

MBIA INC  
Form 10-Q  
November 06, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

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

For the Quarter Ended September 30, 2006

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

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**MBIA INC.**

(Exact name of registrant as specified in its charter)

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**Connecticut**  
(State of Incorporation)

**06-1185706**  
(I.R.S. Employer Identification No.)

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

**10504**  
(Zip Code)

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

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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

As of October 30, 2006, 134,810,616 shares of Common Stock, par value \$1 per share, were outstanding.

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

(In thousands except per share amounts)

|  | September<br>30,<br>2006 | December 31,<br>2005 |
|--|--------------------------|----------------------|
| <b>Assets</b>  |                          |                      |
| Investments:   |                          |                      |
| Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$26,786,671 and \$23,189,684) | \$ 27,209,053            | \$ 23,747,204        |
| Investments held-to-maturity, at amortized cost (fair value \$5,042,568 and \$5,734,335)                           | 5,070,668                | 5,765,182            |
| Investment agreement portfolio pledged as collateral, at fair value (amortized cost \$822,230 and \$712,054)       | 821,417                  | 729,072              |
| Short-term investments, at amortized cost (which approximates fair value)  | 2,000,179                | 1,673,697            |
| Other investments  | 200,963                  | 234,927              |
| <b>Total investments</b>   | <b>35,302,280</b>        | <b>32,150,082</b>    |
| Cash and cash equivalents  | 341,330                  | 230,965              |
| Accrued investment income  | 497,668                  | 396,048              |
| Deferred acquisition costs   | 437,648                  | 427,111              |
| Prepaid reinsurance premiums   | 373,463                  | 407,614              |
| Reinsurance recoverable on unpaid losses   | 47,002                   | 58,965               |
| Goodwill   | 79,406                   | 79,406               |
| Property and equipment, at cost (less accumulated depreciation of \$125,598 and \$116,275)                         | 106,015                  | 107,938              |
| Receivable for investments sold  | 127,136                  | 74,787               |
| Derivative assets  | 441,540                  | 326,867              |
| Other assets   | 186,096                  | 301,611              |
| <b>Total assets</b>  | <b>\$ 37,939,584</b>     | <b>\$ 34,561,394</b> |
| <b>Liabilities and Shareholders Equity</b>   |                          |                      |
| Liabilities:   |                          |                      |
| Deferred premium revenue   | \$ 3,084,419             | \$ 3,185,200         |
| Loss and loss adjustment expense reserves  | 725,629                  | 721,502              |
| Investment agreements  | 11,811,231               | 10,806,277           |
| Commercial paper   | 755,234                  | 859,997              |
| Medium-term notes  | 9,005,718                | 7,542,416            |
| Variable interest entity floating rate notes   | 1,475,750                | 1,280,160            |
| Securities sold under agreements to repurchase   | 757,260                  | 646,343              |
| Short-term debt  | 40,898                   | 58,745               |
| Long-term debt   | 1,216,403                | 1,210,405            |
| Current income taxes   | 38,610                   |                      |
| Deferred income taxes, net   | 510,843                  | 569,536              |
| Deferred fee revenue   | 16,891                   | 20,379               |
| Payable for investments purchased  | 426,522                  | 83,369               |
| Derivative liabilities   | 390,435                  | 384,611              |
| Other liabilities  | 626,983                  | 600,810              |
| <b>Total liabilities</b>   | <b>30,882,826</b>        | <b>27,969,750</b>    |
| Commitments and contingencies (See Note 11)  |                          |                      |
| Shareholders Equity:   |                          |                      |
| Preferred stock, par value \$1 per share; authorized shares 10,000,000; issued and outstanding none                |                          |                      |

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|   |                      |                      |
|---|----------------------|----------------------|
| Common stock, par value \$1 per share; authorized shares 400,000,000; issued shares 157,812,430 and 156,601,779 | 157,812              | 156,602              |
| Additional paid-in capital  | 1,490,066            | 1,435,590            |
| Retained earnings   | 6,260,164            | 5,747,171            |
| Accumulated other comprehensive income, net of deferred income tax of \$177,319 and \$238,881                   | 323,692              | 399,381              |
| Treasury stock, at cost 23,010,663 and 22,554,528 shares  | (1,174,976)          | (1,147,100)          |
| <b>Total shareholders equity</b>  | <b>7,056,758</b>     | <b>6,591,644</b>     |
| <b>Total liabilities and shareholders equity</b>  | <b>\$ 37,939,584</b> | <b>\$ 34,561,394</b> |

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

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

(In thousands except per share amounts)

|  | Three months ended |            | Nine months ended |            |
|--|--------------------|------------|-------------------|------------|
|  | September 30       |            | September 30      |            |
|  | 2006               | 2005       | 2006              | 2005       |
| <b>Insurance</b>   |                    |            |                   |            |
| Revenues:  |                    |            |                   |            |
| Gross premiums written   | \$ 202,178         | \$ 220,970 | \$ 626,526        | \$ 752,554 |
| Ceded premiums   | (26,461)           | (34,608)   | (77,532)          | (98,356)   |
| Net premiums written   | 175,717            | 186,362    | 548,994           | 654,198    |
| Scheduled premiums earned  | 170,112            | 173,302    | 506,957           | 527,964    |
| Refunding premiums earned  | 42,215             | 30,770     | 128,005           | 100,338    |
| Premiums earned (net of ceded premiums of \$35,469, \$35,270, \$109,533 and \$114,175) | 212,327            | 204,072    | 634,962           | 628,302    |
| Net investment income  | 164,418            | 129,848    | 448,820           | 379,411    |
| Fees and reimbursements  | 17,046             | 9,529      | 29,239            | 20,168     |
| Net realized gains (losses)  | 4,021              | (7,526)    | 14,094            | (6,319)    |
| Net gains (losses) on derivative instruments and foreign exchange                      | (4,706)            | 2,485      | 1,356             | 415        |
| Total insurance revenues   | 393,106            | 338,408    | 1,128,471         | 1,021,977  |
| Expenses:  |                    |            |                   |            |
| Losses and loss adjustment   | 20,414             | 20,796     | 60,835            | 63,355     |
| Amortization of deferred acquisition costs   | 16,774             | 16,121     | 50,162            | 49,636     |
| Operating  | 37,455             | 38,943     | 110,071           | 100,377    |
| Interest expense   | 22,225             | 8,363      | 53,929            | 19,867     |
| Total insurance expenses   | 96,868             | 84,223     | 274,997           | 233,235    |
| Insurance income   | 296,238            | 254,185    | 853,474           | 788,742    |
| <b>Investment management services</b>  |                    |            |                   |            |
| Revenues   | 308,473            | 225,671    | 860,978           | 618,449    |
| Net realized gains (losses)  | 361                | 1,284      | 5,594             | 3,000      |
| Net gains (losses) on derivative instruments and foreign exchange                      | 5,415              | 41,607     | 8,723             | 41,633     |
| Total investment management services revenues  | 314,249            | 268,562    | 875,295           | 663,082    |
| Interest expense   | 263,804            | 184,397    | 730,472           | 500,979    |
| Expenses   | 19,062             | 18,341     | 55,113            | 51,808     |
| Total investment management services expenses  | 282,866            | 202,738    | 785,585           | 552,787    |
| Investment management services income  | 31,383             | 65,824     | 89,710            | 110,295    |

**Corporate**

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|   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Net investment income   | 3,297             | 3,492             | 10,724            | 17,217            |
| Net realized gains (losses)                                       | 866               | 226               | 2,333             | (1,388)           |
| Net gains (losses) on derivative instruments and foreign exchange | 268               | 65                | 446               | 200               |
| Interest expense  | 20,270            | 22,148            | 60,709            | 66,379            |
| Corporate expenses  | 5,260             | 81,414            | 11,144            | 92,350            |
| Corporate loss  | (21,099)          | (99,779)          | (58,350)          | (142,700)         |
| Income from continuing operations before income taxes             | 306,522           | 220,230           | 884,834           | 756,337           |
| Provision for income taxes  | 89,969            | 77,500            | 248,855           | 227,381           |
| Income from continuing operations                                 | 216,553           | 142,730           | 635,979           | 528,956           |
| <b>Discontinued Operations (See Note 10)</b>                      |                   |                   |                   |                   |
| Income (loss) from discontinued operations, net of tax            | 1,394             | (946)             | 2,324             | (691)             |
| <b>Net income</b>   | <b>\$ 217,947</b> | <b>\$ 141,784</b> | <b>\$ 638,303</b> | <b>\$ 528,265</b> |
| Income from continuing operations per common share:               |                   |                   |                   |                   |
| <b>Basic</b>  | <b>\$ 1.63</b>    | <b>\$ 1.08</b>    | <b>\$ 4.79</b>    | <b>\$ 3.93</b>    |
| <b>Diluted</b>  | <b>\$ 1.58</b>    | <b>\$ 1.05</b>    | <b>\$ 4.65</b>    | <b>\$ 3.84</b>    |
| Net income per common share:                                      |                   |                   |                   |                   |
| <b>Basic</b>  | <b>\$ 1.64</b>    | <b>\$ 1.07</b>    | <b>\$ 4.81</b>    | <b>\$ 3.93</b>    |
| <b>Diluted</b>  | <b>\$ 1.59</b>    | <b>\$ 1.04</b>    | <b>\$ 4.67</b>    | <b>\$ 3.84</b>    |
| Weighted average number of common shares outstanding:             |                   |                   |                   |                   |
| Basic   | 132,794,395       | 132,622,848       | 132,759,336       | 134,589,606       |
| Diluted   | 136,739,403       | 135,822,330       | 136,676,944       | 137,722,142       |
| Gross revenues from continuing operations                         | 711,786           | 610,753           | 2,017,269         | 1,701,088         |
| Gross expenses from continuing operations                         | 405,264           | 390,523           | 1,132,435         | 944,751           |

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

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**Table of Contents****MBIA INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)****For the nine months ended September 30, 2006**

(In thousands except per share amounts)

|   | Common Stock |            | Accumulated                      |                      |  | Treasury Stock |                | Total<br>Shareholders<br>Equity |
|---|--------------|------------|----------------------------------|----------------------|--|----------------|----------------|---------------------------------|
|   |              |            | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Other<br>Comprehensive<br>Income<br>(Loss) |                |                |                                 |
|   | Shares       | Amount     |                                  |                      |  | Shares         | Amount         |                                 |
|   | Shares       | Amount     | Capital                          | Earnings             | (Loss)                                     | Shares         | Amount         |                                 |
| Balance, January 1, 2006  | 156,602      | \$ 156,602 | \$ 1,435,590                     | \$ 5,747,171         | \$ 399,381                                 | (22,555)       | \$ (1,147,100) | \$ 6,591,644                    |
| Comprehensive income:   |              |            |                                  |                      |  |                |                |                                 |
| Net income  |              |            |                                  | 638,303              |  |                |                | 638,303                         |
| Other comprehensive income (loss):  |              |            |                                  |                      |  |                |                |                                 |
| Change in unrealized appreciation of investments net of change in deferred income taxes of \$(69,799) |              |            |                                  |                      | (111,679)                                  |                |                | (111,679)                       |
| Change in fair value of derivative instruments net of change in deferred income taxes of \$8,435      |              |            |                                  |                      | 15,666                                     |                |                | 15,666                          |
| Change in foreign currency translation net of change in deferred income taxes of \$(198)              |              |            |                                  |                      | 20,324                                     |                |                | 20,324                          |
| Other comprehensive income (loss)   |              |            |                                  |                      |  |                |                | (75,689)                        |
| Comprehensive income  |              |            |                                  |                      |  |                |                | 562,614                         |
| Treasury shares acquired, net   |              |            |                                  |                      |  | (467)          | (28,259)       | (28,259)                        |
| Stock-based compensation  | 1,210        | 1,210      | 54,424                           |                      |  | 11             | 383            | 56,017                          |
| Variable interest entity equity   |              |            | 52                               |                      |  |                |                | 52                              |
| Dividends (declared per common share \$0.930, paid per common share \$0.900)                          |              |            |                                  | (125,310)            |  |                |                | (125,310)                       |
| Balance, September 30, 2006   | 157,812      | \$ 157,812 | \$ 1,490,066                     | \$ 6,260,164         | \$ 323,692                                 | (23,011)       | \$ (1,174,976) | \$ 7,056,758                    |

|  | <b>2006</b>  |
|--|--------------|
| Disclosure of reclassification amount:   |              |
| Change in unrealized appreciation of investments arising during the period, net of taxes | \$ (84,245)  |
| Reclassification adjustment, net of taxes  | (27,434)     |
| Change in net unrealized appreciation, net of taxes                                      | \$ (111,679) |

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



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

(In thousands)

|   | Nine months ended September 30 |              |
|---|--------------------------------|--------------|
|   | 2006                           | 2005         |
| <b>Cash flows from operating activities:</b>  |                                |              |
| Net income  | \$ 638,303                     | \$ 528,265   |
| Loss (income) from discontinued operations, net of tax  | (2,324)                        | 691          |
| Net income from continuing operations   | 635,979                        | 528,956      |
| Adjustments to reconcile net income from continuing operations to net cash provided by operating activities of continuing operations: |                                |              |
| Amortization of bond premium, net   | 24,094                         | 43,875       |
| Increase in accrued investment income   | (101,620)                      | (66,687)     |
| Increase in deferred acquisition costs  | (10,537)                       | (24,975)     |
| Decrease in prepaid reinsurance premiums  | 34,151                         | 17,675       |
| Decrease (increase) in reinsurance recoverable on unpaid losses   | 11,963                         | (11,067)     |
| Depreciation  | 9,323                          | 8,776        |
| Decrease in salvage and subrogation   | 47,530                         | 28,481       |
| Decrease in deferred premium revenue  | (100,781)                      | (3,122)      |
| Increase (decrease) in loss and loss adjustment expense reserves  | 4,127                          | (37,446)     |
| Increase in accrued interest payable  | 120,837                        | 80,495       |
| Penalties and disgorgement  |                                | 75,000       |
| Decrease in accrued expenses  | (25,984)                       | (10,099)     |
| Amortization of medium-term notes and commercial paper premium, net   | (13,869)                       | (15,092)     |
| Net realized (gains) losses on sale of investments  | (22,021)                       | 4,756        |
| Net gains on derivative instruments and foreign exchange  | (10,525)                       | (42,248)     |
| Current income tax provision  | 95,604                         | 13,777       |
| Deferred income tax provision   | 1,288                          | 16,424       |
| Stock option compensation   | 10,962                         | 15,048       |
| Other, net  | (22)                           | (1,635)      |
| Total adjustments to net income   | 74,520                         | 91,936       |
| Net cash provided by operating activities of continuing operations  | 710,499                        | 620,892      |
| <b>Cash flows from investing activities of continuing operations:</b>   |                                |              |
| Purchase of fixed-maturity securities, net of payable for investments purchased   | (14,999,014)                   | (12,071,612) |
| Sale of fixed-maturity securities, net of receivable for investments sold   | 11,018,044                     | 8,795,126    |
| Redemption of fixed-maturity securities, net of receivable for investments redeemed   | 318,912                        | 404,234      |
| Purchase of held-to-maturity investments  | (459,956)                      | (283,863)    |
| Redemptions of held-to-maturity investments   | 1,144,023                      | 1,414,836    |
| Purchase of short-term investments  | (32,189)                       | (147,365)    |
| Sale of other investments   | 29,397                         | 20,288       |
| Capital expenditures  | (7,651)                        | (5,316)      |
| Disposals of capital assets   | 614                            | 1,402        |
| Payments for derivatives  | (24,077)                       |              |
| Other, investing  | 3,011                          |              |
| Net cash used by investing activities of continuing operations  | (3,008,886)                    | (1,872,270)  |

**Cash flows from financing activities of continuing operations:**

|  |             |             |
|--|-------------|-------------|
| Proceeds from issuance of investment agreements                    | 4,289,445   | 5,307,982   |
| Payments for drawdowns of investment agreements                    | (3,406,739) | (3,908,350) |
| Net payments of commercial paper                                   | (135,458)   | (851,921)   |
| Issuance of medium-term notes                                      | 3,647,592   | 2,018,408   |
| Principal paydown of medium-term notes                             | (2,145,301) | (1,061,466) |
| Issuance of variable interest entity floating rate notes           | 300,000     | 200,000     |
| Principal paydown of variable interest entity floating rate notes  | (107,053)   |             |
| Securities sold under agreements to repurchase, net                | 110,917     | (43,452)    |
| Dividends paid   | (121,064)   | (109,708)   |
| Capital issuance costs   | (1,727)     | (2,184)     |
| Net repayment of short term debt                                   | (17,847)    |             |
| Purchase of treasury stock   | (28,259)    | (363,410)   |
| Exercise of stock options  | 22,243      | 18,132      |
| Excess tax benefit on share-based payment                          | 1,181       |             |
| Other, financing   | (709)       | (5,907)     |
| Net cash provided by financing activities of continuing operations | 2,407,221   | 1,198,124   |

**Discontinued operations (Revised - See Note 1):**

|  |            |            |
|--|------------|------------|
| Net cash provided by operating activities            | 1,542      | 943        |
| Net cash provided (used) by investing activities     | 6          | (1,936)    |
| Net cash (used) provided by financing activities     | (17)       | 52         |
| Net cash provided (used) by discontinued operations  | 1,531      | (941)      |
| Net increase (decrease) in cash and cash equivalents | 110,365    | (54,195)   |
| Cash and cash equivalents - beginning of period      | 230,965    | 364,784    |
| Cash and cash equivalents - end of period            | \$ 341,330 | \$ 310,589 |

**Supplemental cash flow disclosures:**

|  |            |            |
|--|------------|------------|
| Income taxes paid                              | \$ 153,024 | \$ 195,327 |
| Interest paid:                                 |            |            |
| Investment agreements                          | \$ 370,730 | \$ 251,493 |
| Commercial paper                               | 30,966     | 46,423     |
| Medium-term notes                              | 287,123    | 172,916    |
| Variable interest entity floating rate notes   | 39,877     | 16,218     |
| Securities sold under agreements to repurchase | 29,765     | 14,226     |
| Other, financing                               | 6,153      | 3,769      |
| Long-term debt                                 | 52,418     | 54,661     |
| Non cash items:                                |            |            |
| Stock compensation                             | \$ 10,962  | \$ 15,048  |
| Dividends declared but not paid                | 41,788     | 37,537     |

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

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****NOTE 1: Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, accordingly, do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America (GAAP). These statements should be read in conjunction with the consolidated financial statements and notes thereto included in Form 10-K for the year ended December 31, 2005 for MBIA Inc. and Subsidiaries (MBIA or the Company). 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 (United States), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the Company's financial position and results of operations.

The results of operations for the nine months ended September 30, 2006 may not be indicative of the results that may be expected for the year ending December 31, 2006. The December 31, 2005 balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. The consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and other entities required by GAAP. All significant intercompany balances have been eliminated and business segment results are presented net of all material intersegment transactions. Certain amounts have been reclassified in prior years' financial statements to conform to the current presentation. This includes the reclassification of variable interest entity (VIE) interest expense from Net investment income to Interest expense, the reclassification of Unearned compensation restricted stock to Additional paid-in capital and the reclassification of amounts related to the Company's municipal services segment, which had no effect on net income, total assets, total liabilities or shareholders' equity as previously reported. See Note 6: Business Segments for information on changes in the Company's segment reporting. In addition, the Company revised its statement of cash flows for the nine months ended September 30, 2005 to separately disclose the operating, investing and financing portions of cash flows attributable to discontinued operations. These amounts were previously reported on a combined basis.

**NOTE 2: Significant Accounting Policies**

The Company has disclosed its significant accounting policies in Note 3: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2005. The following significant accounting policy provides an update to that included under the same caption in the Company's Form 10-K.

**PREMIUM REVENUE RECOGNITION**

Upfront premiums are earned in proportion to the expiration of the related principal balance of an insured obligation. Therefore, for transactions in which the premium is received upfront, premium earnings are greater in the earlier periods when there is a higher amount of principal outstanding. The upfront premiums are apportioned to individual sinking fund payments of a bond issue according to an amortization schedule. After the premiums are allocated to each scheduled sinking fund payment, they are earned on a straight-line basis over the period of that sinking fund payment. Accordingly, deferred premium revenue represents the portion of premiums written that is applicable to the unexpired risk of insured bonds and notes. When an MBIA-insured issue is retired early, is called by the issuer, or is in substance paid in advance through a refunding accomplished by placing U.S. Government securities in escrow, the remaining deferred premium revenue is earned at that time since there is no longer risk to the Company. Installment premiums are earned on a straight-line basis over each installment period, generally one year or less. As the outstanding principal of an installment-based policy is paid down by the issuer of an MBIA-insured obligation, less premium is collected and recognized by MBIA. Both upfront and installment premium recognition methods recognize premiums over the term of an insurance policy in proportion to the remaining outstanding principal balance of the insured obligation.

Premiums ceded to reinsurers reduce the amount of earned premium the Company will recognize from its insurance policies. For both upfront and installment policies, ceded premium expense is recognized in earnings in proportion to and at the same time as the related premium revenue is recognized. Ceding commission income is recognized in earnings at the time the related premium is recognized.

**NOTE 3: Recent Accounting Pronouncements**

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. (SAB) 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 requires that a registrant use both a balance sheet approach and an income statement approach when quantifying and evaluating the materiality of a misstatement. In addition, SAB 108 provides permitted transition methods for correcting and disclosing errors that existed prior to the application of SAB 108.

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when such errors are determined to be material to a registrant's financial statements upon the application of SAB 108. SAB 108 is effective for the first fiscal year ending after November 15, 2006, with early adoption permitted in interim reports filed with the SEC. MBIA will initially apply the provisions of SAB 108 in connection with the preparation of its financial statements for the year ending December 31, 2006. The Company believes that the application of SAB 108 will not have a material effect on its financial condition or results of operations.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. (SFAS) 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements under other accounting

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pronouncements, but does not change the existing guidance as to whether or not an instrument is carried at fair value. SFAS 157 also clarifies that an issuer's credit standing should be considered when measuring liabilities at fair value. SFAS 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy (levels 1, 2 and 3 as defined). SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. MBIA is currently evaluating the provisions of SFAS 157 and their potential impact on the Company's financial statements.

In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement 109. FIN 48 requires that the Company determine whether a tax position is more likely than not to be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets this recognition threshold, the position is measured to determine the amount of benefit to be recognized in the financial statements. FIN 48 also provides guidance on the derecognition, classification and disclosure of tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. MBIA is currently evaluating the provisions of FIN 48 and their potential impact on the Company's financial statements.

In February 2006, the FASB issued SFAS 155, Accounting for Certain Hybrid Financial Instruments, which amends SFAS 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. SFAS 155 permits an entity to measure at fair value any financial instrument that contains an embedded derivative that would otherwise require bifurcation. For the Company, SFAS 155 is effective for those financial instruments acquired or issued after January 1, 2007. MBIA is currently evaluating the provisions of SFAS 155 and their potential impact on the Company's financial statements.

**NOTE 4: Dividends Declared**

Dividends declared by the Company during the nine months ended September 30, 2006 were \$125.3 million.

**NOTE 5: Earnings Per Share**

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share shows the dilutive effect of all stock options and other items outstanding during the period that could potentially result in the issuance of common stock. For the three and nine months ended September 30, 2006 there were 1,699,934 and 1,742,823 stock options outstanding, respectively, and for the three and nine months ended September 30, 2005, there were 2,456,389 and 2,869,503 stock options outstanding, respectively, that were not included in the diluted earnings per share calculation because they were antidilutive.

The following table sets forth the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2006 and 2005:

| In thousands except per share amounts                  | 3rd Quarter |             | Year-to-date |             |
|--|-------------|-------------|--------------|-------------|
|  | 2006        | 2005        | 2006         | 2005        |
| Income from continuing operations, net of tax          | \$ 216,553  | \$ 142,730  | \$ 635,979   | \$ 528,956  |
| Income (loss) from discontinued operations, net of tax | 1,394       | (946)       | 2,324        | (691)       |
| Net income   | \$ 217,947  | \$ 141,784  | \$ 638,303   | \$ 528,265  |
| Basic weighted average shares                          | 132,794,395 | 132,622,848 | 132,759,336  | 134,589,606 |
| Effect of common stock equivalents                     | 3,945,008   | 3,199,482   | 3,917,608    | 3,132,536   |
| Diluted weighted average shares                        | 136,739,403 | 135,822,330 | 136,676,944  | 137,722,142 |

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|  |    |      |    |        |                 |
|--|----|------|----|--------|-----------------|
| <b>Basic EPS:</b>                          |    |      |    |        |                 |
| Income from continuing operations          | \$ | 1.63 | \$ | 1.08   | \$ 4.79 \$ 3.93 |
| Income (loss) from discontinued operations |    | 0.01 |    | (0.01) | 0.02 (0.01)     |
| Net income *                               | \$ | 1.64 | \$ | 1.07   | \$ 4.81 \$ 3.93 |
| <b>Diluted EPS:</b>                        |    |      |    |        |                 |
| Income from continuing operations          | \$ | 1.58 | \$ | 1.05   | \$ 4.65 \$ 3.84 |
| Income (loss) from discontinued operations |    | 0.01 |    | (0.01) | 0.02 (0.01)     |
| Net income *                               | \$ | 1.59 | \$ | 1.04   | \$ 4.67 \$ 3.84 |

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\* May not add due to rounding.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MBIA Inc. and Subsidiaries**

**NOTE 6: Business Segments**

MBIA Inc., through its subsidiaries, is a leading provider of financial guarantee products and specialized financial services. MBIA provides innovative and cost-effective products and services that meet the credit enhancement, financial and investment needs of its public- and private-sector clients worldwide. MBIA manages its activities primarily through two principal business operations: insurance and investment management services. The Company's reportable segments within its business operations are determined based on the way management assesses the performance and resource requirements of such operations.

The insurance operations constitute a reportable segment and provide an unconditional and irrevocable guarantee of the payment of principal and interest on insured obligations when due. MBIA issues financial guarantees for municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, bonds backed by publicly or privately funded public-purpose projects, bonds issued by sovereign and sub-sovereign entities, obligations collateralized by diverse pools of corporate loans and credit default swaps and pools of corporate and asset-backed bonds, both in the new issue and secondary markets. This segment includes all activities related to global credit enhancement services provided principally by MBIA Insurance Corporation and its subsidiaries (MBIA Corp.).

The Company's investment management services operations provide an array of products and services to the public, not-for-profit and corporate sectors. Such products and services are provided primarily through wholly owned subsidiaries of MBIA Asset Management, LLC (MBIA-AML) and include cash management, discretionary asset management and fund administration services and investment agreement, medium-term note and commercial paper programs related to funding assets for third-party clients and for investment purposes. The investment management services operations' reportable segments are comprised of: asset/liability products, which include investment agreements and medium-term notes (MTNs) not related to the conduit program; advisory services, which consist of third-party and related-party fee-based asset management; and conduits.

The asset/liability products segment is principally comprised of the activities of MBIA Investment Management Corp. (IMC), MBIA Global Funding, LLC (GFL) and Euro Asset Acquisition Limited (EAAL). IMC, along with MBIA Inc., provides customized investment agreements, guaranteed by MBIA Corp., for bond proceeds and other public funds for such purposes as construction, loan origination, escrow and debt service or other reserve fund requirements. It also provides customized products for funds that are invested as part of asset-backed or structured product issuances. GFL raises funds through the issuance of MTNs with varying maturities, which are in turn guaranteed by MBIA Corp. GFL lends the proceeds of these MTN issuances to MBIA Inc. (GFL Loans). MBIA Inc. invests the proceeds of investment agreements and GFL Loans in eligible investments, which consist of investment grade securities with a minimum average Double-A credit quality rating. MBIA Inc. primarily purchases domestic securities, which are pledged to MBIA Corp. as security for its guarantees on investment agreements and MTNs. Additionally, MBIA Inc. loans a portion of the proceeds from investment agreements and MTNs to EAAL. EAAL primarily purchases foreign assets as permitted under the Company's investment guidelines.

The advisory services segment is primarily comprised of the operations of MBIA Municipal Investors Service Corporation (MBIA-MISC), MBIA Capital Management Corp. (CMC) and MBIA Asset Management UK (AM-UK). MBIA-MISC provides investment management programs, including pooled investments products and customized asset management services. In addition, MBIA-MISC provides portfolio accounting and reporting for state and local governments, including school districts. MBIA-MISC is a SEC-registered investment adviser. CMC provides fee-based asset management services to the Company, its affiliates and third-party institutional clients. CMC is a SEC-registered investment advisor and National Association of Securities Dealers member firm. AM-UK provides fee-based asset management services to the Company's foreign insurance affiliates and EAAL, and to third-party institutional clients and investment structures. AM-UK is registered with the Financial Services Authority in the United Kingdom.

The Company's conduit segment administers three multi-seller conduit financing vehicles through MBIA Asset Finance, LLC. The conduits provide funding for multiple customers through special purpose vehicles that issue primarily commercial paper and medium-term notes.

Prior to the third quarter of 2006, the Company's municipal services segment included the operations of MBIA MuniServices Company and its wholly owned subsidiaries. In the third quarter of 2006, MBIA finalized a plan to sell MBIA MuniServices Company and certain of its wholly owned subsidiaries (MuniServices). In October 2006, MBIA signed a letter



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of intent to sell MuniServices to an investor group led by the management of MuniServices and expects the sale to be completed during the fourth quarter of 2006. The results of MuniServices have been reported as a discontinued operation for all periods presented herein and not as part of the Company's municipal services segment. The remainder of the municipal services segment, which consists of Capital Asset Holdings GP, Inc. and certain affiliated entities (Capital Asset), a servicer of delinquent tax liens, has been reported within the Company's corporate operations as it is immaterial to the financial condition and results of operations of the Company. See Note 10 for additional information related to the Company's discontinued operations.

The Company's corporate operations constitute a reportable segment and include revenues and expenses that arise from general corporate activities and from the operations of Capital Asset.

Reportable segment results are presented net of material intersegment transactions. Transactions between the Company's segments are executed at an arm's length basis, as established by management. The following tables summarize the Company's operations for the three and nine months ended September 30, 2006 and 2005:

| In thousands  | Three months ended September 30, 2006 |                                      |             |               |
|---|---------------------------------------|--------------------------------------|-------------|---------------|
|   | Insurance                             | Investment<br>Management<br>Services | Corporate   | Total         |
| Revenues <sup>(a)</sup>   | \$ 393,791                            | \$ 308,473                           | \$ 3,297    | \$ 705,561    |
| Net realized gains (losses)                                       | 4,021                                 | 361                                  | 866         | 5,248         |
| Net gains (losses) on derivative instruments and foreign exchange | (4,706)                               | 5,415                                | 268         | 977           |
| Total revenues  | 393,106                               | 314,249                              | 4,431       | 711,786       |
| Interest expense  | 22,225                                | 263,804                              | 20,270      | 306,299       |
| Operating expenses  | 74,643                                | 19,062                               | 5,260       | 98,965        |
| Total expenses  | 96,868                                | 282,866                              | 25,530      | 405,264       |
| Income (loss) before taxes  | \$ 296,238                            | \$ 31,383                            | \$ (21,099) | \$ 306,522    |
| Identifiable assets <sup>(b)</sup>                                | \$ 13,718,999                         | \$ 23,646,910                        | \$ 559,968  | \$ 37,925,877 |

| In thousands  | Three months ended September 30, 2005 |                                      |           |            |
|---|---------------------------------------|--------------------------------------|-----------|------------|
|   | Insurance                             | Investment<br>Management<br>Services | Corporate | Total      |
| Revenues <sup>(a)</sup>   | \$ 343,449                            | \$ 225,671                           | \$ 3,492  | \$ 572,612 |
| Net realized gains (losses)                                       | (7,526)                               | 1,284                                | 226       | (6,016)    |
| Net gains (losses) on derivative instruments and foreign exchange | 2,485                                 | 41,607                               | 65        | 44,157     |
| Total revenues  | 338,408                               | 268,562                              | 3,783     | 610,753    |
| Interest expense  | 8,363                                 | 184,397                              | 22,148    | 214,908    |
| Operating expenses  | 75,860                                | 18,341                               | 81,414    | 175,615    |
| Total expenses  | 84,223                                | 202,738                              | 103,562   | 390,523    |

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|                                    |    |            |    |            |    |          |    |            |
|------------------------------------|----|------------|----|------------|----|----------|----|------------|
| Income (loss) before taxes         | \$ | 254,185    | \$ | 65,824     | \$ | (99,779) | \$ | 220,230    |
| Identifiable assets <sup>(c)</sup> | \$ | 12,536,675 | \$ | 21,892,776 | \$ | 489,247  | \$ | 34,918,698 |

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- (a) Represents the sum of net premiums earned, net investment income, insurance-related fees and reimbursements, investment management fees and other fees.
- (b) Excludes \$13,707 related to discontinued operations.
- (c) Excludes \$11,362 related to discontinued operations.

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| In thousands  | Nine months ended September 30, 2006 |                                |             |               |
|---|--------------------------------------|--------------------------------|-------------|---------------|
|   | Insurance                            | Investment Management Services | Corporate   | Total         |
| Revenues <sup>(a)</sup>   | \$ 1,113,021                         | \$ 860,978                     | \$ 10,724   | \$ 1,984,723  |
| Net realized gains (losses)                                       | 14,094                               | 5,594                          | 2,333       | 22,021        |
| Net gains (losses) on derivative instruments and foreign exchange | 1,356                                | 8,723                          | 446         | 10,525        |
| Total revenues  | 1,128,471                            | 875,295                        | 13,503      | 2,017,269     |
| Interest expense  | 53,929                               | 730,472                        | 60,709      | 845,110       |
| Operating expenses  | 221,068                              | 55,113                         | 11,144      | 287,325       |
| Total expenses  | 274,997                              | 785,585                        | 71,853      | 1,132,435     |
| Income (loss) before taxes  | \$ 853,474                           | \$ 89,710                      | \$ (58,350) | \$ 884,834    |
| Identifiable assets <sup>(b)</sup>                                | \$ 13,718,999                        | \$ 23,646,910                  | \$ 559,968  | \$ 37,925,877 |

| In thousands  | Nine months ended September 30, 2005 |                                |              |               |
|---|--------------------------------------|--------------------------------|--------------|---------------|
|   | Insurance                            | Investment Management Services | Corporate    | Total         |
| Revenues <sup>(a)</sup>   | \$ 1,027,881                         | \$ 618,449                     | \$ 17,217    | \$ 1,663,547  |
| Net realized gains (losses)                                       | (6,319)                              | 3,000                          | (1,388)      | (4,707)       |
| Net gains (losses) on derivative instruments and foreign exchange | 415                                  | 41,633                         | 200          | 42,248        |
| Total revenues  | 1,021,977                            | 663,082                        | 16,029       | 1,701,088     |
| Interest expense  | 19,867                               | 500,979                        | 66,379       | 587,225       |
| Operating expenses  | 213,368                              | 51,808                         | 92,350       | 357,526       |
| Total expenses  | 233,235                              | 552,787                        | 158,729      | 944,751       |
| Income (loss) before taxes  | \$ 788,742                           | \$ 110,295                     | \$ (142,700) | \$ 756,337    |
| Identifiable assets <sup>(c)</sup>                                | \$ 12,536,675                        | \$ 21,892,776                  | \$ 489,247   | \$ 34,918,698 |

(a) Represents the sum of net premiums earned, net investment income, insurance-related fees and reimbursements, investment management fees and other fees.

(b) Excludes \$13,707 related to discontinued operations.

(c) Excludes \$11,362 related to discontinued operations.

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The following tables summarize the segments within the investment management services operations for the three and nine months ended September 30, 2006 and 2005:

| In thousands  | Three months ended September 30, 2006 |                      |              |              | Total                                |
|---|---------------------------------------|----------------------|--------------|--------------|--------------------------------------|
|   | Asset/<br>Liability<br>Products       | Advisory<br>Services | Conduits     | Eliminations | Investment<br>Management<br>Services |
| Revenues <sup>(a)</sup>   | \$ 247,866                            | \$ 16,802            | \$ 51,297    | \$ (7,492)   | \$ 308,473                           |
| Net realized gains (losses)                                       | 354                                   | 7                    |              |              | 361                                  |
| Net gains (losses) on derivative instruments and foreign exchange | 10,364                                | (2)                  | (4,947)      |              | 5,415                                |
| Total revenues  | 258,584                               | 16,807               | 46,350       | (7,492)      | 314,249                              |
| Interest expense  | 218,978                               |                      | 47,238       | (2,412)      | 263,804                              |
| Operating expenses  | 11,211                                | 10,824               | 2,069        | (5,042)      | 19,062                               |
| Total expenses  | 230,189                               | 10,824               | 49,307       | (7,454)      | 282,866                              |
| Income (loss) before taxes  | \$ 28,395                             | \$ 5,983             | \$ (2,957)   | \$ (38)      | \$ 31,383                            |
| Identifiable assets   | \$ 19,948,556                         | \$ 140,650           | \$ 3,811,748 | \$ (254,044) | \$ 23,646,910                        |

| In thousands  | Three months ended September 30, 2005 |                      |              |              | Total                                |
|---|---------------------------------------|----------------------|--------------|--------------|--------------------------------------|
|   | Asset/<br>Liability<br>Products       | Advisory<br>Services | Conduits     | Eliminations | Investment<br>Management<br>Services |
| Revenues <sup>(a)</sup>   | \$ 161,605                            | \$ 14,413            | \$ 53,521    | \$ (3,868)   | \$ 225,671                           |
| Net realized gains (losses)                                       | 1,283                                 | 1                    |              |              | 1,284                                |
| Net gains (losses) on derivative instruments and foreign exchange | 32,214                                | 118                  | 9,275        |              | 41,607                               |
| Total revenues  | 195,102                               | 14,532               | 62,796       | (3,868)      | 268,562                              |
| Interest expense  | 137,915                               |                      | 46,482       |              | 184,397                              |
| Operating expenses  | 9,361                                 | 8,919                | 3,892        | (3,831)      | 18,341                               |
| Total expenses  | 147,276                               | 8,919                | 50,374       | (3,831)      | 202,738                              |
| Income (loss) before taxes  | \$ 47,826                             | \$ 5,613             | \$ 12,422    | \$ (37)      | \$ 65,824                            |
| Identifiable assets   | \$ 16,416,602                         | \$ 63,017            | \$ 5,772,639 | \$ (359,482) | \$ 21,892,776                        |

| In thousands | Nine months ended September 30, 2006 |                      |          |              | Total      |
|--------------|--------------------------------------|----------------------|----------|--------------|------------|
|              | Asset/<br>Liability                  | Advisory<br>Services | Conduits | Eliminations | Investment |

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|   | Products      |            |              | Management Services |               |
|---|---------------|------------|--------------|---------------------|---------------|
| Revenues <sup>(a)</sup>   | \$ 680,726    | \$ 47,585  | \$ 155,204   | \$ (22,537)         | \$ 860,978    |
| Net realized gains (losses)                                       | 5,587         | 7          |              |                     | 5,594         |
| Net gains (losses) on derivative instruments and foreign exchange | 12,252        | (114)      | (3,415)      |                     | 8,723         |
| Total revenues  | 698,565       | 47,478     | 151,789      | (22,537)            | 875,295       |
| Interest expense  | 598,250       |            | 140,044      | (7,822)             | 730,472       |
| Operating expenses  | 32,065        | 30,725     | 6,924        | (14,601)            | 55,113        |
| Total expenses  | 630,315       | 30,725     | 146,968      | (22,423)            | 785,585       |
| Income (loss) before taxes  | \$ 68,250     | \$ 16,753  | \$ 4,821     | \$ (114)            | \$ 89,710     |
| Identifiable assets   | \$ 19,948,556 | \$ 140,650 | \$ 3,811,748 | \$ (254,044)        | \$ 23,646,910 |

<sup>(a)</sup> Represents the sum of interest income, investment management services fees and other fees.

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**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries**

| In thousands  | Nine months ended September 30, 2005 |                      |              |              | Total<br>Investment<br>Management<br>Services |
|---|--------------------------------------|----------------------|--------------|--------------|---|
|   | Asset/<br>Liability<br>Products      | Advisory<br>Services | Conduits     | Eliminations |   |
| Revenues <sup>(a)</sup>   | \$ 438,962                           | \$ 41,703            | \$ 149,678   | \$ (11,894)  | \$ 618,449                                    |
| Net realized gains (losses)                                       | 2,996                                | 4                    |              |              | 3,000   |
| Net gains (losses) on derivative instruments and foreign exchange | 22,111                               | 54                   | 19,468       |              | 41,633  |
| Total revenues  | 464,069                              | 41,761               | 169,146      | (11,894)     | 663,082                                       |
| Interest expense  | 371,651                              | 267                  | 129,061      |              | 500,979                                       |
| Operating expenses  | 26,441                               | 25,461               | 11,692       | (11,786)     | 51,808  |
| Total expenses  | 398,092                              | 25,728               | 140,753      | (11,786)     | 552,787                                       |
| Income (loss) before taxes  | \$ 65,977                            | \$ 16,033            | \$ 28,393    | \$ (108)     | \$ 110,295                                    |
| Identifiable assets   | \$ 16,416,602                        | \$ 63,017            | \$ 5,772,639 | \$ (359,482) | \$ 21,892,776                                 |

<sup>(a)</sup> Represents the sum of interest income, investment management services fees and other fees.

A significant portion of premiums reported within the insurance segment is generated outside the United States. The following table summarizes net premiums earned by geographic location of risk for the three and nine months ended September 30, 2006 and 2005:

| In thousands         | 3rd quarter |            | Year-to-date |            |
|----------------------|-------------|------------|--------------|------------|
|                      | 2006        | 2005       | 2006         | 2005       |
| Net premiums earned: |             |            |              |            |
| United States        | \$ 158,996  | \$ 151,097 | \$ 460,259   | \$ 464,319 |
| Non-United States    | 53,331      | 52,975     | 174,703      | 163,983    |
| Total                | \$ 212,327  | \$ 204,072 | \$ 634,962   | \$ 628,302 |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****NOTE 7: Loss and Loss Adjustment Expense Reserves (LAE)**

Loss and LAE reserves are established in an amount equal to the Company's estimate of unallocated losses, identified or case basis reserves and costs of settlement and other loss mitigation expenses on non-derivative obligations it has insured. A summary of the unallocated and case basis activity and the components of the liability for loss and LAE reserves for the first three quarters of 2006 are shown in the following table:

| <b>In thousands</b>   | <b>3Q 2006</b> | <b>2Q 2006</b> | <b>1Q 2006</b> |
|---|----------------|----------------|----------------|
| Case basis loss and LAE reserves:                                   |                |                |                |
| Beginning balance   | \$ 451,745     | \$ 512,467     | \$ 512,888     |
| Less: reinsurance recoverable                                       | 44,472         | 59,324         | 58,965         |
| Net beginning balance   | 407,273        | 453,143        | 453,923        |
| Case basis transfers from (to) unallocated loss reserve related to: |                |                |                |
| Current year  | 5,448          | 266            |                |
| Prior years   | 11,822         | (18,997)       | 10,650         |
| Total   | 17,270         | (18,731)       | 10,650         |
| Paid related to:  |                |                |                |
| Current year  | 998            | 5,681          |                |
| Prior years   | 4,289          | 21,458         | 11,430         |
| Total paid  | 5,287          | 27,139         | 11,430         |
| Net ending balance  | 419,256        | 407,273        | 453,143        |
| Plus: reinsurance recoverable                                       | 47,002         | 44,472         | 59,324         |
| Case basis reserve ending balance                                   | 466,258        | 451,745        | 512,467        |
| Unallocated loss reserve:   |                |                |                |
| Beginning balance   | 256,548        | 217,885        | 208,614        |
| Losses and LAE incurred <sup>(1)</sup>                              | 20,414         | 20,295         | 20,126         |
| Channel Re elimination <sup>(2)</sup>                               | (321)          | (363)          | (205)          |
| Transfers from (to) case basis and LAE reserves                     | (17,270)       | 18,731         | (10,650)       |
| Unallocated loss reserve ending balance                             | 259,371        | 256,548        | 217,885        |
| Total   | \$ 725,629     | \$ 708,293     | \$ 730,352     |

<sup>(1)</sup> Represents the Company's provision for losses calculated as 12% of scheduled net earned premium.

<sup>(2)</sup> Represents the amount of losses and LAE incurred that have been eliminated in proportion to MBIA's ownership interest in Channel Reinsurance Ltd. (Channel Re), which is carried on an equity-method accounting basis.

During the nine months ended September 30, 2006, total net case basis activity transferred from the Company's unallocated loss reserve was \$9 million. Net case basis activity during 2006 consisted of loss reserves for insured obligations within the CDO, equipment lease pools and home



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equity loan sectors, MBIA's guaranteed tax lien portfolio and insured obligations issued by Allegheny Health, Education and Research Foundation (AHERF). Largely offsetting these loss reserves were reversals of previously established case basis reserves within the aircraft enhanced equipment trust certificates (EETCs) and manufactured housing sectors. The unallocated loss reserve approximated \$259 million at September 30, 2006, which represents the Company's estimate of losses associated with credit deterioration that has occurred in the Company's insured portfolio but have not been specifically identified and is available for future case-specific activity. The Company recorded \$61 million in losses and loss adjustment expenses in the nine months ended September 30, 2006 based on 12% of scheduled net earned premium. See Note 3: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2005 for a description of the Company's loss reserving policy.

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**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****NOTE 8: Long-Term Incentive Plans**

On May 5, 2005, the Company's shareholders approved the MBIA Inc. 2005 Omnibus Incentive Plan (the Omnibus Plan). Under the Omnibus Plan a maximum of 6,000,000 shares of the Company's common stock can be used for any type of award, including stock options, performance shares, performance units, restricted stock, restricted stock units and dividend equivalents. Any shares issued under the Omnibus Plan in connection with stock options shall be counted against this limit as one share covered by such option. For all awards other than stock options, any shares issued shall be counted against this limit as two shares for every share issued.

The stock option component of the Omnibus Plan enables key employees of the Company and its subsidiaries to acquire shares of common stock of the Company or to benefit from appreciation in the price of the common stock of the Company. The stock option grants, which may be awarded every year, provide the right to purchase shares of common stock at the fair value of the stock on the date of the grant. Options granted will either be Incentive Stock Options (ISOs), where they qualify under Section 422(a) of the Internal Revenue Code, or Non-Qualified Stock Options (NQSOs). ISOs and NQSOs are granted at a price not less than 100% of the fair value, defined as the closing price on the grant date, of the Company's common stock. Options are exercisable as specified at the time of grant depending on the level of the recipient (generally four or five years) and expire ten years from the date of grant (or shorter if specified or following termination of employment).

Under the restricted stock component of the Omnibus Plan, certain employees are granted restricted shares of the Company's common stock. These awards have a restriction period lasting three, four or five years depending on the type of award, after which time the awards fully vest. During the vesting period, these shares may not be sold. Restricted stock grants are typically granted from the vice president level up to and including the chief executive officer. Some of the awards made in the first nine months of 2006 and 2005 are linked to the growth in book value per share of the Company's common stock including certain adjustments (modified book value) over a three-year period following the grant date. Actual shares issued at the vesting date will be determined based on the growth in modified book value. If modified book value grows by 30% or more over the three-year period, then 100% of the award will vest. If the growth in modified book value over the three-year period is lower than 30%, then the amount of restricted shares issued will be adjusted downward in proportion to the amount by which actual growth in modified book value is below 30%.

Following the effective date of the Omnibus Plan, no new options or awards were granted under any of the prior plans authorized by the shareholders and all shares authorized but unissued were canceled. All options and awards granted under the prior plans and subsequently canceled or expired after the effective date of the Omnibus Plan become available for grant under the Omnibus Plan. In the first nine months of 2006, 37,500 options were granted and 194,060 options were canceled or expired. In the first nine months of 2006, 756,340 restricted shares were granted and 79,362 restricted shares were canceled. This restricted share activity affects the available share balance for future grants in the Omnibus Plan at a two-for-one ratio. Therefore, 4,836,363 shares are available for future grants under the Omnibus Plan as of September 30, 2006.

In December 2004, the FASB issued SFAS 123(R), Share-Based Payment. SFAS 123(R) is a revision of SFAS 123, Accounting for Stock-Based Compensation and supersedes Accounting Principles Board Opinion (APB) 25, Accounting for Stock Issued to Employees. Effective January 1, 2006 the Company adopted the requirements of SFAS 123(R). SFAS 123(R) requires the Company to expense the fair value of employee stock options and other forms of stock-based compensation. Effective January 1, 2002, the Company adopted the fair value recognition provisions of SFAS 123 and the modified prospective method of adoption under SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure. In addition, SFAS 123(R) classifies share-based payment awards as either liability awards, which are remeasured at fair value at each balance sheet date, or equity awards, which are measured on the grant date and not subsequently remeasured. Generally, awards with cash-based settlement, repurchase features or that are settled at a fixed dollar amount are classified as liability awards, and changes in fair value will be reported in earnings. Awards with net-settlement features or that permit a cashless exercise with third-party brokers are classified as equity awards and changes in fair value are not reported in earnings. The Company's long-term incentive plans include features which would result in both liability and equity awards. For liability awards, the Company currently remeasures these awards at each balance sheet date. In addition, SFAS 123(R) requires the use of a forfeiture estimate. Prior to the adoption of SFAS 123(R), the Company accounted for forfeitures as they occurred as permitted under previous accounting standards. The cumulative effect of adopting the change in estimating forfeitures for both stock option awards and restricted stock awards was \$0.9 million, resulting in a reduction to expense during the first quarter of 2006. The Company uses historical employee termination information to estimate the forfeiture rate applied to current stock-based awards.



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During the first nine months of 2006, the fair value of the restricted shares awarded (net of cancellations), determined on the grant date, was \$40.8 million. Restricted shares have been recorded as unearned compensation, which is a component of Additional paid-in capital within shareholders equity on the Company's Consolidated Balance Sheets and have been included in Stock-based compensation on the Company's Consolidated Statements of Changes in Shareholders' Equity. As of September 30, 2006, the unearned compensation balance for all restricted shares outstanding was \$63.1 million. This amount is expected to be recognized as expense over a weighted average period of 1.66 years. Unearned compensation is amortized to expense over the appropriate three- to five-year vesting period (except for a minor portion granted to members of the MBIA Inc. board of directors which is amortized over a ten-year period). Compensation expense related to the restricted shares, net of estimated forfeitures, was \$18.5 million for the nine months ended September 30, 2006. The tax benefit and excess tax benefit related to the restricted share awards for the Company during the first nine months of 2006 was \$1.8 million and \$0.2 million, respectively.

In May 2002, the MBIA Inc. board of directors approved the MBIA Inc. Annual and Long-Term Incentive Plan (the Incentive Plan). The Incentive Plan has been superseded by the Omnibus Plan. The Incentive Plan included a stock option component and a compensation component linked to the growth in modified book value over a three-year period following the grant date. Target levels for the Incentive Plan awards were established as a percentage of total salary and bonus, based upon the recipient's position. Awards under the Incentive Plan typically were granted from the vice president level up to and including the chief executive officer. Actual amounts to be paid are adjusted upward or downward depending on the growth of modified book value versus a baseline target, with a minimum growth of 8% necessary to receive any payment and an 18% growth necessary to receive the maximum payment. Awards under the Incentive Plan were divided equally between the two components, with approximately 50% of the award to be given in stock options and approximately 50% of the award to be paid in cash or shares of Company stock. Payments are made at the end of each three-year measurement period. During the first nine months of 2006, \$3.1 million was recorded as an expense related to modified book value awards. The tax benefit related to modified book value awards during the first nine months of 2006 was \$1.1 million.

The fair value for stock option awards is estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. The number of options granted and the assumptions used for valuing such option grants during the first nine months of the year are shown in the following table:

|                                 | <b>June 2006</b> |
|---------------------------------|------------------|
| Number of options granted       | 37,500           |
| Exercise price                  | \$ 57.51         |
| Dividend yield                  | 2.405%           |
| Expected volatility             | .3107            |
| Risk-free interest rate         | 5.050%           |
| Expected option term (in years) | 6.37             |

Employee stock option compensation expense, net of estimated forfeitures, for the nine months ended September 30, 2006, totaled \$9.8 million. The tax benefit and excess tax benefit related to the stock option awards for the Company during the first nine months of 2006 was \$3.3 million and \$0.9 million, respectively. As of September 30, 2006, there was \$23.9 million of total unrecognized compensation cost related to nonvested stock options. This amount is expected to be recognized as expense over a weighted average period of 1.75 years.

A summary of the Company's stock option plan as of September 30, 2006 and changes during the first nine months of the year, are set forth in the following table:

| Options | <b>September 30, 2006</b> |                  |
|---------|---------------------------|------------------|
|         | Number                    | Weighted Average |

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|                                    | of Shares | Price per Share |
|------------------------------------|-----------|-----------------|
| Outstanding at beginning of period | 9,699,558 | \$ 46.75        |
| Granted                            | 37,500    | 57.51           |
| Exercised                          | (533,673) | 60.58           |
| Expired or canceled                | (194,060) | 54.14           |
| Outstanding at end of period       | 9,009,325 | \$ 46.87        |
| Exercisable at end of period       | 5,549,485 | \$ 44.30        |

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The following table summarizes information about the plan's stock options at September 30, 2006:

| <b>Range of Average Exercise Price</b> | <b>Number Outstanding at 9/30/06</b> | <b>Weighted Average Remaining Contractual Life in Years</b> | <b>Outstanding Weighted Average Exercise Price</b> | <b>Number Exercisable at 9/30/06</b> | <b>Exercisable Weighted Average Exercise Price</b> |
|--|--------------------------------------|---|--|--------------------------------------|--|
| \$25.92 - 32.92                        | 812,448                              | 3.01  | \$ 32.35   | 812,448                              | \$ 32.35   |
| \$33.96 - 36.69                        | 1,165,454                            | 5.49  | \$ 36.60   | 433,327                              | \$ 36.44   |
| \$36.72 - 47.95                        | 3,648,585                            | 2.79  | \$ 44.42   | 3,097,435                            | \$ 44.82   |
| \$48.35 - 64.86                        | 3,382,838                            | 6.14  | \$ 56.55   | 1,206,275                            | \$ 53.82   |
| <b>Total</b>                           | <b>9,009,325</b>                     | <b>4.42</b>   | <b>\$ 46.87</b>                                    | <b>5,549,485</b>                     | <b>\$ 44.30</b>                                    |

**NOTE 9: Derivative Instruments**

A comprehensive discussion of the Company's derivative instruments is provided in Note 7: Derivative Instruments in the Notes to Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2005. The following provides an update to such discussion and should be read in conjunction with the information included in Note 7: Derivative Instruments in the Company's Form 10-K.

MBIA enters into derivative transactions as an additional form of financial guarantee and for purposes of hedging risks associated with existing assets and liabilities and forecasted transactions. The Company accounts for derivative transactions in accordance with SFAS 133, Accounting for Derivative Instruments and Hedging Activities, as amended, which requires that all such transactions be recorded on the Company's balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings within Net gains (losses) on derivative instruments and foreign exchange or in shareholders' equity within Accumulated other comprehensive income, depending on whether the derivative is designated as a hedge, and if so designated, the type of hedge.

The insurance operations has entered into derivative transactions that it views as an extension of its core financial guarantee business but do not qualify for the financial guarantee scope exception under SFAS 133 and, therefore, must be stated at fair value. The insurance operations, which represent the majority of the Company's notional derivative exposure, have insured derivatives primarily consisting of structured pools of credit default swaps that the Company intends to hold for the entire term of the contract. The insurance operations have also provided guarantees on the value of certain structured closed-end funds, which meet the definition of a derivative under SFAS 133. The Company reduces risks embedded in its insured portfolio through the use of reinsurance and by entering into derivative transactions. This includes cessions of insured derivatives under reinsurance agreements and capital markets transactions in which the Company economically hedges a portion of the credit and market risk associated with its insured credit derivative portfolio. Such arrangements are also accounted for as derivatives under SFAS 133 and recorded in the Company's financial statements at fair value. Premiums received on insured derivatives are recorded as part of premiums earned. Additionally, changes in fair values of derivative transactions within MBIA's insurance operations are recorded in current earnings.

**NOTE 10: Discontinued Operations**

In the third quarter of 2006, MBIA finalized a plan to sell MuniServices. In October 2006, MBIA signed a letter of intent to sell MuniServices to an investor group led by the management of MuniServices and expects the sale to be completed during the fourth quarter of 2006. MuniServices provides revenue enhancement services and products to public-sector clients nationwide consisting of discovery, audit, collections/recovery and information services. The plan to sell MuniServices resulted from the Company's decision that such activities no longer fit within the Company's overall business objectives. The results of MuniServices have been reported as a discontinued operation for all periods presented herein.

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Income/(loss) from discontinued operations, net of tax, for the three months ended September 30, 2006 and 2005 was income of \$1.394 million and a loss of \$946 thousand, respectively. Income/(loss) from discontinued operations, net of tax, for the nine months ended September 30, 2006 and 2005 was income of \$2.324 million and a loss of \$691 thousand, respectively. Included in the after-tax loss for the three and nine months ended September 30, 2005 was a loss of \$1.1 million related to the sale of 1838 Investment Advisors, LLC, which was previously reported as a discontinued operation. The following table reports the amounts included in income/(loss) from discontinued operations before income taxes:

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| In thousands                      | 3rd quarter |            | Year-to-date |            |
|-----------------------------------|-------------|------------|--------------|------------|
|                                   | 2006        | 2005       | 2006         | 2005       |
| Revenues                          | \$ 4,085    | \$ 3,976   | \$ 12,500    | \$ 11,555  |
| Expenses                          | 1,735       | 5,411      | 8,581        | 12,559     |
| Income/(loss) before income taxes | \$ 2,350    | \$ (1,435) | \$ 3,919     | \$ (1,004) |

The following table provides the major classes of asset and liabilities related to discontinued operations that are held for sale and have been reported within Other assets and Other liabilities on the face of the Company's consolidated balance sheets:

| In thousands  | September 30,<br>2006 | December 31,<br>2005 |
|---|-----------------------|----------------------|
| Cash and cash equivalents   | \$ 2,399              | \$ 2,081             |
| Short-term investments  | 4,199                 | 4,584                |
| Accounts receivable, net  | 3,818                 | 5,469                |
| Property and equipment (net of accumulated depreciation of \$5,479 and \$4,890) | 2,914                 | 1,337                |
| Other assets  | 377                   | 258                  |
| Total assets of discontinued operations   | \$ 13,707             | \$ 13,729            |
| Accrued expenses payable  | \$ 2,203              | \$ 3,336             |
| Total liabilities of discontinued operations                                    | \$ 2,203              | \$ 3,336             |

**NOTE 11: Commitments and Contingencies**

In July 2002, MBIA Corp. filed suit against Royal Indemnity Company (Royal) in the United States District Court for the District of Delaware, to enforce insurance policies that Royal issued on certain vocational student loan transactions that MBIA Corp. insured. To date, claims in the amount of approximately \$354 million have been made under the Royal policies with respect to loans that have defaulted. MBIA Corp. expects that there will be additional claims made under the policies with respect to student loans that may default in the future. Royal had filed an action seeking a declaration that it is not obligated to pay on its policies. In October 2003, the court granted MBIA Corp.'s motion for summary judgment and ordered Royal to pay all claims under its policies. Royal appealed the order, and, in connection with the appeal, pledged \$397 million of investment grade collateral to MBIA Corp. to secure the entire amount of the judgment, with interest, and has agreed to post additional security for future claims and interest.

On October 3, 2005, the U.S. Court of Appeals for the Third Circuit upheld the decision of the United States District Court for the District of Delaware insofar as it enforced the Royal insurance policies, but remanded the case to the District Court for a determination of whether the Royal policies cover all losses claimed under the policies. In particular, the Court of Appeals directed the District Court to consider whether the Royal policies would cover losses resulting from the misappropriation of student payments rather than from defaults by students. MBIA Corp. believes that the Royal policies would cover losses even if they result from misappropriation of student payments, but in any event it appears that all or substantially all of the claims made under the Royal policies relate to defaults by students rather than misappropriation of funds. Therefore, MBIA Corp. expects Royal to be required to pay all or substantially all of the claims made under its policies and to be reimbursed for any payments MBIA Corp. made under its policies.

Royal filed a petition with the Third Circuit requesting that the case be reheard, which was denied in April 2006. In April 2006, Royal filed a motion with the District Court seeking a release of the collateral it pledged in connection with its appeal of the District Court judgment against it in 2003. MBIA has opposed Royal's motion to release the collateral and believes that, in light of the Third Circuit affirmance of the parts of the



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District Court judgment enforcing the Royal policies, and the language in the pledge agreement, the collateral should remain subject to the pledge, although there is no assurance that the District Court will not order a release of the collateral.

If the collateral is released and Royal is unable to make payments on the Royal policies, MBIA Corp. would incur substantial losses under its policies. MBIA Corp. does not believe, however, that any such losses will have a material adverse effect on its financial condition.

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In November 2004, the Company received identical document subpoenas from the SEC and the New York Attorney General's Office (NYAG) requesting information with respect to non-traditional or loss mitigation insurance products developed, offered or sold by the Company to third parties from January 1, 1998 to the present. While the subpoenas did not identify any specific transaction, subsequent conversations with the SEC and the NYAG revealed that the investigation included the arrangements entered into by MBIA Corp. in 1998 in connection with the bankruptcy of the Delaware Valley Obligated Group, an entity that is part of AHERF.

On March 9, 2005, the Company received a subpoena from the U.S. Attorney's Office for the Southern District of New York (U.S. Attorney) seeking information related to the agreements it entered into in connection with the AHERF loss. Thereafter, the Company has received additional subpoenas, substantively identical to each other, and additional informal requests, from the SEC and the NYAG for documents and other information.

On August 19, 2005, the Company received a Wells Notice from the SEC indicating that the staff of the SEC is considering recommending that the SEC bring a civil injunctive action against the Company alleging violations of federal securities laws arising from MBIA's action to retroactively reinsure losses it incurred from the AHERF bonds MBIA had guaranteed, including, but not limited to, its entering into excess of loss agreements and quota share agreements with three separate counterparties.

On November 8, 2005, the Company announced that it was in discussions with the SEC, the NYAG and the New York State Insurance Department (NYSID) regarding potential settlements of their investigations into agreements entered into by MBIA Corp. in connection with the AHERF matter. In connection with the potential settlements, the Company announced that it was restating its financial statements to correct and restate its GAAP and statutory accounting for 1998 and subsequent years as discussed in Note 2: Restatement of Consolidated Financial Statements in the Notes to Consolidated Financial Statements in the Company's Form 10-K for the year ended December 31, 2005. In connection with the proposed settlements, the Company accrued \$75 million for the total amount the Company estimates, based on discussions to date, it will have to pay in connection with any settlements.

The Company has been cooperating, and is continuing to cooperate fully with the investigations by the SEC, the NYAG, the NYSID and the U.S. Attorney. To date, no settlements have been approved by the regulatory agencies, and no assurance can be given that any settlements will be approved. Any settlements may have additional or different terms.

The Company has been named as a defendant in private securities actions consolidated as *In re MBIA Inc. Securities Litigation*; (Case No. 05 CV 03514(LLS); S.D.N.Y.) (filed October 3, 2005). Joseph W. Brown, the Company's Chairman and former Chief Executive Officer, Gary C. Dunton, the Company's Chief Executive Officer, Nicholas Ferreri, the Company's former Chief Financial Officer, Neil G. Budnick, a Vice President of the Company and the Company's former Chief Financial Officer and Douglas C. Hamilton, the Company's Controller were also named as defendants in the suit, as were former Chairman and Chief Executive Officer David H. Elliott and former Executive Vice President, Chief Financial Officer and Treasurer Julliette S. Tehrani. The plaintiffs assert claims under Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), Rule 10b-5 promulgated thereunder, and Section 20(a) of the Exchange Act. The lead plaintiffs purport to be acting as representatives for a class consisting of purchasers of the Company's stock during the period from August 5, 2003 to March 30, 2005 (the Class Period).

The allegations contained in the lawsuit include, among other things, violations of the federal securities laws arising out of the Company's allegedly false and misleading statements about its financial condition and the nature of the arrangements entered into by MBIA Corp. in connection with the AHERF loss, and about the effectiveness of the Company's internal controls. The plaintiffs allege that, as a result of these misleading statements or omissions, the Company's stock traded at artificially inflated prices throughout the Class Period. The plaintiffs seek unspecified compensatory damages in connection with purchases by members of the class of the Company's stock at such allegedly inflated prices during the Class Period. The defendants, including the Company, filed motions to dismiss on July 17, 2006. The Company does not expect the outcome of the private securities litigation to have a material adverse affect on its financial condition, although the outcome is uncertain and no assurance can be given that the Company will not suffer a loss.

Certain officers of the Company and certain members of the Company's Board of Directors have been named as defendants in a shareholder derivative action filed in the Supreme Court of New York, Westchester County on November 9, 2005: *Robert Purvis, Derivatively on Behalf of Nominal Defendant MBIA, Inc. v. Joseph W. Brown, Neil G. Budnick, C. Edward Chaplin, David C. Clapp, Clifford D. Corso, Gary C. Dunton,*

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*Claire L. Gaudiani, Daniel P. Kearney, Laurence H. Meyer, Debra J. Perry, John A. Rolls, and Ruth M. Whaley* (Case No. 20099-05) (the Purvis Litigation). The plaintiff asserts claims for the benefit of the Company to redress injuries suffered by the Company as a result of alleged breaches of fiduciary duties by the named defendants in connection with the Company's accounting for certain transactions, including the AHERF

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MBIA Inc. and Subsidiaries**

loss. In addition, the plaintiff alleges that the officer defendants were unjustly enriched as a result of such alleged breach. The lawsuit seeks disgorgement to the Company of compensation granted to such officers, legal costs and unspecified equitable relief to remedy defendants breaches of fiduciary duties.

Certain current and former officers of the Company and certain current and former members of the Company's Board of Directors have been named as defendants in a shareholder derivative action filed in the United States District Court, Southern District on April 24, 2006: *J. Robert Orton Jr., Derivatively on Behalf of Nominal Defendant MBIA, Inc. v. Joseph (Jay) W. Brown, Gary C. Dunton, Neil G. Budnick, Nicholas Ferreri, Douglas C. Hamilton, Juliette S. Tehrani, Richard L. Weill, David H. Elliott, Claire L. Gaudiani, Daniel P. Kearney, David C. Clapp, John A. Rolls, C. Edward Chaplin, Debra J. Perry, Laurence Meyer, Jeffrey W. Yabuki, Pierre-Henri Richard, William H. Gray III, Freda S. Johnson and James A. Lebenthal (Case No. 06 CV 3146)* (the Orton Litigation). The plaintiff asserts claims for the benefit of the Company to redress injuries suffered by the Company as a result of alleged breaches of fiduciary duties, insider trading, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment and violations of the Sarbanes-Oxley Act of 2002 by some or all of the named defendants in connection with alleged false statements in the Company's financial statements arising from improper accounting for certain transactions, including agreements to reinsure the AHERF loss. The lawsuit seeks relief on behalf of the Company that includes disgorgement of certain compensation granted to such officers, unspecified damages, restitution of profits and compensation, legal costs, an order directing the Company to implement certain governance procedures and other equitable relief.

A Special Litigation Committee of three independent directors of MBIA Inc. has determined after a good faith and thorough investigation that pursuit of the Purvis Litigation and the Orton Litigation is not in the best interests of MBIA and its shareholders, and has moved to dismiss the two actions.

There are no other material lawsuits pending or, to the knowledge of the Company, threatened, to which the Company or any of its subsidiaries is a party.

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**MBIA Inc. and Subsidiaries**  
**Management's Discussion and Analysis**  
**of Financial Condition and Results of Operations**

**FORWARD-LOOKING AND CAUTIONARY STATEMENTS**

This quarterly report of MBIA Inc. (MBIA or the Company) 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, intend, will likely result, looking 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. The following are some of the factors that could affect financial performance or could cause actual results to differ materially from estimates contained in or underlying the Company's forward-looking statements:

fluctuations in the economic, credit, interest rate or foreign currency environment in the United States (U.S.) and abroad;

level of activity within the national and international credit markets;

competitive conditions and pricing levels;

legislative or regulatory developments;

technological developments;

changes in tax laws;

the effects of mergers, acquisitions and divestitures; and

uncertainties that have not been identified at this time.

The Company undertakes no obligation to publicly correct or update any forward-looking statement if it later becomes aware that such results are not likely to be achieved.

**OVERVIEW**

MBIA is a leading provider of financial guarantee products and specialized financial services. MBIA provides innovative and cost-effective products and services that meet the credit enhancement, financial and investment needs of its public- and private-sector clients worldwide. MBIA manages its activities primarily through two principal business operations: insurance and investment management services. The Company's corporate operations include revenues and expenses that arise from general corporate activities and not from its two principal business operations. Results of operations included herein are presented in accordance with accounting principles generally accepted in the United States of America (GAAP).

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In the third quarter of 2006, MBIA finalized a plan to sell MBIA MuniServices Company and certain of its wholly owned subsidiaries (MuniServices). In October 2006, MBIA signed a letter of intent to sell MuniServices to an investor group led by the management of MuniServices and expects the sale to be completed during the fourth quarter of 2006. MuniServices provides revenue enhancement services and products to public-sector clients nationwide consisting of discovery, audit, collections/recovery and information services. The plan to sell MuniServices resulted from the Company's decision that such activities no longer fit within the Company's overall business objectives. The results of MuniServices have been reported as a discontinued operation for all periods presented herein and not as part of the Company's municipal services segment. The remainder of the municipal services segment, which consists of Capital Asset Holdings GP, Inc. and certain affiliated entities (Capital Asset), a servicer of delinquent tax liens, has been reported within the Company's corporate operations as it is immaterial to the financial condition and results of operations of the Company. See Note 10 in the Notes to Consolidated Financial Statements for additional information related to the Company's discontinued operations.

### CRITICAL ACCOUNTING ESTIMATES

The Company has disclosed its critical accounting estimates in its Form 10-K for the year ended December 31, 2005. The following critical accounting estimate provides an update to that included under the same caption in the Company's Form 10-K.

### LOSSES AND LOSS ADJUSTMENT EXPENSES

The financial guarantees issued by MBIA Insurance Corporation and its subsidiaries (MBIA Corp.) insure scheduled payments of principal and interest due on various types of financial obligations against a payment default on such payments by the issuers of the obligations. Loss and loss adjustment expense (LAE) reserves are established by the Company's Loss Reserve Committee, which is comprised of members of senior management, and require the use of judgment and estimates with respect to the occurrence, timing and amount of a loss on an insured obligation.

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**Management's Discussion and Analysis**  
**of Financial Condition and Results of Operations**

The Company establishes two types of loss and LAE reserves for non-derivative financial guarantees: an unallocated loss reserve and case basis reserves. The unallocated loss reserve is established with respect to the Company's entire insured portfolio. The Company's unallocated loss reserve represents the Company's estimate of losses that have occurred or are probable to occur as a result of credit deterioration in the Company's insured portfolio but which have not yet been specifically identified and applied to specific insured obligations.

Each quarter the Company calculates its provision for the unallocated loss reserve as a fixed percent of scheduled net earned premium. Annually, the Loss Reserve Committee evaluates the appropriateness of this fixed percent loss factor. In performing this evaluation, the Loss Reserve Committee considers the composition of the Company's insured portfolio by municipal sector, structured asset class, remaining maturity and credit quality, along with the latest industry data, including historical default and recovery experience for the relevant sectors of the fixed-income market in order to determine if a trend is developing that indicates the loss factor should be increased or decreased. In addition, the Company considers its own historical loss activity and how those losses develop over time. The Loss Reserve Committee reviews the results of its annual evaluation over a period of several years to determine whether any long-term trends are developing. The Company's additions to specific case basis reserves in the years ended December 31, 2005 and 2004 exceeded the 12% loss factor currently used by the Company. However, in the nine months ended September 30, 2006 additions to specific case basis reserves were less than the 12% loss factor. The Loss Reserve Committee is continuing to monitor case basis activity and evaluate whether an adjustment to the Company's current loss factor is appropriate. However, if a catastrophic or very unusual loss occurred, the Loss Reserve Committee would consider taking an immediate charge through Losses and loss adjustment expenses and possibly also increasing the loss factor in order to maintain an adequate level of loss reserves. Since 2002, the Company calculated its provision for the unallocated loss reserve as 12% of scheduled net earned premium.

Significant changes to any variables on which the 12% loss factor is based, over an extended period of time, would likely result in an increase or decrease in the Company's loss factor with a corresponding increase or decrease in the amount of the Company's loss and loss adjustment expense provision. For example, as external and internal statistical data are applied to the various sectors of the Company's insured portfolio, a shift in business written toward sectors with high default rates would likely increase the loss factor, while a shift toward sectors with low default rates would likely decrease the loss factor. Additionally, increases in statistical default rates relative to the Company's insured portfolio and in the Company's actual loss experience or decreases in statistical recovery rates and in the Company's actual recovery experience would likely increase the Company's loss factor. Conversely, decreases in statistical default rates relative to the Company's insured portfolio and in the Company's actual loss experience or increases in statistical recovery rates and in the Company's actual recovery experience would likely decrease the Company's loss factor. During the nine months ended September 30, 2006, the Company calculated a provision for the unallocated loss reserve of \$61 million. This provision represents loss and loss adjustment expenses as reported on the Company's income statement.

In the years ended December 31, 2005 and 2004, the Company's actual loss experience, one of the variables on which the loss factor is based, increased significantly above historical levels as case basis incurred activity exceeded the 12% loss factor used by the Company. Given the level of specific case basis losses recorded in 2005 and 2004, if none of the other variables used in deriving the loss factor had changed during this period, the Company's loss factor would approximate 14%. Another variable that changed over the last several years, however, and that affects the determination of the loss factor is the mix of business among different sectors. During this period, the Company has ceased writing business in certain sectors in which loss experience has been high relative to its total portfolio, such as tax liens, lower rated high-yield collateralized bond obligations, manufactured housing and direct corporate risk, which offset the impact that the higher case basis incurred activity would have on the loss factor. Excluding actual loss experience incurred in the sectors listed above, the Company's loss factor through 2005 would approximate 10%. Also mitigating the impact of higher case basis incurred activity is the improvement in the overall credit quality of the insured portfolio, with a greater percentage of the insured portfolio rated A or above over the past few years, as well as a decline in the number of issues on the Company's caution lists.

Considering all of the assumptions used in the assessment of the adequacy of the loss factor, including the higher case basis incurred activity in 2005 and 2004 and the offsetting affect of observed changes in the variables described above, the Company believes that its current loss factor of 12% continues to represent a reasonable estimate of losses that have or are probable to occur as a result of credit deterioration in the Company's insured portfolio but which have not yet been specifically identified and applied to specific insured obligations. In addition, the Company believes that the amount of unallocated loss reserves recorded on its balance sheet at September 30, 2006 are adequate to cover specific losses that may develop from its existing insured portfolio. MBIA continually monitors its insured portfolio and actual loss experience in





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order to identify trends that would indicate a reasonably likely significant change to one or more of the variables on which the loss factor is based. If MBIA determines that any changes to one or more of these variables is likely to have an impact on the level of probable losses in its insured portfolio, the Company will increase or decrease its loss factor accordingly, which will result in an increase or decrease in its loss and loss adjustment expenses.

The Company establishes specific reserves in an amount equal to the Company's estimate of identified or case basis reserves with respect to specific policies. A number of variables are taken into account in establishing specific case basis reserves for individual policies that depend primarily on the nature of the underlying insured obligation. These variables include the nature and creditworthiness of the underlying issuer of the insured obligation, whether the obligation is secured or unsecured and the expected recovery rates on the insured obligation, the projected cash flow or market value of any assets that support the insured obligation and the historical and projected loss rates on such assets. Factors that may affect the actual ultimate realized losses for any policy include the state of the economy, changes in interest rates, rates of inflation and the salvage values of specific collateral. The Company does not believe that changes to these factors would materially change the amount of the Company's case basis loss reserves, with the exception of significant changes in salvage values of specific collateral. However, the Company does not believe that significant changes in salvage values of specific collateral are reasonably likely to occur.

The Company's total loss reserves at September 30, 2006 of \$726 million represent a small fraction of its outstanding net debt service insured of \$900 billion. However, management believes that these reserves are adequate to cover ultimate net losses. Given that the reserves are based on estimates, there can be no assurance that the ultimate liability will not exceed such estimates resulting in the Company recognizing additional loss and loss adjustment expense in earnings. While the underlying principles applied to loss reserving are consistent across the financial guarantee industry, differences exist with regard to the methodology and measurement of loss reserves. Alternate methods may produce different estimates than the method used by the Company. Additionally, the accounting for non-derivative financial guarantee loss reserves is possibly subject to change. See Note 3: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2005 for a description of the Company's loss and loss adjustment expense accounting policy.

**RECENT ACCOUNTING PRONOUNCEMENTS**

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. (SAB) 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 requires that a registrant use both a balance sheet approach and an income statement approach when quantifying and evaluating the materiality of a misstatement. In addition, SAB 108 provides permitted transition methods for correcting and disclosing errors that existed prior to the application of SAB 108 when such errors are determined to be material to a registrant's financial statements upon the application of SAB 108. SAB 108 is effective for the first fiscal year ending after November 15, 2006, with early adoption permitted in interim reports filed with the SEC. MBIA will initially apply the provisions of SAB 108 in connection with the preparation of its financial statements for the year ending December 31, 2006. The Company believes that the application of SAB 108 will not have a material effect on its financial condition or results of operations.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. (SFAS) 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements under other accounting pronouncements, but does not change the existing guidance as to whether or not an instrument is carried at fair value. SFAS 157 also clarifies that an issuer's credit standing should be considered when measuring liabilities at fair value. SFAS 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy (levels 1, 2 and 3 as defined). SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. MBIA is currently evaluating the provisions of SFAS 157 and their potential impact on the Company's financial statements.

In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes" an Interpretation of FASB Statement 109. FIN 48 requires that the Company determine whether a tax position is more likely than not to be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets this recognition threshold, the position is measured to determine the amount of benefit to be recognized in the financial statements. FIN 48 also provides guidance on the derecognition, classification and disclosure of tax positions. FIN 48 is effective for fiscal years

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beginning after December 15, 2006. MBIA is currently evaluating the provisions of FIN 48 and their potential impact on the Company's financial statements.

In February 2006, the FASB issued SFAS 155, Accounting for Certain Hybrid Financial Instruments, which amends SFAS 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. SFAS 155 permits an entity to measure at fair value any financial instrument that contains an embedded derivative that would otherwise require bifurcation. For the Company, SFAS 155 is effective for those financial instruments acquired or issued after January 1, 2007. MBIA is currently evaluating the provisions of SFAS 155 and their potential impact on the Company's financial statements.

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**RESULTS OF OPERATIONS****SUMMARY OF CONSOLIDATED RESULTS**

The following table presents highlights of the Company's consolidated financial results for the three and nine months ended September 30, 2006 and 2005. Items listed under "Other per share information (effect on net income)" are items that management commonly identifies for the readers of its financial statements because they are a by-product of the Company's operations or due to general market conditions beyond the control of the Company.

| <b>In millions except per share amounts</b>                       | <b>3rd Quarter</b> |               | <b>Year-to-date</b> |               |
|---|--------------------|---------------|---------------------|---------------|
|   | <b>2006</b>        | <b>2005</b>   | <b>2006</b>         | <b>2005</b>   |
| <b>Revenues:</b>  |                    |               |                     |               |
| Insurance   | \$ 393             | \$ 338        | \$ 1,128            | \$ 1,022      |
| Investment management services                                    | 314                | 269           | 875                 | 663           |
| Corporate   | 5                  | 4             | 14                  | 16            |
| <b>Gross revenues from continuing operations</b>                  | <b>712</b>         | <b>611</b>    | <b>2,017</b>        | <b>1,701</b>  |
| <b>Expenses:</b>  |                    |               |                     |               |
| Insurance   | 97                 | 84            | 275                 | 233           |
| Investment management services                                    | 283                | 203           | 785                 | 553           |
| Corporate   | 25                 | 103           | 72                  | 159           |
| <b>Gross expenses from continuing operations</b>                  | <b>405</b>         | <b>390</b>    | <b>1,132</b>        | <b>945</b>    |
| <b>Provision for income taxes</b>                                 | <b>90</b>          | <b>78</b>     | <b>249</b>          | <b>227</b>    |
| <b>Income from continuing operations, net of tax</b>              | <b>217</b>         | <b>143</b>    | <b>636</b>          | <b>529</b>    |
| <b>Income (loss) from discontinued operations, net of tax</b>     | <b>1</b>           | <b>(1)</b>    | <b>2</b>            | <b>(1)</b>    |
| <b>Net income</b>   | <b>\$ 218</b>      | <b>\$ 142</b> | <b>\$ 638</b>       | <b>\$ 528</b> |
| <b>Net income per share information:<sup>(1)</sup></b>            |                    |               |                     |               |
| Net income  | \$ 1.59            | \$ 1.04       | \$ 4.67             | \$ 3.84       |
| <b>Other per share information (effect on net income):</b>        |                    |               |                     |               |
| Penalties and disgorgement  | \$                 | \$(0.53)      | \$                  | \$(0.52)      |
| Accelerated premium earned from refunded issues                   | \$ 0.18            | \$ 0.14       | \$ 0.56             | \$ 0.44       |
| Net realized gains (losses)                                       | \$ 0.02            | \$(0.03)      | \$ 0.10             | \$(0.02)      |
| Net gains (losses) on derivative instruments and foreign exchange | \$ 0.00            | \$ 0.21       | \$ 0.05             | \$ 0.20       |
| Income (loss) from discontinued operations                        | \$ 0.01            | \$(0.01)      | \$ 0.02             | \$(0.01)      |

<sup>(1)</sup> All per share calculations are diluted.

In the third quarter of 2006, consolidated revenues from continuing operations increased 17% to \$712 million from \$611 million in the third quarter of 2005. Growth in insurance revenues resulted from an increase in consolidated variable interest entity (VIE) interest income and realized gains on sales of investment securities. A substantial increase in investment management services interest income resulting from growth in asset/liability products was partially offset by a decrease in investment management services net gains on derivative instruments and foreign exchange. Third quarter 2006 consolidated expenses from continuing operations increased 4% to \$405 million from \$390 million in the third

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quarter of 2005. This increase was principally due to an increase in investment management services and insurance interest expense, which was commensurate with the increases in interest income. Substantially offsetting the increases in interest expense was a reduction in corporate expenses resulting from the \$75 million expense recorded in the third quarter of 2005 in connection with estimated settlements of regulatory investigations. Net income for the third quarter of 2006 of \$218 million was up 54% from \$142 million for the third quarter of 2005. Net income per share for the third quarter of 2006 was \$1.59 compared with \$1.04 for the third quarter of 2005, a 53% increase. The slightly larger percent increase in net income compared with net income per share resulted from an approximately 917,000 increase in the average number of diluted shares outstanding as a result of shares issued in connection with stock-based compensation plans.

Consolidated revenues for the nine months ended September 30, 2006 increased 19% to \$2,017 million from \$1,701 million in the same period of 2005. The growth in consolidated revenues was primarily due to a substantial increase in investment management services interest income related to asset/liability products and an increase in insurance investment income related to consolidated VIE interest income and growth in invested assets. Consolidated expenses for the nine months ended September 30, 2006 increased 20% to \$1,132 million from \$945 million in the same period of 2005 principally due to an increase in investment management services and insurance interest expense, which was commensurate with the increase in interest income. Net income for the nine months ended September 30, 2006 of \$638 million was up 21% from \$528 million

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in the same period of 2005. Net income per share for the nine months ended September 30, 2006 was \$4.67 compared with \$3.84 for the same period of 2005, a 22% increase. The slightly larger percent increase in net income per share compared with net income resulted from an approximately 1 million decrease in the average number of diluted shares outstanding as a result of share repurchases the Company made in the first half of 2005 partially offset by shares issued in connection with stock-based compensation plans.

The Company's book value at September 30, 2006 was \$52.35 per share, compared with \$49.17 at December 31, 2005. The increase was principally driven by net income from operations, partially offset by a decline in the unrealized appreciation of investment securities due to the effect of rising interest rates.

**INSURANCE OPERATIONS**

The Company's insurance operations are principally comprised of the activities of MBIA Corp. MBIA Corp. issues financial guarantees for municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, bonds backed by publicly or privately funded public purpose projects, bonds issued by sovereign and sub-sovereign entities, obligations collateralized by diverse pools of corporate loans and credit default swaps and pools of corporate and asset-backed bonds, both in the new issue and secondary markets.

The municipal obligations that MBIA Corp. insures include tax-exempt and taxable indebtedness of states, counties, cities, utility districts and other political subdivisions, as well as airports, higher education and healthcare facilities and similar authorities and obligations issued by private entities that finance projects which serve a substantial public purpose. The asset-backed and structured finance obligations insured by MBIA Corp. typically consist of securities that are payable from or which are tied to the performance of a specified pool of assets that, in most cases, have a defined cash flow. Securities of this type include residential and commercial mortgages, a variety of consumer loans, corporate loans and bonds, trade and export receivables, aircraft, equipment and real property leases and infrastructure projects.

The Company's gross premiums written (GPW), net premiums written (NPW) and net premiums earned for the third quarter and first nine months of 2006 and 2005 are presented in the following table:

|                         | 3rd Quarter |             | Year-to-date |             | Percent Change                     |                                     |
|-------------------------|-------------|-------------|--------------|-------------|------------------------------------|-------------------------------------|
|                         | 2006        | 2005        | 2006         | 2005        | 3rd Quarter<br>2006<br>vs.<br>2005 | Year-to-date<br>2006<br>vs.<br>2005 |
| <b>In millions</b>      | <b>2006</b> | <b>2005</b> | <b>2006</b>  | <b>2005</b> | <b>2005</b>                        | <b>2005</b>                         |
| Gross premiums written: |             |             |              |             |                                    |                                     |
| U.S.                    | \$ 133      | \$ 154      | \$ 383       | \$ 543      | (14)%                              | (30)%                               |
| Non-U.S.                | 69          | 67          | 244          | 210         | 4%                                 | 16%                                 |
| Total                   | \$ 202      | \$ 221      | \$ 627       | \$ 753      | (9)%                               | (17)%                               |
| Net premiums written:   |             |             |              |             |                                    |                                     |
| U.S.                    | \$ 120      | \$ 144      | \$ 349       | \$ 507      | (17)%                              | (31)%                               |
| Non-U.S.                | 56          | 42          | 200          | 147         | 35%                                | 36%                                 |
| Total                   | \$ 176      | \$ 186      | \$ 549       | \$ 654      | (6)%                               | (16)%                               |
| Net premiums earned:    |             |             |              |             |                                    |                                     |
| U.S.                    | \$ 159      | \$ 151      | \$ 460       | \$ 464      | 5%                                 | (1)%                                |

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|          |        |        |        |        |    |    |
|----------|--------|--------|--------|--------|----|----|
| Non-U.S. | 53     | 53     | 175    | 164    | 1% | 7% |
| Total    | \$ 212 | \$ 204 | \$ 635 | \$ 628 | 4% | 1% |

GPW reflects premiums received and accrued for in the period and does not include the present value of future cash receipts expected from installment premium policies originated during the period. GPW was \$202 million in the third quarter of 2006, down 9% from the third quarter of 2005. The decrease in GPW resulted from a decline in the volume of U.S. public finance business written compared with the same period in 2005. For the nine months ended September 30, 2006, GPW decreased 17% due to a 30% decline in business written in the U.S.

NPW represents gross premiums written net of premiums ceded to reinsurers. Reinsurance enables the Company to cede exposure and comply with its single risk and credit guidelines, although the Company continues to be primarily liable on the reinsured policies. In the third quarter of 2006, NPW decreased 6% to \$176 million from \$186 million in the third

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quarter of 2005. The decrease in NPW was a result of the decrease in GPW, along with a decrease in premiums ceded to reinsurers. Premiums ceded to reinsurers from all insurance operations were \$26 million or 13% of GPW in the third quarter of 2006 compared with \$35 million or 16% of GPW in the third quarter of 2005. For the nine months ended September 30, 2006, NPW decreased 16% as a result of the decrease in GPW. Premiums ceded to reinsurers for the nine months ended September 30, 2006 were \$78 million or 12% of GPW compared with \$98 million or 13% of GPW in the first nine months of 2005.

Net premiums earned include scheduled premium earnings, as well as premium earnings from refunded issues. Net premiums earned in the third quarter of 2006 of \$212 million increased 4% from \$204 million in the third quarter of 2005. The increase in net premiums earned was due to a 37% increase in refunded premiums earned offset by a 2% decrease in scheduled premiums earned. In the nine months ended September 30, 2006, net premiums earned were \$635 million, a slight increase over the first nine months of 2005 due to a 28% increase in refunded premiums earned offset by a 4% decrease in scheduled premiums earned.

MBIA evaluates the premium rates it charges for insurance guarantees through the use of internal and external rating agency quantitative models. These models assess the Company's premium rates and return on capital results on a risk adjusted basis. In addition, market research data is used to evaluate pricing levels across the financial guarantee industry for comparable risks. The Company's pricing levels indicate continued acceptable levels in overall portfolio profitability, and the Company believes the pricing charged for its insurance products produces results that meet its long-term return on capital targets.

When an MBIA-insured obligation is refunded or retired early, the related remaining deferred premium revenue is earned at that time. The level of refundings and calls is influenced by a variety of factors such as prevailing interest rates, the coupon rate of the issue, the issuer's desire or ability to modify covenants and applicable regulations under the Internal Revenue Code. Additionally, the Company may receive premiums upon the early termination of installment-based policies, which are earned when received and included in premiums from refunded issues.

**CREDIT QUALITY** Financial guarantee companies use a variety of approaches to assess the underlying credit risk profile of their insured portfolios. MBIA uses both an internally developed credit rating system as well as third-party rating sources in the analysis of credit quality measures of its insured portfolio. In evaluating credit risk, the Company obtains, when available, the underlying rating of the insured obligation before the benefit of its insurance policy from one or more nationally recognized rating agencies (Moody's Investors Service, Inc. (Moody's), Standard and Poor's Corporation (S&P) and Fitch, Inc.). All references to insured credit quality distributions contained herein reflect the underlying rating levels from these third-party sources. Other companies within the financial guarantee industry may report credit quality information based upon internal ratings that would not be comparable to MBIA's presentation.

Total net par insured rated A or above, before giving effect to MBIA's guarantee, was 76% for the nine months ended September 30, 2006 compared with 83% for the same period of 2005, reflecting a change in the mix of business written. At September 30, 2006, 81% of the Company's outstanding net par insured was rated A or above before giving effect to MBIA's guarantee, flat with 81% at September 30, 2005.

**GLOBAL PUBLIC FINANCE MARKET** MBIA's premium writings and premium earnings in both the new issue and secondary global public finance markets are shown in the following table:

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|                              | 3rd Quarter |             | Year-to-date |             | Percent Change            |                            |
|------------------------------|-------------|-------------|--------------|-------------|---------------------------|----------------------------|
|                              | 2006        | 2005        | 2006         | 2005        | 3rd Quarter 2006 vs. 2005 | Year-to-date 2006 vs. 2005 |
| <b>Global Public Finance</b> |             |             |              |             |                           |                            |
| <b>In millions</b>           | <b>2006</b> | <b>2005</b> | <b>2006</b>  | <b>2005</b> | <b>2005</b>               | <b>2005</b>                |
| Gross premiums written:      |             |             |              |             |                           |                            |
| U.S.                         | \$ 65       | \$ 90       | \$ 192       | \$ 345      | (28)%                     | (44)%                      |
| Non-U.S.                     | 36          | 28          | 144          | 89          | 26%                       | 63%                        |
| Total                        | \$ 101      | \$ 118      | \$ 336       | \$ 434      | (15)%                     | (23)%                      |
| Net premiums written:        |             |             |              |             |                           |                            |
| U.S.                         | \$ 63       | \$ 90       | \$ 187       | \$ 336      | (30)%                     | (45)%                      |
| Non-U.S.                     | 31          | 14          | 123          | 59          | 123%                      | 109%                       |
| Total                        | \$ 94       | \$ 104      | \$ 310       | \$ 395      | (10)%                     | (22)%                      |
| Net premiums earned:         |             |             |              |             |                           |                            |
| U.S.                         | \$ 102      | \$ 95       | \$ 293       | \$ 291      | 7%                        | 1%                         |
| Non-U.S.                     | 26          | 26          | 89           | 77          | 1%                        | 16%                        |
| Total                        | \$ 128      | \$ 121      | \$ 382       | \$ 368      | 6%                        | 4%                         |

Global public finance GPW decreased 15% to \$101 million in the third quarter of 2006 from \$118 million in the third quarter of 2005. This decrease reflects a 28% decline in U.S. business as overall market issuance was down and fewer large transactions came to market relative to last year. Additionally, there was a significant decline in insured penetration and competition in the bond insurance market has been strong. Offsetting the decrease in U.S. business written was a 26% increase in non-U.S. business due to a larger number of international deals written in the third quarter of 2006 compared with the same period in 2005. NPW decreased 10% to \$94 million in the third quarter of 2006 as a result of the decrease in GPW offset by a decrease in premiums ceded to reinsurers. The overall cession rate for business written during the third quarter of 2006 of 7% was down from 12% compared with the third quarter of 2005. In the third quarter of 2006, global public finance net premiums earned increased 6% to \$128 million from \$121 million in the third quarter of 2005. The increase in net premiums earned principally resulted from a 33% increase in refunded premiums earned from U.S. business written in prior periods.

For the nine months ended September 30, 2006, global public finance GPW decreased 23% compared with the same period in 2005. This decrease was due to a 44% decline in U.S. business written resulting from weak market conditions and strong competition, partially offset by a 63% increase in non-U.S. business written as a result of two significant international transactions that closed in the second quarter of 2006. Global public finance NPW decreased 22% in the first nine months of 2006 compared with the first nine months of 2005 as a result of the decrease in GPW. The cession rate in the first nine months of 2006 of 8% decreased slightly compared with 9% for the same period in 2005. In the first nine months of 2006, global public finance net premiums earned increased 4% to \$382 million from \$368 million in the first nine months of 2005, driven primarily by increased levels of refunded premiums earned from U.S. and non-U.S. business written in prior periods.

The average credit quality of global public finance net par insured by the Company in 2006 declined compared with 2005. Net par insured rated A or above, before giving effect to the Company's guarantee, represented 82% of global public finance business written in the first nine months of 2006 compared with 91% for the same period in 2005. During 2006, a higher percentage of business was written in sectors that typically have a lower credit quality rating. At September 30, 2006 and 2005, 82% of the outstanding global public finance net par insured was rated A or above before the Company's guarantee.

GLOBAL STRUCTURED FINANCE MARKET MBIA's premium writings and premium earnings in both the new issue and secondary global structured finance markets are shown in the following table:



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|                                  | 3rd Quarter |             | Year-to-date |             | Percent Change                     |                                     |
|----------------------------------|-------------|-------------|--------------|-------------|------------------------------------|-------------------------------------|
|                                  | 2006        | 2005        | 2006         | 2005        | 3rd Quarter<br>2006<br>vs.<br>2005 | Year-to-date<br>2006<br>vs.<br>2005 |
| <b>Global Structured Finance</b> |             |             |              |             |                                    |                                     |
| <b>In millions</b>               | <b>2006</b> | <b>2005</b> | <b>2006</b>  | <b>2005</b> | <b>2005</b>                        | <b>2005</b>                         |
| Gross premiums written:          |             |             |              |             |                                    |                                     |
| U.S.                             | \$ 68       | \$ 64       | \$ 191       | \$ 198      | 6%                                 | (4)%                                |
| Non-U.S.                         | 33          | 39          | 100          | 121         | (13)%                              | (17)%                               |
| Total                            | \$ 101      | \$ 103      | \$ 291       | \$ 319      | (1)%                               | (9)%                                |
| Net premiums written:            |             |             |              |             |                                    |                                     |
| U.S.                             | \$ 57       | \$ 54       | \$ 162       | \$ 171      | 3%                                 | (5)%                                |
| Non-U.S.                         | 25          | 28          | 77           | 88          | (8)%                               | (13)%                               |
| Total                            | \$ 82       | \$ 82       | \$ 239       | \$ 259      | (1)%                               | (8)%                                |
| Net premiums earned:             |             |             |              |             |                                    |                                     |
| U.S.                             | \$ 57       | \$ 56       | \$ 167       | \$ 173      | 2%                                 | (3)%                                |
| Non-U.S.                         | 27          | 27          | 86           | 87          | 1%                                 | (2)%                                |
| Total                            | \$ 84       | \$ 83       | \$ 253       | \$ 260      | 1%                                 | (3)%                                |

Global structured finance GPW decreased 1% in the third quarter of 2006 to \$101 million from \$103 million in the third quarter of 2005 as a result of decreases in non-U.S. business written. In the third quarter of 2006, global structured finance NPW decreased 1% due to the decrease in GPW. The overall cession rate for business written during the third quarter of 2006 and 2005 was 19%. In the third quarter of 2006, global structured finance net premiums earned of \$84 million were 1% above the third quarter of 2005. Growth in net premiums earned has been adversely impacted by maturities and early terminations of previously written business.

Global structured finance GPW decreased 9% in the first nine months of 2006 to \$291 million from \$319 million in the first nine months of 2005 as a result of decreases in U.S. and non-U.S. business written. The global structured finance sector continues to be adversely impacted by increased competition, tight spreads and greater investor demand for uninsured transactions. Global structured finance NPW for the first nine months of 2006 decreased 8% due to the decrease in GPW, offset by a lower cession rate of 18% in the first nine months of 2006 compared with 19% in the same period of 2005. In the first nine months of 2006, global structured finance net premiums earned of \$253 million were 3% below the first nine months of 2005 due to a \$14 million decrease in scheduled net premiums earned from U.S. and non-U.S. business.

The credit quality of MBIA's global structured finance net par insured rated A or above, before giving effect to the Company's guarantee, was 70% in the first nine months of 2006, down from 72% in the same period of 2005. At September 30, 2006 and 2005, 78% of the outstanding global structured finance net par insured was rated A or above before giving effect to the Company's guarantee.

INVESTMENT INCOME The Company's insurance-related net investment income and ending asset balances at amortized cost for the third quarter and first nine months of 2006 and 2005 are presented in the following table:

| In millions    | 3rd Quarter |        | Year-to-date |        | Percent Change               |                               |
|----------------|-------------|--------|--------------|--------|------------------------------|-------------------------------|
|                | 2006        | 2005   | 2006         | 2005   | 3rd Quarter<br>2006 vs. 2005 | Year-to-date<br>2006 vs. 2005 |
| Pre-tax income | \$ 164      | \$ 130 | \$ 449       | \$ 379 | 27%                          | 18%                           |

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|   |        |        |           |           |     |     |
|---|--------|--------|-----------|-----------|-----|-----|
| After-tax income                        | \$ 126 | \$ 103 | \$ 349    | \$ 300    | 23% | 17% |
| Ending asset balances at amortized cost |        |        | \$ 11,951 | \$ 10,609 |     | 13% |

The Company's insurance-related pre-tax net investment income, excluding net realized gains and losses, of \$164 million in the third quarter of 2006 and \$449 million in the first nine months of 2006 increased 27% and 18%, respectively, compared with the same periods of 2005. After-tax net investment income of \$126 million in the third quarter of 2006 and \$349 million in the first nine months of 2006 increased 23% and 17%, respectively, compared with the same periods of 2005.

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Growth in pre-tax net investment income in the third quarter and first nine months of 2006 reflects an increase in consolidated VIE interest income of \$7 million and \$24 million, respectively. VIE interest income is generated from interest bearing assets held by such entities and supports the payment of VIE interest expense on debt issued by these entities. Additionally, third quarter 2006 pre-tax net investment income also included \$13 million related to Northwest Airlines' enhanced equipment trust certificates that the Company received in connection with a remediation and \$6 million related to non-recurring interest received on reimbursed expenses with no comparable amounts recorded in the third quarter of 2005. See the Risk Management section for additional information on the Northwest Airlines' enhanced equipment trust certificates.

Excluding VIE and Northwest Airlines' enhanced equipment trust certificates interest income and non-recurring interest received on reimbursed expenses, insurance-related net investment income increased 6% and 7% on a pre-tax and after-tax basis, respectively, in the first nine months of 2006 compared with the first nine months of 2005. These increases were attributable to growth in average invested assets as a result of premium receipts and slightly higher average investment yields. Ending asset balances at amortized cost, excluding VIE and Northwest Airlines' enhanced equipment trust certificates assets, were \$10,261 million and \$9,809 million at September 30, 2006 and 2005, respectively. Tax-exempt investments represented 52% and 54% of ending asset balances, excluding VIE and Northwest Airlines' enhanced equipment trust certificates assets, at September 30, 2006 and 2005, respectively.

**FEES AND REIMBURSEMENTS** The Company collects fees for services performed in connection with certain transactions. In addition, the Company may be entitled to reimbursement of third-party expenses that it incurs in connection with certain transactions. Depending upon the type of fee received and whether it is related to an insurance policy, the fee is either earned when it is due or deferred and earned over the life of the related transaction. Work, waiver and consent, termination, administrative and management fees are earned when the related services are completed. Structuring fees are earned on a straight-line basis over the life of the related insurance policy and commitment fees are earned on a straight-line basis over the commitment period. Expense reimbursements are earned when received.

Fee and reimbursement revenues increased 79% to \$17 million in the third quarter of 2006 from \$10 million in the third quarter of 2005. In the nine months ended September 30, 2006, fee and reimbursement revenues increased 45% to \$29 million from \$20 million in the same period of 2005. The increase in the third quarter and nine months ended September 30, 2006 was principally driven by an increase in loss prevention expense reimbursements. Due to the transaction-specific nature inherent in fees and reimbursements, these revenues can vary significantly from period to period.

**NET GAINS AND LOSSES** Net realized gains in the insurance operations were \$4 million in the third quarter of 2006 compared with net realized losses of \$8 million in the third quarter of 2005. In the nine months ended September 30, 2006, net realized gains in the insurance operations were \$14 million compared with net realized losses of \$6 million in the same period of 2005. Net realized gains and losses are largely due to sales of investment securities, including the sale of the Company's investment in Ram Re Holdings, Inc., the holding company of Ram Reinsurance Company, Ltd., which generated an \$11 million gain in the second quarter of 2006. Additionally, net realized gains include a \$14 million impairment loss recorded on a salvage receivable in the first quarter of 2006.

Net losses on derivative instruments and foreign exchange in the insurance operations, which typically represent changes in the market value of the Company's insured credit derivative portfolio, were \$5 million in the third quarter of 2006 compared with net gains of \$2 million in the third quarter of 2005. Net losses in the third quarter of 2006 primarily resulted from the reversal of derivative gains on contracts that terminated. For the nine months ended September 30, 2006 and 2005, net gains on derivative instruments and foreign exchange in the insurance operations were \$1 million.

**LOSSES AND LOSS ADJUSTMENT EXPENSES (LAE)** The following table shows the case-specific, reinsurance recoverable and unallocated components of the Company's total loss and LAE reserves at the end of the third quarter of 2006 and 2005, as well as its loss provision and case basis activity for the first nine months of 2006 and 2005.

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| In millions                              | September 30, |        | Percent Change |
|--|---------------|--------|----------------|
|  | 2006          | 2005   | 2006 vs. 2005  |
| <b>Case-specific:</b>                    |               |        |                |
| Gross                                    | \$ 466        | \$ 425 | 10%            |
| Reinsurance recoverable on unpaid losses | 47            | 46     | 3%             |
| <b>Net case reserves</b>                 |               |        |                |
| Unallocated                              | \$ 419        | \$ 379 | 11%            |
|  | 259           | 287    | (10)%          |
| <b>Net loss and LAE reserves</b>         |               |        |                |
|  | \$ 678        | \$ 666 | 2%             |
| <b>Gross loss and LAE reserves</b>       |               |        |                |
|  | \$ 725        | \$ 711 | 2%             |
| <b>Losses and LAE</b>                    |               |        |                |
|  | \$ 61         | \$ 63  | (4)%           |
| <b>Case basis activity</b>               |               |        |                |
|  | \$ 9          | \$ 89  | (90)%          |

The Company recorded \$61 million in losses and LAE in the first nine months of 2006, down from \$63 million in the first nine months of 2005. The variance in losses and LAE corresponds to the decrease in scheduled net earned premium, as scheduled net earned premium is the base upon which the Company's 12% loss factor is applied. At September 30, 2006, the Company had \$259 million in unallocated loss reserves, which represent the Company's estimate of losses associated with credit deterioration that have occurred in the Company's insured portfolio but have not been specifically identified and are available for future case-specific activity.

During the nine months ended September 30, 2006, total net case basis activity transferred from the Company's unallocated loss reserve was \$9 million compared with \$89 million during the same period in 2005. Net case basis activity during 2006 consisted of loss reserves for insured obligations within the CDO, equipment lease pools and home equity loan sectors, MBIA's guaranteed tax lien portfolio and insured obligations issued by Allegheny Health, Education and Research Foundation (AHERF). Largely offsetting these loss reserves were reversals of previously established case basis reserves within the aircraft enhanced equipment trust certificates (EETCs) and manufactured housing sectors. Net case basis activity during 2005 primarily consisted of loss reserves related to insured obligations within the collateralized debt obligation, manufactured housing and mortgage-backed sectors and within MBIA's guaranteed tax lien portfolios.

During the second quarter of 2006, the Company reduced its previously established case loss reserves relating to insured EETCs secured by aircraft financed by Northwest Airlines primarily as a result of claim payments it made, the sale of unsecured claims against Northwest Airlines, which provided unanticipated proceeds, the sale of selected collateral (aircraft) from one of the securitizations and an agreement to sell collateral from another securitization. The reduction of these case loss reserves, net of claim payments and salvage receipts, contributed \$57 million to the Company's unallocated loss reserve. Partially offsetting the reduction in case loss reserves in the second quarter of 2006 was a \$32 million increase to a case loss reserve related to a static multi-sector CDO transaction.

MBIA continues to closely monitor the manufactured housing sector, which has experienced continued stress during the last several years. MBIA ceased writing business in this sector in 2000, other than through certain MBIA-insured CDO transactions. At September 30, 2006, the Company had \$21 million in case basis reserves, net of reinsurance, covering net insured par outstanding of \$530 million on three different transactions within the manufactured housing sector. The Company had additional manufactured housing exposure of \$1.7 billion in net insured par outstanding as of September 30, 2006, of which approximately 35% has been placed on the Company's Caution List-Medium and Caution List-High. An explanation of the Company's Classified List and Caution Lists is provided below.

The Company has significant exposures in its insured portfolio relating to regions impacted by Hurricane Katrina. Insured credits in these regions encompass various types of sectors, including general obligation bonds, tax-backed, healthcare, transportation and higher education, among others. The Company is continuing its communication with issuers, trustees and relevant state officials to evaluate the actual and potential impact that the hurricane may have on its insured credits. During the second quarter of 2006, the Company paid a \$6 million claim relating to an issuer affected by Hurricane Katrina, for which a reimbursement was received in the fourth quarter of 2006. At September 30, 2006, MBIA's exposure to this issuer was \$24.1 million in net insured par outstanding.

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In July 2006, Eurotunnel petitioned for protection under the Paris commercial court for a safeguard procedure, a new procedure under French law with limited similarities to a U.S. Chapter 11 reorganization. At an August 2, 2006 hearing, the

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commercial court granted Eurotunnel protection under the safeguard procedure. Debt restructuring talks are ongoing and MBIA continues to work with the creditors committee toward a consensual restructuring plan to be approved by all Eurotunnel stakeholders. At September 30, 2006, MBIA had approximately \$1.5 billion of net par outstanding related to insured Eurotunnel debt obligations. During the third quarter of 2006, MBIA made a \$0.9 million claim payment related to Eurotunnel, for which it expects to be fully reimbursed. The Company believes that it will not incur an ultimate loss on its Eurotunnel exposure and, therefore, has not established a case loss reserve for this credit.

In October 2006, MBIA exercised a call right with respect to MBIA-insured notes issued by a 2000 vintage static multi-sector CDO in order to reduce future interest costs under its guarantee. Under the terms of the trust agreement, MBIA had the right to call the notes at par as a result of the occurrence of an event of default. In connection with its call of the notes, in October 2006 the Company made a claim payment of \$177 million representing the insured outstanding principal, the proceeds of which were used by the trustee to repay the insured notes. The payment, net of estimated salvage, will be applied against MBIA's existing case basis reserve for this transaction. MBIA did not record additional case basis losses in the third quarter of 2006 for this transaction.

MBIA's Insured Portfolio Management (IPM) Division is responsible for monitoring MBIA insured issues. The level and frequency of MBIA's monitoring of any insured issue depends on the type, size, rating and performance of the insured issue. If IPM identifies concerns with respect to the performance of an insured issue it may designate such insured issue as Caution List-Low, Caution List-Medium or Caution List-High. The designation of any insured issue as Caution List-Medium or Caution List-High is based on the nature and extent of these concerns and requires that increased monitoring and, if needed, a remediation plan be implemented for the related insured issue.

In the event MBIA determines that it must pay a claim or that a claim is probable and estimable with respect to an insured issue, it places the issue on its Classified List and establishes a case basis reserve for that insured issue. As of September 30, 2006, MBIA had 41 open case basis issues on its Classified List that had \$419 million in aggregate case reserves, net of reinsurance. The Company does not establish any case basis reserves for issues that are listed as Caution List-Low, Caution List-Medium or Caution List-High until such issues are placed on the Company's Classified List.

Included in the Company's case basis reserves are both loss reserves for insured obligations for which a payment default has occurred and MBIA has already paid a claim and also for which a payment default has not yet occurred but a claim is probable and estimable in the future. At September 30, 2006, case basis reserves were comprised of the following:

| <b>Dollars in millions</b>   | <b>Number of Case<br/>Basis Issues</b> | <b>Loss<br/>Reserve</b> | <b>Par<br/>Outstanding</b> |
|------------------------------|--|-------------------------|----------------------------|
| <b>Gross of reinsurance:</b> |  |                         |                            |
| Issues with defaults         | 34                                     | \$ 430                  | \$ 2,743                   |
| Issues without defaults      | 7                                      | 36                      | 633                        |
| Total gross                  | 41                                     | \$ 466                  | \$ 3,376                   |
| <b>Net of reinsurance:</b>   |  |                         |                            |
| Issues with defaults         | 34                                     | \$ 405                  | \$ 2,340                   |
| Issues without defaults      | 7                                      | 14                      | 569                        |
| Total net                    | 41                                     | \$ 419                  | \$ 2,909                   |

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When MBIA becomes entitled to the underlying collateral or to a reimbursement of an insured credit under salvage and subrogation rights as a result of having paid a claim, it records the related salvage and subrogation as an asset. Such amounts are included in the Company's balance sheet within Other assets. As of September 30, 2006 and December 31, 2005, the Company had salvage and subrogation of \$96 million and \$143 million, respectively. The decrease in salvage and subrogation principally resulted from amounts collected during the third quarter of 2006. The amount recorded as salvage and subrogation may be influenced by several factors during any period, such as the level of claim payments made for which the Company is entitled to reimbursements, amounts collected and impairment write-downs.

As a result of discussions in January and February 2005 between the SEC staff and several financial guarantee industry participants, including MBIA, the Financial Accounting Standards Board (FASB) staff is considering whether additional guidance with respect to accounting for financial guarantee insurance should be provided. In June 2005, the FASB decided to add to its agenda a project to consider the accounting by insurers for financial guarantee insurance. As part of this project, the FASB is considering several aspects of the insurance accounting model for financial guarantee insurers, including claims liability recognition, premium recognition and the related amortization of

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deferred policy acquisition costs. When the FASB or the SEC reaches a conclusion on this issue, the Company and its financial guarantor peers may be required to change some aspects of its loss reserving policies and the potential changes could extend to premium and expense recognition. The FASB is expected to issue proposed guidance in the fourth quarter of 2006 and final guidance in 2007. The Company cannot currently assess how the FASB and SEC staff's ultimate resolution of this issue will impact its loss reserving policy or the effect it might have on recognizing premium revenue and policy acquisition costs. Until the issue is resolved, the Company intends to continue to apply its existing policies with respect to the establishment of both case basis and unallocated loss reserves and the recognition of premium revenue and policy acquisition costs. A description of the Company's loss reserving policy is included in Note 3: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2005.

**RISK MANAGEMENT** In an effort to mitigate losses, MBIA is regularly involved in the ongoing remediation of credits that may involve, among other things, waivers or renegotiations of financial covenants or triggers, waivers of contractual provisions, the granting of consents, and the taking of various other remedial actions. The nature of any remedial action is based on the type of the insured issue and the nature and scope of the event giving rise to the remediation. In most cases, as part of any such remedial activity, MBIA is able to improve its security position and to obtain concessions from the issuer of the insured bonds. From time to time, the issuer of an MBIA-insured obligation may, with the consent of MBIA, restructure the insured obligation by extending the term, increasing or decreasing the par amount or decreasing the related interest rate with MBIA insuring the restructured obligation. If, as the result of the restructuring, MBIA estimates that it will suffer an ultimate loss on the restructured obligation, MBIA will record a case basis loss reserve for the restructured obligation or, if it has already recorded a case basis loss reserve, it will re-evaluate the impact of the restructuring on the recorded reserve and adjust the amount of the reserve as appropriate.

In the first quarter of 2006 and in connection with its remediation efforts, MBIA exercised a call right with respect to \$411 million of MBIA-insured Northwest Airlines' enhanced equipment trust certificates issued by Northwest Airlines Pass Through Trust 2000-1G (the Certificates). Under the terms of the trust agreement relating to the Certificates, MBIA had the right to call the Certificates at par as a result of the bankruptcy filing by Northwest Airlines. MBIA entered into an agreement with a third party under which the third party financed the call of the Certificates and purchased the Certificates from MBIA as part of a planned future securitization of the Certificates. MBIA's insurance policy guaranteeing payment of the Certificates remains in effect.

Due to certain continuing rights MBIA possesses with respect to the Certificates, MBIA recorded the Certificates and the related financing on its balance sheet under the requirements of SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The Certificates are included within Short-term investments and the related financing is included within Payable for investments purchased on the Company's Consolidated Balance Sheets. During the third quarter of 2006, the carrying value of the Certificates and the related financing was \$260 million as a result of principal payments associated with the sale of certain aircraft collateralizing the Certificates. At such time that MBIA no longer possesses its continuing rights with respect to the Certificates, including the potential completion of a securitization of the Certificates, the Certificates and the related financing are expected to no longer be recorded on the Company's Consolidated Balance Sheets.

**REINSURANCE** Reinsurance enables the Company to cede exposure for purposes of increasing its capacity to write new business while complying with its single risk and credit guidelines. The rating agencies continuously review reinsurers providing coverage to the financial guarantee industry. When a reinsurer is downgraded, less capital credit is given to a financial guarantee provider under rating agency models. Over the past several years, most of MBIA's reinsurers have been downgraded and others remain under review. Any reduced capital credit associated with reinsurer downgrades has not and is not expected to have a material adverse effect on the Company. The Company generally retains the right to reassume the business ceded to reinsurers under certain circumstances, including rating downgrades of its reinsurers. The Company also remains liable on a primary basis for all reinsured risk, and although MBIA believes that its reinsurers remain capable of meeting their obligations, there can be no assurance of such in the future.

As of September 30, 2006, the aggregate amount of insured par ceded by MBIA to reinsurers under reinsurance agreements was \$69 billion. Additionally, the Company has other reimbursement agreements not accounted for as reinsurance, primarily with a Single-A rated reinsurer, covering \$6 billion of insured par. The following table displays the percentage ceded to and reinsurance recoverable from reinsurers by rating levels:



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|  | Standard & Poor's | Moody's     | Percentage of   | Reinsurers     | Recoverable   |
|--|-------------------|-------------|-----------------|----------------|---------------|
| Reinsurers                                     | Rating            | Rating      | Total Par Ceded | (in thousands) |               |
| Channel Reinsurance Ltd.                       | AAA               | Aaa         | 46.78%          | \$             | 5,681         |
| Assured Guaranty Corp.                         | AAA               | Aa1         | 15.93           |                | 13,282        |
| Ram Reinsurance Company, Ltd.                  | AAA               | Aa3         | 12.69           |                | 950           |
| Ambac Assurance Corporation                    | AAA               | Aaa         | 8.61            |                |               |
| Mitsui Sumitomo Insurance Company Ltd.         | AA-               | Aa3         | 6.23            |                | 48            |
| Swiss Reinsurance Company, Zurich, Switzerland | AA-               | Aa2         | 3.19            |                |               |
| Radian Asset Assurance Inc.                    | AA                | Aa3         | 1.59            |                | 8,134         |
| Assured Guaranty Re Ltd.                       | AA                | Aa2         | 0.81            |                |               |
| Sompo Japan Insurance Inc.                     | AA-               | Aa3         | 0.72            |                | 36            |
| Export Development Canada                      | AAA               | Aaa         | 0.61            |                |               |
| Transatlantic Reinsurance Company              | AA-               | Aa3         | 0.57            |                | 1,648         |
| Other <sup>(1)</sup>                           | A or above        | A1 or above | 2.20            |                | 16,942        |
| Not Currently Rated                            |                   |             | 0.07            |                | 281           |
| <b>Total</b>                                   |                   |             | <b>100.00%</b>  | <b>\$</b>      | <b>47,002</b> |

<sup>(1)</sup> Several reinsurers within this category are not rated by Moody's.

While Channel Reinsurance Ltd. (Channel Re) continues to be a Triple-A rated reinsurer of MBIA, S&P reaffirmed its negative outlook on Channel Re during the second quarter of 2006. MBIA does not expect S&P's outlook on Channel Re to have a material negative impact on the Company's financial condition or results of operations.

In May 2006, MBIA sold its 11.4% equity interest in Ram Holdings Inc., the holding company of Ram Reinsurance Company, Ltd., as part of Ram Holdings Inc.'s initial public offering. MBIA continues to own a 17.4% equity interest in Channel Re.

**POLICY ACQUISITION COSTS AND OPERATING EXPENSES** Expenses that vary with and are primarily related to the production of the Company's insurance business (policy acquisition costs) are deferred and recognized over the period in which the related premiums are earned. If an MBIA insured obligation is refunded and the related premium is earned early, the associated acquisition costs previously deferred are also recognized early.

The Company's insurance expenses, as well as its expense ratio, are shown in the following table:

|             | 3rd Quarter |      | Year-to-date |      | Percent Change   |                   |
|-------------|-------------|------|--------------|------|------------------|-------------------|
|             |             |      |              |      | 3rd Quarter 2006 | Year-to-date 2006 |
|             |             |      |              | vs.  | vs.              |                   |
| In millions | 2006        | 2005 | 2006         | 2005 | 2005             | 2005              |
|             |             |      |              |      |                  |                   |

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|  |       |       |        |        |      |      |
|--|-------|-------|--------|--------|------|------|
| Gross expenses                             | \$ 64 | \$ 65 | \$ 190 | \$ 195 | (3)% | (3)% |
| Amortization of deferred acquisition costs | \$ 17 | \$ 16 | \$ 50  | \$ 50  | 4%   | 1%   |
| Operating expenses                         | 37    | 39    | 110    | 100    | (4)% | 10%  |
| Total insurance operating expenses         | \$ 54 | \$ 55 | \$ 160 | \$ 150 | (2)% | 7%   |
| Expense ratio                              | 25.5% | 27.0% | 25.2%  | 23.9%  |      |      |

In the third quarter of 2006, the amortization of deferred acquisition costs increased 4% compared with the third quarter of 2005, in line with the increase in insurance premiums earned. Since December 31, 2004, there has been an increase in the ratio of deferred expenses carried as assets on the balance sheet to deferred revenues carried as liabilities on the balance sheet plus the present value of future installment premiums. The increasing ratio reflects higher costs associated with acquiring new policies and a decrease in deferred premiums. Operating expenses decreased 4% to \$37 million in the third quarter of 2006 from \$39 million in the third quarter of 2005. This decrease was largely due to a reduction in loss prevention costs.

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In the nine months ended September 30 2006, the amortization of deferred acquisition costs increased slightly compared with the same period of 2005, in line with the increase in insurance premiums earned. Operating expenses increased 10% to \$110 million in the nine months ended September 30, 2006 from \$100 million in the same period of 2005. The increase in operating expenses was principally due to a decrease in the rate at which compensation costs are deferred as policy acquisition costs.

Financial guarantee insurance companies use the expense ratio (amortization of deferred acquisition costs and operating expenses divided by net premiums earned) as a measure of expense management. The Company's expense ratio for the third quarter of 2006 of 25.5% was lower than the ratio for the third quarter of 2005 of 27.0% due to the decrease in operating expenses in 2006. For the nine months ended September 30, 2006, the Company's expense ratio of 25.2% increased from 23.9% for the nine months ended September 30, 2005 due to higher operating expenses in 2006.

**INTEREST EXPENSE** Interest expense from MBIA's insurance operations, which primarily consists of interest related to debt issued by consolidated VIEs, the financing of the Northwest Airlines Pass Through Trust 2000-1G certificates and agreements accounted for as deposits, increased to \$22 million in the third quarter of 2006 from \$8 million in the third quarter of 2005. The increase primarily resulted from additional VIEs being consolidated by the Company during 2005 and the financing of the Northwest Airlines Pass Through Trust 2000-1G certificates in 2006. Interest expense related to consolidated VIEs was \$15 million and \$7 million in the third quarters of 2006 and 2005, respectively. For the nine months ended September 30, 2006, interest expense from MBIA's insurance operations increased to \$54 million from \$20 million in the same period of 2005. The increase primarily related to a \$23 million increase in VIE interest expense and \$10 million of interest expense related to the financing of the Northwest Airlines Pass Through Trust 2000-1G certificates. Interest expense related to consolidated VIEs was \$40 million and \$17 million in the nine months ended September 30, 2006 and 2005, respectively.

**VARIABLE INTEREST ENTITIES** The Company provides structured funding and credit enhancement services to global finance clients through the use of certain MBIA-administered, bankruptcy-remote special purpose vehicles (SPVs) and through third-party SPVs, of which certain third-party SPVs are consolidated within the financial statements of the Company. Third-party SPVs are used in a variety of structures guaranteed or managed by MBIA, whereby the Company has risks analogous to those of MBIA-administered SPVs. The Company has determined that such SPVs fall within the definition of a VIE under FIN 46(R), Consolidation of Variable Interest Entities (Revised). Under the provisions of FIN 46(R), MBIA must determine whether it has a variable interest in a VIE and if so, whether that variable interest would cause MBIA to be the primary beneficiary. The primary beneficiary is the entity that will absorb the majority of the expected losses, receive the majority of the expected residual returns, or both, of the VIE and is required to consolidate the VIE.

In the third quarter of 2004, the Company began consolidating two VIEs established in connection with the Capital Asset Research Funding Series 1997A and Series 1998A tax lien securitizations to which the Company provided financial guarantees. The assets of these entities, which are principally reported within Other assets on the Company's Consolidated Balance Sheets, totaled \$1.0 million at September 30, 2006 and \$2.5 million at December 31, 2005. Liabilities of the securitizations substantially represented amounts due to MBIA, which were eliminated in consolidation. Additionally, the Company consolidates certain third-party VIEs as a result of financial guarantees provided by the insurance operations. Third-party VIE assets and liabilities are primarily reported in Investments held-to-maturity and Variable interest entity floating rate notes, respectively, on the Company's Consolidated Balance Sheets. The assets and liabilities of these VIEs each totaled \$1.5 billion at September 30, 2006 and \$1.3 billion at December 31, 2005. Consolidation of such VIEs does not increase MBIA's exposure above that already committed to in its insurance policies.

**INVESTMENT MANAGEMENT SERVICES**

The Company's investment management services operations provide an array of products and services to the public, not-for-profit and corporate sectors. Such products and services are provided primarily through wholly owned subsidiaries of MBIA Asset Management, LLC (MBIA-AML) and include cash management, discretionary asset management and fund administration services and investment agreement, medium-term note and commercial paper programs related to funding assets for third-party clients and for investment purposes. The investment management services operations are comprised of three operating segments: asset/liability products, which include investment agreements and medium-term notes (MTNs) not related to the conduit programs; advisory services, which consist of third-party and related-party fee-based asset management;

and conduits.

In the third quarter of 2006, investment management services revenues of \$314 million increased 17% compared with the third quarter of 2005. Excluding realized gains and losses from investment securities and gains and losses on derivative

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instruments and foreign exchange, revenues of \$309 million increased 37% compared with the third quarter of 2005. For the nine months ended September 30, 2006, total revenues of \$875 million increased 32% over the same period in 2005. Excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, revenues of \$861 million increased 39% over the nine months ended September 30, 2005. The increases in revenues for the three and nine months ended September 30, 2006 were driven by growth in the asset/liability products and advisory segments. Revenues in the asset/liability products segment were favorably impacted by volume growth in investment agreements and MTNs. The advisory services segment revenues were favorable due to growth in assets under management, particularly in cash management products due to higher interest rates in 2006. Conduit segment revenues decreased in the quarter primarily due to a decline in investment income resulting from deal run-off. Conduit segment revenues increased for the nine months ended September 30, 2006 due to the impact of higher interest rates on conduit interest rate swaps that pay a fixed rate and receive a floating rate, partially offset by a decline in investment income resulting from deal run-off. Total investment management services expenses in the third quarter of 2006 were \$283 million, up 40% compared with the third quarter of 2005. For the nine months ended September 30, 2006, total expenses of \$785 million increased by 42% compared with the same period of 2005. The increases in expenses for the three and nine months ended September 30, 2006 were primarily driven by higher interest expense in asset/liability products, consistent with the increase in interest revenues, and the impact of higher interest rates on conduit floating rate debt, which was offset by the increase in interest revenues on swaps.

Net realized gains from investment securities in the investment management services operations were \$0.4 million in the third quarter of 2006 compared with net realized gains of \$1.3 million in the third quarter of 2005. For the nine months ended September 30, 2006, net realized gains were \$5 million compared with net realized gains of \$3 million in the same period of 2005. Net realized gains and losses are generated from the ongoing management of the investment portfolios.

Net gains on derivative instruments and foreign exchange from the investment management services operations in the third quarter of 2006 were \$5 million compared with net gains of \$42 million in the third quarter of 2005. Of the \$42 million net gains recorded in the third quarter of 2005, \$30 million resulted from the restatement of contracts that did not meet certain technical requirements of short-cut method hedge accounting and could not be treated as part of hedging relationships. In the fourth quarter of 2005, these contracts were redesignated as accounting hedges and, as a result, their income statement volatility has been substantially reduced. For the nine months ended September 30, 2006, net gains on derivative instruments and foreign exchange were \$9 million compared with net gains of \$42 million for the nine months ended September 30, 2005.

Fixed-income ending assets under management as of September 30, 2006, excluding conduit assets, were \$55 billion, 24% above the 2005 year-end level and the September 30, 2005 level. Conduit assets totaled \$3.7 billion. Conduit assets are held to their contractual maturities and are originated and managed differently from those held as available-for-sale by the Company or those managed for third parties. The following table summarizes the consolidated investment management services results and assets under management, excluding conduit assets, for the third quarter and first nine months of 2006 and 2005:

| In millions   | 3rd Quarter |        | Year-to-date |        | Percent Change               |                               |
|---|-------------|--------|--------------|--------|------------------------------|-------------------------------|
|   | 2006        | 2005   | 2006         | 2005   | 3rd Quarter<br>2006 vs. 2005 | Year-to-date<br>2006 vs. 2005 |
| Interest and fees   | \$ 309      | \$ 226 | \$ 861       | \$ 618 | 37%                          | 39%                           |
| Net realized gains (losses)                                       |             | 1      | 5            | 3      | (72)%                        | 86%                           |
| Net gains (losses) on derivative instruments and foreign exchange | 5           | 42     | 9            | 42     | (87)%                        | (79)%                         |
| Total revenues  | 314         | 269    | 875          | 663    | 17%                          | 32%                           |
| Interest expense  | 264         | 185    | 730          | 501    | 43%                          | 46%                           |
| Operating expenses  | 19          | 18     | 55           | 52     | 4%                           | 6%                            |

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|  |       |       |           |           |       |       |
|--|-------|-------|-----------|-----------|-------|-------|
| Total expenses                         | 283   | 203   | 785       | 553       | 40%   | 42%   |
| Pre-tax income                         | \$ 31 | \$ 66 | \$ 90     | \$ 110    | (52)% | (19)% |
| <b>Ending assets under management:</b> |       |       |           |           |       |       |
| Fixed-income                           |       |       | \$ 55,036 | \$ 44,289 |       | 24%   |

The following provides a summary of each of the investment management services businesses by segment.

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Asset/liability products pre-tax income, excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, totaled \$18 million in the third quarter of 2006, up 23% compared with the third quarter of 2005. For the nine months ended September 30, 2006, asset/liability products pre-tax income of \$50 million, excluding gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, increased 23% compared with the same period of 2005. At September 30, 2006, principal and accrued interest outstanding on investment agreement and medium-term note obligations and securities sold under agreements to repurchase totaled \$18.8 billion compared with \$15.7 billion at December 31, 2005. Assets supporting these agreements had market values of \$19.0 billion and \$15.9 billion at September 30, 2006 and December 31, 2005, respectively. These assets are comprised of high-quality securities with an average credit quality rating of Double-A.

Advisory services pre-tax income, excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, totaled \$6 million in the third quarter of 2006, up 9% compared with the third quarter of 2005. For the nine months ended September 30, 2006, advisory services pre-tax income of \$17 million, excluding gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, increased 6% over 2005. Third-party ending assets under management were \$25.2 billion and \$17.9 billion at September 30, 2006 and December 31, 2005, respectively. The market values of assets related to the Company's insurance and corporate investment portfolios managed by the investment management services operations at September 30, 2006 were \$10.6 billion, up from \$10.2 billion at December 31, 2005.

Conduit program pre-tax income, excluding gains and losses on derivative instruments and foreign exchange, totaled \$2 million in the third quarter of 2006 compared with \$3 million in the third quarter of 2005. For the nine months ended September 30, 2006, conduit program pre-tax income of \$8 million, excluding gains and losses on derivative instruments and foreign exchange, was down 8% compared to 2005 due to deal run-off. Certain of MBIA's consolidated subsidiaries have invested in MBIA's conduit debt obligations or have received compensation for services provided to MBIA's conduits. As such, MBIA has eliminated intercompany transactions with its conduits from its balance sheet and income statement. After the elimination of such intercompany assets and liabilities, conduit investments and conduit debt obligations were \$3.6 billion and \$3.5 billion, respectively, at September 30, 2006. The difference between the investments and debt obligations is primarily the result of the elimination of conduit debt owned by other MBIA subsidiaries. The effect of the elimination on the Company's consolidated balance sheet is a reduction of fixed-maturity investments, representing investments in conduit medium-term notes by other MBIA subsidiaries, with a corresponding reduction of conduit medium-term notes.

In October 2005, Moody's announced that it is undertaking a review of the non-core activities of financial guaranty insurance companies in order to assess the impact of such activities on the overall credit profile of financial guarantors. In its announcement, Moody's identified non-core activities as including investment management and related services and sponsored medium-term note programs. While Moody's acknowledged that well managed non-core activities can provide certain benefits, it asserted that such activities introduce distinct risks that may contribute to stress at financial guaranty insurance companies. Moody's also noted that significant growth in non-core activities could negatively impact the credit ratings assigned to affected financial guarantors if such growth occurred prior to publishing its findings. Moody's expects to publish a report highlighting its findings upon completion of its review. While MBIA has had discussions with Moody's with respect to its review, the Company cannot predict with certainty the outcome of the review or the effect the outcome will have on MBIA. However, MBIA does not anticipate that the outcome of the review will have a material impact on the Company's ability to grow its investment management services operations.

**CORPORATE**

The corporate operations consist of revenues and expenses related to general corporate activities and Capital Asset. The corporate operations incurred a loss of \$20 million in the third quarter of 2006 compared with a loss of \$99 million in the same period of 2005. For the nine months ended September 30, 2006, the corporate operations incurred a loss of \$58 million compared with a loss of \$143 million in the same period of 2005.

In the third quarter of 2006, net investment income declined 6% to \$3.3 million from \$3.5 million in the third quarter of 2005. For the nine months ended September 30, 2006, net investment income declined 38% to \$11 million from \$17 million in the same period of 2005. The 38%

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decrease was driven by substantially lower average invested assets in 2006 resulting from share repurchases the Company completed in the first half of 2005. Average invested assets in the first nine months of 2005 included proceeds from additional debt issued by MBIA Inc. and dividends paid by MBIA Corp. to MBIA Inc. in the fourth quarter of 2004.

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Net realized gains from investment securities in the corporate operations were \$0.9 million in the third quarter of 2006 compared with \$0.2 million in the third quarter of 2005. During the nine months ended September 30, 2006, the corporate operations generated net realized gains of \$2.3 million compared with net realized losses of \$1.4 million in the same period of 2005. Net realized gains and losses were generated from the ongoing management of the investment portfolios.

The corporate operations incurred interest expense of \$20 million in the third quarter of 2006 compared with \$22 million in the third quarter of 2005. During the nine months ended September 30, 2006, the corporate operations incurred interest expense of \$61 million compared with \$66 million in the same period of 2005. The decrease in interest expense for the three and nine months ended September 30, 2006 resulted from the retirement of \$100 million of debt in the fourth quarter of 2005.

Corporate expenses were \$5 million and \$11 million in the three and nine months ended September 30, 2006, respectively, compared with \$81 million and \$92 million in the three and nine months ended September 30, 2005, respectively. The decreases in corporate expenses resulted from the \$75 million accrual made in the third quarter of 2005, representing the estimated amount the Company expects to pay in connection with a settlement of the regulatory investigations of the Company. In addition, in the nine months ended September 30, 2006 there was a decline of approximately \$5 million in costs for professional services principally associated with the regulatory investigations.

**TAXES**

MBIA's tax policy is to optimize after-tax income by maintaining the appropriate mix of taxable and tax-exempt investments. In general, the effective tax rate fluctuates from time to time as the Company manages its investment portfolio on an after-tax total return basis. The effective tax rate for continuing operations for the third quarter of 2006 decreased to 29.4% from 35.2% for the third quarter of 2005. For the nine months ended September 30, 2006, the effective tax rate for continuing operations decreased to 28.1% from 30.1% for the nine months ended September 30, 2005. The higher effective tax rate in both periods of 2005 resulted from the \$75 million accrual related to the settlement of the regulatory investigations, most of which was not deductible for purposes of calculating the Company's Federal income taxes.

**CAPITAL RESOURCES**

The Company carefully manages its capital resources to minimize its cost of capital while maintaining appropriate claims-paying resources to sustain its Triple-A claims-paying ratings. Capital resources are defined by the Company as total shareholders' equity, long-term debt issued for general corporate purposes and various soft capital credit facilities. At September 30, 2006, total shareholders' equity was \$7.1 billion and total long-term debt was \$1.2 billion. The Company uses debt financing to lower its overall cost of capital. MBIA maintains debt at levels it considers to be prudent based on its cash flow and total capital (shareholders' equity plus long-term debt). The following table shows the Company's long-term debt and the ratio used to measure it:

|                                 | September 30, | December 31, |
|---------------------------------|---------------|--------------|
|                                 | 2006          | 2005         |
| Long-term debt (in millions)    | \$ 1,216      | \$ 1,210     |
| Long-term debt to total capital | 15%           | 16%          |

In July 2004, the Company received authorization from its Board of Directors to repurchase 1 million of common shares under a share repurchase program. On August 5, 2004, the Company's Board of Directors authorized the repurchase of an additional 14 million shares of common stock in connection with this program. As of September 30, 2006, the Company had repurchased a total of 10 million shares under the program at an average price of \$57.25 per share. The Company did not repurchase any shares in the nine months ended September 30, 2006.

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The Company has various soft capital credit facilities, such as lines of credit and equity-based facilities at its disposal, which further support its claims-paying resources. At September 30, 2006, MBIA Corp. maintained a \$450 million limited recourse standby line of credit facility with a group of major Triple-A rated banks to provide funds for the payment of claims in excess of the greater of \$500 million of cumulative claims, net of recoveries, or 5% of average annual debt service with respect to public finance transactions. The agreement is for a ten-year term, which expires in March 2015.

MBIA Corp. has access to \$400 million of Money Market Committed Preferred Custodial Trust securities (CPCT securities) issued by eight trusts, which were created for the primary purpose of issuing CPCT securities and investing the proceeds in high-quality commercial paper or short-term U.S. Government obligations. MBIA Corp. has a put option to sell to the trusts the perpetual preferred stock of MBIA Corp. If MBIA Corp. exercises its put option, the trusts will transfer the

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proceeds to MBIA Corp. in exchange for the preferred stock that will be held by the trusts. The trusts are vehicles for providing MBIA Corp. the opportunity to access new capital at its sole discretion through the exercise of the put options. The trusts are rated AA and Aa2 by S&P and Moody's, respectively. To date, MBIA Corp. has not exercised its put options under any of these arrangements.

From time to time, MBIA accesses the capital markets to support the growth of its businesses. As such, MBIA filed a \$500 million registration statement on Form S-3 with the SEC in June 2003, amended January 2004, utilizing a shelf registration process. In November 2004, the Company completed a \$350 million debt issuance of senior notes and currently has in effect a shelf registration with the SEC for \$150 million. This shelf registration permits the Company to issue various debt and equity securities described in the prospectus filed as part of the registration statement.

**LIQUIDITY**

Cash needs at the parent company level are primarily for dividends to its shareholders and interest payments on its debt. Sources of cash at the parent company level primarily consist of dividend payments from MBIA Corp., investment income and the issuance of debt. Additionally, the parent company maintains excess cash and investments to ensure it is able to meet its ongoing cash requirements.

The consolidated liquidity and operating cash requirements of the Company are met by cash flows generated from operations, which were more than adequate in the nine months ended September 30, 2006. The Company's operating cash flows totaled \$710 million in the nine months ended September 30, 2006 compared with \$621 million in the same period of 2005. The majority of net cash provided by operating activities is generated from premium writings and investment income in the Company's insurance operations. Management of the Company believes that cash flows from operations will be sufficient to meet the Company's liquidity and operating cash requirements for the foreseeable future.

Under New York State insurance law, without prior approval of the superintendent of the state insurance department, financial guarantee insurance companies can pay dividends from earned surplus subject to retaining a minimum capital requirement. In MBIA Corp.'s case, regular dividends in any 12-month period cannot be greater than 10% of policyholders' surplus as shown on MBIA Corp.'s latest filed statutory financial statements. During the nine months ended September 30, 2006, MBIA Corp. declared and paid regular dividends of \$339 million to MBIA Inc. As of September 30, 2006, under the formula applicable to the payment of dividends, MBIA Corp. has dividend capacity of \$12.1 million without special regulatory approval.

The Company has significant liquidity supporting its businesses. At September 30, 2006, cash, cash equivalents and short-term investments totaled \$2.3 billion. If, for any reason, significant cash flow reductions occur in any of its businesses, MBIA has alternatives for meeting ongoing cash requirements. They include selling or pledging its fixed-income investments in its investment portfolio, utilizing existing liquidity facilities and new borrowings.

As a part of MBIA's external borrowing capacity, it maintained a \$500 million bank line with a group of highly rated global banks. In the second quarter of 2006, the Company negotiated more favorable terms of the bank line, including an extension of the maturity from April 2010 to May 2011. At September 30, 2006, there was no balance outstanding under the facility.

The available-for-sale investment portfolio provides a high degree of liquidity, since it is comprised of readily marketable high-quality fixed-income securities and short-term investments. At September 30, 2006, the fair value of the consolidated available-for-sale investment portfolio was \$30.2 billion, as shown in the following table:

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|   | September 30,    | December 31,     | Percent Change |
|---|------------------|------------------|----------------|
| In millions                                       | 2006             | 2005             | 2006 vs. 2005  |
| <b>Available-for-sale investments:</b>            |                  |                  |                |
| <b>Insurance operations:</b>                      |                  |                  |                |
| Amortized cost                                    | \$ 10,520        | \$ 9,940         | 6%             |
| Unrealized net gain (loss)                        | 260              | 310              | (16)%          |
| <b>Fair value</b>                                 | <b>\$ 10,780</b> | <b>\$ 10,250</b> | <b>5%</b>      |
| <b>Investment management services operations:</b> |                  |                  |                |
| Amortized cost                                    | \$ 18,928        | \$ 15,684        | 21%            |
| Unrealized net gain (loss)                        | 186              | 286              | (35)%          |
| <b>Fair value</b>                                 | <b>\$ 19,114</b> | <b>\$ 15,970</b> | <b>20%</b>     |
| <b>Corporate operations:</b>                      |                  |                  |                |
| Amortized cost                                    | \$ 341           | \$ 166           | 105%           |
| Unrealized net gain (loss)                        | (4)              | (1)              | (203)%         |
| <b>Fair value</b>                                 | <b>\$ 337</b>    | <b>\$ 165</b>    | <b>104%</b>    |
| <b>Total available-for-sale portfolio:</b>        |                  |                  |                |
| Amortized cost                                    | \$ 29,789        | \$ 25,790        | 16%            |
| Unrealized net gain (loss)                        | 442              | 595              | (26)%          |
| <b>Fair value</b>                                 | <b>\$ 30,231</b> | <b>\$ 26,385</b> | <b>15%</b>     |

The increase in the amortized cost of insurance-related available-for-sale investments in the nine months ended September 30, 2006 was the result of positive cash flow from operations offset by dividend payments from MBIA Corp. to MBIA Inc. The increase in the amortized cost of available-for-sale investments in the investment management services operations was the result of growth in the Company's asset/liability products program. The increase in the amortized cost of corporate investments was due to dividends received from the insurance operations.

The fair value of the Company's investments is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Differences between fair value and amortized cost arise primarily as a result of changes in interest rates occurring after a fixed-income security is purchased, although other factors influence fair value, including credit-related actions, supply and demand forces and other market factors. When the Company holds its available-for-sale investments to maturity, unrealized gains or losses currently recorded in accumulated other comprehensive income in the shareholders' equity section of the balance sheet will decrease over time as the investments approach maturity. As a result, the Company expects to realize a value substantially equal to amortized cost. However, when investments are sold prior to maturity, the Company will realize any gains or losses in current net income. The Conduit portfolios are considered held-to-maturity, as the Company has the ability and intent to hold these investments to their contractual maturity. Therefore, these portfolios are reported at amortized cost and are not adjusted to reflect unrealized changes in fair value.

During the nine months ended September 30, 2006, there was an increase in the amount of unrealized losses from MBIA's consolidated investment portfolio recorded in accumulated other comprehensive income. This increase resulted solely from the effects of rising interest rates on fixed rate securities. MBIA has evaluated whether such unrealized losses were other than temporary given the circumstances that gave rise to the unrealized losses, along with MBIA's ability and intent to hold these securities to maturity or until such time as to recover an amount equal to their amortized cost. Based on its evaluation, the Company did not consider any of the unrealized losses to be other than temporary. If circumstances change, such as unexpected credit-related actions of an issuer of a security, the general interest rate environment or liquidity events, among others, MBIA will reevaluate its intent to hold a security and determine whether an impairment loss should be realized in current

net income.

The weighted average credit quality of the Company's fixed-income investment portfolios has been maintained at Double-A since its inception. The quality distribution of the Company's fixed-maturity investment portfolios, excluding short-term investments, based on ratings from Moody's as of September 30, 2006 is presented in the following table. Alternate ratings sources, such as S&P, have been used for a small percentage of securities that are not rated by Moody's.

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| In millions | Insurance<br>% of |                  | Investment<br>Management Services<br>% of |                  | Investments Held-to-<br>Maturity |   | Total     |   |
|-------------|-------------------|------------------|---|------------------|----------------------------------|---|-----------|---|
|             | Fair              | Fixed-<br>Income | Fair                                      | Fixed-<br>Income | Fair                             | % of<br>Fixed-<br>Income<br>Investments | Fair      | % of<br>Fixed-<br>Income<br>Investments |
|             | Value             | Investments      | Value                                     | Investments      | Value                            |   | Value     | Investments                             |
| Aaa         | \$ 6,639          | 67%              | \$ 10,408                                 | 57%              | \$ 3,612                         | 72%                                     | \$ 20,659 | 63%                                     |
| Aa          | 2,311             | 24%              | 3,957                                     | 22%              | 331                              | 6%                                      | 6,599     | 19%                                     |
| A           | 795               | 8%               | 3,683                                     | 20%              | 1,100                            | 22%                                     | 5,578     | 17%                                     |
| Baa         | 52                | 1%               | 97  | 1%               |                                  |   | 149       | 1%                                      |
| Total       | \$ 9,797          | 100%             | \$ 18,145                                 | 100%             | \$ 5,043                         | 100%                                    | \$ 32,985 | 100%                                    |

MBIA's consolidated investment portfolio includes investments that are insured by MBIA Corp. (MBIA Insured Investments). At September 30, 2006, MBIA Insured Investments at fair value represented \$3.2 billion or 10% of the Company's total investments, excluding conduit investments. Conduit investments represented \$3.6 billion or 10% of the Company's total investments. Without giving effect to the MBIA guarantee of the MBIA Insured Investments in the consolidated investment portfolio, as of September 30, 2006, based on the actual or estimated underlying ratings (i) the weighted average rating of the investment portfolio would be in the Aa range, (ii) the weighted average rating of just the MBIA Insured Investments in the investment portfolio would be in the A range and (iii) less than 1% of the investment portfolio would be rated below investment grade.

The underlying ratings of the MBIA Insured Investments as of September 30, 2006 are reflected in the following table. Amounts represent the fair value of such investments including the benefit of the MBIA guarantee. The ratings in the table below are the lower underlying rating assigned by S&P or Moody's when an underlying rating exists from either rating service, or when an external underlying rating is not available, the underlying rating is based on the Company's best estimate of the rating of such investment.

| Underlying Ratings Scale | Insurance | Investment<br>Management<br>Services | Held-to-<br>Maturity | Total    |
|--------------------------|-----------|--------------------------------------|----------------------|----------|
|                          | Portfolio | Portfolio                            | Portfolio            |          |
| In millions              |           |                                      |                      |          |
| Aaa                      | \$ 200    | \$ 365                               | \$ 197               | \$ 762   |
| Aa                       | 60        | 195                                  | 450                  | 705      |
| A                        | 254       | 1,017                                | 2,005                | 3,276    |
| Baa                      | 185       | 778                                  | 960                  | 1,923    |
| Below Investment Grade   | 101       | 52                                   |                      | 153      |
| Total                    | \$ 800    | \$ 2,407                             | \$ 3,612             | \$ 6,819 |

Typically, conduit programs involve the use of rating agencies in assessing the quality of asset purchases and in assigning ratings to the various programs funded through the conduits. All transactions currently funded in the conduits had an underlying rating of at least investment grade by



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Moody's and S&P prior to funding. The weighted average underlying rating for transactions currently funded in the conduits was A by S&P and A2 by Moody's at the time such transactions were funded. MBIA estimates that the current weighted average underlying rating of all outstanding conduit transactions was A by S&P and A2 by Moody's as of September 30, 2006.

The Company generates significant liquidity from its operations, as described above. Because of its risk management policies and procedures, diversification and reinsurance, the Company believes that the occurrence of an event that would significantly adversely affect liquidity is unlikely.

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**PART I - FINANCIAL INFORMATION**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There has been no material changes in the Company's market risk during the nine months ended September 30, 2006. For additional information on market risk, refer to page 37 of the Company's 2005 Annual Report or Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Market Risk" of the Company's Form 10-K for the year ended December 31, 2005.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934) was performed under the supervision and with the participation of the Company's senior management, including the Chief Executive Officer and the Chief Financial Officer. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. In addition, there have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the fiscal quarter to which this report relates that have materially affected, or are likely to materially affect, the Company's internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

In July 2002, MBIA Corp. filed suit against Royal Indemnity Company (Royal) in the United States District Court for the District of Delaware, to enforce insurance policies that Royal issued on certain vocational student loan transactions that MBIA Corp. insured. To date, claims in the amount of approximately \$354 million have been made under the Royal policies with respect to loans that have defaulted. MBIA Corp. expects that there will be additional claims made under the policies with respect to student loans that may default in the future. Royal had filed an action seeking a declaration that it is not obligated to pay on its policies. In October 2003, the court granted MBIA Corp.'s motion for summary judgment and ordered Royal to pay all claims under its policies. Royal appealed the order, and, in connection with the appeal, pledged \$397 million of investment grade collateral to MBIA Corp. to secure the entire amount of the judgment, with interest, and has agreed to post additional security for future claims and interest.

On October 3, 2005, the U.S. Court of Appeals for the Third Circuit upheld the decision of the United States District Court for the District of Delaware insofar as it enforced the Royal insurance policies, but remanded the case to the District Court for a determination of whether the Royal policies cover all losses claimed under the policies. In particular, the Court of Appeals directed the District Court to consider whether the Royal policies would cover losses resulting from the misappropriation of student payments rather than from defaults by students. MBIA Corp. believes that the Royal policies would cover losses even if they result from misappropriation of student payments, but in any event it appears that all or substantially all of the claims made under the Royal policies relate to defaults by students rather than misappropriation of funds. Therefore, MBIA Corp. expects Royal to be required to pay all or substantially all of the claims made under its policies and to be reimbursed for any payments MBIA Corp. made under its policies.

Royal filed a petition with the Third Circuit requesting that the case be reheard, which was denied in April 2006. In April 2006, Royal filed a motion with the District Court seeking a release of the collateral it pledged in connection with its appeal of the District Court judgment against it in 2003. MBIA has opposed Royal's motion to release the collateral and believes that, in light of the Third Circuit affirmance of the parts of the District Court judgment enforcing the Royal policies, and the language in the pledge agreement, the collateral should remain subject to the pledge, although there is no assurance that the District Court will not order a release of the collateral.

If the collateral is released and Royal is unable to make payments on the Royal policies, MBIA Corp. would incur substantial losses under its policies. MBIA Corp. does not believe, however, that any such losses will have a material adverse effect on its financial condition.

In November 2004, the Company received identical document subpoenas from the SEC and the NYAG requesting information with respect to non-traditional or loss mitigation insurance products developed, offered or sold by the Company to third parties from January 1, 1998 to the present. While the subpoenas did not identify any specific transaction, subsequent conversations with the SEC and the NYAG revealed that the investigation included the arrangements entered into by MBIA Corp. in 1998 in connection with the bankruptcy of the Delaware Valley Obligated Group, an entity that is part of AHERF.



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On March 9, 2005, the Company received a subpoena from the U.S. Attorney's Office for the Southern District of New York (U.S. Attorney) seeking information related to the agreements it entered into in connection with the AHERF loss. Thereafter, the Company has received additional subpoenas, substantively identical to each other, and additional informal requests, from the SEC and the NYAG for documents and other information.

On August 19, 2005, the Company received a Wells Notice from the SEC indicating that the staff of the SEC is considering recommending that the SEC bring a civil injunctive action against the Company alleging violations of federal securities laws arising from MBIA's action to retroactively reinsure losses it incurred from the AHERF bonds MBIA had guaranteed, including, but not limited to, its entering into excess of loss agreements and quota share agreements with three separate counterparties.

On November 8, 2005, the Company announced that it was in discussions with the SEC, the NYAG and the NYSID regarding potential settlements of their investigations into agreements entered into by MBIA Corp. in connection with the AHERF matter. In connection with the potential settlements, the Company announced that it was restating its financial statements to correct and restate its GAAP and statutory accounting for 1998 and subsequent years as discussed in Note 2: Restatement Of Consolidated Financial Statements in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries in Part II, Item 8 and Restatement of Consolidated Financial Statements in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7. In connection with the proposed settlements, the Company accrued \$75 million for the total amount the Company estimates, based on discussions to date, it will have to pay in connection with any settlements.

The Company has been cooperating, and is continuing to cooperate fully with the investigations by the SEC, the NYAG, the NYSID and the U.S. Attorney. To date, no settlements have been approved by the regulatory agencies, and no assurance can be given that any settlements will be approved. Any settlements may have additional or different terms.

The Company has been named as a defendant in private securities actions consolidated as *In re MBIA Inc. Securities Litigation*; (Case No. 05 CV 03514(LLS); S.D.N.Y.) (filed October 3, 2005). Joseph W. Brown, the Company's Chairman and former Chief Executive Officer, Gary C. Dunton, the Company's Chief Executive Officer, Nicholas Ferreri, the Company's former Chief Financial Officer, Neil G. Budnick, a Vice President of the Company and the Company's former Chief Financial Officer and Douglas C. Hamilton, the Company's Controller were also named as defendants in the suit, as were former Chairman and Chief Executive Officer David H. Elliott and former Executive Vice President, Chief Financial Officer and Treasurer Julliette S. Tehrani. The plaintiffs assert claims under Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), Rule 10b-5 promulgated thereunder, and Section 20(a) of the Exchange Act. The lead plaintiffs purport to be acting as representatives for a class consisting of purchasers of the Company's stock during the period from August 5, 2003 to March 30, 2005 (the Class Period).

The allegations contained in the lawsuit include, among other things, violations of the federal securities laws arising out of the Company's allegedly false and misleading statements about its financial condition and the nature of the arrangements entered into by MBIA Corp. in connection with the AHERF loss, and about the effectiveness of the Company's internal controls. The plaintiffs allege that, as a result of these misleading statements or omissions, the Company's stock traded at artificially inflated prices throughout the Class Period. The plaintiffs seek unspecified compensatory damages in connection with purchases by members of the class of the Company's stock at such allegedly inflated prices during the Class Period. The defendants, including the Company, filed motions to dismiss on July 17, 2006. The Company does not expect the outcome of the private securities litigation to have a material adverse effect on its financial condition, although the outcome is uncertain and no assurance can be given that the Company will not suffer a loss.

Certain officers of the Company and certain members of the Company's Board of Directors have been named as defendants in a shareholder derivative action filed in the Supreme Court of New York, Westchester County on November 9, 2005: *Robert Purvis, Derivatively on Behalf of Nominal Defendant MBIA, Inc. v. Joseph W. Brown, Neil G. Budnick, C. Edward Chaplin, David C. Clapp, Clifford D. Corso, Gary C. Dunton, Claire L. Gaudiani, Daniel P. Kearney, Laurence H. Meyer, Debra J. Perry, John A. Rolls, and Ruth M. Whaley (Case No. 20099-05)* (the Purvis Litigation). The plaintiff asserts claims for the benefit of the Company to redress injuries suffered by the Company as a result of alleged breaches of fiduciary duties by the named defendants in connection with the Company's accounting for certain transactions, including the AHERF loss. In addition, the plaintiff alleges that the officer defendants were unjustly enriched as a result of such alleged breach. The lawsuit seeks disgorgement to the Company of compensation granted to such officers, legal costs and unspecified equitable relief to remedy defendant's breaches of fiduciary duties.

Certain current and former officers of the Company and certain current and former members of the Company's Board of Directors have been named as defendants in a shareholder derivative action filed in the United States District Court, Southern District on April 24, 2006: *J. Robert Orton Jr., Derivatively on Behalf of Nominal Defendant MBIA, Inc. v. Joseph*



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(Jay) W. Brown, Gary C. Dunton, Neil G. Budnick, Nicholas Ferreri, Douglas C. Hamilton, Juliette S. Tehrani, Richard L. Weill, David H. Elliott, Claire L. Gaudiani, Daniel P. Kearney, David C. Clapp, John A. Rolls, C. Edward Chaplin, Debra J. Perry, Laurence Meyer, Jeffrey W. Yabuki, Pierre-Henri Richard, William H. Gray III, Freda S. Johnson and James A. Lebenthal (Case No. 06 CV 3146) (the Orton Litigation). The plaintiff asserts claims for the benefit of the Company to redress injuries suffered by the Company as a result of alleged breaches of fiduciary duties, insider trading, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment and violations of the Sarbanes-Oxley Act of 2002 by some or all of the named defendants in connection with alleged false statements in the Company's financial statements arising from improper accounting for certain transactions, including agreements to reinsure the AHERF loss. The lawsuit seeks relief on behalf of the Company that includes disgorgement of certain compensation granted to such officers, unspecified damages, restitution of profits and compensation, legal costs, an order directing the Company to implement certain governance procedures and other equitable relief.

A Special Litigation Committee of three independent directors of MBIA Inc. has determined after a good faith and thorough investigation that pursuit of the Purvis Litigation and the Orton Litigation is not in the best interests of MBIA and its shareholders, and has moved to dismiss the two actions.

There are no other material lawsuits pending or, to the knowledge of the Company, threatened, to which the Company or any of its subsidiaries is a party.

**Item 1A. Risk Factors**

There has been no material changes in the Company's risk factors during the nine months ended September 30, 2006. For additional information on risk factors, refer to Part I, Item 1A, "Risk Factors" of the Company's Form 10-K for the year ended December 31, 2005.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In July 2004, the Company received authorization from its Board of Directors to repurchase 1 million of common shares under a share repurchase program. On August 5, 2004, the Company's Board of Directors authorized the repurchase of an additional 14 million shares of common stock in connection with this program. As of September 30, 2006, the Company had repurchased a total of 10 million shares under the program at an average price of \$57.25 per share. The Company did not repurchase any shares in the first nine months of 2006. The Company will only repurchase shares of its common stock under the repurchase program when it feels that it is economically attractive to do so and in conformity with regulatory and rating agency guidelines.

The table below sets forth repurchases made by the Company in each month during the third quarter of 2006 all of which were purchased by the Company for settling awards under the Company's long-term incentive plans.

| Month     | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan | Maximum Number of Shares That May Yet Be Purchased Under the Plan |
|-----------|----------------------------------|------------------------------|---|---|
| July      | 51,065                           | \$ 61.03                     | 0   | 4,995,900   |
| August    | 81,242                           | \$ 60.38                     | 0   | 4,995,900   |
| September | 88,468                           | \$ 63.17                     | 0   | 4,995,900   |

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Submission of Matters to a Vote of Security Holders**

None

**Item 5. Other Information**

None



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**Item 6. Exhibits**

- 31.1 Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 99.1 Additional Exhibits - MBIA Insurance Corporation and Subsidiaries Consolidated Financial Statements

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MBIA INC.

Registrant

Date: November 6, 2006

/s/ C. Edward Chaplin  
C. Edward Chaplin  
Chief Financial Officer

Date: November 6, 2006

/s/ Douglas C. Hamilton  
Douglas C. Hamilton  
Controller

(Principal Accounting Officer)

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