MBIA INC
Form 10-Q
November 06, 2018
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United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2018

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.)**
1 Manhattanville Road, Suite 301, Purchase, New York	**10577**
(Address of principal executive offices)	**(Zip Code)**

(914) 273-4545

(Registrant s telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 31, 2018, 90,690,129 shares of Common Stock, par value $1 per share, were outstanding.

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FORWARD-LOOKING AND CAUTIONARY STATEMENTS

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

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

- increased credit losses or impairments on public finance obligations that National Public Finance Guarantee Corporation (National) insures issued by state, local and territorial governments and finance authorities and other providers of public services, located in the U.S. or abroad, that are experiencing fiscal stress;
- the possibility that loss reserve estimates are not adequate to cover potential claims;
- a disruption in the cash flow from our subsidiaries or an inability to access the capital markets and our exposure to significant fluctuations in liquidity and asset values in the global credit markets as a result of collateral posting requirements;
- our ability to fully implement our strategic plan;
- the possibility that MBIA Insurance Corporation will have inadequate liquidity or resources to timely pay claims as a result of higher than expected losses on certain insured transactions or as a result of a delay or failure in collecting expected recoveries, which could lead the New York State Department of Financial Services (NYSDFS) to put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding under Article 74 of the New York Insurance Law and/or take such other actions as the NYSDFS may deem necessary to protect the interests of MBIA Insurance Corporation s policyholders;
- deterioration in the economic environment and financial markets in the United States or abroad, real estate market performance, credit spreads, interest rates and foreign currency levels; and
- the effects of changes to governmental regulation, including insurance laws, securities laws, tax laws, legal precedents and accounting rules.

The above factors provide a summary of and are qualified in their entirety by the risk factors discussed under Risk Factors in Part II Other Information, Item 1A included in this Quarterly Report on Form 10-Q. In addition, refer to Note 1: Business Developments and Risks and Uncertainties in the Notes to Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for a discussion of certain risks and uncertainties related to our financial statements.

This quarterly report of MBIA Inc. also includes statements of the opinion and belief of MBIA management which may be forward-looking statements subject to the preceding cautionary disclosure. Unless otherwise indicated herein, the basis for each statement of opinion or belief of MBIA management in this report is the relevant industry or subject matter experience and views of certain members of MBIA s management. Accordingly, MBIA cautions readers not to place undue reliance on any such statements, because like all statements of opinion or belief they are not statements of fact and may prove to be incorrect. We undertake no obligation to publicly correct or update any statement of opinion or belief if the Company later becomes aware that such statement of opinion or belief was not or is not then accurate. In addition, readers are cautioned that each statement of opinion or belief may be further qualified by disclosures set forth elsewhere in this report or in other disclosures by MBIA.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions except share and per share amounts)

	September 30, 2018	December 31, 2017
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $3,562 and $3,728)	$ 3,533	$ 3,712
Investments carried at fair value	231	200
Investments pledged as collateral, at fair value (amortized cost $32 and $147)	30	148
Short-term investments, at fair value (amortized cost $411 and $589)	411	589
Other investments (includes investments at fair value of $- and $4)	1	6
Total investments	4,206	4,655
Cash and cash equivalents	167	122
Premiums receivable	306	369
Deferred acquisition costs	78	95
Insurance loss recoverable	1,542	511
Other assets	125	128
Assets of consolidated variable interest entities:		
Cash	12	24
Investments held-to-maturity, at amortized cost (fair value $901 and $916)	890	890
Investments carried at fair value	163	182
Loans receivable at fair value	428	1,679
Loan repurchase commitments	415	407
Other assets	29	33
Total assets	**$ 8,361**	**$ 9,095**
Liabilities and Equity		
Liabilities:		
Unearned premium revenue	$ 609	$ 752
Loss and loss adjustment expense reserves	1,033	979
Long-term debt	2,218	2,121
Medium-term notes (includes financial instruments carried at fair value of $123 and $115)	738	765
Investment agreements	314	337
Derivative liabilities	173	262
Other liabilities	196	165
Liabilities of consolidated variable interest entities:		
Variable interest entity notes (includes financial instruments carried at fair value of $709 and $1,069)	1,960	2,289
Total liabilities	**7,241**	**7,670**

Commitments and contingencies (Refer to Note 13: Commitments and Contingencies)		
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--283,625,689 and 283,717,973	284	284
Additional paid-in capital	3,155	3,171
Retained earnings	973	1,095
Accumulated other comprehensive income (loss), net of tax of $7 and $16	(206)	(19)
Treasury stock, at cost--192,936,029 and 192,233,526 shares	(3,098)	(3,118)
Total shareholders equity of MBIA Inc.	1,108	1,413
Preferred stock of subsidiary	12	12
Total equity	**1,120**	**1,425**
Total liabilities and equity	**$ 8,361**	**$ 9,095**

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In millions except share and per share amounts)

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Revenues:				
Premiums earned:				
Scheduled premiums earned	$ 44	$ 26	$ 96	$ 82
Refunding premiums earned	18	27	42	64
Premiums earned (net of ceded premiums of $1, $1, $4 and $4)	62	53	138	146
Net investment income	31	33	96	122
Fees and reimbursements	17	1	23	9
Change in fair value of insured derivatives:				
Realized gains (losses) and other settlements on insured derivatives	(5)	(7)	(49)	(41)
Unrealized gains (losses) on insured derivatives	4	6	36	(10)
Net change in fair value of insured derivatives	(1)	(1)	(13)	(51)
Net gains (losses) on financial instruments at fair value and foreign exchange	5	(11)	18	(55)
Net investment losses related to other-than-temporary impairments:				
Investment losses related to other-than-temporary impairments	-	(26)	-	(80)
Other-than-temporary impairments recognized in accumulated other comprehensive income (loss)	(1)	(45)	(3)	(4)
Net investment losses related to other-than-temporary impairments	(1)	(71)	(3)	(84)
Net gains (losses) on extinguishment of debt	3	1	3	9
Other net realized gains (losses)	1	(1)	-	36
Revenues of consolidated variable interest entities:				
Net investment income	9	8	25	20
Net gains (losses) on financial instruments at fair value and foreign exchange	12	21	29	2
Other net realized gains (losses)	(33)	-	(126)	28
Total revenues	105	33	190	182
Expenses:				
Losses and loss adjustment	46	205	177	469
Amortization of deferred acquisition costs	9	8	17	23
Operating	18	21	57	82
Interest	52	50	155	148
Expenses of consolidated variable interest entities:				
Operating	3	3	8	8
Interest	22	19	63	55
Total expenses	150	306	477	785
Income (loss) before income taxes	(45)	(273)	(287)	(603)
Provision (benefit) for income taxes	-	(6)	2	965

Net income (loss)	**$ (45)**	**$ (267)**	**$ (289)**	**$ (1,568)**
Net income (loss) per common share:				
Basic	$ (0.50)	$ (2.17)	$ (3.24)	$ (12.38)
Diluted	$ (0.50)	$ (2.17)	$ (3.24)	$ (12.38)
Weighted average number of common shares outstanding:				
Basic	89,490,267	122,967,924	89,075,892	126,643,642
Diluted	89,490,267	122,967,924	89,075,892	126,643,642

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

(In millions)

	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Net income (loss)	$ (45)	$ (267)	$ (289)	$ (1,568)
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses) arising during the period	(4)	16	(61)	20
Provision (benefit) for income taxes	-	7	5	7
Total	(4)	9	(66)	13
Reclassification adjustments for (gains) losses included in net income (loss)	(2)	1	(3)	(4)
Provision (benefit) for income taxes	-	(1)	-	(1)
Total	(2)	2	(3)	(3)
Available-for-sale securities with other-than-temporary impairments:				
Other-than-temporary impairments and unrealized gains (losses) arising during the period	25	40	48	6
Provision (benefit) for income taxes	-	2	-	2
Total	25	38	48	4
Reclassification adjustments for (gains) losses included in net income (loss)	2	4	3	6
Provision (benefit) for income taxes	-	1	-	2
Total	2	3	3	4
Foreign currency translation:				
Foreign currency translation gains (losses)	-	1	2	145
Provision (benefit) for income taxes	-	(1)	-	20
Total	-	2	2	125
Instrument-specific credit risk of liabilities measured at fair value:				
Unrealized gains (losses) arising during the period	28	-	(4)	-
Total	28	-	(4)	-
Total other comprehensive income (loss)	49	54	(20)	143
Comprehensive income (loss)	**$ 4**	**$ (213)**	**$ (309)**	**$ (1,425)**

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

For The Nine Months Ended September 30, 2018

(In millions except share amounts)

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Treasury Stock		Total Shareholders Equity of	Preferred Stock of Subsidiary		Total
	Shares	Amount	Capital	Earnings	Income (Loss)	Shares	Amount	MBIA Inc.	Shares	Amount	Equity
Balance, December 31, 2017	**283,717,973**	**$ 284**	**$ 3,171**	**$ 1,095**	**$ (19)**	**(192,233,526)**	**$ (3,118)**	**$ 1,413**	**1,315**	**$ 12**	**$ 1,425**
ASU 2016-01 transition adjustment	-	-	-	164	(164)	-	-	-	-	-	-
ASU 2018-02 transition adjustment	-	-	-	3	(3)	-	-	-	-	-	-
Net income (loss)	-	-	-	(289)	-	-	-	(289)	-	-	(289)
Other comprehensive income (loss)	-	-	-	-	(20)	-	-	(20)	-	-	(20)
Share-based compensation	(92,284)	-	5	-	-	(18,412)	-	5	-	-	5
Treasury shares issued for warrant exercises	-	-	(21)	-	-	1,277,620	34	13	-	-	13
Treasury shares acquired under share repurchase program	-	-	-	-	-	(1,961,711)	(14)	(14)	-	-	(14)
Balance, September 30, 2018	**283,625,689**	**$ 284**	**$ 3,155**	**$ 973**	**$ (206)**	**(192,936,029)**	**$ (3,098)**	**$ 1,108**	**1,315**	**$ 12**	**$ 1,120**

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In millions)

	Nine Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Premiums, fees and reimbursements received	$ 73	$ 41
Investment income received	162	193
Insured derivative commutations and losses paid	(49)	(41)
Financial guarantee losses and loss adjustment expenses paid	(367)	(744)
Proceeds from recoveries and reinsurance	46	100
Operating and employee related expenses paid	(68)	(103)
Interest paid, net of interest converted to principal	(119)	(139)
Income taxes (paid) received	(1)	-
Net cash provided (used) by operating activities	(323)	(693)
Cash flows from investing activities:		
Purchases of available-for-sale investments	(1,684)	(1,146)
Sales of available-for-sale investments	1,647	1,300
Paydowns and maturities of available-for-sale investments	245	392
Purchases of investments at fair value	(142)	(199)
Sales, paydowns and maturities of investments at fair value	162	270
Sales, paydowns and maturities (purchases) of short-term investments, net	269	67
Paydowns and maturities of loans receivable	365	202
Consolidation of variable interest entities	-	18
Deconsolidation of variable interest entities	(7)	-
(Payments) proceeds for derivative settlements	(19)	(58)
Collateral (to) from counterparties	-	4
Capital expenditures	-	(1)
Other investing	-	(23)
Net cash provided (used) by investing activities	836	826
Cash flows from financing activities:		
Proceeds from investment agreements	9	13
Principal paydowns of investment agreements	(30)	(57)
Principal paydowns of medium-term notes	(62)	(55)
Proceeds from the MBIA Corp. Financing Facility	-	328
Principal paydowns of variable interest entity notes	(382)	(311)
Purchases of treasury stock	(15)	(98)
Other financing	-	(4)
Net cash provided (used) by financing activities	(480)	(184)
Net increase (decrease) in cash and cash equivalents	33	(51)
Cash and cash equivalents beginning of period	146	187
Cash and cash equivalents end of period	$ 179	$ 136

Reconciliation of net income (loss) to net cash provided (used) by operating activities:				
Net income (loss)	$	(289)	$	(1,568)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:				
Change in:				
Premiums receivable		54		34
Deferred acquisition costs		18		22
Unearned premium revenue		(142)		(149)
Loss and loss adjustment expense reserves		50		615
Insurance loss recoverable		(192)		(781)
Accrued interest payable		113		81
Accrued expenses		(10)		(26)
Unrealized (gains) losses on insured derivatives		(36)		10
Net (gains) losses on financial instruments at fair value and foreign exchange		(47)		53
Other net realized (gains) losses		126		(64)
Deferred income tax provision (benefit)		1		961
Interest on variable interest entities, net		14		26
Other operating		17		93
Total adjustments to net income (loss)		(34)		875
Net cash provided (used) by operating activities	$	(323)	$	(693)
Supplementary Disclosure of Consolidated Cash Flow Information				
Non-cash investing activities:				
Non-cash consideration received from the sale of MBIA UK Insurance Limited	$	-	$	332

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

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1: Business Developments and Risks and Uncertainties

Summary

MBIA Inc., together with its consolidated subsidiaries, (collectively, MBIA or the Company) operates within the financial guarantee insurance industry. MBIA manages three operating segments: 1) United States (U.S.) public finance insurance; 2) corporate; and 3) international and structured finance insurance. The Company s U.S. public finance insurance business is primarily operated through National Public Finance Guarantee Corporation (National) and its international and structured finance insurance business is primarily operated through MBIA Insurance Corporation and its subsidiaries (MBIA Corp.).

Refer to Note 10: Business Segments for further information about the Company s operating segments.

Business Developments

Financial Strength Ratings

In June of 2017, Standard & Poor s Financial Services LLC (S&P) downgraded the financial strength rating of National which made it difficult for National to compete with higher-rated competitors. Therefore, at that time, National ceased its efforts to actively pursue writing new financial guarantee business. The Company then terminated its agreements with S&P, Kroll Bond Rating Agency (Kroll) and Moody s Investors Services (Moody s) to provide financial strength ratings to MBIA Inc. and certain of its subsidiaries. S&P and Kroll subsequently withdrew all of their ratings. On January 17, 2018, Moody s downgraded the financial strength rating of National to Baa2 from A3 with a stable outlook, affirmed the financial strength rating of MBIA Corp. at Caa1 with a developing outlook, downgraded MBIA Inc. s rating to Ba3 with a stable outlook from Ba1 with a negative outlook, and affirmed the financial strength rating of MBIA Mexico S.A. de C.V. (MBIA Mexico) at Caa1/B3.mx with a developing outlook. Moody s, at its discretion and in the absence of a contract with the Company, continues to maintain ratings on MBIA Inc. and its subsidiaries.

Stock Warrants

In April and June of 2018, the holder of certain MBIA Inc. warrants exercised its right to purchase, in total, 11.85 million shares of MBIA Inc. common stock at an exercise price of $9.59 per share. As a result, the Company issued a total of 1.3 million shares of MBIA Inc. common stock to the holder in accordance with the cashless settlement provision of the warrants. As of September 30, 2018, there were no warrants outstanding.

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. The discussion below highlights the significant risks and uncertainties that could have a material effect on the Company s financial statements and business objectives in future periods.

U.S. Public Finance Market Conditions

National continues to surveil and remediate its existing insured portfolio and will seek opportunities to enhance shareholder value using its strong financial resources, while protecting the interests of all of its policyholders. Certain state and local governments and territory obligors that National insures remain under financial and budgetary stress. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments on a greater number of National s insured transactions. National monitors and analyzes these situations and other stressed credits closely, and the overall extent and duration of this stress is uncertain.

In particular, the Commonwealth of Puerto Rico and certain of its instrumentalities (Puerto Rico) are experiencing significant fiscal stress and constrained liquidity due to, among other things, Puerto Rico s structural budget imbalance, the lack of access to the capital markets, a stagnating local economy, net migration of people out of Puerto Rico and a high debt burden. Although Puerto Rico has tried to address its challenges through various fiscal policies, it continues to experience significant fiscal stress. On January 1, 2018 and July 1, 2018, Puerto Rico defaulted on scheduled debt service for National insured bonds and National paid gross claims in the aggregate of $276 million. Puerto Rico continues in its efforts to rebuild its infrastructure and to otherwise recover from the impact of Hurricane Maria in 2017, aided in part by the Federal Emergency Management Agency and other federal agencies. The extent and duration of such aid is inherently uncertain, and the necessary and greater involvement of the federal government, through its actions to deliver disaster relief and other support services, in addition to the evolving role of the Financial Oversight and Management Board for Puerto Rico (the Oversight Board) and the role of Puerto Rico in its own recovery, heightens political risk in connection with the restructuring of legacy debt. This risk could lead the Oversight Board, Puerto Rico or the federal government to seek to extract greater concessions from creditors based on the uncertainty of Puerto Rico s long term recovery prospects. In this event, losses at National on select Puerto Rico exposures could increase materially.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

MBIA Corp. Insured Portfolio

MBIA Corp. s primary objectives are to satisfy all claims by its policyholders and to maximize future recoveries, if any, for its senior lending and other surplus note holders, and then its preferred stock holders. MBIA Corp. is executing this strategy by, among other things, pursuing various actions focused on maximizing the collection of recoveries and by reducing potential losses on its insurance exposures. MBIA Corp. s insured portfolio could deteriorate and result in additional significant loss reserves and claim payments. MBIA Corp. s ability to meet its obligations is limited by available liquidity and its ability to secure additional liquidity through financing and other transactions. There can be no assurance that MBIA Corp. will be successful in generating sufficient cash to meet its obligations.

Zohar and RMBS Recoveries

Payment of claims totaling $919 million in November of 2015 and January of 2017, on MBIA Corp. s policies insuring the class A-1 and A-2 notes issued by Zohar CDO 2003-1, Limited (Zohar I) and insuring certain notes issued by Zohar II 2005-1, Limited (Zohar II), entitles MBIA Corp. to reimbursement of such amounts plus interest and expenses and/or to exercise certain rights and remedies to seek recovery of such amounts. MBIA Corp. anticipates that the primary source of the recoveries will come from the monetization of the assets of Zohar I and Zohar II, which include, among other things, loans made to, and equity interests in, companies purportedly controlled by the sponsor and former collateral manager of Zohar I and Zohar II (the Zohar Sponsor) (all the assets of Zohar I and Zohar II, the Zohar Assets). On March 11, 2018, the then-director of Zohar I and Zohar II placed those funds into voluntary bankruptcy proceedings in federal bankruptcy court in the District of Delaware (the Zohar Funds Bankruptcy Cases). On May 21, 2018, the Court granted the Zohar funds motion to approve a settlement (the Zohar Bankruptcy Settlement) which established a process by which the debtor funds, through an independent director and a chief restructuring officer, will work with the original sponsor of the funds to monetize the Zohar Assets and repay creditors, including MBIA Corp. In addition, the Zohar Bankruptcy Settlement provides for a stay of all pending litigation between the parties for a minimum of fifteen months. Subsequent to the Zohar Bankruptcy Settlement, the Company deconsolidated Zohar I and Zohar II as variable interest entities (VIEs or VIE) and, as of September 30, 2018, salvage and subrogation recoveries related to Zohar I and Zohar II are reported within Insurance loss recoverable on the Company s consolidated balance sheet. Refer to Note 4: Variable Interest Entities for additional information about the deconsolidation of the Zohar funds. Notwithstanding the Zohar Bankruptcy Settlement, there can be no assurance that the value of the Zohar Assets will be sufficient to permit MBIA Corp. to recover all or substantially all of the payments it made on Zohar I and Zohar II.

MBIA Corp. also projects to collect excess spread from insured residential mortgage-backed securities (RMBS), and to recover proceeds from Credit Suisse Securities (USA) LLC, DLJ Mortgage Capital, Inc. and Select Portfolio Servicing Inc. (collectively, Credit Suisse) arising from its failure to repurchase ineligible loans that were included in a Credit Suisse sponsored RMBS transaction. However, the amount and timing of these collections and recoveries are uncertain.

Failure to collect a substantial amount of its expected recoveries could impede MBIA Corp. s ability to make payments when due on other policies. MBIA Corp. believes that if the New York State Department of Financial Services (NYSDFS) concludes at any time that MBIA Insurance Corporation will not be able to pay its policyholder claims, the NYSDFS would likely put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding under Article 74 of the New York Insurance Law and/or take such other actions as the NYSDFS may deem necessary to protect the interests of MBIA Insurance Corporation s policyholders. The determination to commence such a proceeding or take other such actions is within the exclusive control of the NYSDFS.

Given the separation of MBIA Inc. and MBIA Corp. as distinct legal entities, the absence of any cross defaults between the entities and the lack of reliance by MBIA Inc. on MBIA Corp. for the receipt of dividends, the Company does not believe that a rehabilitation or liquidation proceeding with respect to MBIA Insurance Corporation would have any significant liquidity impact on MBIA Inc. or result in a liquidation or similar proceeding of MBIA Mexico. Such a proceeding could have material adverse consequences for MBIA Corp., including the termination of insured credit default swaps (CDS) and other derivative contracts for which counterparties may assert market-based claims, the acceleration of debt obligations issued by affiliates and insured by MBIA Corp., the loss of control of MBIA Insurance Corporation to a rehabilitator or liquidator, and unplanned costs.

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

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Corporate Liquidity

Subsequent to September 30, 2018, National declared and paid a dividend of $108 million to its ultimate parent, MBIA Inc. Also, subsequent to September 30, 2018, National purchased from MBIA Inc., certain MBIA Inc. 5.700% Senior Notes due 2034 and certain MBIA Inc. 7.000% Debentures due 2025 that were previously repurchased by MBIA Inc. and had not been retired, resulting in an increase to MBIA Inc. s liquidity of $41 million. Based on the Company s projections of National s dividends, additional anticipated releases under its tax sharing agreement and related tax escrow account (Tax Escrow Account), and other cash inflows, the Company expects that MBIA Inc. will have sufficient cash to satisfy its debt service and general corporate needs. However, MBIA Inc. continues to have liquidity risk which could be triggered by deterioration in the performance of invested assets, interruption of or reduction in dividends or tax payments received from operating subsidiaries, impaired access to the capital markets, as well as other factors which are not anticipated at this time. Furthermore, failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp.

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, 2017. 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, 2017. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the Company s consolidated financial position and results of operations. All material intercompany balances and transactions have been eliminated.

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

The results of operations for the three and nine months ended September 30, 2018 may not be indicative of the results that may be expected for the year ending December 31, 2018. The December 31, 2017 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. Certain amounts have been reclassified in the prior year s financial statements to conform to the current presentation. This includes a change in the classification of certain cash receipts and cash payments on the Company s consolidated statement of cash flows as required under Accounting Standards Update (ASU) 2016-15, Statement of Cash Flows (Topic 230) . This classification change affected Interest paid, net of interest converted to principal , in operating cash flows, and Principal paydowns of investment agreements and Principal paydowns of medium-term notes , in financing cash flows, on the Company s consolidated statement of cash flows for the prior period. Such reclassifications did not materially impact total revenues, expenses, assets, liabilities, shareholders equity, operating cash flows, investing cash flows, or financing cash flows for all periods presented.

During the third quarter of 2018, the Company corrected an error related to the second quarter of 2018 of $3 million and an error related to the first quarter of 2017 of $3 million, which, in aggregate, reduced the third quarter of 2018 s net loss by $6 million. The first quarter of 2017 error related to a gain on the extinguishment of debt and the second quarter of 2018 error related to a benefit on losses and loss adjustment expense. The Company evaluated the materiality of these errors in accordance with Securities and Exchange Commission (SEC) Staff Accounting

Bulletin No. 99, Materiality, and SEC Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements, and concluded that these errors, individually and in the aggregate, were immaterial to the three months ended September 30, 2018 and the prior periods to which these errors relate.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 3: Recent Accounting Pronouncements

Recently Adopted Accounting Standards

Revenue from Contracts with Customers (Topic 606) (ASU 2014-09) and *Deferral of the Effective Date (ASU 2015-14)*

In May of 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 amends the accounting guidance for recognizing revenue for the transfer of goods or services from contracts with customers unless those contracts are within the scope of other accounting standards. ASU 2014-09 does not apply to financial guarantee insurance contracts within the scope of Topic 944, Financial Services Insurance. In August of 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606) Deferral of the Effective Date. ASU 2015-14 defers the effective date of ASU 2014-09 to interim and annual periods beginning January 1, 2018, and is applied on a retrospective or modified retrospective basis. The Company adopted ASU 2014-09 in the first quarter of 2018 and the adoption of ASU 2014-09 did not affect the Company s consolidated financial statements.

Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01)

In January of 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 requires certain equity investments other than those accounted for under the equity method of accounting or result in consolidation of the investee to be measured at fair value with changes in fair value recognized in net income, and permits an entity to measure equity investments that do not have readily determinable fair values at cost less any impairment plus or minus adjustments for certain changes in observable prices. An entity is also required to evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale (AFS) debt securities in combination with the entity s other deferred tax assets. ASU 2016-01 requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability that results from a change in the instrument-specific credit risk for financial liabilities that the entity has elected to measure at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 was effective for interim and annual periods beginning January 1, 2018. As such, the Company reclassed a loss of $162 million from retained earnings to accumulated other comprehensive income (AOCI) related to the instrument-specific credit risk portion of financial liabilities measured at fair value in accordance with the fair value option. In addition, the Company reclassed net unrealized gains of $2 million from AOCI to retained earnings related to equity investments. As of September 30, 2018 and December 31, 2017, the Company had a full valuation allowance against its deferred tax asset.

Income Statement Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (ASU 2018-02)

In February of 2018, the FASB issued ASU 2018-02, Income Statement Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 permits, but does not require, the reclassification of the income tax effects of the Tax Cuts and Jobs Act (the Act) from AOCI to retained earnings. ASU 2018-02 is effective for interim and annual periods beginning after December 15, 2018. Early adoption of ASU 2018-02 is permitted and is applied in the period of adoption or retroactively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Act is recognized. The Company adopted ASU 2018-02 in the first quarter of 2018. As such, the Company reclassed income taxes of $3 million from AOCI to retained earnings. The Company s accounting policy related to releasing income tax effects that are lodged in AOCI is on a portfolio approach basis.

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 3: Recent Accounting Pronouncements (continued)

Recent Accounting Developments

Leases (Topic 842) (ASU 2016-02)

In February of 2016, the FASB issued ASU 2016-02, Leases (Topic 842) , that amends the accounting guidance for leasing transactions. ASU 2016-02 requires a lessee to classify lease contracts as finance or operating leases, and to recognize assets and liabilities for the rights and obligations created by leasing transactions with lease terms more than twelve months. ASU 2016-02 substantially retains the criteria for classifying leasing transactions as finance or operating leases. For finance leases, a lessee recognizes a right-of-use asset and a lease liability initially measured at the present value of the lease payments, and recognizes interest expense on the lease liability separately from the amortization of the right-of-use asset. For operating leases, a lessee recognizes a right-of-use asset and a lease liability initially measured at the present value of the lease payments, and recognizes lease expense on a straight-line basis. ASU 2016-02 is effective for interim and annual periods beginning January 1, 2019 with early adoption permitted, and is applied on a modified retrospective basis. The Company is currently evaluating its lease commitments and expects an increase in its total assets and total liabilities on its consolidated balance sheet reflecting the recognition of its right-of-use asset and lease liability, respectively. The gross up of the assets and liabilities is expected to have no impact on the Company s statement of operations. Refer to Note 13: Commitments and Contingencies for information about the Company s lease commitments.

Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13)

In June of 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 requires financing receivables and other financial assets measured at amortized cost to be presented at the net amount expected to be collected by recording an allowance for credit losses with changes in the allowance recorded as credit loss expense or reversal of credit loss expense based on management s current estimate of expected credit losses each period. ASU 2016-13 does not apply to credit losses on financial guarantee insurance contracts within the scope of Topic 944, Financial Services-Insurance. ASU 2016-13 also requires impairment relating to credit losses on AFS debt securities to be presented through an allowance for credit losses with changes in the allowance recorded in the period of the change as credit loss expense or reversal of credit loss expense. Any impairment amount not recorded through an allowance for credit losses on AFS debt securities is recorded through other comprehensive income. ASU 2016-13 is effective for interim and annual periods beginning January 1, 2020 with early adoption permitted beginning January 1, 2019. ASU 2016-13 is applied on a modified retrospective basis except that prospective application is applied to AFS debt securities with other-than-temporary impairments (OTTI) recognized before the date of adoption. The Company is evaluating the impact of adopting ASU 2016-13.

Fair Value Measurement (Topic 820): Disclosure Framework Changes to the Disclosure Requirements for Fair Value Measurement (ASU 2018-13)

In August of 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework Changes to the Disclosure Requirements for Fair Value Measurement. ASU 2018-13 modifies the disclosure requirements on fair value measurements. ASU 2018-13 is effective for interim and annual periods beginning January 1, 2020 with early adoption permitted to remove or modify disclosures upon issuance of the standard and delay adoption of the additional disclosures until the effective date. Upon the effective date, certain amendments should be applied prospectively, while others are to be applied retrospectively to all periods presented. The Company is evaluating the impact of adopting ASU 2018-13. Since the amendments of ASU 2018-13 only impact disclosure requirements, the Company does not expect the adoption of ASU 2018-13 to have an impact on its consolidated financial statements.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities

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

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

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

Consolidated VIEs

The carrying amounts of assets and liabilities of consolidated VIEs were $1.9 billion and $2.0 billion, respectively, as of September 30, 2018, and $3.2 billion and $2.3 billion, respectively, as of December 31, 2017. 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. 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. In May of 2018, the Court overseeing the Zohar Funds Bankruptcy Cases approved the Zohar Bankruptcy Settlement, which concerns two entities that the Company had consolidated as VIEs. As a result, in the second quarter of 2018, the Company deconsolidated these two VIEs and recorded a $93 million loss within Other net realized gains (losses) under Revenues of consolidated variable interest entities on the Company s consolidated statement of operations. The loss resulted from the difference between the fair value of the VIE assets that were deconsolidated and the Company s current estimate of salvage and subrogation recoveries from those VIEs under insurance accounting. Refer to Note 1: Business Developments and Risks and Uncertainties for further information about the Zohar Bankruptcy Settlement. In the third quarter of 2018, three VIEs were deconsolidated. No additional VIEs were consolidated during the nine months ended September 30, 2018.

Holders of insured obligations of issuer-sponsored VIEs related to the Company s international and structured finance 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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

Nonconsolidated VIEs

The following tables present the total assets of nonconsolidated VIEs in which the Company holds a variable interest as of September 30, 2018 and December 31, 2017, 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 September 30, 2018 and December 31, 2017. The maximum exposure to loss as a result of MBIA s variable interests in VIEs is represented by insurance in force. Insurance in force is the maximum future payments of principal and interest which may be required under commitments to make payments on insured obligations issued by nonconsolidated VIEs. 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 and any investments in obligations issued by nonconsolidated VIEs.

	September 30, 2018						
			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)
Insurance:							
Global structured finance:							
Mortgage-backed residential	$ 5,879	$ 3,251	$ 18	$ 20	$ 143	$ 18	$ 356
Mortgage-backed commercial	131	59	-	-	-	-	-
Consumer asset-backed	4,514	586	-	2	1	1	10
Corporate asset-backed	3,854	1,377	-	9	839	11	10
Total global structured finance	14,378	5,273	18	31	983	30	376
Global public finance	15,058	2,296	-	9	-	12	-
Total insurance	$ 29,436	$ 7,569	$ 18	$ 40	$ 983	$ 42	$ 376

(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.

In millions	VIE Assets	Maximum Exposure to Loss	December 31, 2017 Carrying Value of Assets Investments(1)	Premiums Receivable(2)	Insurance Loss Recoverable(3)	Carrying Value of Liabilities Unearned Premium Revenue(4)	Loss and Loss Adjustment Expense Reserves(5)
Insurance:							
Global structured finance:							
Mortgage-backed residential	$ 7,295	$ 3,741	$ 19	$ 22	$ 172	$ 20	$ 396
Mortgage-backed commercial	216	94	-	-	-	-	-
Consumer asset-backed	5,010	981	-	4	1	3	10
Corporate asset-backed	2,418	1,645	-	13	-	14	-
Total global structured finance	14,939	6,461	19	39	173	37	406
Global public finance	15,568	2,524	-	10	-	14	-
Total insurance	$ 30,507	$ 8,985	$ 19	$ 49	$ 173	$ 51	$ 406

(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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 5: Loss and Loss Adjustment Expense Reserves

U.S. Public Finance Insurance

U.S. public finance insured transactions consist of municipal bonds, including tax-exempt and taxable indebtedness of U.S. political subdivisions, as well as utilities, airports, health care institutions, higher educational facilities, student loan issuers, housing authorities and other similar agencies and obligations issued by private entities that finance projects that serve a substantial public purpose. The Company estimates future losses by using probability-weighted cash flow scenarios that are customized to each insured transaction. Future loss estimates consider debt service due for each insured transaction, which includes par outstanding and interest due, as well as recoveries for such payments, if any. Gross par outstanding for capital appreciation bonds represents the par amount at the time of issuance of the insurance policy.

Certain local governments remain under financial and budgetary stress and a few have filed for protection under Title 11 of the United States Code (the Bankruptcy Code), or have entered into state statutory proceedings established to assist municipalities in managing through periods of severe fiscal stress. In the case of Puerto Rico, certain credits that the Company insures have filed petitions for covered instrumentalities under Title III of the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA), which incorporates by reference provisions from the Bankruptcy Code. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments in greater amounts on the Company s insured transactions. The filing for protection under the Bankruptcy Code or entering state statutory proceedings does not necessarily result in a default or indicate that an ultimate loss will occur. Refer to Note 1: Business Development and Risk and Uncertainties , for further information on the Company s Puerto Rico exposures.

International and Structured Finance Insurance

The international and structured finance insurance segment s case basis reserves and insurance loss recoveries recorded in accordance with GAAP do not include estimates for a policy insuring a credit derivative or on financial guarantee VIEs that are eliminated in consolidation. The policy insuring a credit derivative contract is accounted for as a derivative and is carried at fair value in the Company s consolidated financial statements under GAAP. The fair value of an insured credit derivative contract is 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 an insured credit derivative contract or the early termination of such contract at a loss, the cumulative unrealized losses recorded from this contract should reverse before or at the maturity of the contract. As the Company s insured credit derivative has similar terms, conditions, risks, and economic profiles to its financial guarantee insurance policies, the Company evaluates it for impairment, under statutory accounting principles, in the same way that it estimates loss and loss adjustment expense (LAE) for its financial guarantee policies. Refer to Note 8: Derivative Instruments for a further discussion of the Company s use of derivatives and their impact on the Company s consolidated financial statements.

RMBS Case Basis Reserves (Financial Guarantees)

The Company s RMBS reserves and recoveries relate to financial guarantee insurance policies, excluding those on consolidated VIEs. The Company s first-lien RMBS case basis reserves primarily relate to RMBS backed by alternative A-paper and subprime mortgage loans. The Company s second-lien RMBS case basis reserves relate to RMBS backed by home equity lines of credit and closed-end second mortgages. The Company calculated RMBS case basis reserves as of September 30, 2018 for both first and second-lien RMBS transactions using a process called the Roll Rate Methodology. The Roll Rate Methodology is a multi-step process using databases of loan level information, proprietary internal cash flow models, and commercially available models to estimate potential losses and recoveries on insured bonds. Refer to Note 6: Loss and Loss Adjustment Expense Reserves in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2017, for additional information regarding the Company s Roll Rate Methodology for its RMBS case basis reserves.

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.

RMBS Recoveries

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

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Excess Spread

Excess spread within insured RMBS securitizations is the difference between interest inflows on mortgage loan collateral and interest outflows on the insured RMBS notes. The aggregate amount of excess spread depends on the future loss trends, which include future delinquency trends, average time to charge-off/liquidate delinquent loans, the future spread between Prime and the LIBOR interest rates, and borrower refinancing behavior (which may be affected by changes in the interest rate environment) that results in voluntary prepayments. Minor deviations in loss trends and voluntary prepayments may substantially impact the amounts collected from excess spread. Excess spread also includes subsequent recoveries on previously charged-off loans associated with insured second-lien RMBS securitizations.

Second-lien Put-Back Claims Related to Ineligible Loans

The Company has settled the majority of the Company s put-back claims relating to the inclusion of ineligible loans in securitizations it insured. Only its claims against Credit Suisse remain outstanding. 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. The Company s settlement amounts on its prior put-back claims have been consistent with the put-back recoveries that had been included in the Company s financial statements at the times preceding the settlements. Based on the Company s assessment of the strength of its contractual put-back rights against Credit Suisse, as well as on its prior settlements with other sellers/servicers and success of other monolines put-back settlements, the Company believes it will prevail in enforcing its contractual rights and that it is entitled to collect the full amount of its incurred losses.

Refer to Note 6: Loss and Loss Adjustment Expense Reserves in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2017, and Note 13: Commitments and Contingencies for further information about the Company s litigation with Credit Suisse.

CDO Reserves and Recoveries

The Company also has loss and LAE reserves on certain transactions within its collateralized debt obligations (CDO) portfolio, primarily its multi-sector CDO asset class that was insured in the form of financial guarantee policies. MBIA s insured multi-sector 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, multi-sector and corporate CDOs).

Zohar Recoveries

MBIA Corp. will seek to recover the payments it made (plus interest and expenses) with respect to Zohar I and Zohar II. MBIA Corp. anticipates that the primary source of the recoveries will come from the monetization of the Zohar Assets as anticipated in the Zohar Bankruptcy Settlement. Since the second quarter of 2018, the Company no longer consolidates the Zohar funds as VIEs and estimated recoveries from Zohar I and Zohar II are included in Insurance loss recoverable on the Company s consolidated balance sheets. As of March 31, 2018 and December 31, 2017, the fair value of the assets of Zohar I and Zohar II are included in Loans receivable at fair value under Assets of consolidated variable interest entities on the Company s consolidated balance sheets. Refer to Note 1: Business Developments and Risks and Uncertainties for additional information about the estimated Zohar recoveries. Notwithstanding the procedures agreed to in the Zohar Bankruptcy Settlement, there can be no assurance that the value of the Zohar Assets will be sufficient to permit MBIA Corp. to recover all or substantially all of the payments it made on Zohar I and Zohar II.

Failure to recover a substantial amount of such payments could impede MBIA Corp. s ability to make payments when due on other policies. MBIA Corp. believes that if the NYSDFS concludes at any time that MBIA Insurance Corporation will not be able to pay its policyholder claims, the NYSDFS would likely put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding under Article 74 of the New York Insurance Law and/or take such other actions as the NYSDFS may deem necessary to protect the interests of MBIA Insurance Corporation s policyholders. The determination to commence such a proceeding or take other such actions is within the exclusive control of the

NYSDFS.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Summary of Loss and LAE Reserves and Recoveries

The Company s loss and LAE reserves and recoveries before consolidated VIE eliminations, along with amounts that were eliminated as a result of consolidated VIEs, which are included in the Company s consolidated balance sheets as of September 30, 2018 and December 31, 2017 are presented in the following table:

In millions	As of September 30, 2018 Balance Sheet Line Item		As of December 31, 2017 Balance Sheet Line Item	
	Insurance loss recoverable	Loss and LAE reserves	Insurance loss recoverable	Loss and LAE reserves
U.S. Public Finance Insurance	$ 554	$ 634	$ 333	$ 512
International and Structured Finance Insurance:				
Before VIE eliminations(1)	1,457	628	1,478	710
VIE eliminations(1)	(469)	(229)	(1,300)	(243)
Total international and structured finance insurance	988	399	178	467
Total	$ 1,542	$ 1,033	$ 511	$ 979

(1) - Includes loan repurchase commitments of $415 million and $407 million as of September 30, 2018 and December 31, 2017, respectively.

Changes in Loss and LAE Reserves

The Company s recoveries are based on either salvage rights, the rights conferred to MBIA through the transactional documents (inclusive of the insurance agreements), 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, the right to recovery 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 estimated future claim payments. As claim payments are made, the recorded amount of potential recoveries may exceed the remaining amount of the claim liability for a given policy. The gross claim liability and gross potential recoveries reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by the Company.

The following table presents changes in the Company s loss and LAE reserves for the nine months ended September 30, 2018. Changes in loss reserves attributable to the accretion of the claim liability discount, changes in discount rates, changes in amount and timing of estimated claim payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations. As of September 30, 2018, the weighted average risk-free rate used to discount the Company s loss reserves (claim liability) was 3.03%. LAE reserves are generally expected to be settled within a one-year period and are not discounted. As of September 30, 2018 and December 31, 2017, the Company s gross loss and LAE reserves included $74 million and $66 million, respectively, related to LAE.

In millions	Changes in Loss and LAE Reserves for the Nine Months Ended September 30, 2018							
Gross Loss and LAE Reserves as of December 31, 2017	Loss Payments	Accretion of Claim Liability Discount	Changes in Discount Rates	Changes in Assumptions	Changes in Unearned Premium Revenue	Changes in LAE Reserves	Other[(1)]	Gross Loss and LAE Reserves as of September 30, 2018
$ 979	$ (344)	$ 18	$ 25	$ 336	$ 12	$ 8	$ (1)	$ 1,033

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

The increase in the Company s gross loss and LAE reserves during the nine months ended September 30, 2018 was primarily related to certain Puerto Rico exposures and changes in the interest rate environment, partially offset by decreases in insured RMBS and other insured financial guarantee transactions.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses

Current period changes in the Company s estimate of potential recoveries may be recorded as an insurance loss recoverable asset, netted against the gross loss and LAE reserve liability, or both. The following table presents changes in the Company s insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company s claim liability for the nine months ended September 30, 2018. Changes in insurance loss recoverable attributable to the accretion of the discount on the recoverable, changes in discount rates, changes in amount and timing of estimated collections, changes in assumptions and changes in LAE recoveries are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations.

		Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses for the Nine Months Ended September 30, 2018						
In millions	Gross Reserve as of December 31, 2017	Collections for Cases	Accretion of Recoveries	Changes in Discount Rates	Changes in Assumptions	Changes in LAE Recoveries	Other[1]	Gross Reserve as of September 30, 2018
Insurance loss recoverable	$ 511	$ (42)	$ 14	$ (29)	$ 1,084[2]	$ -	$ 4	$ 1,542
Recoveries on unpaid losses [3]	35	-	1	(1)	(8)	(6)	-	21
Total	$ 546	$ (42)	$ 15	$ (30)	$ 1,076	$ (6)	$ 4	$ 1,563

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

(2) - Includes amounts which have been paid and are expected to be recovered in the future.

(3) - As of September 30, 2018 and December 31, 2017, excludes Puerto Rico recoveries which have been netted against reserves.

The increase in the Company s insurance loss recoverable reflected in the preceding table was primarily due to the re-establishment of recoveries for Zohar I and Zohar II upon deconsolidation during the second quarter of 2018 and to a lesser extent, amounts related to the anticipated recovery of claims paid to certain Puerto Rico credits.

Loss and LAE Activity

For the three months ended September 30, 2018, losses and LAE incurred primarily related to increases in actual and expected payments on Puerto Rico exposures.

For the nine months ended September 30, 2018, losses and LAE incurred primarily related to increases in actual and expected payments on Puerto Rico exposures, partially offset by a decrease on actual and expected payments on insured RMBS transactions.

For the three months ended September 30, 2017, losses and LAE incurred primarily related to increases in actual and expected payments on certain Puerto Rico exposures and decreases in projected collections from mortgage insurance included in the Company s excess spread within its second-lien RMBS transactions from the settlement of litigation regarding insurance coverage involving Old Republic Insurance Corporation, Bank of America, N.A. and the Bank of New York Mellon.

For the nine months ended September 30, 2017, incurred loss and LAE activity related to increases in actual and expected payments on certain Puerto Rico exposures and insured first-lien RMBS securitizations and a decrease in actual and projected collections from mortgage insurance included in the Company s excess spread within its second-lien RMBS transactions from the settlement of litigation regarding insurance coverage involving Old Republic Insurance Corporation, Bank of America, N.A. and the Bank of New York Mellon.

Costs associated with remediating insured obligations assigned to the Company s surveillance categories are recorded as LAE and are included in Losses and loss adjustment expenses on the Company s consolidated statements of operations. For the three months ended September 30, 2018 and 2017, gross LAE related to remediating insured obligations were $6 million. For the nine months ended September 30, 2018 and 2017, gross LAE related to remediating insured obligations were $28 million and $33 million, respectively.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Surveillance Categories

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of September 30, 2018:

	Surveillance Categories				
$ in millions	Caution List Low	Caution List Medium	Caution List High	Classified List	Total
Number of policies	56	20	-	243	319
Number of issues [(1)]	16	6	-	109	131
Remaining weighted average contract period (in years)	7.2	8.0	-	9.7	9.0
Gross insured contractual payments outstanding: [(2)]					
Principal	$ 1,933	$ 262	$ -	$ 5,465	$ 7,660
Interest	2,314	131	-	5,443	7,888
Total	$ 4,247	$ 393	$ -	$ 10,908	$ 15,548
Gross Claim Liability [(3)]	$ -	$ -	$ -	$ 1,076	$ 1,076
Less:					
Gross Potential Recoveries [(4)]	-	-	-	2,058	2,058
Discount, net [(5)]	-	-	-	(483)	(483)
Net claim liability (recoverable)	$ -	$ -	$ -	$ (499)	$ (499)
Unearned premium revenue	$ 6	$ 4	$ -	$ 65	$ 75
Reinsurance recoverable on paid and unpaid losses [(6)]					$ 23

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

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

(3) - The gross claim liability with respect to Puerto Rico exposures are net of expected recoveries for policies in a net payable position.

(4) - Gross potential recoveries with respect to certain Puerto Rico exposures are net of the claim liability for policies in a net recoverable position.

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

(6) - Included in Other assets on the Company s consolidated balance sheets.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of December 31, 2017:

	Surveillance Categories				
$ in millions	**Caution List Low**	**Caution List Medium**	**Caution List High**	**Classified List**	**Total**
Number of policies	89	5	1	280	375
Number of issues (1)	20	4	1	119	144
Remaining weighted average contract period (in years)	7.4	4.3	8.7	9.7	8.9
Gross insured contractual payments outstanding: (2)					
Principal	$ 2,764	$ 13	$ 104	$ 6,083	$ 8,964
Interest	2,676	3	46	5,756	8,481
Total	$ 5,440	$ 16	$ 150	$ 11,839	$ 17,445
Gross Claim Liability (3)	$ -	$ -	$ -	$ 1,082	$ 1,082
Less:					
Gross Potential Recoveries (4)	-	-	-	782	782
Discount, net (5)	-	-	-	(178)	(178)
Net claim liability (recoverable)	$ -	$ -	$ -	$ 478	$ 478
Unearned premium revenue	$ 9	$ -	$ 4	$ 77	$ 90
Reinsurance recoverable on paid and unpaid losses (6)					$ 17

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

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

(3) - The gross claim liability with respect to Puerto Rico exposures are net of expected recoveries for policies in a net payable position.

(4) - Gross potential recoveries with respect to certain Puerto Rico exposures are net of the claim liability for policies in a net recoverable position.

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

(6) - Included in Other assets on the Company s consolidated balance sheets.

The change from a net claim liability as of December 31, 2017 to a net claim recoverable as of September 30, 2018 is due to the fact that the Company no longer consolidates the Zohar funds as VIEs and estimated recoveries from Zohar I and Zohar II are included in Insurance loss recoverable on the Company s consolidated balance sheet. As of March 31, 2018 and December 31, 2017, gross potential recoveries exclude the recoveries of Zohar I and Zohar II that are included in Loans receivable at fair value which are presented in Assets of consolidated variable interest entities on the Company s consolidated balance sheets.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments

Fair Value Measurement

Financial Assets

Financial 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, along with its third-party portfolio manager, reviews the assumptions, inputs and methodologies used by pricing services and brokers to obtain reasonable assurance that the prices used in its valuations reflect fair value. When the Company and its third-party portfolio manager believe a third-party quotation differs significantly from its internally developed expectation of fair value, whether higher or lower, the Company reviews its data or assumptions with the provider. This review includes comparing significant assumptions such as prepayment speeds, default ratios, forward yield curves, credit spreads and other significant quantitative inputs to internal assumptions, and working with the price provider to reconcile the differences. The price provider may subsequently provide an updated price. In the event that the price provider does not update its price, and the Company still does not agree with the price provided, its third-party portfolio manager will obtain a price from another third-party provider or use an internally developed price which it believes represents the fair value of the investment. The fair values of investments for which internal prices were used were not significant to the aggregate fair value of the Company s investment portfolio as of September 30, 2018 or December 31, 2017. All challenges to third-party prices are reviewed by staff of the Company as well as its third-party portfolio manager with relevant expertise to ensure reasonableness of assumptions. A pricing analysis is reviewed and approved by the Company s valuation committee.

Financial Liabilities (excluding derivative liabilities)

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

Derivative Liabilities

The Company s derivative liabilities are primarily interest rate swaps and an insured credit derivative. The Company s insured credit derivative contract is a non-traded structured credit derivative transaction and since it is highly customized, there is generally no observable market for this derivative. The Company estimates its fair value in a hypothetical market based on an internal model that incorporates market or estimated prices of similar securities that are obtained for all collateral within a transaction, the present value of the market-implied potential loss and nonperformance risk. 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.

Internal Review Process

All significant financial assets and liabilities are reviewed by the valuation committee to ensure compliance with the Company s policies and risk procedures in the development of fair values of financial assets and liabilities. The valuation committee reviews, 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 committee also reviews any significant impairment or improvements in fair values of the financial instruments from prior periods. The committee is comprised of senior finance team members with relevant experience in the financial instruments their committee is responsible for. The committee documents its agreement with the fair value measurements reported in the Company s consolidated financial statements.

Valuation Techniques

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

Fixed-Maturity Securities Held as Available-For-Sale, Investments Carried at Fair Value, Investments Pledged as Collateral and Short-term Investments

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

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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 investment in the fixed-income fund was measured at fair value by applying the net asset value per share practical expedient. The investment in the fixed-income fund may be redeemed on a quarterly basis with prior redemption notification of ninety days subject to withdrawal limitations. The investment is required to be held for a minimum of twelve months, and any subsequent quarterly redemption is limited to 25% of the investment or a complete redemption over four consecutive quarters in the amounts of 25%, 33%, 50%, and 100% of the remaining investment balance as of the first, second, third and fourth consecutive quarters, respectively.

Investments based on quoted market prices of identical investments in active markets are classified as Level 1 of the fair value hierarchy. Level 1 investments generally consist of U.S. Treasury and government agency, money market securities and perpetual debt and equity securities. 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

The carrying amounts of cash and cash equivalents approximate fair value due to the short-term nature and credit worthiness of these instruments and are categorized in Level 1 of the fair value hierarchy.

Loans Receivable at Fair Value

Loans receivable at fair value are comprised of loans held by consolidated VIEs consisting of residential mortgage and corporate loans. Fair values of residential mortgage loans are determined using quoted prices for MBS issued by the respective VIE and adjusted for the fair values of the financial guarantees provided by MBIA Corp. on the related MBS. The fair values of the financial guarantees consider expected claim payments, net of recoveries, under MBIA Corp. s policies. Fair values of corporate loans, which are to privately held companies, are based on methodologies that generally use comparable EBITDA multiples and the most current available EBITDAs.

Loan Repurchase Commitments

Loan repurchase commitments are obligations owed by the sellers/servicers of mortgage loans to MBIA as reimbursement of paid claims. 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. Fair values of loan repurchase commitments are determined using discounted cash flow techniques and are categorized in Level 3 of the fair value hierarchy.

Other Assets

A VIE consolidated by the Company has entered into a derivative instrument consisting of a cross currency swap. The cross currency swap is entered into to manage the variability in cash flows resulting from fluctuations in foreign currency rates. The fair value of the VIE derivative is determined based on inputs from unobservable cash flows projection of the derivative, discounted using observable discount rates. As the significant inputs are unobservable, the derivative contract is categorized in Level 3 of the fair value hierarchy.

Other assets also include receivables representing the right to receive reimbursement payments on claim payments expected to be made on certain insured VIE liabilities due to risk mitigating transactions with third parties executed to effectively defease, or, in-substance commute the Company s exposure on its financial guarantee policies. The right to receive reimbursement payments is based on the value of the Company s financial guarantee determined using the cash flow model. The fair value of the financial guarantee primarily contains unobservable inputs and is categorized in Level 3 of the fair value hierarchy.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Medium-term Notes at Fair Value

The Company has elected to measure certain MTNs at fair value on a recurring basis. 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 to determine fair value based on the quoted market prices received for similar instruments and considering the MTNs stated maturity and interest rate. Nonperformance risk is included in the quoted market prices and the matrix pricing grid. MTNs are categorized in 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. 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.

Derivatives

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

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 based on observable inputs and considering nonperformance risk of the Company. Negotiated settlements are also considered to validate the valuation models and to reflect assumptions the Company believes market participants would use.

Valuation Model Overview

The Company uses an internally developed Direct Price Model to value its insured credit derivative that incorporates market prices or estimated prices of similar securities that are obtained for all collateral within a transaction, the present value of the market-implied potential losses, and nonperformance risk. The valuation of the insured credit derivative includes the impact of its credit standing. The insured credit derivative is categorized in Level 3 of the fair value hierarchy based on unobservable inputs that are significant to the fair value measurement in its entirety.

The Company also has other derivative liabilities as a result of a commutation that occurred in 2014. The fair value of the derivative is determined using a discounted cash flow model. Key inputs include unobservable cash flows projected over the expected term of the derivative. As the significant inputs are unobservable, the derivative contract is categorized in Level 3 of the fair value hierarchy.

Other Liabilities

Stock warrants issued by the Company are valued using the Black-Scholes model and are recorded at fair value. Inputs into the warrant valuation include the Company s stock price, the strike price of the warrant, time to expiration, a volatility parameter, interest rates, and dividend data. As all significant inputs are market-based and observable, warrants are categorized in Level 2 of the fair value hierarchy. As of September 30, 2018, there were no warrants outstanding.

Other payable relates to certain contingent consideration. The fair value of the liability is based on the cash flow methodologies using observable and unobservable inputs. Unobservable inputs include invested asset balances and asset management fees that are significant to the fair value estimate and the liability is categorized in Level 3 of the fair value hierarchy.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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 September 30, 2018 and December 31, 2017.

In millions	Fair Value as of September 30, 2018	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	$ 428	Market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee(1)	-18% - 63% (-5%)
Loan repurchase commitments	415	Discounted cash flow	Recovery rates(2)	
			Breach rates(2)	
Liabilities of consolidated VIEs:				
Variable interest entity notes	382	Market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 65% (40%)
Credit derivative liabilities:				
CMBS	27	Direct Price Model	Nonperformance risk	54% - 54% (54%)
Other derivative liabilities	7	Discounted cash flow	Cash flows	$0 - $49 ($25)(3)

(1) - Negative percentage represents financial guarantee policies in a receivable position.
(2) - Recovery rates and breach rates include estimates about potential variations in the outcome of litigation with a counterparty.
(3) - Midpoint of cash flows are used for the weighted average.

In millions	Fair Value as of December 31, 2017	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	$ 1,679	Market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee(1)	-25% - 35% (-2%)
		Multiples of EBITDA	Multiples(2)	
Loan repurchase commitments	407	Discounted cash flow	Recovery rates(3)	
			Breach rates(3)	

Liabilities of consolidated VIEs:				
Variable interest entity notes	406	Market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 60% (36%)
Credit derivative liabilities:				
CMBS	63	Direct Price Model	Nonperformance risk	54% - 54% (54%)
Other derivative liabilities	4	Discounted cash flow	Cash flows	$0 - $49 ($25)[4]

(1) - Negative percentage represents financial guarantee policies in a receivable position.

(2) - Unobservable inputs are primarily based on comparable companies   EBITDA multiples.

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

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Sensitivity of Significant Unobservable Inputs

As of September 30, 2018, 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, net of recoveries, under the policy. As the value of the financial guarantee provided by the Company under the insurance policy increases, 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. In addition to the impact of the financial guarantee, as of December 31, 2017, the fair value of loans receivable also includes certain methodologies using multiples of EBITDA. Multiples are external factors that are considered when determining the fair values of corporate loans. These loans are to privately held companies for which the Company has limited information.

The significant unobservable inputs used in the fair value measurement of the Company s loan repurchase commitments of consolidated VIEs are the recovery rates and breach rates. Recovery rates reflect the estimates of future cash flows reduced for litigation delays and risks and/or potential financial distress of the sellers/servicers. The estimated recoveries of the loan repurchase commitments may differ from the actual recoveries that may be received in the future. Breach rates represent the rate at which mortgages fail to comply with stated representations and warranties of the sellers/servicers. Significant increases or decreases in the recovery rates and the breach rates would result in significantly higher or lower fair values of the loan repurchase commitments, respectively. Additionally, changes in the legal environment and the ability of the counterparties to pay would impact the recovery rate assumptions, which could significantly impact the fair value measurement. Any significant challenges by the counterparties to the Company s determination of breaches of representations and warranties could have a material adverse impact on 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 input used in the fair value measurement of MBIA Corp. s commercial mortgage-backed securities (CMBS) credit derivative, which is valued using the Direct Price Model, is nonperformance risk. The nonperformance risk is an assumption of MBIA Corp. s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Any significant increase or decrease in MBIA Corp. s nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively.

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

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Fair Value Measurements

The following tables present the fair value of the Company s assets (including short-term investments) and liabilities measured and reported at fair value on a recurring basis as of September 30, 2018 and December 31, 2017:

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)	Balance as of September 30, 2018
Assets:				
Fixed-maturity investments:				
U.S. Treasury and government agency	$ 765	$ 89	$ -	$ 854
State and municipal bonds	-	757	-	757
Foreign governments	-	11	-	11
Corporate obligations	20	1,603	-	1,623
Mortgage-backed securities:				
Residential mortgage-backed agency	-	220	-	220
Residential mortgage-backed non-agency	-	30	-	30
Commercial mortgage-backed	-	50	7(1)	57
Asset-backed securities:				
Collateralized debt obligations	-	146	-	146
Other asset-backed	-	217	4(1)	221
Total fixed-maturity investments	785	3,123	11	3,919
Money market securities	147	-	-	147
Perpetual debt and equity securities	26	38	-	64
Fixed-income fund	-	-	-	75(2)
Cash and cash equivalents	167	-	-	167
Derivative assets:				
Non-insured derivative assets:				
Interest rate derivatives	-	2	-	2

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using			
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance as of September 30, 2018**
Assets of consolidated VIEs:				
Corporate obligations	-	9	5(1)	14
Mortgage-backed securities:				
Residential mortgage-backed non-agency	-	98	-	98
Commercial mortgage-backed	-	35	-	35
Asset-backed securities:				
Collateralized debt obligations	-	6	1(1)	7
Other asset-backed	-	9	-	9
Cash	12	-	-	12
Loans receivable at fair value:				
Residential loans receivable	-	-	428	428
Loan repurchase commitments	-	-	415	415
Other assets:				
Currency derivatives	-	-	14(1)	14
Other	-	-	15(1)	15
Total assets	$ 1,137	$ 3,320	$ 889	$ 5,421
Liabilities:				
Medium-term notes	$ -	$ -	$ 123(1)	$ 123
Derivative liabilities:				
Insured derivatives:				
Credit derivatives	-	2	27	29
Non-insured derivatives:				
Interest rate derivatives	-	137	-	137
Other	-	-	7	7
Other liabilities:				
Other payable	-	-	5(1)	5
Liabilities of consolidated VIEs:				
Variable interest entity notes	-	327	382	709
Total liabilities	$ -	$ 466	$ 544	$ 1,010

(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.

(2) - Investment that was measured at fair value by applying the net asset value per share practical expedient, and was required not to be classified in the fair value hierarchy.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	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)	Balance as of December 31, 2017
Assets:				
Fixed-maturity investments:				
U.S. Treasury and government agency	$ 1,256	$ 96	$ -	$ 1,352
State and municipal bonds	-	858	-	858
Foreign governments	-	10	-	10
Corporate obligations	-	1,338	2[(1)]	1,340
Mortgage-backed securities:				
Residential mortgage-backed agency	-	368	-	368
Residential mortgage-backed non-agency	-	32	-	32
Commercial mortgage-backed	-	60	7[(1)]	67
Asset-backed securities:				
Collateralized debt obligations	-	118	-	118
Other asset-backed	-	178	5[(1)]	183
Total fixed-maturity investments	1,256	3,058	14	4,328
Money market securities	180	-	-	180
Perpetual debt and equity securities	26	37	-	63
Fixed-income fund	-	-	-	82[(2)]
Cash and cash equivalents	122	-	-	122
Derivative assets:				
Non-insured derivative assets:				
Interest rate derivatives	-	2	-	2

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using			
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance as of December 31, 2017**
Assets of consolidated VIEs:				
Corporate obligations	-	19	-	19
Mortgage-backed securities:				
Residential mortgage-backed non-agency	-	108	-	108
Commercial mortgage-backed	-	30	6(1)	36
Asset-backed securities:				
Collateralized debt obligations	-	8	1(1)	9
Other asset-backed	-	10	-	10
Cash	24	-	-	24
Loans receivable at fair value:				
Residential loans receivable	-	-	759	759
Corporate loans receivable	-	-	920	920
Loan repurchase commitments	-	-	407	407
Other assets:				
Currency derivatives	-	-	19(1)	19
Other	-	-	14(1)	14
Total assets	$ 1,608	$ 3,272	$ 2,140	$ 7,102
Liabilities:				
Medium-term notes	$ -	$ -	$ 115(1)	$ 115
Derivative liabilities:				
Insured derivatives:				
Credit derivatives	-	2	63	65
Non-insured derivatives:				
Interest rate derivatives	-	193	-	193
Other	-	-	4	4
Other liabilities:				
Warrants	-	6	-	6
Other payable	-	-	7(1)	7
Liabilities of consolidated VIEs:				
Variable interest entity notes	-	663	406	1,069
Total liabilities	$ -	$ 864	$ 595	$ 1,459

(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.

(2) - Investment that was measured at fair value by applying the net asset value per share practical expedient, and was required not to be classified in the fair value hierarchy.

Level 3 assets at fair value as of September 30, 2018 and December 31, 2017 represented approximately 16% and 30%, respectively, of total assets measured at fair value. Level 3 liabilities at fair value as of September 30, 2018 and December 31, 2017 represented approximately 54% and 41%, respectively, of total liabilities measured at fair value.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

The following tables present the fair values and carrying values of the Company s assets and liabilities that are disclosed at fair value but not reported at fair value on the Company s consolidated balance sheets as of September 30, 2018 and December 31, 2017:

	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 September 30, 2018	Carry Value Balance as of September 30, 2018
Assets:					
Other investments	$ -	$ 1	$ -	$ 1	$ 1
Assets of consolidated VIEs:					
Investments held-to-maturity	-	-	901	901	890
Total assets	$ -	$ 1	$ 901	$ 902	$ 891
Liabilities:					
Long-term debt	$ -	$ 1,132	$ -	$ 1,132	$ 2,218
Medium-term notes	-	-	416	416	615
Investment agreements	-	-	381	381	314
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	382	900	1,282	1,251
Total liabilities	$ -	$ 1,514	$ 1,697	$ 3,211	$ 4,398
Financial Guarantees:					
Gross	$ -	$ -	$ 1,231	$ 1,231	$ 100
Ceded	-	-	68	68	38

	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, 2017	Carry Value Balance as of December 31, 2017
Assets:					
Other investments	$ -	$ 2	$ -	$ 2	$ 2

Assets of consolidated VIEs:										
Investments held-to-maturity		-		-		916		916		890
Total assets	$	-	$	2	$	916	$	918	$	892
Liabilities:										
Long-term debt	$	-	$	1,002	$	-	$	1,002	$	2,121
Medium-term notes		-		-		406		406		650
Investment agreements		-		-		433		433		337
Liabilities of consolidated VIEs:										
Variable interest entity notes		-		352		916		1,268		1,220
Total liabilities	$	-	$	1,354	$	1,755	$	3,109	$	4,328
Financial Guarantees:										
Gross	$	-	$	-	$	1,785	$	1,785	$	1,220
Ceded		-		-		61		61		39

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the three months ended September 30, 2018 and 2017:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended September 30, 2018

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 September 30, 2018
Assets:													
Commercial mortgage-backed	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 7	$ -	$ 7	$ -
Other asset-backed	6	-	-	-	-	-	-	-	-	-	(2)	4	-
Assets of consolidated VIEs:													
Corporate obligations	5	-	-	-	-	-	-	-	-	-	-	5	-
Collateralized debt obligations	1	-	-	-	-	-	-	-	-	-	-	1	-
Loans receivable-residential	683	-	20	-	-	-	-	(24)	(251)	-	-	428	21
Loan repurchase commitments	415	-	-	-	-	-	-	-	-	-	-	415	-
Currency derivatives	14	-	2	-	(2)	-	-	-	-	-	-	14	-
Other	14	-	1	-	-	-	-	-	-	-	-	15	1
Total assets	$ 1,138	$ -	$ 23	$ -	$ (2)	$ -	$ -	$ (24)	$ (251)	$ 7	$ (2)	$ 889	$ 22

In millions	Balance, Beginning of Period	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in Credit Risk 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 September 30, 2018
Liabilities:													
Medium-term notes	$ 149	$ (5)	$ (1)	$ 11	$ (1)	$ -	$ -	$ (30)	$ -	$ -	$ -	$ 123	$ (2)
Credit derivatives	31	6	(4)	-	-	-	-	(6)	-	-	-	27	(4)
Other derivatives	4	-	3	-	-	-	-	-	-	-	-	7	3
Other payable	5	-	-	-	-	-	-	-	-	-	-	5	-
Liabilities of consolidated VIEs:													
VIE notes	389	10	3	(11)	5	-	1	(15)	-	-	-	382	8
Total liabilities	$ 578	$ 11	$ 1	$ -	$ 4	$ -	$ 1	$ (51)	$ -	$ -	$ -	$ 544	$ 5

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

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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 September 30, 2017

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 September 30, 2017
Assets:													
Commercial mortgage-backed	$ 7	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (7)	$ -	$ -
Other asset-backed	5	-	-	-	-	-	-	-	-	-	-	5	-
Assets of consolidated VIEs:													
Commercial mortgage-backed	3	-	-	-	-	-	-	-	(3)	-	-	-	-
Collateralized debt obligations	1	-	-	-	-	-	-	-	-	-	-	1	-
Loans receivable-residential	815	-	2	-	-	-	-	(58)	-	-	-	759	2
Loans receivable-corporate	875	-	4	-	-	-	-	(6)	-	-	-	873	4
Loan repurchase commitments	407	-	(1)	-	-	-	-	-	-	-	-	406	(1)
Currency derivatives	9	-	3	-	1	-	-	-	-	-	-	13	4
Other	-	-	-	-	-	17	-	-	-	-	-	17	-
Total assets	$ 2,122	$ -	$ 8	$ -	$ 1	$ 17	$ -	$ (64)	$ (3)	$ -	$ (7)	$ 2,074	$ 9

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 September 30, 2017
Liabilities:													
Medium-term notes	$ 123	$ -	$ (1)	$ -	$ 5	$ -	$ -	$ -	$ -	$ -	$ -	$ 127	$ 4
Credit derivatives	80	7	(6)	-	-	-	-	(7)	-	-	-	74	(6)
Other derivatives	4	-	-	-	-	-	-	-	-	-	-	4	-
Other payable	-	-	1	-	-	6	-	-	-	-	-	7	1
Liabilities of consolidated VIEs:													
VIE notes	491	-	4	-	-	-	-	(14)	(51)	-	-	430	4
Total liabilities	$ 698	$ 7	$ (2)	$ -	$ 5	$ 6	$ -	$ (21)	$ (51)	$ -	$ -	$ 642	$ 3

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

For the three months ended September 30, 2018, sales include the impact of the deconsolidation of VIEs. Refer to Note 4: Variable Interest Entities for additional information about the deconsolidation of VIEs. For the three months ended September 30, 2018, transfers into Level 3 and out of Level 2 were related to CMBS, where inputs, which are significant to their valuation, became unobservable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. Other asset-backed comprised the instruments transferred out of Level 3 where inputs, which are significant to their valuation, became observable during the quarter. There were no transfers into or out of Level 1 for the three months ended September 30, 2018.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

For the three months ended September 30, 2017, there were no transfers into Level 3 and out of Level 2. CMBS comprised the instruments transferred 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 for the three months ended September 30, 2017.

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 nine months ended September 30, 2018 and 2017:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months Ended September 30, 2018

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 September 30, 2018
Assets:													
Corporate obligations	$ 2	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (2)	$ -	$ -
Commercial mortgage-backed	7	-	-	-	-	-	-	-	-	7	(7)	7	-
Other asset-backed	5	-	-	-	-	5	-	(2)	(2)	-	(2)	4	-
Assets of consolidated VIEs:													
Corporate obligations	-	-	-	-	-	-	-	(1)	-	6	-	5	-
Commercial mortgage-backed	6	-	-	-	-	-	-	-	-	-	(6)	-	-
Collateralized debt obligations	1	-	-	-	-	-	-	-	-	-	-	1	-
Loans receivable-residential	759	-	26	-	-	-	-	(106)	(251)	-	-	428	23
Loans receivable-corporate	920	-	11	-	-	-	-	(6)	(925)	-	-	-	-
Loan repurchase commitments	407	-	8	-	-	-	-	-	-	-	-	415	8
Currency derivatives	19	-	(3)	-	(2)	-	-	-	-	-	-	14	(5)

Other	14	-	1	-	-	-	-	-	-	-	-	15	1
Total assets	$ 2,140	$ -	$ 43	$ -	$ (2)	$ 5	$ -	$ (115)	$ (1,178)	$ 13	$ (17)	$ 889	$ 27

In millions	Balance, Beginning of Year	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in Credit Risk 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 September 30, 2018
Liabilities:													
Medium-term notes	$ 115	$ (5)	$ (1)	$ 51	$ (7)	$ -	$ -	$ (30)	$ -	$ -	$ -	$ 123	$ (8)
Credit derivatives	63	49	(36)	-	-	-	-	(49)	-	-	-	27	(36)
Other derivatives	4	-	3	-	-	-	-	-	-	-	-	7	3
Other payable	7	-	2	-	-	-	-	(4)	-	-	-	5	2
Liabilities of consolidated VIEs:													
VIE notes	406	22	(12)	(10)	3	-	7	(34)	-	-	-	382	(9)
Total liabilities	$ 595	$ 66	$ (44)	$ 41	$ (4)	$ -	$ 7	$ (117)	$ -	$ -	$ -	$ 544	$ (48)

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

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months Ended September 30, 2017

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 September 30, 2017
Assets:													
Corporate obligations	$ 2	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (2)	$ -	$ -
Commercial mortgage-backed	-	-	-	-	-	-	-	-	-	7	(7)	-	-
Collateralized debt obligations	15	-	-	-	-	-	-	(7)	-	-	(8)	-	-
Other asset-backed	44	-	-	2	-	-	-	(41)	-	-	-	5	-
State and municipal bonds	-	-	-	-	-	-	-	-	-	1	(1)	-	-
Assets of consolidated VIEs:													
Corporate obligations	-	-	-	-	-	-	-	(2)	-	6	(4)	-	-
Commercial mortgage-backed	-	-	-	-	-	-	-	-	(3)	3	-	-	-
Collateralized debt obligations	1	-	-	-	-	-	-	-	-	-	-	1	-
Other asset-backed	1	-	-	-	-	-	-	-	-	1	(2)	-	-
Loans receivable-residential	916	-	29	-	-	-	-	(186)	-	-	-	759	29
Loans receivable-corporate	150	-	36	-	-	719	-	(32)	-	-	-	873	36
Loan repurchase commitments	404	-	2	-	-	-	-	-	-	-	-	406	2
Currency derivatives	19	-	(2)	-	(4)	-	-	-	-	-	-	13	(6)
Other	-	-	-	-	-	17	-	-	-	-	-	17	-
Total assets	$ 1,552	$ -	$ 65	$ 2	$ (4)	$ 736	$ -	$ (268)	$ (3)	$ 18	$ (24)	$ 2,074	$ 61

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 September 30, 2017
Liabilities:													
Medium-term notes	$ 101	$ -	$ 13	$ -	$ 13	$ -	$ -	$ -	$ -	$ -	$ -	$ 127	$ 26
Credit derivatives	64	41	10	-	-	-	-	(41)	-	-	-	74	12
Other derivatives	20	-	18	-	-	-	-	(34)	-	-	-	4	18
Other payable	-	-	1	-	-	6	-	-	-	-	-	7	1
Liabilities of consolidated VIEs:													
VIE notes	476	-	56	-	-	-	-	(51)	(51)	-	-	430	56
Total liabilities	$ 661	$ 41	$ 98	$ -	$ 13	$ 6	$ -	$ (126)	$ (51)	$ -	$ -	$ 642	$ 113

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

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

For the nine months ended September 30, 2018, sales include the impact of the deconsolidation of VIEs. Refer to Note 4: Variable Interest Entities for additional information about the deconsolidation of VIEs. For the nine months ended September 30, 2018, transfers into Level 3 and out of Level 2 were principally related to CMBS and corporate obligations, where inputs, which are significant to their valuation, became unobservable during the period. CMBS, corporate obligations and other asset-backed comprised the majority of the instruments transferred out of Level 3 where inputs, which are significant to their valuation, became observable during the period. 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.

For the nine months ended September 30, 2017, transfers into Level 3 and out of Level 2 were principally related to CMBS and corporate obligations, where inputs, which are significant to their valuation, became unobservable during the period. CDOs, CMBS and corporate obligations comprised the majority of the instruments transferred out of Level 3 where inputs, which are significant to their valuation, became observable during the period. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

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

Gains and losses (realized and unrealized) included in earnings related to Level 3 assets and liabilities for the three months ended September 30, 2018 and 2017 are reported on the Company s consolidated statements of operations as follows:

	Three Months Ended September 30, 2018		Three Months Ended September 30, 2017	
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 September 30, 2018**	**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 September 30, 2017**
Revenues:				
Unrealized gains (losses) on insured derivatives	$ 4	$ 4	$ 6	$ 6
Realized gains (losses) and other settlements on insured derivatives	(6)	-	(7)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	4	(1)	(4)	(4)
Other net realized gains (losses)	-	-	(1)	(1)

Revenues of consolidated VIEs:								
Net gains (losses) on financial instruments at fair value and foreign exchange		3		14		5		5
Total	$	5	$	17	$	(1)	$	6

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Gains and losses (realized and unrealized) included in earnings relating to Level 3 assets and liabilities for the nine months ended September 30, 2018 and 2017 are reported on the Company s consolidated statements of operations as follows:

	Nine Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
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 September 30, 2018**	**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 September 30, 2017**
Revenues:				
Unrealized gains (losses) on insured derivatives	$ 36	$ 36	$ (10)	$ (12)
Realized gains (losses) and other settlements on insured derivatives	(49)	-	(41)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	10	5	(44)	(44)
Other net realized gains (losses)	(2)	(2)	(1)	(1)
Revenues of consolidated VIEs:				
Net gains (losses) on financial instruments at fair value and foreign exchange	28	36	5	5
Total	$ 23	$ 75	$ (91)	$ (52)

Fair Value Option

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

The following table presents the gains and (losses) included in the Company s consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017 for financial instruments for which the fair value option was elected:

In millions	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Investments carried at fair value[1]	$ 1	$ 2	$ (4)	$ 8
Fixed-maturity securities held at fair value-VIE[2]	(7)	(2)	(19)	(16)
Loans receivable at fair value:				
Residential mortgage loans[2]	(3)	(55)	(79)	(157)
Corporate loans[2]	-	(2)	11	4
Loan repurchase commitments[2]	-	(1)	9	3
Other assets-VIE[2]	1	-	1	-
Medium-term notes[1]	7	(4)	14	(26)
Variable interest entity notes [2]	23	70	106	160
Other liabilities[3]	-	(1)	(2)	(1)

(1) - Reported within Net gains (losses) on financial instruments at fair value and foreign exchange on MBIA s consolidated statements of operations.

(2) - Reported within Net gains (losses) on financial instruments at fair value and foreign exchange-VIE on MBIA s consolidated statements of operations.

(3) - Reported within Other net realized gains (losses) on MBIA s consolidated statements of operations.

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Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Instrument-Specific Credit Risk of Liabilities Elected Under the Fair Value Option

As of September 30, 2018, the cumulative changes in instrument-specific credit risk of liabilities elected under the fair value option were a loss of $166 million reported in Accumulated other comprehensive income on the Company s consolidated balance sheets. Changes in value attributable to instrument-specific credit risk were derived principally from changes in the Company s credit spread. For liabilities of VIEs, additional adjustments to instrument-specific credit risk are required, which is determined by an analysis of deal specific performance of collateral that support these liabilities. During the three and nine months ended September 30, 2018, the portions of instrument-specific credit risk included in AOCI that were recognized in earnings due to settlement of liabilities were losses of $38 million and $48 million, respectively.

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding as of September 30, 2018 and December 31, 2017 for loans and notes for which the fair value option was elected:

	As of September 30, 2018			As of December 31, 2017		
In millions	Contractual Outstanding Principal	Fair Value	Difference	Contractual Outstanding Principal	Fair Value	Difference
Loans receivable at fair value:						
Residential mortgage loans	$ 390	$ 389	$ 1	$ 732	$ 727	$ 5
Residential mortgage loans (90 days or more past due)	165	39	126	170	32	138
Corporate loans (90 days or more past due)	-	-	-	1,394	920	474
Total loans receivable at fair value	555	428	127	2,296	1,679	617
Variable interest entity notes	1,525	709	816	1,882	1,069	813
Medium-term notes	139	123	16	180	115	65

The difference between the contractual outstanding principal and the fair values on loans receivable, VIE notes and MTNs, in the preceding table, are primarily attributable to credit risk. This is due to the high rate of defaults on loans and the collateral supporting the VIE notes and the nonperformance risk of the Company on its MTNs, which resulted in depressed pricing of the financial instruments.

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Notes to Consolidated Financial Statements (Unaudited)

Note 7: Investments

Investments, excluding those elected under the fair value option, include debt and equity securities classified as either AFS or held-to-maturity (HTM).

The following tables present the amortized cost, fair value, corresponding gross unrealized gains and losses and OTTI for AFS and HTM investments in the Company s consolidated investment portfolio as of September 30, 2018 and December 31, 2017:

			September 30, 2018		
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	$ 843	$ 20	$ (19)	$ 844	$ -
State and municipal bonds	659	111	(14)	756	47
Foreign governments	10	-	-	10	-
Corporate obligations	1,672	6	(122)	1,556	(68)
Mortgage-backed securities:					
Residential mortgage-backed agency	222	-	(7)	215	-
Residential mortgage-backed non-agency	32	1	(3)	30	-
Commercial mortgage-backed	57	-	(2)	55	-
Asset-backed securities:					
Collateralized debt obligations	143	-	-	143	-
Other asset-backed	214	1	(1)	214	1
Total AFS investments	$ 3,852	$ 139	$ (168)	$ 3,823	$ (20)
HTM Investments					
Assets of consolidated VIEs:					
Corporate obligations	$ 890	$ 13	$ (2)	$ 901	$ -
Total HTM investments	$ 890	$ 13	$ (2)	$ 901	$ -

(1) - Represents unrealized gains or losses on OTTI 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.

			December 31, 2017		
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	$ 1,317	$ 34	$ (6)	$ 1,345	$ -
State and municipal bonds	840	29	(12)	857	-
Foreign governments	10	-	-	10	-
Corporate obligations	1,332	25	(80)	1,277	(72)
Mortgage-backed securities:					
Residential mortgage-backed agency	365	1	(4)	362	-
Residential mortgage-backed non-agency	35	1	(4)	32	-
Commercial mortgage-backed	66	-	-	66	-
Asset-backed securities:					
Collateralized debt obligations	116	-	-	116	-
Other asset-backed	175	-	-	175	1
Total fixed-maturity investments	4,256	90	(106)	4,240	(71)
Money market securities	179	-	-	179	-
Perpetual debt and equity securities	3	1	-	4	-
Total AFS investments	$ 4,438	$ 91	$ (106)	$ 4,423	$ (71)
HTM Investments					
Assets of consolidated VIEs:					
Corporate obligations	$ 890	$ 26	$ -	$ 916	$ -
Total HTM investments	$ 890	$ 26	$ -	$ 916	$ -

(1) - Represents unrealized gains or losses on OTTI 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.

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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 September 30, 2018. Contractual maturity may differ from expected maturity as borrowers may have the right to call or prepay obligations.

In millions	AFS Securities Amortized Cost	AFS Securities Fair Value	HTM Securities Consolidated VIEs Amortized Cost	HTM Securities Consolidated VIEs Fair Value
Due in one year or less	$ 790	$ 802	$ -	$ -
Due after one year through five years	677	702	-	-
Due after five years through ten years	670	589	-	-
Due after ten years	1,047	1,073	890	901
Mortgage-backed and asset-backed	668	657	-	-
Total fixed-maturity investments	$ 3,852	$ 3,823	$ 890	$ 901

Deposited and Pledged Securities

The fair value of securities on deposit with various regulatory authorities as of September 30, 2018 and December 31, 2017 was $10 million. These deposits are required to comply with state insurance laws.

Pursuant to the Company s tax sharing agreement, securities held by MBIA Inc. in the Tax Escrow Account are included as Investments pledged as collateral, at fair value on the Company s consolidated balance sheets.

Investment agreement obligations require the Company to pledge securities as collateral. Securities pledged in connection with investment agreements may not be repledged by the investment agreement counterparty. As of September 30, 2018 and December 31, 2017, the fair value of securities pledged as collateral for these investment agreements approximated $320 million and $353 million, respectively. The Company s collateral as of September 30, 2018 consisted principally of U.S. Treasury and government agency and state and municipal bonds, and was primarily held with major U.S. banks.

Impaired Investments

The following tables present the gross unrealized losses related to AFS and HTM investments as of September 30, 2018 and December 31, 2017:

	September 30, 2018					
	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	$ 396	$ (7)	$ 206	$ (12)	$ 602	$ (19)
State and municipal bonds	92	(3)	123	(11)	215	(14)

Foreign governments	9	-	-	-	9	-
Corporate obligations	1,116	(38)	213	(84)	1,329	(122)
Mortgage-backed securities:						
Residential mortgage-backed agency	119	(2)	95	(5)	214	(7)
Residential mortgage-backed non-agency	-	-	14	(3)	14	(3)
Commercial mortgage-backed	29	-	19	(2)	48	(2)
Asset-backed securities:						
Collateralized debt obligations	73	-	-	-	73	-
Other asset-backed	121	(1)	30	-	151	(1)
Total AFS investments	$ 1,955	$ (51)	$ 700	$ (117)	$ 2,655	$ (168)
HTM Investments						
Assets of consolidated VIEs:						
Corporate obligations	$ 313	$ (2)	$ -	$ -	$ 313	$ (2)
Total HTM investments	$ 313	$ (2)	$ -	$ -	$ 313	$ (2)

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 7: Investments (continued)

	December 31, 2017					
	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	$ 353	$ (1)	$ 124	$ (5)	$ 477	$ (6)
State and municipal bonds	203	(8)	116	(4)	319	(12)
Foreign governments	8	-	-	-	8	-
Corporate obligations	425	(3)	163	(77)	588	(80)
Mortgage-backed securities:						
Residential mortgage-backed agency	105	(1)	156	(3)	261	(4)
Residential mortgage-backed non-agency	-	-	14	(4)	14	(4)
Commercial mortgage-backed	27	-	5	-	32	-
Asset-backed securities:						
Collateralized debt obligations	12	-	-	-	12	-
Other asset-backed	71	-	39	-	110	-
Total AFS investments	$ 1,204	$ (13)	$ 617	$ (93)	$ 1,821	$ (106)

Gross unrealized losses on AFS investments increased as of September 30, 2018 compared with December 31, 2017 primarily due to higher interest rates.

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 September 30, 2018 and December 31, 2017 was 13 and 12 years, respectively. As of September 30, 2018 and December 31, 2017, there were 131 and 133 securities, respectively, that were in an unrealized loss position for a continuous twelve-month period or longer, of which, fair values of 75 and 24 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 where fair value was below book value by more than 5% as of September 30, 2018:

		AFS Securities	
Percentage of Fair Value Below Book Value	Number of Securities	Book Value (in millions)	Fair Value (in millions)
> 5% to 15%	60	$ 368	$ 338
> 15% to 25%	11	61	50
> 25% to 50%	-	-	-
> 50%	4	100	32
Total	75	$ 529	$ 420

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 September 30, 2018 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.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 7: Investments (continued)

Other-Than-Temporary Impairments

The Company s fixed-maturity securities for which fair value is less than amortized cost are reviewed quarterly in order to determine whether a credit loss exists. The portion of certain OTTI losses on fixed-maturity securities that does not represent credit losses is recognized in AOCI. Refer to Note 8: Investments in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2017 for a discussion of the Company s policy for OTTI and its determination of credit loss. 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. The additional credit loss impairments for the three and nine months ended September 30, 2018 were primarily related to an impaired security for which a loss was recognized as the difference between the amortized cost and net present value of projected cash flows. This OTTI resulted from liquidity concerns and other adverse financial conditions of the issuer. The additional credit loss impairment for the nine months ended September 30, 2017 was primarily related to municipal bonds for which a loss was recognized as the difference between their amortized cost and their recovery value in the second quarter of 2017. This OTTI resulted from liquidity concerns, recent credit rating downgrades and other adverse financial conditions of the issuer. The reduction from credit loss impairment for the three and nine months ended September 30, 2017 was primarily related to municipal bonds previously impaired which were further impaired to fair value during the third quarter 2017.

In millions **Credit Losses Recognized in Earnings Related to**	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
Other-Than-Temporary Impairments	**2018**	**2017**	**2018**	**2017**
Beginning balance	$ 34	$ 42	$ 32	$ 29
Additions for credit loss impairments recognized in the current period on securities not previously impaired	-	-	-	11
Additions for credit loss impairments recognized in the current period on securities previously impaired	1	2	3	4
Reductions for credit loss impairments previously recognized on securities sold during the period	-	(2)	-	(2)
Reductions for credit loss impairments previously recognized on securities impaired to fair value during the period	-	(11)	-	(11)
Ending balance	$ 35	$ 31	$ 35	$ 31

The Company does not recognize OTTI on securities insured by MBIA Corp. and National since those securities, whether or not owned by the Company, are evaluated for impairments in accordance with its loss reserving policy. The following table provides information about securities held by the Company as of September 30, 2018 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)**
Mortgage-backed:			
MBIA(1)	$ 14	$ (3)	$ 14

Corporate obligations:			
MBIA[1]	70	(12)	-
Other:			
MBIA[1]	6	-	-
Other	2	-	-
Total other	8	-	-
Total	$ 92	$ (15)	$ 14

(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.

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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 within Net gains (losses) on financial instruments at fair value and foreign exchange on the Company s consolidated statements of operations. The proceeds and the gross realized gains and losses from sales of fixed-maturity securities held as AFS for the three and nine months ended September 30, 2018 and 2017 are as follows:

In millions	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Proceeds from sales	$ 583	$ 312	$ 1,647	$ 1,300
Gross realized gains	$ 1	$ 5	$ 4	$ 24
Gross realized losses	$ (2)	$ (5)	$ (15)	$ (9)

Equity Investments

Unrealized gains and losses recognized on equity investments held as of September 30, 2018 for the three and nine months ended September 30, 2018 are as follows:

In millions	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Net gains (losses) recognized during the period on equity securities	$ 3	$ 3
Less:		
Net gains (losses) recognized during the period on equity securities sold during the period	-	1
Unrealized gains (losses) recognized during the period on equity securities still held as of September 30, 2018	$ 3	$ 2

Note 8: 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 and are accounted for as derivative instruments.

Corporate

The Company has entered into derivative instruments primarily consisting of interest rate swaps to manage the risks associated with fluctuations in interest rates affecting the value of certain assets and liabilities.

International and Structured Finance Insurance

The Company has entered into a derivative instrument to provide financial guarantee insurance to a structured finance transaction that does not qualify for the financial guarantee scope exception and, therefore, is accounted for as a derivative. The insured CDS contract, referencing CMBS, is intended to be held for the entire term of the contract unless a settlement with the counterparty is negotiated. The Company no longer insures new CDS contracts except for transactions related to the restructuring or reduction of existing derivative exposure. The Company s derivative exposure within its international and structured finance insurance segment also includes insured interest rate and inflation-linked swaps related to insured debt issues.

The Company has also entered into a derivative contract as a result of a commutation that occurred in 2014. Changes in the fair value of the Company s non-insured derivative are included in Net gains (losses) on financial instruments at fair value and foreign exchange on the Company s consolidated statements of operations.

Variable Interest Entities

A VIE consolidated by the Company has entered into a cross currency swap, which was entered into to manage the variability in cash flows resulting from fluctuations in foreign currency rates.

Credit Derivatives Sold

The following tables present information about credit derivatives sold by the Company s insurance operations that were outstanding as of September 30, 2018 and December 31, 2017. Credit ratings represent the lower of underlying ratings assigned to the collateral by Moody s, S&P or MBIA.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 8: Derivative Instruments (continued)

$ in millions		As of September 30, 2018						
		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	0.3 Years	$ -	$ -	$ -	$ -	$ 77	$ 77	$ (27)
Insured swaps	15.5 Years	-	107	1,539	915	-	2,561	(2)
Total notional		$ -	$ 107	$ 1,539	$ 915	$ 77	$ 2,638	
Total fair value		$ -	$ -	$ (1)	$ (1)	$ (27)		$ (29)

$ in millions		As of December 31, 2017						
		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	1.0 Years	$ -	$ -	$ -	$ -	$ 127	$ 127	$ (63)
Insured swaps	15.5 Years	-	117	1,818	846	20	2,801	(2)
Total notional		$ -	$ 117	$ 1,818	$ 846	$ 147	$ 2,928	
Total fair value		$ -	$ -	$ (1)	$ (1)	$ (63)		$ (65)

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 insured CDS and insured swaps is estimated as the notional value of such contracts.

MBIA may hold recourse provisions with third parties in derivative instruments through subrogation rights, whereby if MBIA makes a claim payment, it may be 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 corporate segment. 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 MBIA or the counterparty is downgraded below a specified credit rating.

Under these agreements, the Company may receive or provide cash, U.S. Treasury or other highly rated securities 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 September 30, 2018 and December 31, 2017, the Company did not hold or post cash collateral to derivative counterparties.

As of September 30, 2018 and December 31, 2017, the Company had securities with a fair value of $183 million and $237 million, respectively, posted to derivative counterparties and these amounts are included within Fixed-maturity securities held as available-for-sale, at fair value on the Company s consolidated balance sheets.

As of September 30, 2018 and December 31, 2017, the fair value on one Credit Support Annex (CSA) was $2 million. 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 September 30, 2018 and December 31, 2017, the counterparty was rated A1 by Moody s and A by S&P.

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MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 8: Derivative Instruments (continued)

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 CDS and insured swaps are not subject to master netting agreements. VIE derivative assets and liabilities are not presented net of any master netting agreements. Counterparty netting of derivative assets and liabilities offsets balances in Interest rate swaps , when applicable.

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 September 30, 2018:

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	$ 77	Other assets	$ -	Derivative liabilities	$ (27)
Insured swaps	2,561	Other assets	-	Derivative liabilities	(2)
Interest rate swaps	722	Other assets	2	Derivative liabilities	(136)
Interest rate swaps-embedded	296	Medium-term notes	-	Medium-term notes	(10)
Currency swaps-VIE	64	Other assets-VIE	14	Derivative liabilities-VIE	-
All other	49	Other assets	-	Derivative liabilities	(8)
Total non-designated derivatives	$ 3,769		$ 16		$ (183)

(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 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, 2017:

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	$ 127	Other assets	$ -	Derivative liabilities	$ (63)
Insured swaps	2,801	Other assets	-	Derivative liabilities	(2)
Interest rate swaps	747	Other assets	2	Derivative liabilities	(193)
Interest rate swaps-embedded	305	Medium-term notes	1	Medium-term notes	(6)
Currency swaps-VIE	69	Other assets-VIE	19	Derivative liabilities-VIE	-

All other		49	Other assets		-	Derivative liabilities	(4)
All other-embedded		2	Other investments		-	Other investments	(1)
Total non-designated derivatives	$	4,100		$	22	$	(269)

(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.