ResCap.

On May 14, 2012, ResCap and its wholly-owned subsidiary companies, RFC and GMAC, each filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code. MBIA asserted claims based on the inclusion of ineligible loans against RFC, GMAC and ResCap, based upon the direct contractual relationship between the Company, RFC and GMAC.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

As of May 23, 2013, Ally, ResCap, RFC, GMAC and the Consenting Claimants (which includes MBIA), among other parties, executed a term sheet and supplemental term sheet agreeing to, among other things, a settlement amount of $796 million (based upon an estimate of estate values at the time of the agreement, which are subject to change) to be paid to MBIA as part of a proposed plan to resolve claims against Ally and RFC, GMAC and ResCap. The settlement and anticipated recoveries are consistent with the put-back recoveries recorded by the Company. The agreement will be implemented through a plan of reorganization in ResCap s Chapter 11 cases, subject to anticipated bankruptcy court approval in the fall of 2013. In June of 2013, the bankruptcy court issued a Memorandum Opinion approving the Plan. MBIA anticipates an initial distribution of funds to the Company and other claimants in late 2013. This anticipated timeline may change in the course of events in the bankruptcy court plan confirmation process.

The Company continues to refine the indicative scenarios used to calculate put-back recoveries for ResCap based upon information received during the bankruptcy process. The Company has made additional adjustments to its recovery calculations related to ResCap in consideration of the agreed upon recovery amount as described in the executed term sheet, supplemental term sheet and plan support agreement submitted in motions filed in May of 2013.

In addition, the Company believes that it will prevail in enforcing its contractual put-back rights against Credit Suisse. Based on the Company s assessment of the strength of these claims, the Company believes it is entitled to collect the full amount of its incurred losses, and interest on amounts paid. However, uncertainty remains with respect to the ultimate outcome of the litigation with Credit Suisse, which is contemplated in the scenario based-modeling the Company utilizes. The Credit Suisse recovery scenarios are based on the amount of incurred losses measured against certain probabilities of ultimate resolution of the dispute with Credit Suisse over the inclusion of ineligible mortgage loans in the HEMT securitization. Most of the probability weight is assigned to partial recovery scenarios.

Expected cash inflows from recoveries are discounted using the current risk-free discount rates associated with the underlying transaction s cash flows which ranged from 1.5% to 2.5%, depending upon the transaction s expected average life, which ranged from 5.2 years to 9.6 years.

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

The Company consistently reviews the approach and assumptions it applies to calculate put-back recoveries. The same transactional documents that provide the Company with its put-back rights against Credit Suisse 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 against Credit Suisse 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, the Company currently calculates its put-back recoveries using the contractual interest rate, which is lower than the New York State statutory rate.

To date, MBIA has either settled or agreed to settle the majority of the Company s put-back claims, with only Credit Suisse remaining as an outstanding dispute. The settlement amounts have been consistent with the put-back recoveries previously included in the Company s financial statements. 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 the litigation against Credit Suisse can be found in the Recovery Litigation discussion within Note 14: Commitments and Contingencies .

The Company s assessment of the remaining unsettled recoveries related to insured Credit Suisse second-lien RMBS is principally based on the following factors:

1. the settlement of the majority of the Company s put-back claims with sellers/servicers, including those with Bank of America and Flagstar Bank in May of 2013;

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

2. Assured Guaranty s favorable court ruling in its put-back litigation against Flagstar Bank, awarding it the vast majority of the claims paid on the relevant transactions plus interest, fees and expenses, as well as their subsequent settlement with Flagstar Bank, which resolved Assured Guaranty s put-back claims; and

3. the court rulings in MBIA s put-back litigations.

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 and/or changes to the financial condition of Credit Suisse. While the Company believes it will be successful in realizing recoveries from contractual 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 June 30, 2013, which primarily relate to RMBS backed by alternative A-paper and subprime mortgage loans, were determined using the Roll Rate Methodology. The Company assumes that the Roll Rate for loans in foreclosure, REO and bankruptcy are 90%, 90% and 75%, respectively. Roll Rates for current, 30-59 day delinquent loans, 60-89 day delinquent loans and 90+ day delinquent loans are calculated on a transaction-specific basis. The Current Roll to Loss rates stay at the May 31, 2013 level for one month before declining to 25% of this level over a 24-month period.

The Company estimates future losses by probability-weight averaging three different scenarios: base; stress; and additional stress. The three scenarios differ in the roll rates to loss of 90+ day delinquent loans. In the base scenario, the Company uses deal-specific roll rates obtained from historic loan level roll rate data. In the stress scenario, the Company assumes a 90% roll rate for all 90+ day delinquent loans. In the additional stress scenario, the roll rates for each deal are an average of the deal-specific roll rate used in the base scenario and the 90% rate. The Roll Rates are applied to the amounts in each deal s respective 90+ delinquency bucket based on delinquencies as of May 31, 2013 in order to estimate future losses from loans that are delinquent as of June 30, 2013.

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.

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 currently insured in the form of financial guarantees. Since the fourth quarter of 2007, MBIA s insured par exposure within the ABS CDO portfolio has been substantially reduced through a combination of terminations and commutations. Accordingly, as of June 30, 2013, the insured par exposure of the ABS CDO financial guarantee insurance policies and credit derivatives portfolio has declined by approximately 96% of the insured amount as of December 31, 2007.

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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

As of June 30, 2013, the Company established loss and LAE reserves totaling $86 million related to ABS CDO financial guarantee insurance policies after the elimination of $210 million as a result of consolidating VIEs. For the six months ended June 30, 2013, the Company had a benefit of $48 million of losses and LAE recorded in earnings related to ABS CDO financial guarantee insurance policies after the elimination of a $26 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 substantially.

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 June 30, 2013, which included 84 structured CMBS pools, CRE CDOs and CRE loan pool policies totaling $41.6 billion of gross insured exposure. The Company considers the range of commutations achieved over the past several years with multiple counterparties. This approach results in an estimated price to commute the remaining policies with price estimates, based on this experience. It is customized by counterparty and is dependent on the level of dialogue with the counterparty and the credit quality and payment profile of the underlying exposure.

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

The last 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 last approach no adjustments were made for loans lower than $75 million regardless of any mitigating factors.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

The loss severities projected by these scenarios vary widely, from moderate to substantial losses. 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. Prior to June 30, 2013, the Company incorporated an additional approach based on recent Roll Rates experienced within each of the commercial mortgage-backed index series. This actuarial approach was eliminated as a result of more emphasis being placed on loan-specific scenarios.

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 six months ended June 30, 2013, the Company had a benefit of $38 million of losses and LAE recorded in earnings related to CRE CDO financial guarantee insurance policies. For the six months ended June 30, 2013, additional credit impairments and LAE on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be $399 million as a result of additional delinquencies and loan level liquidations, as well as continued refinements of MBIA s assessment of various commutation possibilities. The cumulative credit impairments and LAE on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be $4.0 billion through June 30, 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. During the second quarter of 2013, the Company paid claims on a CMBS pool transaction that experienced deterioration such that all remaining deductible was eliminated.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Loss and LAE Activity

Financial Guarantee Insurance Losses (Non-Derivative)

The Company s financial guarantee insurance losses and LAE for the six months ended June 30, 2013 are presented in the following table:

Losses and LAE

In millions	Second-lien RMBS	First-lien RMBS	Other[1]	Total
	Six Months Ended June 30, 2013			
Losses and LAE related to actual and expected payments	$ 99	$ (2)	$ 114	$ 211
Recoveries of actual and expected payments	(219)	(5)	9	(215)
Gross losses incurred	(120)	(7)	123	(4)
Reinsurance	-	-	(2)	(2)
Losses and LAE	$ (120)	$ (7)	$ 121	$ (6)

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

The second-lien RMBS recoveries of actual and expected payments included in the preceding table primarily include $308 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 $97 million reduction in excess spread. The losses and LAE related to actual and expected payments of $114 million in other, include $110 million of losses related to U.S. public finance transactions primarily related to certain general obligation issues. The second-lien RMBS losses and LAE related to actual and expected payments comprise net increases of previously established reserves.

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of June 30, 2013:

$ in millions	Caution List Low	Caution List Medium	Caution List High	Classified List	Total
	Surveillance Categories				
Number of policies	53	23	7	207	290
Number of issues[1]	28	16	6	139	189
Remaining weighted average contract period (in years)	8.0	4.9	10.3	9.3	8.5
Gross insured contractual payments outstanding:[2]					

Principal	$ 3,812	$ 1,263	$ 80	$ 8,653	$ 13,808
Interest	2,580	322	44	4,807	7,753
Total	$ 6,392	$ 1,585	$ 124	$ 13,460	$ 21,561
Gross claim liability	$ -	$ -	$ -	$ 1,600	$ 1,600
Less:					
Gross potential recoveries	-	-	-	1,496	1,496
Discount, net	-	-	-	241	241
Net claim liability (recoverable)	$ -	$ -	$ -	$ (137)	$ (137)
Unearned premium revenue	$ 124	$ 20	$ 1	$ 105	$ 250

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

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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

	Surveillance Categories				
$ in millions	**Caution List Low**	**Caution List Medium**	**Caution List High**	**Classified List**	**Total**
Number of policies	54	25	10	206	295
Number of issues[1]	29	15	10	136	190
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.

The gross claim liability as of June 30, 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 and U.S. public finance 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 June 30, 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 June 30, 2013**	**As of December 31, 2012**
Loss reserves (claim liability)	$ 711	$ 790
LAE reserves	63	63
Loss and LAE reserves	$ 774	$ 853
Insurance claim loss recoverable	$ (902)	$ (3,610)
LAE insurance loss recoverable	(5)	(38)
Insurance loss recoverable	$ (907)	$ (3,648)
Reinsurance recoverable on unpaid losses	$ 13	$ 14
Reinsurance recoverable on LAE reserves	1	-
Reinsurance recoverable on paid losses	-	1
Reinsurance recoverable on paid and unpaid losses	$ 14	$ 15

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

As of June 30, 2013, loss and LAE reserves include $1.2 billion of reserves for expected future payments offset by expected recoveries of such future payments of $397 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 June 30, 2013, the insurance loss recoverable principally related to expected future recoveries on second-lien RMBS transactions resulting from expected excess spread generated by performing loans in such transactions. As of 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.

To date, as a result of the Bank of America and Flagstar Bank settlements, as well as the agreement between Consenting Claimants, ResCap and Ally, in the ResCap bankruptcy proceeding discussed above, the Company expects to be reimbursed for the majority of its potential recoveries related to ineligible mortgage loans by the end of 2013, which are primarily included in Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company s consolidated balance sheets.

For the six months ended June 30, 2013 the Company collected approximately $2.9 billion, net of reinsurance, of which $2.8 billion, net of reinsurance related to insured second-lien RMBS transactions. The Company made payments of $223 million, of which $152 million related to insured second-lien RMBS transactions. For the six months ended June 30, 2013, the decrease in insurance loss recoverable related to paid losses totaled $2.7 billion, and primarily resulted from the collections of previously established recoveries related to the settlement with Bank of America on the ineligible mortgage loans related to insured second-lien RMBS transactions.

The following table presents the amounts of the Company s second-lien RMBS exposure, gross undiscounted claim liability and potential recoveries related to non-consolidated VIEs and consolidated VIEs, included in the Company s Classified List, as of June 30, 2013.

Second-lien RMBS Exposure		**Outstanding**		**Gross Undiscounted**	
$ in billions	**Issues**	**Gross Principal**	**Gross Interest**	**Claim Liability**	**Potential Recoveries**
Non-consolidated VIEs	23	$ 3.7	$ 1.3	$ 0.2	$ 0.9
Consolidated VIEs	11	$ 1.9	$ 0.7	$ 0.1	$ 1.4

The following table presents changes in the Company s loss and LAE reserves for the six months ended June 30, 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 June 30, 2013, the weighted average risk-free rate used to discount the Company s loss reserves (claim liability) was 1.98%. LAE reserves are expected to be settled within a one-year period and are not discounted.

In millions	**Changes in Loss and LAE Reserves for the Six Months Ended June 30, 2013**								
Gross Loss and LAE	**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 June 30, 2013**

Reserves as of December 31, 2012									
$ 853	$ (152)	$ 6	$ (62)	$ 47	$ 52	$ 13	$ 17	$ -	$ 774

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 and changes in discount rates, partially offset by changes in amount and timing of net payments.

21

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Current period changes in the Company s estimate of potential recoveries may be recorded as an insurance loss recoverable asset, netted against the gross loss and LAE reserve liability, or both. The following table presents changes in the Company s insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company s claim liability for the six months ended June 30, 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 Six Months Ended June 30, 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 June 30, 2013
Insurance loss recoverable	$ 3,648	$ (2,852)	$ 13	$ (22)	$ -	$ (1)	$ 154	$ (33)	$ 907
Recoveries on unpaid losses	332	-	2	(22)	-	-	83	2	397
Total	$ 3,980	$ (2,852)	$ 15	$ (44)	$ -	$ (1)	$ 237	$ (31)	$ 1,304

The Company s insurance loss recoverable decreased during 2013 primarily due to recoveries associated with issues outstanding as of December 31, 2012, which related to the settlement with Bank of America on the 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. Recoveries on unpaid losses increased primarily due to changes in assumptions on certain general obligation exposures and a toll road transaction, partially offset by changes in discount rates.

The following table presents the Company s total estimated recoveries from ineligible mortgage loans included in certain insured second-lien mortgage loan securitizations as of June 30, 2013. The total estimated recoveries from ineligible mortgage loans of $1.1 billion include $18 million recorded as Insurance loss recoverable and $1.1 billion recorded as Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company s consolidated balance sheets.

In millions

Total Estimated Recoveries from Ineligible Mortgage Loans as of December 31,	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 June 30, 2013

2012						
$ 3,583	$ 15	$ (3)	$ (2,897)	$ 1	$ 434	$ 1,133

The decrease in the Company s total estimated recoveries from ineligible mortgage loans in the preceding table primarily resulted from the collections of previously established recoveries related to the settlement with Bank of America and Flagstar Bank on the ineligible mortgage loans related to insured second-lien RMBS securitizations.

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

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

	Six Months Ended June 30,	
In millions	**2013**	**2012**
Loss adjustment expense incurred, gross	$ 33	$ 81

22

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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.

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 June 30, 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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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.

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.

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

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

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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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.

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.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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.

Approximately 99% of the balance sheet fair value of insured credit derivatives as of June 30, 2013 was valued based on the Binomial Expansion Technique (BET) Model. Approximately 1% of the balance sheet fair value of insured credit derivatives as of June 30, 2013 was valued based on the internally developed Direct Price Model and the dual-default model. The valuation of insured derivatives includes the impact of its credit standing. All of these derivatives are categorized as Level 3 of the fair value hierarchy as their fair value is derived using significant unobservable inputs.

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;

- Collateral assets are generally considered on an average basis rather than being modeled on an individual basis; and

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

2. BET Model Inputs

a. Credit spreads

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

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

Spread Hierarchy:

- Collateral-specific credit spreads when observable;
- Sector-specific spread tables by asset class and rating;
- Corporate spreads, including Bloomberg spread tables based on rating; and
- Benchmark from most relevant market source when corporate spreads are not directly relevant.

There were some transactions where the Company incorporated multiple levels within the hierarchy, including using actual collateral-specific credit spreads in combination with a calculated spread based on an assumed relationship. In those cases, MBIA classified the transaction as being benchmarked from the most relevant spread source even though the majority of the average spread was from actual collateral-specific spreads. As of June 30, 2013, sector-specific spreads were used in 11% of the transactions valued using the BET Model. Corporate spreads were used in 48% of the transactions and spreads benchmarked from the most relevant spread source were used for 41% 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 69% 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 June 30, 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.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Overall Model Results

As of June 30, 2013 and December 31, 2012, the Company s net insured derivative liability was $1.6 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 $485 million 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 June 30, 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 June 30, 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 June 30, 2013	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	$ 1,790	Quoted market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee	0% - 18% (4%)
Loan repurchase commitments	1,115	Discounted cash flow	Recovery rates	10% - 66% (34%)
			Breach rates	67% - 92% (77%)
Liabilities of consolidated VIEs:				
Variable interest entity notes	824	Quoted market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 29% (10%)
Credit derivative liabilities, net:				
CMBS	1,024	BET Model	Recovery rates	25% - 90% (60%)
			Nonperformance risk	9% - 53% (23%)
			Weighted average life (in years)	1.6 - 28.5 (3.8)
			CMBS spreads	1.2% - 25.3% (12%)
Multi-sector CDO	15	Direct Price Model	Nonperformance risk	53% - 53% (53%)
Other	609	BET Model	Recovery rates	42% - 70% (47%)
			Nonperformance risk	13% - 23% (21%)
			Weighted average life (in years)	0.2 - 3.8 (2.3)

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%)
	1,086	Discounted cash flow	Recovery rates	10% - 75% (47%)

Loan repurchase commitments				
			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 VIE notes of consolidated VIEs is the impact of the financial guarantee. The fair value of VIE notes is calculated by adding the value of the financial guarantee to the market value of VIE assets. The value of a financial guarantee is estimated by the Company as the present value of expected cash payments under the policy. As the value of the guarantee provided by the Company to the obligations issued by the VIE increases, the credit support adds value to the liabilities of the VIE. This results in an increase in the fair value of the liabilities of the VIE.

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 June 30, 2013 and December 31, 2012:

	Fair Value Measurements at Reporting Date Using				
In millions	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of June 30, 2013
Assets:					
Fixed-maturity investments:					
U.S. Treasury and government agency	$ 1,021	$ 220	$ -	$ -	$ 1,241
State and municipal bonds	-	1,394	63(1)	-	1,457
Foreign governments	94	90	3(1)	-	187
Corporate obligations	-	1,119	63(1)	-	1,182
Mortgage-backed securities:					
Residential mortgage-backed agency	-	907	3(1)	-	910
Residential mortgage-backed non-agency	-	80	1(1)	-	81
Commercial mortgage-backed	-	26	13(1)	-	39
Asset-backed securities:					
Collateralized debt obligations	-	68	85(1)	-	153
Other asset-backed	-	85	64(1)	-	149
Total fixed-maturity investments	1,115	3,989	295	-	5,399
Money market securities	1,067	1	-	-	1,068
Perpetual debt and equity securities	26	14	10(1)	-	50
Cash and cash equivalents	928	-	-	-	928
Derivative assets:					
Non-insured derivative assets:					
Interest rate derivatives	-	62	-	(59)	3
Total derivative assets	-	62	-	(59)	3

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of June 30, 2013**
Assets of consolidated VIEs:					
Corporate obligations	-	48	48(1)	-	96
Mortgage-backed securities:					
Residential mortgage-backed non-agency	-	265	2(1)	-	267
Commercial mortgage-backed	-	109	4(1)	-	113
Asset-backed securities:					
Collateralized debt obligations	-	20	35(1)	-	55
Other asset-backed	-	69	63(1)	-	132
Money market securities	321	-	-	-	321
Cash	78	-	-	-	78
Loans receivable	-	-	1,790	-	1,790
Loan repurchase commitments	-	-	1,115	-	1,115
Interest rate derivatives	-	1	-	-	1
Total assets	$ 3,535	$ 4,578	$ 3,362	$ (59)	$ 11,416
Liabilities:					
Medium-term notes	$ -	$ -	$ 188(1)	$ -	$ 188
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	7	1,648	-	1,655
Non-insured derivatives:					
Interest rate derivatives	-	209	-	(209)	-
Currency derivatives	-	1	-	(1)	-
Other liabilities:					
Warrants	-	85	-	-	85
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,766	824	-	2,590
Derivative liabilities:					
Interest rate derivatives	-	2	-	-	2
Currency derivatives	-	-	16(1)	-	16
Total liabilities	$ -	$ 2,070	$ 2,676	$ (210)	$ 4,536

(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)

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of December 31, 2012**
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)

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of December 31, 2012**
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.

Level 3 assets at fair value, as of June 30, 2013 and December 31, 2012 represented approximately 29% of total assets measured at fair value. Level 3 liabilities at fair value, as of June 30, 2013 and December 31, 2012 represented approximately 59% 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 June 30, 2013 and December 31, 2012:

In millions	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Balance as of June 30, 2013	Carry Value Balance as of June 30, 2013
Assets:					
Other investments	$ -	$ -	$ 9	$ 9	$ 9
Accrued investment income(1)	42	-	-	42	42
Receivable for investments sold(1)	12	-	-	12	12
Net cash collateral pledged(1)	55	-	-	55	55
Assets of consolidated VIEs:					
Investments held-to-maturity	-	-	2,690	2,690	2,818
Total assets	$ 109	$ -	$ 2,699	$ 2,808	$ 2,936
Liabilities:					
Investment agreements	$ -	$ -	$ 931	$ 931	$ 775
Medium-term notes	-	-	1,018	1,018	1,373
Long-term debt	-	1,371	-	1,371	1,524
Payable for investments purchased(2)	43	-	-	43	43
Accrued interest expense(2)	9	100	-	109	125
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	-	2,965	2,965	3,117
Total liabilities	$ 52	$ 1,471	$ 4,914	$ 6,437	$ 6,957
Financial Guarantees:					
Gross	$ -	$ -	$ 3,677	$ 3,677	$ 2,507
Ceded	-	-	85	85	85

(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)

	Fair Value Measurements at Reporting Date Using				
In millions	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Balance as of December 31, 2012	Carry Value Balance as of December 31, 2012
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 June 30, 2013 and 2012:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended June 30, 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 or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[1]	Transfers out of Level 3[1]	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of June 30, 2013
Assets:													
Foreign governments	$ 8	$ -	$ -	$ -	$ -	$ -	$ -	$ (8)	$ -	$ 3	$ -	$ 3	$ -
Corporate obligations	57	-	1	3	-	2	-	-	-	-	-	63	1
Residential mortgage-backed agency	-	-	-	-	-	-	-	-	-	3	-	3	-
Residential mortgage-backed non-agency	1	-	-	-	-	-	-	-	-	-	-	1	-
Commercial mortgage-backed	13	-	-	-	-	-	-	-	-	-	-	13	-
Collateralized debt obligations	37	(1)	-	2	-	61	-	(8)	(5)	9	(10)	85	1
Other asset-backed	67	-	-	(1)	-	3	-	(3)	-	2	(4)	64	-
State and municipal bonds	23	-	-	-	-	-	-	(2)	-	42	-	63	-
Perpetual debt and equity securities	10	-	-	-	-	-	-	-	-	-	-	10	-
Assets of consolidated VIEs:													
	79	(4)	(6)	6	-	-	-	(2)	(25)	-	-	48	(1)

Corporate obligations													
Residential mortgage-backed non-agency	6	-	(1)	-	-	-	-	-	-	-	(3)	2	-
Commercial mortgage-backed	28	-	-	-	-	-	-	-	(24)	-	-	4	-
Collateralized debt obligations	117	-	-	5	-	-	-	(1)	(86)	-	-	35	3
Other asset-backed	47	-	14	-	-	-	-	(6)	(2)	10	-	63	11
Loans receivable	1,819	-	212	-	-	-	-	(68)	(173)	-	-	1,790	212
Loan repurchase commitments	1,176	-	49	-	-	-	-	(110)	-	-	-	1,115	49
Total assets	$ 3,488	$ (5)	$ 269	$ 15	$ -	$ 66	$ -	$ (208)	$ (315)	$ 69	$ (17)	$ 3,362	$ 276

In millions	Balance, Beginning of Period	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3(1)	Transfers out of Level 3(1)	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of June 30, 2013
Liabilities:													
Medium-term notes	$ 181	$ -	$ 5	$ -	$ 2	$ -	$ -	$ -	$ -	$ -	$ -	$ 188	$ 7
Credit derivatives, net	2,994	1,532	(1,350)	-	-	-	-	(1,532)	-	4	-	1,648	162
Interest rate derivatives, net	(1)	-	1	-	1	-	-	-	-	-	(1)	-	(6)
Currency derivatives, net	1	-	(1)	-	1	-	-	-	-	-	(1)	-	-
Liabilities of consolidated VIEs:													
VIE notes	1,901	-	24	-	-	-	-	(26)	(1,075)	-	-	824	24
Currency derivatives, net	23	-	(4)	-	(3)	-	-	-	-	-	-	16	(7)
Total liabilities	$ 5,099	$ 1,532	$ (1,325)	$ -	$ 1	$ -	$ -	$ (1,558)	$ (1,075)	$ 4	$ (2)	$ 2,676	$ 180

(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 June 30, 2012

In millions	Balance, Beginning of Period	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[1]	Transfers out of Level 3[1]	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of June 30, 2012
Assets:													
Foreign governments	$ 12	$ -	$ -	$ -	$ (1)	$ 7	$ -	$ (3)	$ (3)	$ -	$ -	$ 12	$ -
Corporate obligations	185	-	2	13	(2)	16	-	(15)	(115)	14	-	98	2
Residential mortgage-backed agency	9	-	-	-	-	-	-	-	-	4	(9)	4	-
Residential mortgage-backed non-agency	14	-	-	(4)	-	-	-	(5)	(1)	26	-	30	-
Commercial mortgage-backed	25	-	-	2	-	-	-	-	-	-	-	27	-
Collateralized debt obligations	35	(1)	-	3	-	-	-	(4)	(7)	4	(1)	29	-
Other asset-backed	115	(2)	-	10	-	2	-	(2)	(50)	4	(5)	72	-
State and municipal bonds	27	-	-	-	-	-	-	(2)	-	-	-	25	-
Perpetual debt and equity securities	10	-	-	-	-	-	-	-	-	3	-	13	-
Assets of consolidated VIEs:													
Corporate obligations	75	-	(6)	(6)	-	28	-	(2)	-	6	-	95	-
Residential mortgage-backed	25	-	1	-	-	-	-	(2)	(15)	1	-	10	-

non-agency													
Commercial mortgage-backed	15	-	1	-	-	-	-	(1)	(8)	5	-	12	1
Collateralized debt obligations	218	-	(2)	(3)	-	-	-	-	(75)	2	-	140	6
Other asset-backed	71	-	3	-	-	4	-	(3)	(36)	3	-	42	2
Loans receivable	2,025	-	(49)	-	-	-	-	(71)	(2)	-	-	1,903	(49)
Loan repurchase commitments	1,076	-	(44)	-	-	-	-	-	-	-	-	1,032	(44)
Total assets	$ 3,937	$ (3)	$ (94)	$ 15	$ (3)	$ 57	$ -	$ (110)	$ (312)	$ 72	$ (15)	$ 3,544	$ (82)

In millions	Balance, Beginning of Period	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[(1)]	Transfers out of Level 3[(1)]	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of June 30, 2012
Liabilities:													
Medium-term notes	$ 174	$ -	$ (16)	$ -	$ (7)	$ -	$ -	$ -	$ -	$ -	$ -	$ 151	$ (16)
Credit derivatives, net	4,487	443	(1,202)	-	-	-	-	(443)	-	-	-	3,285	(641)
Interest rate derivatives, net	(4)	-	-	-	-	-	-	-	-	-	-	(4)	-
Liabilities of consolidated VIEs:													
VIE notes	2,864	-	62	-	-	-	-	(76)	(983)	-	-	1,867	62
Credit derivatives, net	82	-	-	-	-	-	-	-	(82)	-	-	-	-
Currency derivatives, net	19	-	2	-	-	-	-	-	-	-	-	21	2
Total liabilities	$ 7,622	$ 443	$ (1,154)	$ -	$ (7)	$ -	$ -	$ (519)	$ (1,065)	$ -	$ -	$ 5,320	$ (593)

(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 $73 million and $19 million, respectively, for the three months ended June 30, 2013. Transfers into and out of Level 2 were $19 million and $73 million, respectively, for the three months ended June 30, 2013. Transfers into Level 3 were principally related to state and municipal bonds, CDOs, and other ABS, where inputs, which are significant to their valuation, became unobservable during the quarter. CDOs, other ABS and RMBS 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.

Transfers into and out of Level 3 were $72 million and $15 million, respectively, for the three months ended June 30, 2012. Transfers into and out of Level 2 were $15 million and $72 million, respectively, for the three months ended June 30, 2012. Transfers into Level 3 were principally related to RMBS non-agency and corporate obligations where inputs, which are significant to their valuation, became unobservable during the quarter. RMBS agency and other ABS 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.

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 six months ended June 30, 2013 and 2012:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Six Months Ended June 30, 2013

In millions	Balance, Beginning of Year	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[1]	Transfers out of Level 3[1]	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of June 30, 2013
Assets:													
Foreign governments	$ 3	$ -	$ -	$ -	$ -	$ -	$ -	$ (8)	$ -	$ 11	$ (3)	$ 3	$ -
Corporate obligations	76	2	5	4	(1)	2	-	(1)	(24)	-	-	63	5

Residential mortgage-backed agency	-	-	-	-	-	-	-	-	-	3	-	3	-
Residential mortgage-backed non-agency	4	-	-	-	-	-	-	(3)	-	-	-	1	-
Commercial mortgage-backed	28	-	-	4	-	-	-	-	(19)	1	(1)	13	-
Collateralized debt obligations	31	(2)	-	4	-	61	-	(12)	(5)	19	(11)	85	1
Other asset-backed	26	-	-	(1)	-	4	-	(5)	-	44	(4)	64	-
State and municipal bonds	103	2	-	(1)	-	-	-	(3)	(12)	42	(68)	63	-
Perpetual debt and equity securities	14	-	-	-	(1)	-	-	-	-	-	(3)	10	-
Assets of consolidated VIEs:													
Corporate obligations	78	(4)	(8)	6	-	-	-	(3)	(24)	3	-	48	(1)
Residential mortgage-backed non-agency	6	-	6	-	-	-	-	(7)	-	1	(4)	2	-
Commercial mortgage-backed	7	-	1	-	-	-	-	-	(24)	20	-	4	1
Collateralized debt obligations	125	-	(9)	5	-	-	-	(1)	(85)	1	(1)	35	4
Other asset-backed	64	-	-	-	-	-	-	(9)	(2)	10	-	63	4
Loans receivable	1,881	-	221	-	-	-	-	(137)	(175)	-	-	1,790	207
Loan repurchase commitments	1,086	-	139	-	-	-	-	(110)	-	-	-	1,115	139
Total assets	$ 3,532	$ (2)	$ 355	$ 21	$ (2)	$ 67	$ -	$ (299)	$ (370)	$ 155	$ (95)	$ 3,362	$ 360

40

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

In millions	Balance, Beginning of Year	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3(1)	Transfers out of Level 3(1)	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of June 30, 2013
Liabilities:													
Medium-term notes	$ 165	$ -	$ 25	$ -	$ (2)	$ -	$ -	$ -	$ -	$ -	$ -	$ 188	$ 23
Credit derivatives, net	2,921	1,521	(1,277)	-	-	-	-	(1,521)	-	4	-	1,648	218
Interest rate derivatives, net	(1)	-	2	-	-	-	-	-	-	-	(1)	-	(6)
Currency derivatives, net	1	-	-	-	-	-	-	-	-	-	(1)	-	-
Liabilities of consolidated VIEs:													
VIE notes	1,932	-	146	-	-	-	-	(178)	(1,076)	-	-	824	59
Currency derivatives, net	21	-	(5)	-	-	-	-	-	-	-	-	16	(5)
Total liabilities	$ 5,039	$ 1,521	$ (1,109)	$ -	$ (2)	$ -	$ -	$ (1,699)	$ (1,076)	$ 4	$ (2)	$ 2,676	$ 289

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

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

In millions	Balance, Beginning of Year	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3(1)	Transfers out of Level 3(1)	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of June 30, 2012
Assets:													
Foreign governments	$ 11	$ -	$ -	$ -	$ -	$ 13	$ -	$ (9)	$ (3)	$ -	$ -	$ 12	$ -
Corporate obligations	207	(15)	5	26	-	15	-	(16)	(138)	14	-	98	5
Residential mortgage-backed agency	8	-	-	1	-	-	-	-	-	4	(9)	4	-
Residential mortgage-backed non-agency	17	-	-	(3)	-	-	-	(7)	(1)	26	(2)	30	-
Commercial mortgage-backed	24	-	-	4	-	-	-	-	-	-	(1)	27	-
Collateralized debt obligations	60	(4)	-	9	-	-	-	(9)	(10)	10	(27)	29	-
Other asset-backed	317	(61)	-	73	-	4	-	(8)	(252)	6	(7)	72	-
State and municipal bonds	28	-	-	-	-	-	-	(3)	-	-	-	25	-
Perpetual debt and equity securities	11	-	-	-	-	-	-	-	-	4	(2)	13	-
Assets of consolidated VIEs:													
Corporate obligations	69	-	(5)	(6)	-	28	-	(3)	-	12	-	95	1
Residential mortgage-backed non-agency	21	-	6	-	-	-	-	(4)	(15)	3	(1)	10	5
Commercial mortgage-backed	22	-	2	-	-	-	-	(3)	(8)	5	(6)	12	1
Collateralized debt obligations	203	-	-	(2)	-	-	-	-	(75)	14	-	140	7
Other asset-backed	67	-	5	-	-	4	-	(3)	(36)	5	-	42	4
Loans receivable	2,046	-	(10)	-	-	-	-	(131)	(2)	-	-	1,903	(10)
Loan repurchase commitments	1,077	-	(45)	-	-	-	-	-	-	-	-	1,032	(45)
Total assets	$ 4,188	$ (80)	$ (42)	$ 102	$ -	$ 64	$ -	$ (196)	$ (540)	$ 103	$ (55)	$ 3,544	$ (32)

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

In millions	Balance, Beginning of Year	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3(1)	Transfers out of Level 3(1)	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of June 30, 2012
Liabilities:													
Medium-term notes	$ 165	$ -	$ (11)	$ -	$ (3)	$ -	$ -	$ -	$ -	$ -	$ -	$ 151	$ (11)
Credit derivatives, net	4,790	463	(1,505)	-	-	-	-	(463)	-	-	-	3,285	(571)
Interest rate derivatives, net	(3)	-	(1)	-	-	-	-	-	-	-	-	(4)	7
Liabilities of consolidated VIEs:													
VIE notes	2,889	-	221	-	-	-	-	(260)	(983)	-	-	1,867	165
Credit derivatives, net	80	-	2	-	-	-	-	-	(82)	-	-	-	-
Currency derivatives, net	17	-	4	-	-	-	-	-	-	-	-	21	4
Total liabilities	$ 7,938	$ 463	$ (1,290)	$ -	$ (3)	$ -	$ -	$ (723)	$ (1,065)	$ -	$ -	$ 5,320	$ (406)

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

Transfers into and out of Level 3 were $159 million and $97 million, respectively, for the six months ended June 30, 2013. Transfers into and out of Level 2 were $97 million and $159 million, respectively, for the six months ended June 30, 2013. Transfers into Level 3 were principally related to other ABS, state and municipal bonds, CDOs and CMBS where inputs, which are significant to their valuation, became unobservable during the quarter. State and municipal bonds and CDOs 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 $103 million and $55 million, respectively, for the six months ended June 30, 2012. Transfers into and out of Level 2 were $55 million and $103 million, respectively, for the six months ended June 30, 2012. Transfers into Level 3 were principally related to RMBS non-agency and corporate obligations, CDOs and other ABS where inputs, which are significant to their valuation, became unobservable during the year. CDOs and RMBS agency comprised the majority of the transferred instruments out of Level 3 where inputs, which are significant to their valuation, became observable during the year. 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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Gains and losses (realized and unrealized) included in earnings related to Level 3 assets and liabilities for the three months ended June 30, 2013 and 2012 are reported on the Company s consolidated statements of operations as follows:

	Three Months Ended June 30, 2013		Three Months Ended June 30, 2012	
In millions	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 June 30, 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 June 30, 2012
Revenues:				
Unrealized gains (losses) on insured derivatives	$ 1,350	$ (162)	$ 1,202	$ 641
Realized gains (losses) and other settlements on insured derivatives	(1,532)	-	(443)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	(8)	1	18	18
Net investment losses related to other-than-temporary impairments	-	-	(3)	-
Revenues of consolidated VIEs:				
Net gains (losses) on financial instruments at fair value and foreign exchange	244	257	(160)	(148)
Total	$ 54	$ 96	$ 614	$ 511

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Gains and losses (realized and unrealized) included in earnings relating to Level 3 assets and liabilities for the six months ended June 30, 2013 and 2012 are reported on the Company s consolidated statements of operations as follows:

	Six Months Ended June 30, 2013		Six Months Ended June 30, 2012	
In millions	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 June 30, 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 June 30, 2012
Revenues:				
Net investment income	$ -	$ -	$ (5)	$ -
Unrealized gains (losses) on insured derivatives	1,277	(218)	1,505	571
Realized gains (losses) and other settlements on insured derivatives	(1,521)	-	(463)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	(18)	(11)	2	9
Net investment losses related to other-than-temporary impairments	-	-	(60)	-
Revenues of consolidated VIEs:				
Net gains (losses) on financial instruments at fair value and foreign exchange	205	300	(274)	(206)
Total	$ (57)	$ 71	$ 705	$ 374

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.

The following table presents the changes in fair value included in the Company s consolidated statements of operations for the three and six months ended June 30, 2013 and 2012 for all financial instruments for which the fair value option was elected:

	Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange			
	Three Months Ended June 30,		Six Months Ended June 30,	
In millions	**2013**	**2012**	**2013**	**2012**
Fixed-maturity securities held at fair value	$ (16)	$ (56)	$ 2	$ (57)
Loans receivable at fair value:				
Residential mortgage loans	145	(117)	71	(99)
Other loans	-	(2)	13	(41)
Loan repurchase commitments	50	44	139	43
Long-term debt	(160)	135	(79)	128

Substantially all gains and losses included in earnings during the three and six months ended June 30, 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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding as of June 30, 2013 and December 31, 2012 for loans and VIE notes for which the fair value option was elected:

	As of June 30, 2013			As of December 31, 2012		
In millions	**Contractual Outstanding Principal**	**Fair Value**	**Difference**	**Contractual Outstanding Principal**	**Fair Value**	**Difference**
Loans receivable at fair value:						
Residential mortgage loans	$ 2,025	$ 1,704	$ 321	$ 2,307	$ 1,735	$ 572
Residential mortgage loans (90 days or more past due)	228	86	142	244	54	190
Other loans	-	-	-	22	22	-
Other loans (90 days or more past due)	-	-	-	197	70	127
Total loans receivable at fair value	$ 2,253	$ 1,790	$ 463	$ 2,770	$ 1,881	$ 889
Variable interest entity notes	$ 4,013	$ 2,590	$ 1,423	$ 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 June 30, 2013 and December 31, 2012:

	June 30, 2013				
In millions	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Other-Than-Temporary Impairments(1)**
AFS Investments					
Fixed-maturity investments:					
U.S. Treasury and government agency	$ 1,203	$ 23	$ (8)	$ 1,218	$ -
State and municipal bonds	1,463	35	(43)	1,455	-
Foreign governments	178	9	-	187	-
Corporate obligations	1,055	27	(38)	1,044	-
Mortgage-backed securities:					
Residential mortgage-backed agency	892	11	(21)	882	-
Residential mortgage-backed non-agency	71	11	(6)	76	-
Commercial mortgage-backed	34	-	(1)	33	-
Asset-backed securities:					
Collateralized debt obligations	215	1	(66)	150	(18)

Other asset-backed	145	2	(12)	135	-
Total fixed-maturity investments	5,256	119	(195)	5,180	(18)
Money market securities	1,057	-	-	1,057	-
Perpetual debt and equity securities	13	1	-	14	-
Assets of consolidated VIEs:					
Money market securities	321	-	-	321	-
Total AFS investments	$ 6,647	$ 120	$ (195)	$ 6,572	$ (18)
HTM Investments					
Assets of consolidated VIEs:					
Corporate obligations	$ 2,818	$ 3	$ (131)	$ 2,690	$ -
Total HTM investments	$ 2,818	$ 3	$ (131)	$ 2,690	$ -

(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)

	December 31, 2012				
In millions	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Other-Than-Temporary Impairments(1)
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.

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 June 30, 2013. Contractual maturity may differ from expected maturity as borrowers may have the right to call or prepay obligations.

	AFS Securities		HTM Securities Consolidated VIEs	
In millions	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 933	$ 934	$ -	$ -
Due after one year through five years	798	812	-	-
Due after five years through ten years	819	818	-	-
Due after ten years	1,349	1,340	2,818	2,690
Mortgage-backed and asset-backed	1,357	1,276	-	-
Total fixed-maturity investments	$ 5,256	$ 5,180	$ 2,818	$ 2,690

Deposited and Pledged Securities

The fair value of securities on deposit with various regulatory authorities was $11 million and $10 million as of June 30, 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 June 30, 2013 and December 31, 2012, the fair value of securities pledged as collateral for these investment agreements approximated $762 million and $820 million, respectively. The Company s collateral as of June 30, 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 $33 million and $144 million as of June 30, 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 June 30, 2013 and December 31, 2012:

	June 30, 2013					
	Less than 12 Months		12 Months or Longer		Total	
In millions	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AFS Investments						
Fixed-maturity investments:						
U.S. Treasury and government agency	$ 690	$ (8)	$ 1	$ -	$ 691	$ (8)
State and municipal bonds	696	(40)	60	(3)	756	(43)
Foreign governments	12	-	-	-	12	-
Corporate obligations	519	(24)	47	(14)	566	(38)
Mortgage-backed securities:						
Residential mortgage-backed agency	556	(21)	33	-	589	(21)
Residential mortgage-backed non-agency	5	-	20	(6)	25	(6)
Commercial mortgage-backed	25	(1)	-	-	25	(1)
Asset-backed securities:						
Collateralized debt obligations	14	-	124	(66)	138	(66)
Other asset-backed	23	-	62	(12)	85	(12)
Total fixed-maturity investments	2,540	(94)	347	(101)	2,887	(195)
Perpetual debt and equity securities	6	-	-	-	6	-
Total AFS investments	$ 2,546	$ (94)	$ 347	$ (101)	$ 2,893	$ (195)
HTM Investments						
Assets of consolidated VIEs:						
Corporate obligations	$ 306	$ (10)	$ 1,304	$ (121)	$ 1,610	$ (131)
Total HTM investments	$ 306	$ (10)	$ 1,304	$ (121)	$ 1,610	$ (131)

48

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 7: Investments (continued)

	December 31, 2012					
	Less than 12 Months		12 Months or Longer		Total	
In millions	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 securities increased as of June 30, 2013 compared with December 31, 2012 primarily due to market price depreciation caused by rising interest rates. Gross unrealized losses on HTM securities decreased as of June 30, 2013 compared with December 31, 2012 primarily due to market price appreciation driven by a decline in credit spreads.

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 June 30, 2013 and December 31, 2012 was 20 and 23 years, respectively. As of June 30, 2013 and December 31, 2012, there were 70 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 40 and 89 securities, respectively, were below book value by more than 5%.

The following table presents the distribution of securities in an unrealized loss position for a continuous twelve-month period or longer by percentage of fair value below book value by more than 5%:

	AFS Securities			HTM Securities		
Percentage of Fair Value Below Book Value	**Number of Securities**	**Book Value (in millions)**	**Fair Value (in millions)**	**Number of Securities**	**Book Value (in millions)**	**Fair Value (in millions)**
> 5% to 15%	13	$ 114	$ 104	-	$ -	$ -
> 15% to 25%	10	118	94	1	575	478
> 25% to 50%	5	10	6	-	-	-
> 50%	11	78	17	-	-	-
Total	39	$ 320	$ 221	1	$ 575	$ 478

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 June 30, 2013 for which fair value was less than amortized cost. The credit ratings are based on ratings from Moody s as of June 30, 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	
Asset Type	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	$ 14	$ -	$ 62	$ (5)	$ 3	$ -	$ 4	$ -	$ 140	$ (73)	$ -	$ -	$ 223	$ (78)
MBS	589	(21)	6	-	7	-	17	(1)	5	(1)	15	(5)	639	(28)
Corporate obligations	47	(1)	164	(7)	238	(13)	99	(16)	18	(1)	-	-	566	(38)
Total	$ 650	$ (22)	$ 232	$ (12)	$ 248	$ (13)	$ 120	$ (17)	$ 163	$ (75)	$ 15	$ (5)	$ 1,428	$ (144)

The total ABS, MBS and corporate obligations reported in the preceding table include those which are guaranteed by financial guarantors. In addition, the following table presents information on ABS, MBS and corporate obligations guaranteed by the Company and third-party financial guarantors.

			Insured Securities Rated Below Investment Grade without the Effect of Guarantee	
Asset Type	Average Credit Rating with the Effect of Guarantee	Average Credit Rating without the Effect of Guarantee	(in millions) Fair Value	Percentage
ABS	Below investment grade	Below investment grade	$ 105	65 %
MBS	Baa	Below investment grade	15	87 %
Corporate obligations	Baa	Baa	-	- %

Refer to the table in the Determination of Credit Loss Guaranteed by the Company and Other Third-Party Guarantors section within the OTTI section of this note for information on the insured securities included in the table above.

The Company concluded that it does not have the intent to sell securities in an unrealized loss position and it is more likely than not, that it would not have to sell these securities before recovery of their cost basis. In making this conclusion, the Company examined the cash flow projections for its investment portfolios, the potential sources and uses of cash in its businesses, and the cash resources available to its business other than sales of securities. It also considered the existence of any risk management or other plans as of June 30, 2013 that would require the sale of impaired securities. Impaired securities that the Company intends to sell before the expected recovery of such securities fair values have been written down to fair value.

Other-Than-Temporary Impairments

Evaluating AFS Securities for OTTI

The Company has an ongoing review process for all securities in its investment portfolio, including a quarterly assessment of OTTI. This evaluation includes both qualitative and quantitative considerations. In assessing whether a decline in value is related to a credit loss, the Company considers several factors, including but not limited to (i) the magnitude and duration of declines in fair value; (ii) the reasons for the declines in fair value, such as general credit spread movements in each asset-backed sector, transaction-specific changes in credit spreads, credit rating downgrades, modeled defaults, and principal and interest payment priorities within each investment structure; and (iii) any guarantees associated with a security such as those provided by financial guarantee insurance companies, including MBIA Corp. and National.

In calculating credit-related losses, the Company utilizes cash flow modeling based on the type of security. The Company s cash flow analysis considers all sources of cash, including credit enhancement, that support the payment of amounts owed by an issuer of a security. This includes the consideration of cash expected to be provided by financial guarantors, including MBIA Corp., resulting from an actual or potential insurance policy claim. In general, any change in the amount and/or timing of cash flows received or expected to be received, whether or not such cash flows are contractually defined, is reflected in the Company s cash flow analysis for purposes of assessing an OTTI loss on an impaired security.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 7: Investments (continued)

Each quarter, an internal committee, comprising staff that is independent of the Company s evaluation process for determining OTTI of securities, reviews and approves the valuation of investments. Among other responsibilities, this committee ensures that the Company s process for identifying and calculating OTTI, including the use of models and assumptions, is reasonable and complies with the Company s internal policy.

Determination of Credit Loss on ABS, MBS and Corporate Obligations

Investments with unrealized losses that met the above criteria were tested for OTTI and principally related to ABS, MBS and corporate obligations.

ABS investments are evaluated for OTTI using historical collateral performance, deal waterfall and structural protections, credit ratings, and forward looking projections of collateral performance based on business and economic conditions specific to each collateral type and risk. The underlying collateral is evaluated to identify any specific performance concerns, and stress scenarios are considered in forecasting ultimate returns of principal. Based on this evaluation, if a principal default is projected for a security, estimated future cash flows are discounted at the security s interest rate used to recognize interest income on the security. For CDO investments, the Company utilizes the same tools as for RMBS investments discussed below, aggregating the bond level cash flows to the CDO investment level. If the present value of cash flows is less than the Company s amortized cost for the security, the difference is recorded as an OTTI loss.

RMBS investments are evaluated for OTTI using several quantitative tools. Loan level data are obtained and analyzed in a model that produces prepayment, default, and severity vectors. The model utilizes macro inputs, including housing price assumptions and interest rates. The vector outputs are used as inputs to a third-party cash flow model, which considers deal waterfall dynamics and structural features, to generate cash flows for an RMBS investment. The expected cash flows of the security are then discounted at the interest rate used to recognize interest income of the security to arrive at a present value amount. If the present value of the cash flows is less than the Company s amortized cost for the investment, the difference is recorded as an OTTI loss.

Corporate obligation investments are evaluated for OTTI using credit analysis techniques. The Company s analysis includes a detailed review of a number of quantitative and qualitative factors impacting the value of an individual security. These factors include the interest rate of the security (fixed or floating), the security s current market spread, any collateral supporting the security, the security s position in the issuer s capital structure, and credit rating upgrades or downgrades. Additionally, these factors include an assessment of various issuer-related credit metrics including market capitalization, earnings, cash flow, capitalization, interest coverage, leverage, liquidity, management and a third-party quantitative default probability model. The Company s analysis is augmented by comparing market prices for similar securities of other issuers in the same sector, as well as any recent corporate or government actions that may impact the ultimate return of principal. If the Company determines that, after considering these factors, a principal default is projected, a recovery analysis is performed using the above data. If the Company s estimated recovery value for the security is less than its amortized cost, the difference is recorded as an OTTI loss.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 7: Investments (continued)

For the six months ended June 30, 2012, the credit losses recognized in earnings were related to RMBS and CDOs. There were no impairments in 2013. The following table presents a summary of the significant inputs considered in determining the measurement of the credit losses on securities in which a portion of the impairment is included in AOCI:

Asset-backed Securities	**Six Months Ended June 30, 2012**
Expected size of losses(1):	
Range(2)	9.73% to 100.00%
Weighted average(3)	92.10%
Current subordination levels(4):	
Range(2)	0.00% to 0.00%
Weighted average(3)	0.00%
Prepayment speed (annual constant prepayment rate)(5):	
Range(2)	0.00% to 49.60%
Weighted average(3)	11.59%

(1) - Represents future expected credit losses on impaired assets expressed as a percentage of total outstanding balance.

(2) - Represents the range of inputs/assumptions based upon the individual securities within each category.

(3) - Calculated by weighting the relevant input/assumption for each individual security by the outstanding notional of the security.

(4) - Represents current level of credit protection (subordination) for the securities, expressed as a percentage of the balance of the collateral group backing the bond.

(5) - Values represent high and low points of lifetime vectors of constant prepayment rates.

Determination of Credit Loss Guaranteed by the Company and Other Third-Party Guarantors

The Company does not record OTTI related to credit concerns about issuers of securities insured by MBIA Corp. and National since investors in these securities, including MBIA, are guaranteed payment of principal and interest when due by MBIA. Securities insured by the Company, whether or not owned by the Company, are evaluated for impairment as part of its insurance surveillance process and, therefore, losses on securities insured by the Company are recorded in accordance with its loss reserving policy. Refer to 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 for information about the Company s loss reserving policy and Note 5: Loss and Loss Adjustment Expense Reserves for information about loss reserves.

In considering cash expected to be provided from other third-party financial guarantors, the Company assesses the financial guarantor s ability to make claim payments under a variety of scenarios that test the guarantor s ultimate claims paying ability. The weighted average outcome of these scenarios, combined with the cash flows provided by the insured security, are used to determine the recoverability of the Company s amortized cost.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 7: Investments (continued)

The following table provides information about securities held by the Company as of June 30, 2013 that were in an unrealized loss position and insured by a financial guarantor, along with the amount of insurance loss reserves corresponding to the par amount owned by the Company:

In millions	Fair Value	Unrealized Loss	Insurance Loss Reserve (2)
Asset-backed:			
MBIA(1)	$ 151	$ (56)	$ 15
Other	11	(4)	-
Total asset-backed	162	(60)	15
Mortgage-backed:			
MBIA(1)	2	-	-
Other	15	(1)	-
Total mortgage-backed	17	(1)	-
Corporate obligations:			
Other	11	(9)	-
Total corporate obligations	11	(9)	-
Other:			
MBIA(1)	97	(4)	-
Other	12	-	-
Total other	109	(4)	-
Total	$ 299	$ (74)	$ 15

(1) - Includes investments insured by MBIA Corp. and National.

(2) - Insurance loss reserve estimates are based on the proportion of par value owned to the total amount of par value insured.

Credit Loss Rollforward

The portion of certain OTTI losses on fixed-maturity securities that does not represent credit losses is recognized in AOCI. For these impairments, the net amount recognized in earnings represents the difference between the amortized cost of the security and the net present value of its projected future discounted cash flows prior to impairment. Any remaining difference between the fair value and amortized cost is recognized in AOCI. The following table presents the amount of credit loss impairments recognized in earnings on fixed-maturity securities held by MBIA as of the dates indicated, for which a portion of the OTTI losses was recognized in AOCI, and the corresponding changes in such amounts.

In millions Credit Losses Recognized in Earnings Related to Other-Than-Temporary Impairments	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Beginning balance	$ 195	$ 277	$ 197	$ 341
Additions for credit loss impairments recognized in the current period on securities previously impaired	-	1	-	3
Reductions for credit loss impairments previously recognized on securities sold during the period	(8)	(9)	(10)	(16)
Reductions for credit loss impairments previously recognized on securities impaired to fair value during the period(1)	-	-	-	(59)
Reductions for increases in cash flows expected to be collected over the remaining life of the security	(1)	-	(1)	-
Ending balance	$ 186	$ 269	$ 186	$ 269

(1) - Represents circumstances where the Company determined in the current period that it intends to sell the security or it is more likely than not that it will be required to sell the security before recovery of the security s amortized cost.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 7: Investments (continued)

Sales of Available-For-Sale Investments

Gross realized gains and losses are recorded in Net gains (losses) on financial instruments at fair value and foreign exchange in the Company s consolidated statements of operations. The proceeds and gross realized gains and losses from sales of AFS investments for the six months ended June 30, 2013 and 2012 are as follows:

In millions	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Proceeds from sales	$ 1,436	$ 2,482	$ 2,314	$ 4,534
Gross realized gains	$ 11	$ 27	$ 47	$ 58
Gross realized losses	$ (7)	$ (16)	$ (10)	$ (96)

Note 8: Derivative Instruments

Overview

MBIA has entered into derivative instruments through its financial guarantee of CDS and for purposes of hedging risks associated with existing assets and liabilities and forecasted transactions. The Company accounts for derivative instruments in accordance with the accounting principles for derivative and hedging activities, which requires that all such instruments be recorded on the balance sheet at fair value. Refer to Note 6: Fair Value of Financial Instruments for the method of determining the fair value of derivative instruments.

U.S. Public Finance Insurance

The Company s derivative exposure within its U.S. public finance insurance operations primarily consists of insured interest rate and inflation-linked swaps related to insured U.S. public finance debt issues. These derivatives do not qualify for the financial guarantee scope exception. The Company has also purchased certain investments containing embedded derivatives. All derivatives are recorded at fair value on the Company s consolidated balance sheets with the changes in fair value recorded on the Company s consolidated statements of operations within Unrealized gains (losses) on insured derivatives, for the insured derivatives, or Net gains (losses) on financial instruments at fair value and foreign exchange for the embedded derivatives.

Structured Finance and International Insurance

The Company entered into derivative instruments that it viewed as an extension of its core financial guarantee business but which do not qualify for the financial guarantee scope exception and, therefore, must be recorded at fair value on the balance sheet. These insured CDS contracts, primarily referencing corporate, asset-backed, residential mortgage-backed, commercial mortgage-backed, CRE loans and CDO securities, are intended to be held for the entire term of the contract absent a negotiated settlement with the counterparty.

Changes in the fair value of derivatives, excluding insured derivatives, are recorded each period in current earnings within Net gains (losses) on financial instruments at fair value and foreign exchange. Changes in the fair value of insured derivatives are recorded each period in current earnings within Net change in fair value of insured derivatives. The net change in the fair value of the Company s insured derivatives has two primary components: (i) realized gains (losses) and other settlements on insured derivatives and (ii) unrealized gains (losses) on insured derivatives. Realized gains (losses) and other settlements on insured derivatives include (i) premiums received and receivable on sold CDS contracts, (ii) premiums paid and payable to reinsurers in respect to CDS contracts, (iii) net amounts received or paid on reinsurance commutations, (iv) losses paid and payable to CDS contract counterparties due to the occurrence of a credit event or settlement agreement, (v) losses recovered and recoverable on purchased CDS contracts due to the occurrence of a credit event or settlement agreement and (vi) fees relating to CDS contracts. The Unrealized gains (losses) on insured derivatives include all other changes in fair value of the insured derivative contracts.

In certain instances, the Company s structured finance and international insurance business purchased or issued securities that contain embedded derivatives. In accordance with the accounting guidance for derivative instruments and hedging activities, the balance sheet location of the Company s embedded derivative instruments is determined by the location of the related security.

Variable Interest Entities

VIEs consolidated by the Company have entered into derivative instruments primarily consisting of interest rate swaps. Interest rate swaps are entered into to mitigate the risks associated with fluctuations in interest rates or fair values of certain contracts.

54

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 8: Derivative Instruments (continued)

Asset/Liability Products

The Company s asset/liability products business has entered into derivative instruments primarily consisting of interest rate swaps, cross currency swaps, and CDS contracts. Interest rate swaps are entered into to hedge the risks associated with fluctuations in interest rates or fair values of certain contracts. Cross currency swaps are entered into to hedge the variability in cash flows resulting from fluctuations in foreign currency rates. CDS contracts are entered into to hedge credit risk or to replicate investments in cash assets consistent with the Company s risk objectives and credit guidelines for its asset management business.

In certain instances, the Company s asset/liability products business purchased or issued securities that contain embedded derivatives. In accordance with the accounting guidance for derivative instruments and hedging activities, the balance sheet location of the Company s embedded derivative instruments is determined by the location of the related security.

Changes in the fair value of the Company s asset/liability products business derivatives are recorded on the Company s consolidated statements of operations within Net gains (losses) on financial instruments at fair value and foreign exchange .

Credit Derivatives Sold

The following tables present information about credit derivatives sold by the Company s insurance operations that were outstanding as of June 30, 2013 and December 31, 2012. Credit ratings represent the lower of underlying ratings assigned to the collateral by Moody s, S&P or MBIA.

$ in millions				**As of June 30, 2013**				
				Notional Value				
Credit Derivatives Sold	**Weighted Average Remaining Expected Maturity**	**AAA**	**AA**	**A**	**BBB**	**Below Investment Grade**	**Total Notional**	**Fair Value Asset (Liability)**
Insured credit default swaps	2.8 Years	$ 7,418	$ 3,217	$ 2,856	$ 7,140	$ 6,195	$ 26,826	$ (1,641)
Insured swaps	19.1 Years	-	84	3,666	1,789	-	5,539	(7)
All others	28.5 Years	-	-	-	-	36	36	(7)
Total notional		$ 7,418	$ 3,301	$ 6,522	$ 8,929	$ 6,231	$ 32,401	
Total fair value		$ (4)	$ -	$ (6)	$ (603)	$ (1,042)		$ (1,655)

$ in millions				**As of December 31, 2012**				
				Notional Value				
Credit Derivatives Sold	**Weighted Average**	**AAA**	**AA**	**A**	**BBB**	**Below Investment**	**Total Notional**	**Fair Value Asset**

	Remaining Expected Maturity				Grade			(Liability)
Insured credit default swaps	5.1 Years	$ 10,457	$ 5,862	$ 5,253	$ 11,571	$ 13,859	$ 47,002	$ (2,858)
Insured swaps	19.4 Years	-	103	3,661	1,982	71	5,817	(8)
All others	1.8 Years	-	-	-	-	195	195	(68)
Total notional		$ 10,457	$ 5,965	$ 8,914	$ 13,553	$ 14,125	$ 53,014	
Total fair value		$ (7)	$ (70)	$ (72)	$ (732)	$ (2,053)		$ (2,934)

Internal credit ratings assigned by MBIA on the underlying collateral are derived by the Company s surveillance group. In assigning an internal rating, current status reports from issuers and trustees, as well as publicly available transaction-specific information, are reviewed. Also, where appropriate, cash flow analyses and collateral valuations are considered. The maximum potential amount of future payments (undiscounted) on CDS contracts are estimated as the notional value plus any additional debt service costs, such as interest or other amounts owing on CDS contracts. The maximum amount of future payments that MBIA may be required to make under these guarantees as of June 30, 2013 is $27.5 billion. This amount is net of $72 million of insured derivatives ceded under reinsurance agreements in which MBIA economically hedges a portion of the credit and market risk associated with its insured derivatives and offsetting agreements with a counterparty. The maximum potential amount of future payments (undiscounted) on insured swaps are estimated as the notional value of such contracts.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 8: Derivative Instruments (continued)

MBIA may hold recourse provisions with third parties in derivative instruments through both reinsurance and subrogation rights. MBIA s reinsurance arrangements provide that in the event MBIA pays a claim under a guarantee of a derivative contract, MBIA has the right to collect amounts from any reinsurers that have reinsured the guarantee on either a proportional or non-proportional basis, depending upon the underlying reinsurance agreement. MBIA may also have recourse through subrogation rights whereby if MBIA makes a claim payment, it is entitled to any rights of the insured counterparty, including the right to any assets held as collateral.

Counterparty Credit Risk

The Company manages counterparty credit risk on an individual counterparty basis through master netting agreements covering derivative instruments in the asset/liability products segment. There are no master netting agreements in the structured finance and international insurance or the U.S. public finance insurance segments. The master netting agreements in the asset/liability products segment 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 MBIA or the counterparty is downgraded below a specified credit rating.

Under these arrangements, the Company may receive or provide U.S. Treasury and other highly rated securities or cash to secure counterparties exposure to the Company or its exposure to counterparties, respectively. Such collateral is available to the holder to pay for replacing the counterparty in the event that the counterparty defaults. As of June 30, 2013, the Company did not hold cash collateral to derivative counterparties but posted cash collateral to derivative counterparties of $223 million. Of this amount, $151 million is netted within Derivative liabilities , $16 million is included within Other liabilities as cash collateral netted against accrued interest on derivative liabilities and an additional $56 million is included in Other assets on the Company s consolidated balance sheets. As of December 31, 2012, the Company did not hold cash collateral to derivative counterparties but posted cash collateral to derivative counterparties of $285 million. Of this amount, $203 million is netted within Derivative liabilities , $16 million is included within Other liabilities as cash collateral netted against accrued interest on derivative liabilities and an additional $66 million is included in Other assets on the Company s consolidated balance sheets. As of June 30, 2013 and December 31, 2012, the Company did not post securities to derivative counterparties.

As of June 30, 2013 and December 31, 2012, the fair value on one positive Credit Support Annex (CSA) was $3 million and $4 million, respectively. This CSA governs collateral posting requirements between MBIA and its derivative counterparties. The Company did not receive collateral due to the Company s credit rating, which was below the CSA minimum credit ratings level for holding counterparty collateral. As of June 30, 2013 and December 31, 2012, the counterparty was rated A2 by Moody s and A by S&P.

Financial Statement Presentation

The fair value of amounts recognized for eligible derivative contracts executed with the same counterparty under a master netting agreement, including any cash collateral that may have been received or posted by the Company, is presented on a net basis in accordance with accounting guidance for the offsetting of fair value amounts related to derivative instruments. Insured CDSs and insured swaps are not subject to master netting agreements. VIE derivative assets and liabilities are not presented net of any master netting agreements.

As of June 30, 2013, the total fair value of the Company s derivative assets, after counterparty netting of $59 million, was $12 million, of which $4 million was reported within Other assets and Other assets presented under Assets of consolidated variable interest entities on the Company s consolidated balance sheets. Embedded derivatives of $8 million were reported within Medium-term notes on the Company s consolidated balance sheets.

As of June 30, 2013, the total fair value of the Company s derivative liabilities, after counterparty netting of $59 million and cash collateral posted by the Company of $151 million was $1.7 billion, which was reported within Derivative liabilities and Derivative liabilities presented under Liabilities of consolidated variable interest entities on the Company s consolidated balance sheets. Embedded derivatives of $30 million were reported within Medium-term notes on the Company s consolidated balance sheets.

Counterparty netting of derivative assets and liabilities offsets balances in Interest rate and Currency swaps in the table below.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 8: Derivative Instruments (continued)

The following table presents the total fair value of the Company s derivative assets and liabilities by instrument and balance sheet location, before counterparty netting and posting of cash collateral, as of June 30, 2013:

In millions		**Derivative Assets[1]**		**Derivative Liabilities[1]**	
Derivative Instruments	**Notional Amount Outstanding**	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Not designated as hedging instruments:					
Insured credit default swaps	$ 26,826	Other assets	$ -	Derivative liabilities	$ (1,641)
Insured swaps	5,539	Other assets	-	Derivative liabilities	(7)
Non-insured credit default swaps	5	Other assets	-	Derivative liabilities	-
Interest rate swaps	1,601	Other assets	62	Derivative liabilities	(209)
Interest rate swaps-VIE	127	Other assets-VIE	-	Derivative liabilities-VIE	(2)
Interest rate swaps-embedded	472	Medium-term notes	8	Medium-term notes	(30)
Currency swaps	19	Other assets	-	Derivative liabilities	(1)
Currency swaps-VIE	104	Other assets-VIE	-	Derivative liabilities-VIE	(16)
All other	36	Other assets	-	Derivative liabilities	(7)
All other-VIE	280	Other assets-VIE	1	Derivative liabilities-VIE	-
All other-embedded	13	Other investments	-	Other investments	-
Total non-designated derivatives	$ 35,022		$ 71		$ (1,913)

(1) - In accordance with the accounting guidance for derivative instruments and hedging activities, the balance sheet location of the Company s embedded derivative instruments is determined by the location of the related host contract.

As of December 31, 2012, the total fair value of the Company s derivative assets, after counterparty netting of $90 million, was $12 million, of which $4 million was reported within Other assets and Other assets presented under Assets of consolidated variable interest entities on the Company s consolidated balance sheets. Embedded derivatives of $8 million were reported within Medium-term notes on the Company s consolidated balance sheets.

As of December 31, 2012, the total fair value of the Company s derivative liabilities, after counterparty netting of $90 million and cash collateral posted by the Company of $203 million, was $3.1 billion which was reported within Derivative liabilities and Derivative liabilities presented under Liabilities of consolidated variable interest entities on the Company s consolidated balance sheets. Embedded derivatives of $36 million were reported within Medium-term notes and Other investments on the Company s consolidated balance sheets.

Counterparty netting of derivative assets and liabilities offsets balances in Interest rate swaps and Currency swaps in the table below.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 8: Derivative Instruments (continued)

The following table presents the total fair value of the Company s derivative assets and liabilities by instrument and balance sheet location, before counterparty netting and posting of cash collateral, as of December 31, 2012:

In millions		**Derivative Assets[1]**		**Derivative Liabilities[1]**	
Derivative Instruments	**Notional Amount Outstanding**	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Not designated as hedging instruments:					
Insured credit default swaps	$ 47,320	Other assets	$ -	Derivative liabilities	$ (2,858)
Insured swaps	5,817	Other assets	-	Derivative liabilities	(8)
Non-insured credit default swaps	10	Other assets	-	Derivative liabilities	-
Interest rate swaps	1,637	Other assets	94	Derivative liabilities	(290)
Interest rate swaps-VIE	2,728	Other assets-VIE	-	Derivative liabilities-VIE	(141)
Interest rate swaps-embedded	483	Medium-term notes	8	Medium-term notes	(35)
Currency swaps	40	Other assets	-	Derivative liabilities	(3)
Currency swaps-VIE	110	Other assets-VIE	-	Derivative liabilities-VIE	(21)
All other	195	Other assets	-	Derivative liabilities	(68)
All other-VIE	280	Other assets-VIE	-	Derivative liabilities-VIE	-
All other-embedded	20	Other investments	-	Other investments	(1)
Total non-designated derivatives	$ 58,640		$ 102		$ (3,425)

(1) - In accordance with the accounting guidance for derivative instruments and hedging activities, the balance sheet location of the Company s embedded derivative instruments is determined by the location of the related host contract.

The following table presents the effect of derivative instruments on the consolidated statements of operations for the three months ended June 30, 2013:

In millions **Derivatives Not Designated as Hedging Instruments**	**Location of Gain (Loss) Recognized in Income on Derivative**	**Net Gain (Loss) Recognized in Income**
Insured credit default swaps	Unrealized gains (losses) on insured derivatives	$ 1,318
Insured credit default swaps	Realized gains (losses) and other settlements on insured derivatives	(1,532)
Interest rate swaps	Net gains (losses) on financial instruments at fair value and foreign exchange	38
Currency swaps-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE	7
All other	Unrealized gains (losses) on insured derivatives	32
Total		$ (137)

The following tables present the effect of derivative instruments on the consolidated statements of operations for the three months ended June 30, 2012:

In millions

Derivatives in Fair Value Hedging Relationships	**Location of Gain (Loss) Recognized in Income on Derivative**	**Gain (Loss) Recognized in Income on Derivative**	**Gain (Loss) Recognized in Income on Hedged Item**	**Net Gain (Loss) Recognized in Income**
Interest rate swaps	Net gains (losses) on financial instruments at fair value and foreign exchange	$ 10	$ (10)	$ -
Interest rate swaps	Interest income (expense)	-	-	(1)
Total		$ 10	$ (10)	$ (1)

58

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 8: Derivative Instruments (continued)

In millions Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative		Net Gain (Loss) Recognized in Income
Insured credit default swaps	Unrealized gains (losses) on insured derivatives	$	1,202
Insured credit default swaps	Realized gains (losses) and other settlements on insured derivatives		(428)
Interest rate swaps	Net gains (losses) on financial instruments at fair value and foreign exchange		(60)
Interest rate swaps-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE		10
Currency swaps	Net gains (losses) on financial instruments at fair value and foreign exchange		2
Currency swaps-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE		(2)
All other	Unrealized gains (losses) on insured derivatives		1
All other-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE		(1)
Total		$	724

The following table presents the effect of derivative instruments on the consolidated statements of operations for the six months ended June 30, 2013:

In millions Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative		Net Gain (Loss) Recognized in Income
Insured credit default swaps	Unrealized gains (losses) on insured derivatives	$	1,216
Insured credit default swaps	Realized gains (losses) and other settlements on insured derivatives		(1,520)
Interest rate swaps	Net gains (losses) on financial instruments at fair value and foreign exchange		41
Interest rate swaps-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE		14
Currency swaps	Net gains (losses) on financial instruments at fair value and foreign exchange		2
Currency swaps-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE		6
All other	Unrealized gains (losses) on insured derivatives		61
Total		$	(180)

The following tables present the effect of derivative instruments on the consolidated statements of operations for the six months ended June 30, 2012:

In millions Derivatives in Fair Value Hedging Relationships	Location of Gain (Loss) Recognized in Income on	Gain (Loss) Recognized in Income on	Gain (Loss) Recognized in Income on	Net Gain (Loss) Recognized in Income

	Derivative	Derivative	Hedged Item	
Interest rate swaps	Net gains (losses) on financial instruments at fair value and foreign exchange	$ 37	$ (37)	$ -
Interest rate swaps	Interest income (expense)	-	-	(2)
Total		$ 37	$ (37)	$ (2)

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 8: Derivative Instruments (continued)

In millions

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Net Gain (Loss) Recognized in Income
Insured credit default swaps	Unrealized gains (losses) on insured derivatives	$ 1,502
Insured credit default swaps	Realized gains (losses) and other settlements on insured derivatives	(432)
Insured swaps	Unrealized gains (losses) on insured derivatives	1
Non-insured credit default swaps	Net gains (losses) on financial instruments at fair value and foreign exchange	(1)
Non-insured credit default swaps-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE	(1)
Interest rate swaps	Net gains (losses) on financial instruments at fair value and foreign exchange	(50)
Interest rate swaps-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE	31
Currency swaps-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE	(3)
All other	Unrealized gains (losses) on insured derivatives	3
All other	Net gains (losses) on financial instruments at fair value and foreign exchange	11
All other-VIE	Net gains (losses) on financial instruments at fair value and foreign exchange-VIE	(2)
Total		$ 1,059

Note 9: Debt

The Company has disclosed its debt in Note 10: Debt 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 debt discussion provides an update to the Company s Annual Report on Form 10-K.

Long-Term Debt

In connection with the BofA Settlement Agreement, MBIA Corp. received $136 million principal amount of the 5.70% Senior Notes due 2034 as consideration for the settlement. These notes were subsequently transferred to National. On a consolidated basis, receipt of these notes by the Company reduced its outstanding debt.

Interest and principal payments on the 14% Fixed to Floating Rate Surplus Notes due 2033 are subject to prior approval by the Superintendent of the NYSDFS. MBIA Insurance Corporation s request for approval of the January 15, 2013, April 15, 2013, and July 15, 2013 note interest payments were denied by the NYSDFS. MBIA Insurance Corporation provided notice to the Fiscal Agent that it has not made a scheduled interest payment. The deferred interest payment will become due on the first business day on or after which MBIA Insurance Corporation obtains approval to make such payment. No interest will accrue on the deferred interest. As of June 30, 2013, the Company had accrued interest related to these surplus notes of $117 million, which was included in Other liabilities on the Company s consolidated balance sheets.

Medium-Term Note Obligations

During the six months ended June 30, 2013, the Company redeemed $336 million par value outstanding of MTNs issued by the Company s conduit segment at a cost of 100% of par value. The Company also repurchased approximately $38 million par value outstanding of MBIA Global Funding, LLC (GFL) MTNs issued by the Company s asset/liability segment at a weighted average cost of approximately 97% of par value.

Other Borrowing Arrangements

Blue Ridge Secured Loan

In connection with the BofA Settlement Agreement in May of 2013, MBIA Insurance Corporation and Blue Ridge entered into the Blue Ridge Secured Loan, pursuant to which Blue Ridge agreed to make revolving loans to MBIA Insurance Corporation in an aggregate of up to $500 million. The following is a summary of the material terms of the Loan Agreement, as amended by Amendment No. 1 entered into in June of 2013. This summary is not complete and is subject to the full text of the document described below.

Use of Proceeds

The proceeds of the Blue Ridge Secured Loan can be used for general corporate purposes. Once the Blue Ridge Secured Loan amount outstanding exceeds $50 million, the proceeds must be used for the purpose of meeting ordinary course liquidity requirements expected to arise during the 30 days following such borrowing.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note 9: Debt (continued)

Conditions to Borrowings

Blue Ridge s obligation to make loans is subject to usual and customary conditions precedent, including that on the date of the borrowing (i) no default is continuing or would occur as a result of that borrowing and (ii) the representations and warranties specified in the Blue Ridge Secured Loan agreement are true and accurate in all material respects.

Security

The Loans are secured by a pledge of collateral consisting of the following: (i) MBIA Insurance Corporation s right to receive put-back recoveries related to ineligible mortgage loans included in its insured RMBS transactions; (ii) MBIA Insurance Corporation s future recoveries on defaulted insured RMBS transactions resulting from expected excess spread generated by performing loans in such transactions; (iii) MBIA Insurance Corporation s future installment premiums; and (iv) 65% of the voting capital stock of MBIA Corp. s equity interest in MBIA UK (Holdings) Limited (the collateral described in clauses (ii) and (iii) above, the (Other Prepayment Collateral). Under the Blue Ridge Secured Loan, the value of the collateral described in clauses (i) through (iii) above, must at all times be greater than $1.0 billion. As of June 30, 2013, the value of the collateral was approximately $2.5 billion.

Interest Rate and Fees

Borrowings under the Blue Ridge Secured Loan have a variable interest rate, at MBIA Insurance Corporation s option based on either: (i) the adjusted LIBOR plus an applicable margin (LIBOR Loans), or (ii) the highest between (a) Bank of America s prime rate and (b) the sum of the federal funds effective rate plus 0.5% and (c) the adjusted LIBOR plus 1.00%, plus an applicable margin (Base Rate Loans). The applicable margin for the LIBOR Loans and the Base Rate Loans is 7.50% and 6.50%, respectively. With respect to any available but undrawn amounts under the Blue Ridge Secured Loan, MBIA Insurance Corporation is obligated to pay a commitment fee on such undrawn amounts of 2.00% per annum. The amount of the commitment fee expense for the six months ended June 30, 2013 was $1 million.

Scheduled Repayment

The maturity date of the Blue Ridge Secured Loan is three years from the closing date, at which time any then outstanding loans will be due and payable.

Mandatory Prepayments

Loans are required to be prepaid (and Blue Ridge s commitments reduced) in an amount equal to the following: (i) 100% of the proceeds of any put-back recoveries and (ii) on and after the first anniversary of the closing date, from the proceeds of any Other Prepayment Collateral in an amount equal to (x) from the first anniversary of the closing date to the second anniversary of the closing date, 50% of such proceeds and (y) from the second anniversary of the closing date to the maturity date, 100% of such proceeds. In addition, loans must be prepaid (and Blue Ridge s commitments reduced) in an amount equal to 100% of the proceeds of certain disposals of assets to the extent exceeding $1 million in aggregate for all such disposals. Finally, loans must be prepaid (but without any commitment reduction) to the extent the proceeds of any borrowing that is a liquidity borrowing are not in fact used for such purposes and have not otherwise been used to repay loans within the required 30-day period.

Representations and Warranties

The Blue Ridge Secured Loan contains certain customary representations and warranties for loan facilities of this type, which are given on the closing date and at each borrowing under the Blue Ridge Secured Loan agreement, including with respect to organization of MBIA Insurance

Corporation, power of authority, enforceability of the loan documents, receipt of any necessary governmental approvals, financial condition and solvency, and compliance with laws.

Covenants

The Blue Ridge Secured Loan contains certain affirmative, negative and financial covenants, which are customary for loan facilities of this type in relation to, among other matters, delivery of financial statements, notice of material events, existence and conduct of business, payment of taxes and other obligations, maintenance of books and records, compliance with all material laws, and maintenance of insurance, and includes a requirement that MBIA Insurance Corporation maintain at least $750 million of statutory capital (defined as policyholders surplus plus contingency reserves).

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note 9: Debt (continued)

In addition, MBIA Insurance Corporation may not, without Blue Ridge s consent, consummate any amendments, compromises or commutations with respect to insurance obligations and settlements of litigation to the extent (x) that payments made in respect of such remediation efforts subsequent to June 28, 2013 exceed $260 million in the aggregate, (y) after giving effect thereto and to any borrowings of loans in connection therewith, the aggregate principal amount of loans outstanding would exceed $200 million or (z) after giving effect thereto, all remediation efforts taken as a whole since the closing date, would, cumulatively, have reduced MBIA Insurance Corporation s statutory capital by $100 million or more.

In addition, MBIA Insurance Corporation may not prepay, redeem, purchase, defease or otherwise satisfy prior to the scheduled maturity thereof in any manner, or make any payment of principal, interest or fees or any other payment on, any of its indebtedness (including the Surplus Notes), except for payments of the loans under the Blue Ridge Secured Loan agreement and except for certain refinancings and refundings of its indebtedness.

Change of Control

MBIA Insurance Corporation may be required to prepay all amounts outstanding under the Blue Ridge Secured Loan agreement upon the occurrence of a change of control.

Events of Default

The Blue Ridge Secured Loan agreement contains certain events of default which are customary for loan facilities of this type (and with customary cure periods), including failure to pay principal, interest or fees on the loans, misrepresentation, failure to observe covenants or conditions, failure to pay other material indebtedness, insolvency and bankruptcy matters, and unlawfulness or invalidity of the loan documents.

Note 10: Income Taxes

The Company s income taxes and the related effective tax rates for the three and six months ended June 30, 2013 and 2012 are as follows:

In millions	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Income (loss) before income taxes	$ (264)	$ 795	$ (49)	$ 816
Provision (benefit) for income taxes	$ (86)	$ 214	$ (35)	$ 225
Effective tax rate	32.6%	26.9%	71.4%	27.6%

For the six months ended June 30, 2013, the Company s effective tax rate applied to its pre-tax loss was higher than the U.S. statutory tax rate primarily as a result of the decrease in the valuation allowance against its deferred tax asset, net of certain nondeductible expenses.

For the six months ended June 30, 2012, the Company s effective tax rate applied to its income before income taxes was lower than the U.S. statutory tax rate as a result of the decrease in the valuation allowance, the release of a portion of the reserve for uncertain tax benefits and the benefit of tax-exempt interest income from investments.

For interim reporting purposes, the Company has calculated its effective tax rate for the full year of 2013 by adjusting annual forecasted pre-tax income for mark-to-market income, fair value adjustments, capital gains/losses, and other adjustments, when projecting its full year effective tax rate. The Company has accounted for these items at the federal applicable tax rate after applying the projected full year effective tax rate to actual six-month results before discrete items.

Deferred Tax Asset, Net of Valuation Allowance

The Company establishes a valuation allowance against its deferred tax asset when it is more likely than not that all or a portion of the deferred tax asset will not be realized. All evidence, both positive and negative, needs to be identified and considered in making the determination. Future realization of the existing deferred tax asset ultimately depends, in part, on the existence of sufficient taxable income of appropriate character (for example, ordinary income versus capital gains) within the carryforward period available under the tax law.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 10: Income Taxes (continued)

As of June 30, 2013, the Company reported a net deferred tax asset of $1.3 billion. The $1.3 billion net deferred tax asset is net of a $93 million valuation allowance. As of June 30, 2013, the Company had a valuation allowance against a portion of the deferred tax asset related to losses from asset impairments as these losses are considered capital losses, have a five-year carryforward period, once recognized, and can only offset capital gain income. The June 30, 2013 valuation allowance reflects a decrease of $53 million from the December 31, 2012 valuation allowance of $146 million. The decrease in the valuation allowance for the six months ended June 30, 2013 was primarily due to the generation of capital gain income from the termination of certain contracts.

The Company has concluded that it is more likely than not that its net deferred tax asset will be realized. In its conclusion, the Company considered the following evidence (both positive and negative):

Due to the long-tail nature of the financial guarantee business, MBIA Inc. s insurance subsidiaries, without regard to any new business, will have a steady stream of scheduled premium earnings with respect to the existing insured portfolio. Additionally, MBIA Corp. s announcement in February 2008 of a suspension in writing new structured finance transactions and a permanent cessation with respect to insuring new CDS contracts, except in transactions related to the reduction of existing derivative exposure, would not have an impact on the expected earnings related to the existing insured portfolio.

The Company performed taxable income projections over a twenty-year period to determine whether it will have sufficient income to offset its deferred tax asset that will generate future ordinary deductions. In this analysis, the Company concluded that premium earnings, including projected new business at National, combined with investment income, less deductible expenses, will be sufficient to recover its net deferred tax asset. The Company s taxable income projections used to assess the recoverability of its deferred tax asset include an estimate of future loss and LAE equal to the present value discount of loss reserves already recognized on the balance sheet and an estimate of LAE which is generally insignificant. The Company does not assume additional losses, with the exception of the accretion of its existing present value loss reserves, because the Company establishes case basis reserves on a present value basis based on an estimate of probable losses on specifically identified credits that have defaulted or are expected to default.

While the lack of strong credit ratings assigned by the rating agencies have significantly adversely impacted the Company s ability to write new insurance business, these ratings did not have a material impact on earnings from the existing insured portfolio, which the Company believes will be sufficient to absorb losses in the event that the cumulative unrealized losses become fully impaired.

With respect to installment policies, the Company generally does not have an automatic cancellation provision solely in connection with ratings downgrades. With regard to upfront policies, to the extent that the issuer chooses to terminate a policy, any unearned premium reserve with respect to that policy will be accelerated into earnings (i.e. refundings).

After reviewing all of the evidence available, both positive and negative, the Company believes that it has appropriately valued the recoverability of its deferred tax assets, net of the valuation allowance, as of June 30, 2013. The Company continues to assess the adequacy of its valuation allowance as additional evidence becomes available. The Company s recent financial results have been volatile which has impacted management s ability to accurately project future taxable income. Continued volatility or losses beyond those projected may cause the Company to conclude that certain of the deferred tax assets within the total deferred tax assets of $1.3 billion as of June 30, 2013 may not be realizable. The Company performs an analysis every quarter to review its conclusion as to the ability to realize the deferred tax asset.

Accounting for Uncertainty in Income Taxes

The Company s policy is to record and disclose any change in UTB and related interest and/or penalties to income tax in the consolidated statements of operations.

In millions		
Unrecognized tax benefit as of December 31, 2012	$	47
The gross amount of the increase/(decrease) in the UTB as a result of tax positions taken:		
During a prior year		-
During the current year		11
The amounts of decreases in the UTB related to settlements with taxing authorities		-
The reduction in the UTB as a result of the applicable statute of limitations		-
Unrecognized tax benefit as of June 30, 2013	$	58

MBIA s major tax jurisdictions include the U.S. and the U.K. MBIA and its U.S. subsidiaries file a U.S. consolidated federal income tax return.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 10: Income Taxes (continued)

The U.K. tax authorities are currently auditing tax years 2005 through 2010. On June 5, 2013, the Company met with the HM Revenue & Customs and discussions are ongoing.

In June of 2013, the New York State Department of Taxation contacted the Company to request a meeting to discuss their position regarding certain issues related to the 2008 tax year. The Company will be meeting with the New York State Department of Taxation in the third quarter of 2013.

As of December 31, 2012, the Company s consolidated NOL carryforward was $1.4 billion which will expire between tax years 2029 through 2032. As of December 31, 2012, the Company also had a capital loss carryforward of $162 million which will expire between tax years 2013 through 2017.

Note 11: Business Segments

MBIA manages its activities through three principal business operations: U.S. public finance insurance, structured finance and international insurance, and advisory services. The Company s U.S. public finance insurance business is operated through National, its structured finance and international insurance business is operated through MBIA Corp., and its advisory services business is primarily operated through Cutwater. MBIA Inc. and certain of its subsidiaries also manage certain other business activities, the results of which are reported in its corporate, asset/liability products, and conduit segments. The corporate segment includes revenues and expenses that arise from general corporate activities. While the asset/liability products and conduit businesses represent separate business segments, they may be referred to collectively as wind-down operations as the funding programs managed through those businesses are in wind-down.

As defined by segment reporting, an operating segment is a component of a company (i) that engages in business activities from which it earns revenue and incurs expenses, (ii) whose operating results are regularly reviewed by the Chief Operating Decision Maker to assess the performance of the segment and to make decisions about the allocation of resources to the segment and, (iii) for which discrete financial information is available. The following sections provide a description of each of the Company s reportable operating segments.

U.S. Public Finance Insurance

The Company s U.S. public finance insurance segment is principally conducted through National. The financial guarantees issued by National provide unconditional and irrevocable guarantees of the payment of principal of, and interest or other amounts owing on, U.S. public finance insured obligations when due. The obligations are generally not subject to acceleration, except that National may have the right, at its discretion, to accelerate insured obligations upon default or otherwise. National issues financial guarantees for municipal bonds, including tax-exempt and taxable indebtedness of U.S. political subdivisions, as well as utility districts, airports, health care institutions, higher educational facilities, student loan issuers, housing authorities and other similar agencies and obligations issued by private entities that finance projects that serve a substantial public purpose. Municipal bonds and privately issued bonds used for the financing of public purpose projects are generally supported by taxes, assessments, fees or tariffs related to the use of these projects, lease payments or other similar types of revenue streams. National has not written any meaningful amount of business since its formation in 2009.

Structured Finance and International Insurance

The Company s structured finance and international insurance segment is principally conducted through MBIA Corp. The financial guarantees issued by MBIA Corp. generally provide unconditional and irrevocable guarantees of the payment of principal of, and interest or other amounts owing on, global structured finance and non-U.S. public finance insured obligations when due, or in the event MBIA Corp. has the right, at its discretion, to accelerate insured obligations upon default or otherwise, upon MBIA Corp. s acceleration. Certain guaranteed investment contracts written by MBIA Inc. are insured by MBIA Corp., and if MBIA Inc. were to have insufficient assets to pay amounts due upon maturity or termination, MBIA Corp. would make such payments. MBIA Corp. also insures debt obligations of the following affiliates:

MBIA Inc.;

GFL;

Meridian Funding Company, LLC;

LaCrosse Financial Products, LLC, a wholly-owned affiliate, in which MBIA Corp. has written insurance policies guaranteeing the obligations under CDS, including termination payments that may become due upon certain events including the insolvency or payment default of the financial guarantor or the CDS issuer.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 11: Business Segments (continued)

MBIA Corp. s guarantees insure structured finance and asset-backed obligations, privately issued bonds used for the financing of public purpose projects, which are primarily located outside of the U.S. and that include toll roads, bridges, airports, public transportation facilities, utilities and other types of infrastructure projects serving a substantial public purpose, and obligations of sovereign-related and sub-sovereign issuers. Structured finance and ABS typically are securities repayable from expected cash flows generated by a specified pool of assets, such as residential and commercial mortgages, insurance policies, consumer loans, corporate loans and bonds, trade and export receivables, and leases for equipment, aircraft and real estate property. The Company is no longer insuring new credit derivative contracts except for transactions related to the reduction of existing derivative exposure. MBIA Corp. has not written any meaningful amount of business since 2008.

Advisory Services

The advisory services segment primarily consists of the operations of Cutwater Investor Services Corp. (Cutwater-ISC), Cutwater Asset Management Corp. (Cutwater-AMC), and Trifinium. Cutwater-ISC and Cutwater-AMC provide advisory services, including cash management, discretionary asset management and structured products on a fee-for-service basis. Cutwater offers these services to public, not-for-profit, corporate and financial services clients, including MBIA Inc. and its subsidiaries, as well as portfolio accounting and reporting services. Cutwater-ISC and Cutwater-AMC are Securities and Exchange Commission registered investment advisers. Cutwater-AMC is also a Financial Industry Regulatory Authority member firm. Trifinium provides fee-based asset management and advisory services to the Company s foreign insurance affiliate and to third-party clients and investment structures. Trifinium is regulated by the Financial Conduct Authority in the U.K.

Corporate

The Company s corporate segment is principally conducted through Optinuity Alliance Resources Corporation (Optinuity), which provides general support services to the corporate segment and other operating businesses. Optinuity is a reportable segment that includes revenues and expenses that arise from general corporate activities, such as fees, net investment income, net gains and losses, interest expense on MBIA Inc. debt and general corporate expenses. Employees of the service company provide various support services including management, legal, accounting, treasury, information technology, and insurance portfolio surveillance, among others, on a fee-for-service basis. The service company s revenues and expenses are included in the results of the corporate segment.

Wind-down Operations

The Company s wind-down operations consist of the asset/liability products and conduit segments. The asset/liability products segment principally consists of the activities of MBIA Inc., MBIA Investment Management Corp. (IMC) and GFL. IMC, along with MBIA Inc., provided customized investment agreements, guaranteed by MBIA Corp., for bond proceeds and other public funds for such purposes as construction, loan origination, escrow and debt service or other reserve fund requirements. It also provided customized products for funds that are invested as part of asset-backed or structured product transactions. GFL raised funds through the issuance of MTNs with varying maturities, which were, in turn, guaranteed by MBIA Corp. GFL lent the proceeds of these MTN issuances to MBIA Inc. (GFL Loans). MBIA Inc. invested the proceeds of investment agreements and GFL Loans in eligible investments, which consisted of investment grade securities rated investment grade at the time of purchase and maintained a minimum average double-A credit quality rating at the time of purchase. MBIA Inc. primarily purchases domestic securities, which are pledged to MBIA Corp. as security for its guarantees on investment agreements and MTNs.

The Company s conduit segment administers one conduit through MBIA Asset Finance, LLC. Assets financed by this conduit are currently funded by MTNs.

The ratings downgrades of MBIA Corp. have resulted in a substantial reduction of funding activities and the termination and collateralization of certain investment agreements, as well as winding down of existing asset/liability products and conduit obligations.

65

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 11: Business Segments (continued)

Segments Results

The following tables provide the Company s segment results for the three months ended June 30, 2013 and 2012:

	Three Months Ended June 30, 2013						
In millions	U.S. Public Finance Insurance	Structured Finance and International Insurance	Advisory Services	Corporate	Wind-down Operations	Eliminations	Consolidated
Revenues[1]	$ 113	$ 39	$ 6	$ 4	$ 6	$ -	$ 168
Net change in fair value of insured derivatives	-	(182)	-	-	-	-	(182)
Net gains (losses) on financial instruments at fair value and foreign exchange	(2)	12	-	(4)	(12)	-	(6)
Net gains (losses) on extinguishment of debt	22	17	-	-	-	-	39
Revenues of consolidated VIEs	-	97	-	(9)	5	-	93
Inter-segment revenues[2]	3	(5)	5	(5)	-	2	-
Total revenues	136	(22)	11	(14)	(1)	2	112
Losses and loss adjustment	66	122	-	-	-	-	188
Operating	30	35	16	32	1	-	114
Interest	-	29	-	11	20	-	60
Expenses of consolidated VIEs	-	12	-	-	2	-	14
Inter-segment expenses[2]	26	36	1	2	2	(67)	-
Total expenses	122	234	17	45	25	(67)	376
Income (loss) before income taxes	$ 14	$ (256)	$ (6)	$ (59)	$ (26)	$ 69	$ (264)
Identifiable assets	$ 6,651	$ 12,669	$ 46	$ 931	$ 2,009	$ (4,184)[3]	$ 18,122

(1) - Represents the sum of third-party financial guarantee net premiums earned, net investment income, insurance-related fees and reimbursements, investment management fees and other fees.

(2) - Represents intercompany premium income and expense, intercompany asset management fees and expenses, and intercompany interest income and expense pertaining to intercompany receivables and payables.

(3) - Consists of intercompany reinsurance balances, repurchase agreements and deferred income taxes.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 11: Business Segments (continued)

	Three Months Ended June 30, 2012						
In millions	U.S. Public Finance Insurance	Structured Finance and International Insurance	Advisory Services	Corporate	Wind-down Operations	Eliminations	Consolidated
Revenues[1]	$ 145	$ 80	$ 5	$ 5	$ 16	$ -	$ 251
Net change in fair value of insured derivatives	-	775	-	-	-	-	775
Net gains (losses) on financial instruments at fair value and foreign exchange	11	20	-	3	(40)	-	(6)
Net investment losses related to other-than-temporary impairments	-	(1)	-	-	(2)	-	(3)
Other net realized gains (losses)	-	-	-	6	-	-	6
Revenues of consolidated VIEs	-	(20)	-	-	36	-	16
Inter-segment revenues[2]	43	(11)	11	56	(21)	(78)	-
Total revenues	199	843	16	70	(11)	(78)	1,039
Losses and loss adjustment	(3)	65	-	-	-	-	62
Operating	23	32	11	24	3	-	93
Interest	-	33	-	15	23	-	71
Expenses of consolidated VIEs	-	14	-	-	4	-	18
Inter-segment expenses[2]	31	54	5	3	40	(133)	-
Total expenses	51	198	16	42	70	(133)	244
Income (loss) before income taxes	$ 148	$ 645	$ -	$ 28	$ (81)	$ 55	$ 795
Identifiable assets	$ 7,120	$ 17,395	$ 46	$ 759	$ 3,205	$ (6,230)[3]	$ 22,295

(1) - Represents the sum of third-party financial guarantee net premiums earned, net investment income, insurance-related fees and reimbursements, investment management fees and other fees.

(2) - Represents intercompany premium income and expense, intercompany asset management fees and expenses, and intercompany interest income and expense pertaining to intercompany receivables and payables.

(3) - Consists of intercompany reinsurance balances, repurchase agreements and loans.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 11: Business Segments (continued)

The following tables provide the Company s segment results for the six months ended June 30, 2013 and 2012:

	Six Months Ended June 30, 2013						
In millions	**U.S. Public Finance Insurance**	**Structured Finance and International Insurance**	**Advisory Services**	**Corporate**	**Wind-down Operations**	**Eliminations**	**Consolidated**
Revenues[1]	$ 221	$ 81	$ 10	$ 5	$ 15	$ -	$ 332
Net change in fair value of insured derivatives	-	(243)	-	-	-	-	(243)
Net gains (losses) on financial instruments at fair value and foreign exchange	30	34	-	2	(9)	-	57
Net gains (losses) on extinguishment of debt	22	17	-	-	4	-	43
Revenues of consolidated VIEs	-	144	-	(9)	7	-	142
Inter-segment revenues[2]	49	15	12	21	(2)	(95)	-
Total revenues	322	48	22	19	15	(95)	331
Losses and loss adjustment	70	(76)	-	-	-	-	(6)
Operating	44	69	26	96	1	-	236
Interest	-	57	-	23	40	-	120
Expenses of consolidated VIEs	-	26	-	-	4	-	30
Inter-segment expenses[2]	52	92	3	5	15	(167)	-
Total expenses	166	168	29	124	60	(167)	380
Income (loss) before income taxes	$ 156	$ (120)	$ (7)	$ (105)	$ (45)	$ 72	$ (49)
Identifiable assets	$ 6,651	$ 12,669	$ 46	$ 931	$ 2,009	$ (4,184)[3]	$ 18,122

(1) - Represents the sum of third-party financial guarantee net premiums earned, net investment income, insurance-related fees and reimbursements, investment management fees and other fees.

(2) - Represents intercompany premium income and expense, intercompany asset management fees and expenses, intercompany interest income, expenses pertaining to intercompany receivables and payables and intercompany loans.

(3) - Consists of intercompany reinsurance balances, repurchase agreements and deferred income taxes.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 11: Business Segments (continued)

	Six Months Ended June 30, 2012						
In millions	U.S. Public Finance Insurance	Structured Finance and International Insurance	Advisory Services	Corporate	Wind-down Operations	Eliminations	Consolidated
Revenues(1)	$ 270	$ 135	$ 11	$ 7	$ 35	$	