

MBIA INC  
Form 10-Q  
November 14, 2005

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

---

**FORM 10-Q**

---

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

For the Quarter Ended September 30, 2005

OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-9583

I.R.S. Employer Identification No. 06-1185706

---

**MBIA INC.**

**A Connecticut Corporation**

**113 King Street, Armonk, N. Y. 10504**

**(914) 273-4545**

---

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 an accelerated filer (as specified in Rule 12 b-2 of the Act). Yes  No

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 31, 2005, there were outstanding 134,061,568 shares of Common Stock, par value \$1 per share, of the registrant.

---

**INDEX**

|  | <b><u>PAGE</u></b> |
|--|--------------------|
| <b>PART I FINANCIAL INFORMATION</b>  |                    |
| Item 1. Financial Statements (Unaudited)   |                    |
| MBIA Inc. and Subsidiaries   |                    |
| <u>Consolidated Balance Sheets - September 30, 2005 and December 31, 2004 (Restated)</u>                           | 3                  |
| <u>Consolidated Statements of Income - Three and nine months ended September 30, 2005 and 2004 (Restated)</u>      | 4                  |
| <u>Consolidated Statement of Changes in Shareholders' Equity - Nine months ended September 30, 2005 (Restated)</u> | 5                  |
| <u>Consolidated Statements of Cash Flows - Nine months ended September 30, 2005 and 2004 (Restated)</u>            | 6                  |
| <u>Notes to Consolidated Financial Statements</u>  | 7 17               |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>               | 18 37              |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 38                 |
| Item 4. <u>Controls and Procedures</u>   | 38                 |
| <b>PART II OTHER INFORMATION, AS APPLICABLE</b>  |                    |
| Item 1. <u>Legal Proceedings</u>   | 38 39              |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | 40                 |
| Item 6. <u>Exhibits</u>  | 40                 |
| <b><u>SIGNATURES</u></b>   | 41                 |

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

(In thousands except per share amounts)

|  | <u>September 30, 2005</u> | <u>December 31, 2004</u> |
|--|---------------------------|--------------------------|
|  |                           | <b>Restated</b>          |
| <b>Assets</b>  |                           |                          |
| Investments:   |                           |                          |
| Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$22,715,894 and \$18,802,894) | \$ 23,388,776             | \$ 19,679,905            |
| Investments held-to-maturity, at amortized cost (fair value \$6,343,585 and \$7,535,787)                           | 6,374,234                 | 7,540,218                |
| Investment agreement portfolio pledged as collateral, at fair value (amortized cost \$391,173 and \$713,704)       | 409,481                   | 730,870                  |
| Short-term investments, at amortized cost (which approximates fair value)  | 1,987,668                 | 2,405,192                |
| Other investments  | 243,845                   | 261,865                  |
| <b>Total investments</b>   | <b>32,404,004</b>         | <b>30,618,050</b>        |
| Cash and cash equivalents  | 311,486                   | 366,236                  |
| Accrued investment income  | 378,895                   | 312,208                  |
| Deferred acquisition costs   | 431,010                   | 406,035                  |
| Prepaid reinsurance premiums   | 417,293                   | 434,968                  |
| Reinsurance recoverable on unpaid losses   | 45,677                    | 34,610                   |
| Goodwill   | 79,406                    | 79,406                   |
| Property and equipment, at cost (less accumulated depreciation of \$118,204 and \$108,848)                         | 109,050                   | 114,692                  |
| Receivable for investments sold  | 191,315                   | 67,205                   |
| Derivative assets  | 292,255                   | 288,564                  |
| Other assets   | 269,669                   | 314,321                  |
| <b>Total assets</b>  | <b>\$ 34,930,060</b>      | <b>\$ 33,036,295</b>     |
| <b>Liabilities and Shareholders Equity</b>   |                           |                          |
| Liabilities:   |                           |                          |
| Deferred premium revenue   | \$ 3,208,059              | \$ 3,211,181             |
| Loss and loss adjustment expense reserves  | 711,423                   | 748,869                  |
| Investment agreements  | 10,061,756                | 8,678,768                |
| Commercial paper   | 1,745,767                 | 2,598,655                |
| Medium-term notes  | 7,905,890                 | 6,943,840                |
| Variable interest entity floating rate notes   | 801,115                   | 600,505                  |
| Securities sold under agreements to repurchase   | 603,652                   | 647,104                  |
| Short-term debt  | 58,745                    | 58,745                   |
| Long-term debt   | 1,313,375                 | 1,332,540                |
| Deferred income taxes, net   | 557,166                   | 599,627                  |
| Deferred fee revenue   | 20,917                    | 26,780                   |
| Payable for investments purchased  | 499,902                   | 94,609                   |
| Derivative liabilities   | 421,918                   | 527,455                  |
| Other liabilities  | 525,598                   | 408,820                  |

Edgar Filing: MBIA INC - Form 10-Q

|   |                      |                      |
|---|----------------------|----------------------|
| <b>Total liabilities</b>  | <b>28,435,283</b>    | <b>26,477,498</b>    |
| Shareholders' Equity:   |                      |                      |
| Preferred stock, par value \$1 per share; authorized shares 10,000,000; issued and outstanding none             |                      |                      |
| Common stock, par value \$1 per share; authorized shares 400,000,000; issued shares 156,539,205 and 155,607,737 | 156,539              | 155,608              |
| Additional paid-in capital  | 1,473,190            | 1,410,799            |
| Retained earnings   | 5,601,993            | 5,187,484            |
| Accumulated other comprehensive income, net of deferred income tax of \$264,632 and \$321,565                   | 454,178              | 618,606              |
| Unearned compensation - restricted stock  | (48,699)             | (34,686)             |
| Treasury stock, at cost 22,478,210, and 16,216,405 shares   | (1,142,424)          | (779,014)            |
| <b>Total shareholders' equity</b>   | <b>6,494,777</b>     | <b>6,558,797</b>     |
| <b>Total liabilities and shareholders' equity</b>   | <b>\$ 34,930,060</b> | <b>\$ 33,036,295</b> |

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

## MBIA INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

(In thousands except per share amounts)

|   | Three months ended<br>September 30 |                  | Nine months ended<br>September 30 |                  |
|---|------------------------------------|------------------|-----------------------------------|------------------|
|   | 2005                               | 2004<br>Restated | 2005                              | 2004<br>Restated |
| <b>Insurance</b>  |                                    |                  |                                   |                  |
| Revenues:   |                                    |                  |                                   |                  |
| Gross premiums written  | \$ 220,970                         | \$ 255,609       | \$ 752,554                        | \$ 833,211       |
| Ceded premiums  | (34,608)                           | (42,289)         | (98,356)                          | (107,340)        |
| Net premiums written  | 186,362                            | 213,320          | 654,198                           | 725,871          |
| Scheduled premiums earned   | 173,302                            | 177,808          | 527,964                           | 525,756          |
| Refunding premiums earned   | 30,770                             | 33,186           | 100,338                           | 113,486          |
| Premiums earned (net of ceded premiums of \$35,270,<br>\$32,292, \$114,175 and \$110,048) | 204,072                            | 210,994          | 628,302                           | 639,242          |
| Net investment income   | 122,435                            | 117,363          | 362,583                           | 354,060          |
| Advisory fees   | 9,529                              | 6,156            | 20,168                            | 29,211           |
| Net realized gains (losses)   | (7,526)                            | (416)            | (6,319)                           | 62,812           |
| Net gains (losses) on derivative instruments and<br>foreign exchange                      | 2,485                              | 1,897            | 415                               | 3,167            |
| Total insurance revenues  | 330,995                            | 335,994          | 1,005,149                         | 1,088,492        |
| Expenses:   |                                    |                  |                                   |                  |
| Losses and loss adjustment  | 20,796                             | 21,336           | 63,355                            | 63,090           |
| Amortization of deferred acquisition costs  | 16,121                             | 16,200           | 49,636                            | 49,495           |
| Operating   | 39,893                             | 28,080           | 103,416                           | 88,034           |
| Total insurance expenses  | 76,810                             | 65,616           | 216,407                           | 200,619          |
| Insurance income  | 254,185                            | 270,378          | 788,742                           | 887,873          |
| <b>Investment management services</b>   |                                    |                  |                                   |                  |
| Revenues  | 225,671                            | 142,323          | 618,449                           | 390,039          |
| Net realized gains (losses)   | 1,284                              | 378              | 3,000                             | (2,565)          |
| Net gains (losses) on derivative instruments and<br>foreign exchange                      | 41,607                             | (14,324)         | 41,633                            | (14,373)         |
| Total investment management services revenues   | 268,562                            | 128,377          | 663,082                           | 373,101          |
| Interest expense  | 184,397                            | 106,431          | 500,979                           | 289,904          |
| Expenses  | 18,341                             | 19,620           | 51,808                            | 56,964           |

Edgar Filing: MBIA INC - Form 10-Q

|   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Total investment management services expenses                     | 202,738           | 126,051           | 552,787           | 346,868           |
| Investment management services income                             | 65,824            | 2,326             | 110,295           | 26,233            |
| <b>Municipal services</b>   |                   |                   |                   |                   |
| Revenues  | 5,611             | 8,245             | 16,545            | 19,956            |
| Net realized gains (losses)                                       | (51)              | (48)              | (136)             | (90)              |
| Net gains (losses) on derivative instruments and foreign exchange | 64                |                   | 200               |                   |
| Total municipal services revenues                                 | 5,624             | 8,197             | 16,609            | 19,866            |
| Expenses  | 5,321             | 7,633             | 15,834            | 19,013            |
| Municipal services income   | 303               | 564               | 775               | 853               |
| <b>Corporate</b>  |                   |                   |                   |                   |
| Net investment income   | 3,411             | 1,934             | 17,114            | 6,511             |
| Net realized gains (losses)                                       | 226               | 390               | (1,301)           | (186)             |
| Interest expense  | 22,080            | 17,798            | 66,141            | 53,343            |
| Corporate expenses  | 81,391            | 4,174             | 92,470            | 14,134            |
| Corporate loss  | (99,834)          | (19,648)          | (142,798)         | (61,152)          |
| Income from continuing operations before income taxes             | 220,478           | 253,620           | 757,014           | 853,807           |
| Provision for income taxes  | 77,601            | 70,409            | 227,656           | 240,206           |
| Income from continuing operations                                 | 142,877           | 183,211           | 529,358           | 613,601           |
| Income (loss) from discontinued operations, net of tax            | (1,093)           |                   | (1,093)           | (481)             |
| Gain on sale of discontinued operations, net of tax               |                   |                   |                   | 3,178             |
| Income (loss) from discontinued operations                        | (1,093)           |                   | (1,093)           | 2,697             |
| <b>Net income</b>   | <b>\$ 141,784</b> | <b>\$ 183,211</b> | <b>\$ 528,265</b> | <b>\$ 616,298</b> |
| Income from continuing operations per common share:               |                   |                   |                   |                   |
| <b>Basic</b>  | <b>\$ 1.08</b>    | <b>\$ 1.30</b>    | <b>\$ 3.93</b>    | <b>\$ 4.30</b>    |
| <b>Diluted</b>  | <b>\$ 1.05</b>    | <b>\$ 1.27</b>    | <b>\$ 3.84</b>    | <b>\$ 4.21</b>    |
| Net income per common share:                                      |                   |                   |                   |                   |
| <b>Basic</b>  | <b>\$ 1.07</b>    | <b>\$ 1.30</b>    | <b>\$ 3.93</b>    | <b>\$ 4.32</b>    |
| <b>Diluted</b>  | <b>\$ 1.04</b>    | <b>\$ 1.27</b>    | <b>\$ 3.84</b>    | <b>\$ 4.23</b>    |
| Weighted-average number of common shares outstanding:             |                   |                   |                   |                   |
| Basic   | 132,622,848       | 141,408,855       | 134,589,606       | 142,819,366       |
| Diluted   | 135,822,330       | 144,125,409       | 137,722,142       | 145,781,763       |
| Gross revenues from continuing operations                         | 608,818           | 474,892           | 1,700,653         | 1,487,784         |
| Gross expenses from continuing operations                         | 388,340           | 221,272           | 943,639           | 633,977           |

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

## MBIA INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

For the nine months ended September 30, 2005

(In thousands except per share amounts)

|  | Common Stock                           |         | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Unearned<br>Compensation-<br>Restricted<br>Stock | Treasury Stock |              | Total<br>Shareholders<br>Equity |                             |
|--|--|---------|----------------------------------|----------------------|---|--|----------------|--------------|---------------------------------|-----------------------------|
|  | Shares                                 | Amount  |                                  |                      |   |  | Shares         | Amount       |                                 |                             |
|  | Balance, January 1,<br>2005 (Restated) | 155,608 |                                  |                      |   |  | \$ 155,608     | \$ 1,410,799 |                                 | \$ 5,187,484 <sub>(1)</sub> |
| Comprehensive income:  |  |         |                                  |                      |   |  |                |              |                                 |                             |
| Net income   |  |         |                                  | 528,265              |   |  |                |              |                                 | 528,265                     |
| Other comprehensive<br>income (loss):  |  |         |                                  |                      |   |  |                |              |                                 |                             |
| Change in unrealized<br>appreciation of<br>investments net of<br>change in deferred<br>income taxes of<br>\$(73,735) |  |         |                                  |                      | (157,980)                                       |  |                |              |                                 | (157,980)                   |
| Change in fair value of<br>derivative instruments<br>net of change in<br>deferred income taxes of<br>\$14,559        |  |         |                                  |                      | 27,039  |  |                |              |                                 | 27,039                      |
| Change in foreign<br>currency translation net<br>of change in deferred<br>income taxes of \$2,243                    |  |         |                                  |                      | (33,487)  |  |                |              |                                 | (33,487)                    |
| Other comprehensive<br>income (loss)   |  |         |                                  |                      |   |  |                |              |                                 | (164,428)                   |
| Comprehensive income   |  |         |                                  |                      |   |  |                |              |                                 | 363,837                     |
| Treasury shares<br>acquired, net   |  |         |                                  |                      |   |  | (6,262)        | (363,410)    |                                 | (363,410)                   |
| Stock-based<br>compensation  | 931                                    | 931     | 62,391                           |                      |   | (14,013)   |                |              |                                 | 49,309                      |
| Dividends (declared per<br>common share \$0.840,<br>paid per common share<br>\$0.800)                                |  |         |                                  | (113,756)            |   |  |                |              |                                 | (113,756)                   |



Edgar Filing: MBIA INC - Form 10-Q

|                             |         |            |              |              |            |             |          |                |              |
|-----------------------------|---------|------------|--------------|--------------|------------|-------------|----------|----------------|--------------|
| Balance, September 30, 2005 | 156,539 | \$ 156,539 | \$ 1,473,190 | \$ 5,601,993 | \$ 454,178 | \$ (48,699) | (22,478) | \$ (1,142,424) | \$ 6,494,777 |
|-----------------------------|---------|------------|--------------|--------------|------------|-------------|----------|----------------|--------------|

(1) Restated; previously reported \$5,215,191.

(2) Restated; previously reported \$611,173.

|  | <u>2005</u>         |
|--|---------------------|
| Disclosure of reclassification amount:   |                     |
| Unrealized appreciation of investments arising during the period, net of taxes | \$ (138,497)        |
| Reclassification adjustment, net of taxes                                      | (19,483)            |
| Net unrealized appreciation, net of taxes                                      | <u>\$ (157,980)</u> |

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

## MBIA INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)

|   | Nine months ended September 30 |                  |
|---|--------------------------------|------------------|
|   | 2005                           | 2004<br>Restated |
| <b>Cash flows from operating activities of continuing operations:</b>   |                                |                  |
| Net income  | \$ 528,265                     | \$ 616,298       |
| Loss from discontinued operations, net of tax   | 1,093                          | 481              |
| Gain on sale of discontinued operations, net of tax   |                                | (3,178)          |
|   | <u>529,358</u>                 | <u>613,601</u>   |
| Income from continuing operations   | 529,358                        | 613,601          |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations: |                                |                  |
| Increase in accrued investment income   | (66,687)                       | (25,353)         |
| Increase in deferred acquisition costs  | (24,975)                       | (28,223)         |
| Decrease (increase) in prepaid reinsurance premiums   | 17,675                         | (28,416)         |
| (Decrease) increase in deferred premium revenue   | (3,122)                        | 83,922           |
| (Decrease) increase in loss and loss adjustment expense reserves  | (37,446)                       | 32,499           |
| (Increase) decrease in reinsurance recoverable on unpaid losses   | (11,067)                       | 27,504           |
| Depreciation  | 9,356                          | 10,204           |
| Amortization of discount on bonds, net  | 43,875                         | 52,511           |
| Amortization of premium on medium-term notes and commercial paper   | (15,092)                       | (14,028)         |
| Net realized (gains) losses on sale of investments  | 4,756                          | (59,971)         |
| Current income tax benefit  |                                | (9,627)          |
| Deferred income tax provision   | 16,424                         | 35,844           |
| Net (gains) losses on derivative instruments and foreign exchange   | (42,248)                       | 11,206           |
| Stock option compensation   | 15,048                         | 16,156           |
| Accrued interest payable  | 80,495                         | 38,014           |
| Penalties and disgorgement  | 75,000                         |                  |
| Other, net  | 29,983                         | (47,329)         |
|   | <u>91,975</u>                  | <u>94,913</u>    |
| Total adjustments to income from continuing operations  | 91,975                         | 94,913           |
|   | <u>621,333</u>                 | <u>708,514</u>   |
| Net cash provided by operating activities of continuing operations  | 621,333                        | 708,514          |
| <b>Cash flows from investing activities of continuing operations:</b>   |                                |                  |
| Purchases of fixed-maturity securities, net of payable for investments purchased  | (7,698,659)                    | (6,377,166)      |
| Sale of fixed-maturity securities, net of receivable for investments sold   | 7,196,062                      | 5,183,061        |
| Redemption of fixed-maturity securities, net of receivable for investments redeemed   | 404,234                        | 631,247          |
| Purchases for investment agreement and medium-term note portfolios, net of payable for investments purchased                      | (4,374,560)                    | (11,469,730)     |
| Sales for investment agreement and medium-term note portfolios, net of receivable for investments sold                            | 1,599,064                      | 9,213,312        |
| Purchases of held-to-maturity investments   | (283,863)                      | (30,323)         |
| Proceeds from principal paydown of held-to-maturity investments   | 1,414,836                      | 2,348,660        |

Edgar Filing: MBIA INC - Form 10-Q

|   |                   |                   |
|---|-------------------|-------------------|
| (Purchase) sale of short-term investments                                 | (147,365)         | 173,658           |
| Sale of other investments   | 20,288            | 75,798            |
| Capital expenditures  | (5,646)           | (5,801)           |
| Disposals of capital assets   | 1,402             | 2,255             |
|   | <u>          </u> | <u>          </u> |
| Net cash used by investing activities of continuing operations            | (1,874,207)       | (255,029)         |
|   | <u>          </u> | <u>          </u> |
| <b>Cash flows from financing activities of continuing operations:</b>     |                   |                   |
| Proceeds from issuance of investment agreements                           | 5,307,982         | 4,825,943         |
| Payments for drawdowns of investment agreements                           | (3,908,350)       | (3,415,023)       |
| Decrease in commercial paper, net   | (851,921)         | (226,138)         |
| Issuance of medium-term notes   | 2,018,408         | 1,173,745         |
| Issuance of variable interest entity floating rate notes                  | 200,000           |                   |
| Principal paydown of medium-term notes                                    | (1,061,466)       | (2,341,657)       |
| Securities sold under agreements to repurchase, net                       | (43,452)          | (133,834)         |
| Dividends paid  | (109,708)         | (98,102)          |
| Net proceeds from issuance of short-term debt                             |                   | 1,408             |
| Capital issuance costs  | (2,184)           | (1,761)           |
| Other borrowings and deposits   | (5,907)           | (23,383)          |
| Purchase of treasury stock  | (363,410)         | (233,031)         |
| Exercise of stock options   | 18,132            | 37,721            |
|   | <u>          </u> | <u>          </u> |
| Net cash provided (used) by financing activities of continuing operations | 1,198,124         | (434,112)         |
|   | <u>          </u> | <u>          </u> |
| <b>Discontinued operations:</b>   |                   |                   |
| Net cash provided by discontinued operations                              |                   | 14,717            |
|   | <u>          </u> | <u>          </u> |
| Net (decrease) increase in cash and cash equivalents                      | (54,750)          | 34,090            |
| Cash and cash equivalents - beginning of period                           | 366,236           | 227,544           |
|   | <u>          </u> | <u>          </u> |
| Cash and cash equivalents - end of period                                 | \$ 311,486        | \$ 261,634        |
|   | <u>          </u> | <u>          </u> |
| <b>Supplemental cash flow disclosures:</b>                                |                   |                   |
| Income taxes paid   | \$ 195,327        | \$ 213,108        |
| Interest paid:  |                   |                   |
| Investment agreements   | \$ 251,493        | \$ 183,854        |
| Commercial paper  | 46,423            | 24,263            |
| Medium-term notes   | 172,916           | 95,469            |
| Variable interest entity floating rate notes                              | 16,218            | 6,039             |
| Securities sold under agreements to repurchase                            | 14,226            | 8,963             |
| Long-term debt  | 54,661            | 50,965            |
| Other borrowings and deposits   | 3,039             | 5,446             |
| Non cash items:   |                   |                   |
| Stock compensation  | \$ 15,048         | \$ 16,156         |
| Dividends declared but not paid   | 37,537            | 33,969            |

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

---

**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, as amended, for the year ended December 31, 2004 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, 2005 may not be indicative of the results that may be expected for the year ending December 31, 2005. The December 31, 2004 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. Business segment results are presented net of all material intersegment transactions.

NOTE 2: Restatement of Consolidated Financial Statements

On November 8, 2005, MBIA announced its decision to correct and restate its previously issued financial statements for 1998 and subsequent years in connection with potential settlements of investigations by the Securities and Exchange Commission (SEC) and the New York Attorney General's Office (NYAG) regarding agreements entered into by its subsidiary, MBIA Insurance Corporation, in 1998.

In 1998, three reinsurers, Converium Reinsurance (North America) Inc. (Converium), AXA Re Finance S.A. (ARF) and Muenchener Rueckversicherungs-Gesellschaft (Munich Re) paid the Company \$170 million under three separate agreements (the Excess-of-Loss Agreements) in connection with losses the Company incurred on \$265 million of MBIA-insured bonds issued by the Alleghany Health, Education and Research Foundation (AHERF). The Excess-of-Loss Agreements were structured as three successive excess-of-loss facilities that aggregated to \$170 million. Under the Excess-of-Loss Agreements, Converium paid the Company \$70 million, and Munich Re and ARF each paid the Company \$50 million.

In connection with the arrangements for the Excess-of-Loss Agreements, the Company entered into quota share agreements with Munich Re, ARF and Converium (each a Quota Share Agreement and, collectively, the Quota Share Agreements). Under the Quota Share Agreements, the Company agreed to cede to the three reinsurers new business written with an aggregate par sufficient to generate \$297 million in gross premiums over a six year period ending October 1, 2004. Of the \$297 million in premiums to be ceded under the Quota Share Agreements, the Company agreed to cede to Converium cash premiums equal to \$102 million, to ARF adjusted gross premiums of \$97 million and to Munich Re adjusted gross premiums of \$98 million over this period.

On March 8, 2005, the Company announced its decision to restate its financial statements for 1998 and subsequent years to correct the accounting for the agreements with Converium and reflected this correction in the consolidated financial statements of its original Annual Report on Form 10-K for the year ended December 31, 2004. At that time, the Company believed that the accounting for the Excess of Loss Agreements and Quota Share Agreements with Munich Re and ARF was appropriate under Statement of Financial Accounting Standards (SFAS) 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts.

## Edgar Filing: MBIA INC - Form 10-Q

This restatement of the Company's financial statements for the Munich Re and ARF Excess-of-Loss and Quota Share Agreements, made in connection with the potential settlements, corrects and restates its accounting for these agreements because, taking into account developments in the regulatory investigations since March and further accounting analyses, they did not satisfy the risk transfer requirements for reinsurance accounting under SFAS 113. As a result, the Company is restating its previously issued financial statements to reflect the Excess-of-Loss and Quota Share Agreements with Munich Re and ARF under deposit accounting in accordance with Statement of Position (SOP) 98-7, "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Risk" instead of under reinsurance accounting. The Company is also correcting and restating its 2004 statutory financial statements for the Munich Re and ARF Excess-of-Loss and Quota Share Agreements because they did not satisfy the requirements for reinsurance accounting under Regulation 108 of the New York State Insurance Department. The restatements do not have a significant effect on the Company's financial position.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## MBIA Inc. and Subsidiaries

Additionally, in the third quarter of 2005, the Company completed a detailed review of its derivative instruments for which it applied shortcut method hedge accounting under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities", as amended. Shortcut method hedge accounting allows the assumption that the change in fair value of a hedged item exactly offsets the change in fair value of the related derivative. After completing its review, the Company determined that certain hedging relationships did not meet every technical aspect of shortcut method hedge accounting, although, such hedging relationships would have qualified for basic hedge accounting. Since the documentation that the Company prepared was designed to support shortcut method hedge accounting, it was not sufficient to support basic hedge accounting. As a result, the Company must account for these derivatives, from 2001 to the present, as if they were not part of hedging relationships, which requires the change in fair value of these derivatives to be reflected in the Company's income statement without an offsetting change in fair value of the hedged items. The Company has restated its financial statements to correct the accounting for these derivatives for the year ended December 31, 2001 and subsequent years.

The following table presents the effects of the Munich Re, ARF and derivative accounting restatement on the consolidated financial statements of the Company for the three months ended March 31, 2005 and June 30, 2005. The effect of the Converium restatement was reflected in the previously issued consolidated financial statements of the Company for these periods.

| In thousands except per share information                                   | As of and For the Three Months |             | As of and For the Three Months |             |
|---|--------------------------------|-------------|--------------------------------|-------------|
|   | Ended                          |             | Ended                          |             |
|   | March 31, 2005                 |             | June 30, 2005                  |             |
|   | Previously Reported            | Restated    | Previously Reported            | Restated    |
| <b>Consolidated Statement of Income Data:</b>                               |                                |             |                                |             |
| Ceded premiums  | \$ (35,688)                    | \$ (32,126) | \$ (33,641)                    | \$ (31,622) |
| Net premiums written  | 246,931                        | 250,493     | 215,324                        | 217,343     |
| Increase in deferred premium revenue  | (40,693)                       | (39,648)    | (6,391)                        | (3,958)     |
| Scheduled premiums earned   | 169,873                        | 173,760     | 177,207                        | 180,902     |
| Refunding premiums earned   | 36,365                         | 37,085      | 31,726                         | 32,483      |
| Premiums earned   | 206,238                        | 210,845     | 208,933                        | 213,385     |
| Net gains (losses) on derivative instruments and foreign exchange-insurance | (6,075)                        | (6,072)     | 4,119                          | 4,002       |
| Total insurance revenues  | 325,945                        | 330,555     | 339,264                        | 343,599     |
| Losses and loss adjustment expenses   | 20,385                         | 20,851      | 21,265                         | 21,708      |
| Amortization of deferred acquisition costs                                  | 16,293                         | 16,657      | 16,506                         | 16,858      |
| Operating expenses  | 29,166                         | 30,262      | 32,268                         | 33,261      |
| Total insurance expenses  | 65,844                         | 67,770      | 70,039                         | 71,827      |
| Insurance income  | 260,101                        | 262,785     | 269,225                        | 271,772     |
| Net gains (losses) on derivative instruments and foreign exchange-IMS       | 11,178                         | 27,421      | (3,439)                        | (27,395)    |
| Investment management services income                                       | 36,812                         | 53,055      | 15,372                         | (8,584)     |
| Income from continuing operations before income taxes                       | 277,706                        | 296,633     | 261,312                        | 239,903     |
| Provision for income taxes  | 77,202                         | 83,826      | 73,722                         | 66,229      |
| Income from continuing operations   | 200,504                        | 212,807     | 187,590                        | 173,674     |
| Net income  | \$ 200,504                     | \$ 212,807  | \$ 187,590                     | \$ 173,674  |
| <b>Basic EPS:</b>   |                                |             |                                |             |
| Income from continuing operations   | \$ 1.46                        | \$ 1.55     | \$ 1.40                        | \$ 1.30     |
| Net income  | \$ 1.46                        | \$ 1.55     | \$ 1.40                        | \$ 1.30     |

Edgar Filing: MBIA INC - Form 10-Q

Diluted EPS:

|                                   |         |         |         |         |
|-----------------------------------|---------|---------|---------|---------|
| Income from continuing operations | \$ 1.43 | \$ 1.52 | \$ 1.37 | \$ 1.27 |
| Net income                        | \$ 1.43 | \$ 1.52 | \$ 1.37 | \$ 1.27 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## MBIA Inc. and Subsidiaries

**Consolidated Balance Sheet Data:**

|   |              |              |              |              |
|---|--------------|--------------|--------------|--------------|
| Deferred acquisition costs                | \$ 371,932   | \$ 417,454   | \$ 383,006   | \$ 428,613   |
| Prepaid reinsurance premiums              | 462,390      | 427,028      | 451,113      | 418,184      |
| Reinsurance recoverable on unpaid losses  | 33,202       | 34,091       | 42,869       | 41,671       |
| Derivative assets                         | 270,648      | 270,485      | 252,637      | 252,544      |
| Other assets                              | 282,295      | 281,406      | 253,843      | 255,041      |
| Total assets                              | 33,756,665   | 33,766,662   | 34,784,595   | 34,797,180   |
| Loss and loss adjustment expense reserves | 755,563      | 778,064      | 667,570      | 690,801      |
| Investment agreements                     | 9,316,470    | 9,318,116    | 10,005,780   | 9,998,534    |
| Deferred income taxes, net                | 573,849      | 563,551      | 661,184      | 654,888      |
| Derivative liabilities                    | 428,360      | 427,334      | 484,842      | 484,003      |
| Other liabilities                         | 381,426      | 397,724      | 396,596      | 412,019      |
| Total liabilities                         | 27,320,654   | 27,349,775   | 28,197,097   | 28,221,370   |
| Retained earnings                         | 5,377,327    | 5,361,923    | 5,527,063    | 5,497,743    |
| Accumulated other comprehensive income    | 500,516      | 496,796      | 630,628      | 648,260      |
| Total shareholders' equity                | \$ 6,436,011 | \$ 6,416,887 | \$ 6,587,498 | \$ 6,575,810 |

Additionally, the following table presents the effects of the ARF, Munich Re and derivative accounting restatement on the consolidated financial statements of the Company for the three and nine months ended September 30, 2004.

| In thousands except per share information                                       | As of and For the Three Months Ended<br>September 30, 2004 |             | As of and For the Nine Months Ended<br>September 30, 2004 |              |
|---|--|-------------|---|--------------|
|   | Previously<br>Reported                                     | Restated    | Previously<br>Reported                                    | Restated     |
| <b>Consolidated Statement of Income Data:</b>                                   |  |             |   |              |
| Ceded premiums  | \$ (47,682)  | \$ (42,289) | \$ (123,473)  | \$ (107,340) |
| Net premiums written  | 207,927  | 213,320     | 709,738   | 725,871      |
| Increase in deferred premium revenue  | (3,606)  | (2,326)     | (92,765)  | (86,629)     |
| Scheduled premiums earned   | 171,741  | 177,808     | 505,691   | 525,756      |
| Refunding premiums earned   | 32,580   | 33,186      | 111,282   | 113,486      |
| Premiums earned   | 204,321  | 210,994     | 616,973   | 639,242      |
| Net gains (losses) on derivative instruments and foreign<br>exchange- insurance | 1,929  | 1,897       | 3,209   | 3,167        |
| Total insurance revenues  | 329,353  | 335,994     | 1,066,265   | 1,088,492    |
| Losses and loss adjustment expenses   | 20,608   | 21,336      | 60,682  | 63,090       |
| Amortization of deferred acquisition costs                                      | 15,680   | 16,200      | 47,759  | 49,495       |
| Operating expenses  | 26,575   | 28,080      | 83,256  | 88,034       |
| Total insurance expenses  | 62,863   | 65,616      | 191,697   | 200,619      |
| Insurance income  | 266,490  | 270,378     | 874,568   | 887,873      |
| Net gains (losses) on derivative instruments and foreign<br>exchange-IMS        | (3,843)  | (14,324)    | (3,839)   | (14,373)     |
| Investment management services income   | 12,807   | 2,326       | 36,767  | 26,233       |
| Income from continuing operations before income taxes                           | 260,213  | 253,620     | 851,036   | 853,807      |
| Provision for income taxes  | 72,717   | 70,409      | 239,237   | 240,206      |
| Income from continuing operations   | 187,496  | 183,211     | 611,799   | 613,601      |
| Net income  | \$ 187,496   | \$ 183,211  | \$ 614,496  | \$ 616,298   |
| Basic EPS:  |  |             |   |              |



Edgar Filing: MBIA INC - Form 10-Q

|                                   |         |         |         |         |
|-----------------------------------|---------|---------|---------|---------|
| Income from continuing operations | \$ 1.33 | \$ 1.30 | \$ 4.28 | \$ 4.30 |
| Net income                        | \$ 1.33 | \$ 1.30 | \$ 4.30 | \$ 4.32 |
| Diluted EPS:                      |         |         |         |         |
| Income from continuing operations | \$ 1.30 | \$ 1.27 | \$ 4.20 | \$ 4.21 |
| Net income                        | \$ 1.30 | \$ 1.27 | \$ 4.22 | \$ 4.23 |

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MBIA Inc. and Subsidiaries****Consolidated Balance Sheet Data:**

|   |                     |                     |                     |                     |
|---|---------------------|---------------------|---------------------|---------------------|
| Deferred acquisition costs                | \$ 345,243          | \$ 401,255          | \$ 345,243          | \$ 401,255          |
| Prepaid reinsurance premiums              | 489,042             | 419,187             | 489,042             | 419,187             |
| Reinsurance recoverable on unpaid losses  | 32,492              | 33,898              | 32,492              | 33,898              |
| Derivative assets                         | 234,428             | 233,935             | 234,428             | 233,935             |
| Other assets                              | 283,422             | 282,016             | 283,422             | 282,016             |
| <b>Total assets</b>                       | <b>30,875,612</b>   | <b>30,861,276</b>   | <b>30,875,612</b>   | <b>30,861,276</b>   |
| Loss and loss adjustment expense reserves | 721,841             | 744,330             | 721,841             | 744,330             |
| Investment agreements                     | 8,375,723           | 8,376,949           | 8,375,723           | 8,376,949           |
| Deferred income taxes, net                | 525,948             | 503,119             | 525,948             | 503,119             |
| Derivative liabilities                    | 415,987             | 413,914             | 415,987             | 413,914             |
| Other liabilities                         | 420,933             | 450,180             | 420,933             | 450,180             |
| <b>Total liabilities</b>                  | <b>24,397,427</b>   | <b>24,425,487</b>   | <b>24,397,427</b>   | <b>24,425,487</b>   |
| Retained earnings                         | 5,047,873           | 4,994,223           | 5,047,873           | 4,994,223           |
| Accumulated other comprehensive income    | 562,552             | 573,806             | 562,552             | 573,806             |
| <b>Total shareholders' equity</b>         | <b>\$ 6,478,185</b> | <b>\$ 6,435,789</b> | <b>\$ 6,478,185</b> | <b>\$ 6,435,789</b> |

Information presented in the Notes to Consolidated Financial Statements gives effect to the restatement, as applicable.

**NOTE 3: Dividends Declared**

Dividends declared by the Company during the nine months ended September 30, 2005 were \$114 million.

**NOTE 4: Earnings Per Share (Restated)**

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, 2005 there were 2,456,389 and 2,869,503 stock options outstanding, respectively, and for the three and nine months ended September 30, 2004, there were 2,466,960 and 2,247,601 stock options outstanding, respectively, that were not included in the diluted earnings per share calculation because they were antidilutive.

---

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**MBIA Inc. and Subsidiaries**

The following table sets forth the computation of basic and diluted earnings per share for the third quarter and nine months ended September 30, 2005 and 2004:

| <b>In millions except per share amounts</b>            | <b>3rd Quarter</b> |                          | <b>Year-to-date</b> |                          |
|--|--------------------|--------------------------|---------------------|--------------------------|
|  | <b>2005</b>        | <b>Restated<br/>2004</b> | <b>2005</b>         | <b>Restated<br/>2004</b> |
| Income from continuing operations, net of tax          | \$ 143             | \$ 183                   | \$ 529              | \$ 613                   |
| Income from discontinued operations, net of tax        | (1)                |                          | (1)                 | 3                        |
| <b>Net income</b>                                      | <b>\$ 142</b>      | <b>\$ 183</b>            | <b>\$ 528</b>       | <b>\$ 616</b>            |
| <b>Diluted weighted average shares (in thousands):</b> |                    |                          |                     |                          |
| Basic weighted average shares outstanding              | 132,623            | 141,409                  | 134,590             | 142,819                  |
| Effect of stock based compensation                     | 3,199              | 2,716                    | 3,132               | 2,963                    |
| <b>Diluted weighted average shares</b>                 | <b>135,822</b>     | <b>144,125</b>           | <b>137,722</b>      | <b>145,782</b>           |
| <b>Basic EPS:</b>                                      |                    |                          |                     |                          |
| Income from continuing operations                      | \$ 1.08            | \$ 1.30                  | \$ 3.93             | \$ 4.30                  |
| Income from discontinued operations                    | (0.01)             |                          | (0.01)              | 0.02                     |
| <b>Net income *</b>                                    | <b>\$ 1.07</b>     | <b>\$ 1.30</b>           | <b>\$ 3.93</b>      | <b>\$ 4.32</b>           |
| <b>Diluted EPS:</b>                                    |                    |                          |                     |                          |
| Income from continuing operations                      | \$ 1.05            | \$ 1.27                  | \$ 3.84             | \$ 4.21                  |
| Income from discontinued operations                    | (0.01)             |                          | (0.01)              | 0.02                     |
| <b>Net income *</b>                                    | <b>\$ 1.04</b>     | <b>\$ 1.27</b>           | <b>\$ 3.84</b>      | <b>\$ 4.23</b>           |

\* May not add due to rounding.

**NOTE 5: Business Segments (Restated)**

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 three principal business operations: insurance, investment management services and municipal 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.

## Edgar Filing: MBIA INC - Form 10-Q

The insurance operations 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. The Company views its insurance operations as a reportable segment. 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 the origination of assets 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 programs, advisory services and conduits. During the second quarter of 2004, the Company completed the sale of the assets of 1838 Investment Advisors, LLC, the Company's equity advisory services segment. This segment is reported as a discontinued operation.

---

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**MBIA Inc. and Subsidiaries**

The Company's municipal services operations provide revenue enhancement services and products to public-sector clients nationwide consisting of discovery, audit, collections/recovery and information services through MBIA MuniServices and its wholly owned subsidiaries. Additionally, the municipal services operations include Capital Asset Holdings GP, Inc. and certain affiliated entities, a servicer of delinquent tax certificates. The Company views its municipal services operations as a reportable segment.

The Company's corporate operations include investment income, interest expense and general expenses that relate to general corporate activities and not to one of the Company's three principal business operations. The Company views its corporate operations as a reportable segment.

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 table summarizes the Company's continuing operations for the three and nine months ended September 30, 2005 and 2004:

| In thousands  | Three months ended September 30, 2005 |                                |                    |             |               |
|---|---------------------------------------|--------------------------------|--------------------|-------------|---------------|
|   | Insurance                             | Investment Management Services | Municipal Services | Corporate   | Total         |
| Revenues <sup>(a)</sup>   | \$ 336,036                            | \$ 225,671                     | \$ 5,611           | \$ 3,411    | \$ 570,729    |
| Net realized gains (losses)                                       | (7,526)                               | 1,284                          | (51)               | 226         | (6,067)       |
| Net gains (losses) on derivative instruments and foreign exchange | 2,485                                 | 41,607                         | 64                 |             | 44,156        |
| Total revenues  | 330,995                               | 268,562                        | 5,624              | 3,637       | 608,818       |
| Interest expense  |                                       | 184,397                        |                    | 22,080      | 206,477       |
| Operating expenses  | 76,810                                | 18,341                         | 5,321              | 81,391      | 181,863       |
| Total expenses  | 76,810                                | 202,738                        | 5,321              | 103,471     | 388,340       |
| Income (loss) before taxes  | \$ 254,185                            | \$ 65,824                      | \$ 303             | \$ (99,834) | \$ 220,478    |
| Identifiable assets <sup>(b)</sup>                                | \$ 12,530,174                         | \$ 21,892,776                  | \$ 23,244          | \$ 483,866  | \$ 34,930,060 |

**Restated**

| In thousands | Three months ended September 30, 2004 |                                |                    |           |       |
|--------------|---------------------------------------|--------------------------------|--------------------|-----------|-------|
|              | Insurance                             | Investment Management Services | Municipal Services | Corporate | Total |

Edgar Filing: MBIA INC - Form 10-Q

|   |                      |                      |                  |                    |                      |
|---|----------------------|----------------------|------------------|--------------------|----------------------|
| Revenues <sup>(a)</sup>   | \$ 334,513           | \$ 142,323           | \$ 8,245         | \$ 1,934           | \$ 487,015           |
| Net realized gains (losses)                                       | (416)                | 378                  | (48)             | 390                | 304                  |
| Net gains (losses) on derivative instruments and foreign exchange | 1,897                | (14,324)             |                  |                    | (12,427)             |
| <b>Total revenues</b>   | <b>335,994</b>       | <b>128,377</b>       | <b>8,197</b>     | <b>2,324</b>       | <b>474,892</b>       |
| Interest expense  |                      | 106,431              |                  | 17,798             | 124,229              |
| Operating expenses  | 65,616               | 19,620               | 7,633            | 4,174              | 97,043               |
| <b>Total expenses</b>   | <b>65,616</b>        | <b>126,051</b>       | <b>7,633</b>     | <b>21,972</b>      | <b>221,272</b>       |
| <b>Income (loss) before taxes</b>                                 | <b>\$ 270,378</b>    | <b>\$ 2,326</b>      | <b>\$ 564</b>    | <b>\$ (19,648)</b> | <b>\$ 253,620</b>    |
| <b>Identifiable assets<sup>(b)</sup></b>                          | <b>\$ 11,979,738</b> | <b>\$ 18,377,639</b> | <b>\$ 25,771</b> | <b>\$ 478,123</b>  | <b>\$ 30,861,271</b> |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## MBIA Inc. and Subsidiaries

| Nine months ended September 30, 2005                              |               |                                      |                       |              |               |
|---|---------------|--------------------------------------|-----------------------|--------------|---------------|
| In thousands  | Insurance     | Investment<br>Management<br>Services | Municipal<br>Services | Corporate    | Total         |
| Revenues <sup>(a)</sup>   | \$ 1,011,053  | \$ 618,449                           | \$ 16,545             | \$ 17,114    | \$ 1,663,161  |
| Net realized gains (losses)                                       | (6,319)       | 3,000                                | (136)                 | (1,301)      | (4,756)       |
| Net gains (losses) on derivative instruments and foreign exchange | 415           | 41,633                               | 200                   |              | 42,248        |
| Total revenues  | 1,005,149     | 663,082                              | 16,609                | 15,813       | 1,700,653     |
| Interest expense  |               | 500,979                              |                       | 66,141       | 567,120       |
| Operating expenses  | 216,407       | 51,808                               | 15,834                | 92,470       | 376,519       |
| Total expenses  | 216,407       | 552,787                              | 15,834                | 158,611      | 943,639       |
| Income (loss) before taxes  | \$ 788,742    | \$ 110,295                           | \$ 775                | \$ (142,798) | \$ 757,014    |
| Identifiable assets <sup>(b)</sup>                                | \$ 12,530,174 | \$ 21,892,776                        | \$ 23,244             | \$ 483,866   | \$ 34,930,060 |
| <b>Restated</b>   |               |                                      |                       |              |               |
| Nine months ended September 30, 2004                              |               |                                      |                       |              |               |
| In thousands  | Insurance     | Investment<br>Management<br>Services | Municipal<br>Services | Corporate    | Total         |
| Revenues <sup>(a)</sup>   | \$ 1,022,513  | \$ 390,039                           | \$ 19,956             | \$ 6,511     | \$ 1,439,019  |
| Net realized gains (losses)                                       | 62,812        | (2,565)                              | (90)                  | (186)        | 59,971        |
| Net gains (losses) on derivative instruments and foreign exchange | 3,167         | (14,373)                             |                       |              | (11,206)      |
| Total revenues  | 1,088,492     | 373,101                              | 19,866                | 6,325        | 1,487,784     |
| Interest expense  |               | 289,904                              |                       | 53,343       | 343,247       |
| Operating expenses  | 200,619       | 56,964                               | 19,013                | 14,134       | 290,730       |
| Total expenses  | 200,619       | 346,868                              | 19,013                | 67,477       | 633,977       |
| Income (loss) before taxes  | \$ 887,873    | \$ 26,233                            | \$ 853                | \$ (61,152)  | \$ 853,807    |
| Identifiable assets <sup>(b)</sup>                                | \$ 11,979,738 | \$ 18,377,639                        | \$ 25,771             | \$ 478,123   | \$ 30,861,271 |

(a) Represents the sum of net premiums earned, net investment income, advisory fees, investment management fees and other fees.

Edgar Filing: MBIA INC - Form 10-Q

(b) At September 30, 2005, there were no assets associated with the Company's discontinued operations. At September 30, 2004, identifiable assets related to the Company's discontinued operations were \$5 thousand.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## MBIA Inc. and Subsidiaries

The following table summarizes the segments within the investment management services operations for the three and nine months ended September 30, 2005 and 2004:

| Three months ended September 30, 2005                             |                                 |                      |              |              |   |
|---|---------------------------------|----------------------|--------------|--------------|---|
| In thousands  | Asset/<br>Liability<br>Products | Advisory<br>Services | Conduits     | Eliminations | Total<br>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                                 |
| Restated  |                                 |                      |              |              |   |
| Three months ended September 30, 2004                             |                                 |                      |              |              |   |
| In thousands  | Asset/<br>Liability<br>Products | Advisory<br>Services | Conduits     | Eliminations | Total<br>Investment<br>Management<br>Services |
| Revenues <sup>(a)</sup>   | \$ 101,606                      | \$ 12,829            | \$ 28,284    | \$ (396)     | \$ 142,323                                    |
| Net realized gains (losses)                                       | 372                             | 6                    |              |              | 378   |
| Net gains (losses) on derivative instruments and foreign exchange | (7,936)                         | (17)                 | (6,371)      |              | (14,324)                                      |
| Total revenues  | 94,042                          | 12,818               | 21,913       | (396)        | 128,377                                       |
| Interest expense  | 84,936                          |                      | 21,495       |              | 106,431                                       |
| Operating expenses  | 6,716                           | 8,622                | 4,678        | (396)        | 19,620  |
| Total expenses  | 91,652                          | 8,622                | 26,173       | (396)        | 126,051                                       |

Edgar Filing: MBIA INC - Form 10-Q

|                            |               |           |              |              |               |
|----------------------------|---------------|-----------|--------------|--------------|---------------|
| Income (loss) before taxes | \$ 2,390      | \$ 4,196  | \$ (4,260)   | \$ 0         | \$ 2,326      |
| Identifiable assets        | \$ 12,486,580 | \$ 62,041 | \$ 6,080,688 | \$ (251,670) | \$ 18,377,639 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## MBIA Inc. and Subsidiaries

| In thousands  | Nine months ended September 30, 2005 |                      |              |              |   |
|---|--------------------------------------|----------------------|--------------|--------------|---|
|   | Asset/<br>Liability<br>Products      | Advisory<br>Services | Conduits     | Eliminations | Total<br>Investment<br>Management<br>Services |
| 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                                 |

## Restated

| In thousands  | Nine months ended September 30, 2004 |                      |              |              |   |
|---|--------------------------------------|----------------------|--------------|--------------|---|
|   | Asset/<br>Liability<br>Products      | Advisory<br>Services | Conduits     | Eliminations | Total<br>Investment<br>Management<br>Services |
| Revenues <sup>(a)</sup>   | \$ 286,346                           | \$ 37,851            | \$ 73,410    | \$ (7,568)   | \$ 390,039                                    |
| Net realized gains (losses)                                       | (2,197)                              | (368)                |              |              | (2,565)                                       |
| Net gains (losses) on derivative instruments and foreign exchange | (16,570)                             | (26)                 | 2,223        |              | (14,373)                                      |
| Total revenues  | 267,579                              | 37,457               | 75,633       | (7,568)      | 373,101                                       |
| Interest expense  | 234,880                              |                      | 55,024       |              | 289,904                                       |
| Operating expenses  | 23,873                               | 25,598               | 14,298       | (6,805)      | 56,964  |
| Total expenses  | 258,753                              | 25,598               | 69,322       | (6,805)      | 346,868                                       |
| Income (loss) before taxes  | \$ 8,826                             | \$ 11,859            | \$ 6,311     | \$ (763)     | \$ 26,233                                     |
| Identifiable assets   | \$ 12,486,580                        | \$ 62,041            | \$ 6,080,688 | \$ (251,670) | \$ 18,377,639                                 |

Edgar Filing: MBIA INC - Form 10-Q

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

An increasingly 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, 2005 and 2004:

| <u>In thousands</u>  | 3rd Quarter       |                   | Year-to-date      |                   |
|----------------------|-------------------|-------------------|-------------------|-------------------|
|                      | Restated          |                   | Restated          |                   |
|                      | 2005              | 2004              | 2005              | 2004              |
| Net premiums earned: |                   |                   |                   |                   |
| United States        | \$ 151,097        | \$ 159,474        | \$ 464,319        | \$ 486,717        |
| Non-United States    | 52,975            | 51,520            | 163,983           | 152,525           |
| <b>Total</b>         | <b>\$ 204,072</b> | <b>\$ 210,994</b> | <b>\$ 628,302</b> | <b>\$ 639,242</b> |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## MBIA Inc. and Subsidiaries

NOTE 6: Loss and Loss Adjustment Expense (LAE) Reserves (Restated)

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 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 2005 are shown in the following table:

| <u>In thousands</u>  | <u>3Q 2005</u> | <u>Restated</u><br><u>2Q 2005</u> | <u>Restated</u><br><u>1Q 2005</u> |
|--|----------------|-----------------------------------|-----------------------------------|
| Case basis loss and LAE reserves:                              |                |                                   |                                   |
| Beginning balance  | \$ 372,338     | \$ 463,161                        | \$ 434,924                        |
| Less: reinsurance recoverable                                  | 41,671         | 34,091                            | 34,610                            |
| Net beginning balance  | 330,667        | 429,070                           | 400,314                           |
| Case basis transfers from unallocated loss reserve related to: |                |                                   |                                   |
| Current year   | 21,689         | 23                                |                                   |
| Prior years  | 30,145         | 17,839                            | 19,721                            |
| Total  | 51,834         | 17,862                            | 19,721                            |
| Paid (recovered) related to:                                   |                |                                   |                                   |
| Current year   | 390            | (1)                               | (4,231)                           |
| Prior years  | 3,509          | 116,266                           | (4,804)                           |
| Total paid (recovered)   | 3,899          | 116,265                           | (9,035)                           |
| Net ending balance   | 378,602        | 330,667                           | 429,070                           |
| Plus: reinsurance recoverable                                  | 45,677         | 41,671                            | 34,091                            |
| Case basis loss and LAE reserve ending balance                 | 424,279        | 372,338                           | 463,161                           |
| Unallocated loss reserve:                                      |                |                                   |                                   |
| Beginning balance  | 318,463        | 314,903                           | 313,945                           |
| Losses and LAE incurred <sup>(1)</sup>                         | 20,796         | 21,708                            | 20,851                            |
| Channel Re elimination <sup>(2)</sup>                          | (281)          | (286)                             | (172)                             |
| Transfers to case basis and LAE reserves                       | (51,834)       | (17,862)                          | (19,721)                          |
| Unallocated loss reserve ending balance                        | 287,144        | 318,463                           | 314,903                           |
| Total  | \$ 711,423     | \$ 690,801                        | \$ 778,064                        |

## Edgar Filing: MBIA INC - Form 10-Q

- (1) Represents the Company's provision for losses calculated as 12% of scheduled net earned premium.
- (2) 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.

Case basis activity transferred from the Company's unallocated loss reserve was approximately \$89 million in the first nine months of 2005 and 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. Total paid and recovery activity of \$111 million for the first nine months of 2005 primarily consisted of payments related to Fort Worth Osteopathic Hospital and estimated recoveries for AHERF reclassified from Other assets, both of which reduced the respective case basis loss reserve. Unallocated loss reserves approximated \$287 million at September 30, 2005, which represent the Company's estimate of losses associated with credit deterioration that has occurred in the Company's insured portfolio and are available for future case-specific activity. The Company incurred \$63 million of loss and loss adjustment expenses in the first nine months of 2005 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, 2004 for a description of the Company's loss reserving policy.

The Company has significant exposures in its insured portfolio relating to regions impacted by hurricanes Katrina, Rita and Wilma. 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 efforts with issuers, trustees and relevant state officials to evaluate the actual and potential impact that the hurricanes may have on its insured credits. Based on available information, the Company does not currently expect there to be material cases of prolonged nonpayment that would result in unreimbursed losses. As a result, during the third quarter of 2005, MBIA did not establish specific reserves for its exposure to the regions impacted by these hurricanes. To date, MBIA has paid \$2 million in claim payments, for which it has been fully reimbursed.

---

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MBIA Inc. and Subsidiaries**

NOTE 7: Contingencies

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 the Pittsburgh-based 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 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 included herein. 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 New York State Insurance Department 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 a consolidated private securities litigation suit: *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 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. Elliot 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 act 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).

## Edgar Filing: MBIA INC - Form 10-Q

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. The plaintiffs allege that, as a result of these misleading statements or omissions, the Company's stock traded at artificially inflated prices. These lawsuits 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 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.

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.



**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**

## Edgar Filing: MBIA INC - Form 10-Q

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 these activities through three principal business operations: insurance, investment management services and municipal services. The Company's corporate operations include revenues and expenses that arise from general corporate activities and not from one of the Company's three principal business operations. Results of operations included herein are presented in accordance with accounting principles generally accepted in the United States of America (GAAP).

### RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

On November 8, 2005, MBIA announced its decision to correct and restate its previously issued financial statements for 1998 and subsequent years in connection with potential settlements of investigations by the Securities and Exchange Commission (SEC) and the New York Attorney General's Office (NYAG) regarding agreements entered into by its subsidiary, MBIA Insurance Corporation, in 1998.

In 1998, three reinsurers, Converium Reinsurance (North America) Inc. (Converium), AXA Re Finance S.A. (ARF) and Muenchener Rueckversicherungs-Gesellschaft (Munich Re) paid the Company \$170 million under three separate agreements (the Excess-of-Loss Agreements) in connection with losses the Company incurred on \$265 million of MBIA-insured bonds issued by the Alleghany Health, Education and Research Foundation (AHERF). The Excess-of-Loss Agreements were structured as three successive excess-of-loss facilities that aggregated to \$170 million. Under the Excess-of-Loss Agreements, Converium paid the Company \$70 million, and Munich Re and ARF each paid the Company \$50 million.

In connection with the arrangements for the Excess-of-Loss Agreements, the Company entered into quota share agreements with Munich Re, ARF and Converium (each a Quota Share Agreement and, collectively, the Quota Share Agreements). Under the Quota Share Agreements, the Company agreed to cede to the three reinsurers new business written with an aggregate par sufficient to generate \$297 million in gross premiums over a six year period ending October 1, 2004. Of the \$297 million in premiums to be ceded under the Quota Share Agreements, the Company agreed to cede to Converium cash premiums equal to \$102 million, to ARF adjusted gross premiums of \$97 million and to Munich Re adjusted gross premiums of \$98 million over this period.

On March 8, 2005, the Company announced its decision to restate its financial statements for 1998 and subsequent years to correct the accounting for the agreements with Converium and reflected this correction in the consolidated financial statements of its original Annual Report on Form 10-K for the year ended December 31, 2004. At that time, the Company believed that the accounting for the Excess of Loss Agreements and Quota Share Agreements with Munich Re and ARF was appropriate under Statement of Financial Accounting Standards (SFAS) 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts.

This restatement of the Company's financial statements for the Munich Re and ARF Excess-of-Loss and Quota Share Agreements, made in connection with the potential settlements, corrects and restates its accounting for these agreements because, taking into account developments in the regulatory investigations since March and further accounting analyses, they did not satisfy the risk transfer requirements for reinsurance accounting under SFAS 113. As a result, the Company is restating its previously issued financial statements to reflect the Excess-of-Loss and Quota Share Agreements with Munich Re and ARF under deposit accounting in accordance with Statement of Position (SOP) 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Risk instead of under reinsurance accounting. The Company is also correcting and restating its 2004 statutory financial statements for the Munich Re and ARF Excess-of-Loss and Quota Share Agreements because they did not satisfy the requirements for reinsurance accounting under Regulation 108 of the New York State Insurance Department. The restatements do not have a significant effect on the Company's financial position.

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

Additionally, in the third quarter of 2005, the Company completed a detailed review of its derivative instruments for which it applied shortcut method hedge accounting under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. Shortcut method hedge accounting allows the assumption that the change in fair value of a hedged item exactly offsets the change in fair value of the related derivative. After completing its review, the Company determined that certain hedging relationships did not meet every technical aspect of shortcut method hedge accounting, although, such hedging relationships would have qualified for basic hedge accounting. Since the documentation that the Company prepared was designed to support shortcut method hedge accounting, it was not sufficient to support basic hedge accounting. As a result, the Company must account for these derivatives, from 2001 to the present, as if they were not part of hedging relationships, which requires the change in fair value of these derivatives to be reflected in the Company's income statement without an offsetting change in fair value of the hedged items. The Company has restated its financial statements to correct the accounting for these derivatives for the year ended December 31, 2001 and subsequent years.

**MBIA Inc. and Subsidiaries**

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

The following table presents the effects of the Munich Re, ARF and derivative accounting restatement on the consolidated financial statements of the Company for the three months ended March 31, 2005 and June 30, 2005. The effect of the Converium restatement was reflected in the previously issued consolidated financial statements of the Company for these periods.

| <b>In thousands except per share information</b>                             | <b>As of and For the Three Months Ended<br/>March 31, 2005</b> |                   | <b>As of and For the Three Months Ended<br/>June 30, 2005</b> |                   |
|--|--|-------------------|---|-------------------|
|  | <b>Previously</b>  | <b>Previously</b> | <b>Previously</b>   | <b>Previously</b> |
|  | <b>Reported</b>  | <b>Restated</b>   | <b>Reported</b>   | <b>Restated</b>   |
| <b>Consolidated Statement of Income Data:</b>                                |  |                   |   |                   |
| Ceded premiums   | \$ (35,688)  | \$ (32,126)       | \$ (33,641)   | \$ (31,622)       |
| Net premiums written   | 246,931  | 250,493           | 215,324   | 217,343           |
| Increase in deferred premium revenue   | (40,693)   | (39,648)          | (6,391)   | (3,958)           |
| Scheduled premiums earned  | 169,873  | 173,760           | 177,207   | 180,902           |
| Refunding premiums earned  | 36,365   | 37,085            | 31,726  | 32,483            |
| Premiums earned  | 206,238  | 210,845           | 208,933   | 213,385           |
| Net gains (losses) on derivative instruments and foreign exchange- insurance | (6,075)  | (6,072)           | 4,119   | 4,002             |
| Total insurance revenues   | 325,945  | 330,555           | 339,264   | 343,599           |
| Losses and loss adjustment expenses  | 20,385   | 20,851            | 21,265  | 21,708            |
| Amortization of deferred acquisition costs                                   | 16,293   | 16,657            | 16,506  | 16,858            |
| Operating expenses   | 29,166   | 30,262            | 32,268  | 33,261            |
| Total insurance expenses   | 65,844   | 67,770            | 70,039  | 71,827            |
| Insurance income   | 260,101  | 262,785           | 269,225   | 271,772           |
| Net gains (losses) on derivative instruments and foreign exchange-IMS        | 11,178   | 27,421            | (3,439)   | (27,395)          |
| Investment management services income  | 36,812   | 53,055            | 15,372  | (8,584)           |
| Income from continuing operations before income taxes                        | 277,706  | 296,633           | 261,312   | 239,903           |
| Provision for income taxes   | 77,202   | 83,826            | 73,722  | 66,229            |
| Income from continuing operations  | 200,504  | 212,807           | 187,590   | 173,674           |
| Net income   | \$ 200,504   | \$ 212,807        | \$ 187,590  | \$ 173,674        |
| <b>Basic EPS:</b>  |  |                   |   |                   |
| Income from continuing operations  | \$ 1.46  | \$ 1.55           | \$ 1.40   | \$ 1.30           |
| Net income   | \$ 1.46  | \$ 1.55           | \$ 1.40   | \$ 1.30           |
| <b>Diluted EPS:</b>  |  |                   |   |                   |
| Income from continuing operations  | \$ 1.43  | \$ 1.52           | \$ 1.37   | \$ 1.27           |
| Net income   | \$ 1.43  | \$ 1.52           | \$ 1.37   | \$ 1.27           |
| <b>Consolidated Balance Sheet Data:</b>                                      |  |                   |   |                   |
| Deferred acquisition costs   | \$ 371,932   | \$ 417,454        | \$ 383,006  | \$ 428,613        |
| Prepaid reinsurance premiums   | 462,390  | 427,028           | 451,113   | 418,184           |
| Reinsurance recoverable on unpaid losses                                     | 33,202   | 34,091            | 42,869  | 41,671            |
| Derivative assets  | 270,648  | 270,485           | 252,637   | 252,544           |
| Other assets   | 282,295  | 281,406           | 253,843   | 255,041           |
| Total assets   | 33,756,665   | 33,766,662        | 34,784,595  | 34,797,180        |
| Loss and loss adjustment expense reserves                                    | 755,563  | 778,064           | 667,570   | 690,801           |

Edgar Filing: MBIA INC - Form 10-Q

|  |                     |                     |                     |                     |
|--|---------------------|---------------------|---------------------|---------------------|
| Investment agreements                  | 9,316,470           | 9,318,116           | 10,005,780          | 9,998,534           |
| Deferred income taxes, net             | 573,849             | 563,551             | 661,184             | 654,888             |
| Derivative liabilities                 | 428,360             | 427,334             | 484,842             | 484,003             |
| Other liabilities                      | 381,426             | 397,724             | 396,596             | 412,019             |
| <b>Total liabilities</b>               | <b>27,320,654</b>   | <b>27,349,775</b>   | <b>28,197,097</b>   | <b>28,221,370</b>   |
| Retained earnings                      | 5,377,327           | 5,361,923           | 5,527,063           | 5,497,743           |
| Accumulated other comprehensive income | 500,516             | 496,796             | 630,628             | 648,260             |
| <b>Total shareholders' equity</b>      | <b>\$ 6,436,011</b> | <b>\$ 6,416,887</b> | <b>\$ 6,587,498</b> | <b>\$ 6,575,810</b> |

## MBIA Inc. and Subsidiaries

## Management's Discussion and Analysis

## of Financial Condition and Results of Operations

Additionally, the following table presents the effects of the ARF, Munich Re and derivative accounting restatement on the consolidated financial statements of the Company for the three and nine months ended September 30, 2004.

| In thousands except per share information                                       | As of and For the Three Months Ended<br>September 30, 2004 |             | As of and For the Nine Months Ended<br>September 30, 2004 |              |
|---|--|-------------|---|--------------|
|   | Previously<br>Reported                                     | Restated    | Previously<br>Reported                                    | Restated     |
| <b>Consolidated Statement of Income Data:</b>                                   |  |             |   |              |
| Ceded premiums  | \$ (47,682)  | \$ (42,289) | \$ (123,473)  | \$ (107,340) |
| Net premiums written  | 207,927  | 213,320     | 709,738   | 725,871      |
| Increase in deferred premium revenue  | (3,606)  | (2,326)     | (92,765)  | (86,629)     |
| Scheduled premiums earned   | 171,741  | 177,808     | 505,691   | 525,756      |
| Refunding premiums earned   | 32,580   | 33,186      | 111,282   | 113,486      |
| Premiums earned   | 204,321  | 210,994     | 616,973   | 639,242      |
| Net gains (losses) on derivative instruments and foreign<br>exchange- insurance | 1,929  | 1,897       | 3,209   | 3,167        |
| Total insurance revenues  | 329,353  | 335,994     | 1,066,265   | 1,088,492    |
| Losses and loss adjustment expenses   | 20,608   | 21,336      | 60,682  | 63,090       |
| Amortization of deferred acquisition costs                                      | 15,680   | 16,200      | 47,759  | 49,495       |
| Operating expenses  | 26,575   | 28,080      | 83,256  | 88,034       |
| Total insurance expenses  | 62,863   | 65,616      | 191,697   | 200,619      |
| Insurance income  | 266,490  | 270,378     | 874,568   | 887,873      |
| Net gains (losses) on derivative instruments and foreign<br>exchange-IMS        | (3,843)  | (14,324)    | (3,839)   | (14,373)     |
| Investment management services income   | 12,807   | 2,326       | 36,767  | 26,233       |
| Income from continuing operations before income taxes                           | 260,213  | 253,620     | 851,036   | 853,807      |
| Provision for income taxes  | 72,717   | 70,409      | 239,237   | 240,206      |
| Income from continuing operations   | 187,496  | 183,211     | 611,799   | 613,601      |
| Net income  | \$ 187,496   | \$ 183,211  | \$ 614,496  | \$ 616,298   |
| <b>Basic EPS:</b>   |  |             |   |              |
| Income from continuing operations   | \$ 1.33  | \$ 1.30     | \$ 4.28   | \$ 4.30      |
| Net income  | \$ 1.33  | \$ 1.30     | \$ 4.30   | \$ 4.32      |
| <b>Diluted EPS:</b>   |  |             |   |              |
| Income from continuing operations   | \$ 1.30  | \$ 1.27     | \$ 4.20   | \$ 4.21      |
| Net income  | \$ 1.30  | \$ 1.27     | \$ 4.22   | \$ 4.23      |
| <b>Consolidated Balance Sheet Data:</b>   |  |             |   |              |
| Deferred acquisition costs  | \$ 345,243   | \$ 401,255  | \$ 345,243  | \$ 401,255   |
| Prepaid reinsurance premiums  | 489,042  | 419,187     | 489,042   | 419,187      |
| Reinsurance recoverable on unpaid losses  | 32,492   | 33,898      | 32,492  | 33,898       |
| Derivative assets   | 234,428  | 233,935     | 234,428   | 233,935      |
| Other assets  | 283,422  | 282,016     | 283,422   | 282,016      |
| Total assets  | 30,875,612   | 30,861,276  | 30,875,612  | 30,861,276   |
| Loss and loss adjustment expense reserves                                       | 721,841  | 744,330     | 721,841   | 744,330      |
| Investment agreements   | 8,375,723  | 8,376,949   | 8,375,723   | 8,376,949    |
| Deferred income taxes, net  | 525,948  | 503,119     | 525,948   | 503,119      |

Edgar Filing: MBIA INC - Form 10-Q

|  |              |              |              |              |
|--|--------------|--------------|--------------|--------------|
| Derivative liabilities                 | 415,987      | 413,914      | 415,987      | 413,914      |
| Other liabilities                      | 420,933      | 450,180      | 420,933      | 450,180      |
| Total liabilities                      | 24,397,427   | 24,425,487   | 24,397,427   | 24,425,487   |
| Retained earnings                      | 5,047,873    | 4,994,223    | 5,047,873    | 4,994,223    |
| Accumulated other comprehensive income | 562,552      | 573,806      | 562,552      | 573,806      |
| Total shareholders' equity             | \$ 6,478,185 | \$ 6,435,789 | \$ 6,478,185 | \$ 6,435,789 |

The restatement of the Company's financial statements did not have a material effect on its financial condition and MBIA does not expect the restatement to have any impact on its ratings or on the Triple-A ratings of MBIA Insurance.

---

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

Corporation. The following information presented in Management's Discussion and Analysis of Financial Condition and Results of Operations gives effect to the restatement.

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, 2005 and 2004. 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 the result of changes in accounting standards, a by-product of the Company's operations or due to general market conditions beyond the control of the Company.

| <u>In millions except per share amounts</u>            | 3rd Quarter |                  | Year-to-Date |                  |
|--|-------------|------------------|--------------|------------------|
|  | 2005        | Restated<br>2004 | 2005         | Restated<br>2004 |
| Revenues:  |             |                  |              |                  |
| Insurance  | \$ 331      | \$ 336           | \$ 1,005     | \$ 1,088         |
| Investment management services                         | 269         | 129              | 663          | 373              |
| Municipal services                                     | 6           | 8                | 17           | 20               |
| Corporate  | 3           | 2                | 16           | 7                |
|  | 609         | 475              | 1,701        | 1,488            |
| Revenues from continuing operations                    |             |                  |              |                  |
| Expenses:  |             |                  |              |                  |
| Insurance  | 77          | 66               | 216          | 201              |
| Investment management services                         | 203         | 126              | 553          | 347              |
| Municipal services                                     | 5           | 7                | 16           | 19               |
| Corporate  | 103         | 22               | 159          | 68               |
|  | 388         | 221              | 944          | 635              |
| Expenses from continuing operations                    |             |                  |              |                  |
| Provision for income taxes                             | 78          | 71               | 228          | 240              |
|  | 143         | 183              | 529          | 613              |
| Income from continuing operations, net of tax          |             |                  |              |                  |
| Income (loss) from discontinued operations, net of tax | (1)         |                  | (1)          | 3                |
|  | \$ 142      | \$ 183           | \$ 528       | \$ 616           |
| Net income   |             |                  |              |                  |

Net income per share information:\*



Edgar Filing: MBIA INC - Form 10-Q

|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Net income  | \$ 1.04   | \$ 1.27   | \$ 3.84   | \$ 4.23   |
| Other per share information (effect on net income):               |           |           |           |           |
| Penalties and disgorgement  | \$ (0.53) |           | \$ (0.52) |           |
| Accelerated premium earned from refunded issues                   | \$ 0.14   | \$ 0.14   | \$ 0.44   | \$ 0.47   |
| Net realized gains (losses)                                       | \$ (0.03) | \$ 0.00   | \$ (0.02) | \$ 0.27   |
| Net gains (losses) on derivative instruments and foreign exchange | \$ 0.21   | \$ (0.06) | \$ 0.20   | \$ (0.05) |

\* All per share calculations are diluted.

In the third quarter of 2005, consolidated revenues from continuing operations increased 28% to \$609 million from \$475 million in the third quarter of 2004. The growth in consolidated revenues was primarily due to a substantial increase in investment management services interest income resulting from growth in asset/liability products and gains on derivative instruments. Insurance revenues decreased 1% primarily as a result of a decline in earned premium and an increase in losses on investment securities. Consolidated expenses from continuing operations for the third quarter of 2005 increased 76% to \$388 million from \$221 million in the third quarter of 2004. This increase was principally due to an increase in investment management services interest expense, which was commensurate with the increase in interest income, estimated penalties and disgorgement related to the potential settlement of regulatory investigations of the Company and an increase in insurance operating expenses resulting from overall higher expenses and a decline in those expenses deferred as policy acquisition costs. Net income for the third quarter of 2005 of \$142 million was down 23% from \$183 million in the third quarter of 2004. Net income per share was down 18% from the third quarter of 2004. The decline in net income per share was principally due to the increase in corporate expenses related to the regulatory investigations.

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

Consolidated revenues from continuing operations for the nine months ended September 30, 2005 increased 14% to \$1,701 million from \$1,488 million in the first nine months of 2004. The growth in consolidated revenues was primarily due to a substantial increase in investment management services' interest income and gains on derivative instruments. Offsetting the increase in investment management services' revenues was an 8% decrease in insurance revenues as a result of a decline in gains on investment securities and, to a lesser extent, lower earned premium and advisory fee income. Consolidated expenses from continuing operations for the nine months of 2005 increased 49% to \$944 million from \$635 million in the first nine months of 2004. This increase was principally due to an increase in investment management services' interest expense, which was commensurate with the increase in interest income, and estimated penalties and disgorgement related to the potential settlement of regulatory investigations of the Company. Net income for the nine months ended September 30, 2005 of \$528 million was down 14% from \$616 million in the first nine months of 2004. Net income per share was \$3.84 for the first nine months of 2005 compared with \$4.23 in the first nine months of 2004.

The Company's book value at September 30, 2005 was \$48.45 per share, up from \$47.05 at December 31, 2004. Book value increased principally due to the effect of income from operations somewhat offset by the effect of repurchasing shares into treasury stock at prices above the Company's book value per share.

**INSURANCE OPERATIONS**

The Company's insurance operations are principally comprised of the activities of MBIA Insurance Corporation and its subsidiaries (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.

Third quarter 2005 revenues from the Company's insurance operations were \$331 million compared with \$336 million in the third quarter of 2004, a 1% decrease. The decline in insurance operations' revenues was primarily the result of a decline in earned premium and an increase in losses on investment securities offset by an increase in investment income and advisory fees. Insurance expenses, which consist of loss and loss adjustment expenses, the amortization of deferred acquisition costs and operating expenses, increased 17% in the third quarter of 2005. This increase was largely due to loss prevention costs, costs associated with the Company's Money Market Committed Preferred Custodial Trust securities (CPCT securities), consulting services and a decrease in the rate at which compensation costs are deferred as policy acquisition costs. Gross insurance expenses (expenses before the deferral or amortization of acquisition costs) increased 8% in the third quarter of 2005 compared with the third quarter of 2004.

## Edgar Filing: MBIA INC - Form 10-Q

The Company's insurance operations revenues for the nine months ended September 30, 2005 were \$1,005 million compared with \$1,088 million in the first nine months of 2004. The decline in insurance operations revenues was primarily the result of a decrease in net gains from investment securities and, to a lesser extent, a decrease in earned premium and advisory fee income. Insurance expenses increased 8% for the nine months ended September 30, 2005 while gross insurance expenses (expenses before the deferral or amortization of acquisition costs) increased 4% for the nine months ended September 30, 2005 compared with the same period of 2004.

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

The Company's gross premiums written (GPW), net premiums written (NPW) and net premiums earned for the third quarter and first nine months of 2005 and 2004 are presented in the following table:

| <u>In millions</u>             | 3rd Quarter   |               | Year-to-date  |               | Percent Change |              |
|--------------------------------|---------------|---------------|---------------|---------------|----------------|--------------|
|                                | Restated      |               | Restated      |               | 3rd            | Year-to-date |
|                                | 2005          | 2004          | 2005          | 2004          | Quarter        | Year-to-date |
|                                | 2005          | 2004          | 2005          | 2004          | 2005           | 2005         |
|                                |               |               |               |               | vs.            | vs.          |
|                                |               |               |               |               | 2004           | 2004         |
| <b>Gross premiums written:</b> |               |               |               |               |                |              |
| U.S.                           | \$ 154        | \$ 165        | \$ 543        | \$ 557        | (6)%           | (3)%         |
| Non-U.S.                       | 67            | 91            | 210           | 276           | (27)%          | (24)%        |
| <b>Total</b>                   | <b>\$ 221</b> | <b>\$ 256</b> | <b>\$ 753</b> | <b>\$ 833</b> | <b>(14)%</b>   | <b>(10)%</b> |
| <b>Net premiums written:</b>   |               |               |               |               |                |              |
| U.S.                           | \$ 144        | \$ 148        | \$ 507        | \$ 522        | (2)%           | (3)%         |
| Non-U.S.                       | 42            | 65            | 147           | 204           | (36)%          | (28)%        |
| <b>Total</b>                   | <b>\$ 186</b> | <b>\$ 213</b> | <b>\$ 654</b> | <b>\$ 726</b> | <b>(13)%</b>   | <b>(10)%</b> |
| <b>Net premiums earned:</b>    |               |               |               |               |                |              |
| U.S.                           | \$ 151        | \$ 159        | \$ 464        | \$ 487        | (5)%           | (5)%         |
| Non-U.S.                       | 53            | 52            | 164           | 152           | 3%             | 8%           |
| <b>Total</b>                   | <b>\$ 204</b> | <b>\$ 211</b> | <b>\$ 628</b> | <b>\$ 639</b> | <b>(3)%</b>    | <b>(2)%</b>  |

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 \$221 million in the third quarter of 2005, down 14% from the third quarter of 2004, reflecting a decline in business written both in and outside the U.S. For the nine months ended September 30, 2005, GPW decreased 10% also due to a decline in business written in and outside the U.S.

NPW of \$186 million, which represents gross premiums written net of premiums ceded to reinsurers, decreased 13% in the third quarter of 2005 compared to the third quarter of 2004. For the first nine months of 2005, NPW of \$654 million was 10% below the first nine months of 2004. The decline in the third quarter and first nine months of 2005 was consistent with the decline in GPW. Premiums ceded to reinsurers were \$35 million or 16% of GPW in the third quarter of 2005 compared with \$42 million or 17% in the third quarter of 2004. For the nine months ended September 30, 2005, premiums ceded to reinsurers were \$98 million or 13% of GPW compared with \$107 million or 13% in the first nine months of 2004. 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 insurance policies it underwrites.

Net premiums earned include scheduled premium earnings as well as premium earnings from refunded issues. Net premiums earned in the third quarter of 2005 of \$204 million decreased 3% from the third quarter of 2004 due to a 7% decrease in refunded premiums earned and a 3% decrease in scheduled premiums earned. In the nine months ended September 30, 2005, net premiums earned were \$628 million, an \$11 million decrease compared with the first nine months of 2004 resulting from a 12% decrease in refunded premiums earned. The decrease in refunded premiums earned resulted from a slow down in refinancing activity in the municipal market from historically high levels.

MBIA evaluates the premium rates it receives 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 trends in overall portfolio profitability under all models, 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 bond refundings and calls is influenced by a variety of factors such as prevailing interest rates, the coupon rate of the bond issue, the issuer's desire or ability to modify bond covenants and applicable regulations under the Internal Revenue Code.

**CREDIT QUALITY** Financial guarantee insurance 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

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

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 each insured obligation before the benefit of its insurance policy from nationally recognized rating agencies (Moody's Investors Service (Moody's), Standard and Poor's (S&P) and Fitch Ratings). 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.

The credit quality of business insured during 2005 remained high as 83% of total insured credits were rated A or above before giving effect to MBIA's guarantee, compared with 75% for the same period of 2004. At September 30, 2005, 81% of the Company's outstanding book of business was rated A or above before giving effect to MBIA's guarantee, up from 79% at September 30, 2004.

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:

|                                |                 |               |                 |               | <u>Percent Change</u> |                     |
|--------------------------------|-----------------|---------------|-----------------|---------------|-----------------------|---------------------|
|                                |                 |               |                 |               | <u>3rd</u>            |                     |
|                                |                 |               |                 |               | <u>Quarter</u>        | <u>Year-to-date</u> |
|                                |                 |               |                 |               | <u>2005</u>           | <u>2005</u>         |
| <b>Global Public Finance</b>   | <b>Restated</b> |               | <b>Restated</b> |               | <b>vs.</b>            | <b>vs.</b>          |
| <u>In millions</u>             | <u>2005</u>     | <u>2004</u>   | <u>2005</u>     | <u>2004</u>   | <u>2004</u>           | <u>2004</u>         |
| <b>Gross premiums written:</b> |                 |               |                 |               |                       |                     |
| U.S.                           | \$ 90           | \$ 101        | \$ 345          | \$ 349        | (11)%                 | (1)%                |
| Non-U.S.                       | 28              | 50            | 89              | 140           | (43)%                 | (37)%               |
| <b>Total</b>                   | <b>\$ 118</b>   | <b>\$ 151</b> | <b>\$ 434</b>   | <b>\$ 489</b> | <b>(21)%</b>          | <b>(11)%</b>        |
| <b>Net premiums written:</b>   |                 |               |                 |               |                       |                     |
| U.S.                           | \$ 90           | \$ 92         | \$ 336          | \$ 338        | (2)%                  | 1%                  |
| Non-U.S.                       | 14              | 38            | 59              | 101           | (64)%                 | (41)%               |
| <b>Total</b>                   | <b>\$ 104</b>   | <b>\$ 130</b> | <b>\$ 395</b>   | <b>\$ 439</b> | <b>(20)%</b>          | <b>(10)%</b>        |
| <b>Net premiums earned:</b>    |                 |               |                 |               |                       |                     |
| U.S.                           | \$ 95           | \$ 99         | \$ 291          | \$ 308        | (5)%                  | (6)%                |
| Non-U.S.                       | 26              | 23            | 77              | 64            | 13%                   | 20%                 |
| <b>Total</b>                   | <b>\$ 121</b>   | <b>\$ 122</b> | <b>\$ 368</b>   | <b>\$ 372</b> | <b>(2)%</b>           | <b>(1)%</b>         |

## Edgar Filing: MBIA INC - Form 10-Q

Global public finance GPW decreased 21% to \$118 million in the third quarter of 2005 from \$151 million in the third quarter of 2004. This decrease was due to a decline in business written both in and outside the U.S. NPW decreased 20% to \$104 million as a result of the decrease in GPW, partially offset by a lower reinsurance rate on U.S. business. In the third quarter of 2005, global public finance net premiums earned of \$121 million decreased 2% compared with the third quarter of 2004 as a decline in U.S. business was offset by an increase in non-U.S. business.

For the nine months ended September 30, 2005, global public finance GPW decreased 11% compared with the same period of 2004. This decrease reflects a drop in European business as significantly fewer transactions came to market during 2005. U.S. GPW declined 1% compared with 2004, reflecting steady flow business, particularly within the military housing and transportation sectors. NPW decreased 10% to \$395 million in the first nine months of 2005 as a result of the decrease in GPW. In the first nine months of 2005, global public finance net premiums earned decreased 1% to \$368 million from \$372 million in the first nine months of 2004. This decline reflects a 13% decrease in refunded premiums earned, primarily from U.S. business, offset by earnings generated from increased levels of non-U.S. business written over the last several years and a declining cession rate.

The credit quality of global public finance business written by the Company in 2005 remained high. Insured credits rated A or above before the Company's guarantee represented 91% of global public finance business written in 2005, compared with 87% in the first nine months of 2004. At September 30, 2005, 82% of the outstanding global public finance book of business was rated A or above before the Company's guarantee, constant from September 30, 2004.

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

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:

|                                | 3rd Quarter   |               | Year-to-date  |               | Percent Change |              |
|--------------------------------|---------------|---------------|---------------|---------------|----------------|--------------|
|                                |               |               |               |               | 3rd            |              |
|                                |               |               |               |               | Quarter        | Year-to-date |
|                                |               |               |               |               | 2005           | 2005         |
| Global Structured Finance      | Restated      |               | Restated      |               | vs.            | vs.          |
| In millions                    | 2005          | 2004          | 2005          | 2004          | 2004           | 2004         |
| <b>Gross premiums written:</b> |               |               |               |               |                |              |
| U.S.                           | \$ 64         | \$ 64         | \$ 198        | \$ 208        | (1)%           | (5)%         |
| Non-U.S.                       | 39            | 41            | 121           | 136           | (7)%           | (11)%        |
| <b>Total</b>                   | <b>\$ 103</b> | <b>\$ 105</b> | <b>\$ 319</b> | <b>\$ 344</b> | <b>(2)%</b>    | <b>(7)%</b>  |
| <b>Net premiums written:</b>   |               |               |               |               |                |              |
| U.S.                           | \$ 54         | \$ 56         | \$ 171        | \$ 184        | (2)%           | (7)%         |
| Non-U.S.                       | 28            | 27            | 88            | 103           | 1%             | (15)%        |
| <b>Total</b>                   | <b>\$ 82</b>  | <b>\$ 83</b>  | <b>\$ 259</b> | <b>\$ 287</b> | <b>(1)%</b>    | <b>(10)%</b> |
| <b>Net premiums earned:</b>    |               |               |               |               |                |              |
| U.S.                           | \$ 56         | \$ 60         | \$ 173        | \$ 179        | (5)%           | (3)%         |
| Non-U.S.                       | 27            | 29            | 87            | 88            | (6)%           | (2)%         |
| <b>Total</b>                   | <b>\$ 83</b>  | <b>\$ 89</b>  | <b>\$ 260</b> | <b>\$ 267</b> | <b>(5)%</b>    | <b>(2)%</b>  |

In the third quarter of 2005, global structured finance GPW decreased 2% to \$103 million from \$105 million in the third quarter of 2004 as a result of decreases in U.S. and non-U.S. business written. Similarly, NPW decreased 1% due to the decrease in GPW and slightly lower cession rates on non-U.S. business written. In the third quarter of 2005, global structured finance net premiums earned of \$83 million decreased 5% compared with the third quarter of 2004 and reflects a decline in earnings from prepayments and maturities of insured U.S. issues.

Global structured finance GPW decreased 7% in the first nine months of 2005 to \$319 million from \$344 million in the first nine months of 2004, resulting from 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. NPW for the first nine months of 2005 decreased 10% due to the decrease in GPW and slightly higher cession rates on U.S. and non-U.S. business written. In the first nine months of 2005, global structured finance net premiums earned of \$260 million were 2% below the first nine months of 2004. The decrease in net premiums earned resulted from a decline in business written and prepayments and maturities of insured issues.



## Edgar Filing: MBIA INC - Form 10-Q

The credit quality of MBIA's global structured finance insured business written rated A or above before giving effect to the Company's guarantee was 72% in the first nine months of 2005, up from 59% in the first nine months of 2004. At September 30, 2005, 78% of the outstanding global structured finance book of business was rated A or above before giving effect to the Company's guarantee, up from 75% at September 30, 2004.

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

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 2005 and 2004 are presented in the following table:

| <u>In millions</u>                      | 3rd Quarter |        | Year-to-date |          | Percent Change |              |
|---|-------------|--------|--------------|----------|----------------|--------------|
|   |             |        |              |          | 3rd<br>Quarter | Year-to-date |
|   |             |        |              |          | 2005           | 2005         |
|   |             |        |              |          | vs.<br>2004    | vs.<br>2004  |
|   | 2005        | 2004   | 2005         | 2004     | 2004           | 2004         |
| Pre-tax income                          | \$ 122      | \$ 117 | \$ 363       | \$ 354   | 4%             | 2%           |
| After-tax income                        | \$ 98       | \$ 94  | \$ 289       | \$ 280   | 5%             | 3%           |
| Ending asset balances at amortized cost |             |        | \$ 9,809     | \$ 9,379 |                | 5%           |

The Company's insurance-related net investment income, excluding net realized gains and losses, increased 4% to \$122 million in the third quarter of 2005 from \$117 million in the third quarter of 2004. After-tax net investment income increased 5% compared with the third quarter of 2004. For the nine months ended September 30, 2005, net investment income increased 2% to \$363 million from \$354 million for the nine months ended September 30, 2004. After-tax net investment income increased 3% for the first nine months of 2005. The marginally higher increase in after-tax investment income is a result of a slightly higher concentration of tax-exempt investments. Growth in investment income has been unfavorably affected by the low interest rate environment and a substantial increase in dividends paid by MBIA Corp. to MBIA Inc. during 2004, which resulted in only a 5% increase in the insurance portfolio's ending asset balance at amortized cost from September 30, 2004 to September 30, 2005.

ADVISORY FEES The Company collects advisory fees 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 and expense reimbursements 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.

In the third quarter of 2005, advisory fee revenues increased 55% to \$10 million from \$6 million in the third quarter of 2004. This increase was largely due to an increase in expense reimbursements related to loss prevention expense recorded within insurance operating expenses. Advisory fee revenues for the first nine months of 2005 decreased 31% from the first nine months of 2004 to \$20 million. The decrease in advisory fees during the first nine months was primarily due to a decline in waiver and consent and commitment fees, as well as a decline in work fees reflecting fewer large complex transactions requiring advisory services. Fees earned when due represented 71% of total advisory fee income in the first nine months of 2005 compared with 61% in the same period of 2004. Due to the transaction-specific nature inherent in advisory fees, fee income can vary significantly from period to period.

## Edgar Filing: MBIA INC - Form 10-Q

**NET GAINS AND LOSSES** Net realized losses from investment securities in the insurance operations were \$8 million in the third quarter of 2005 compared to \$416 thousand in the third quarter of 2004. For the first nine months of 2005, net realized losses from investment securities were \$6 million compared to net realized gains of \$63 million for the first nine months of 2004. The variance for the year was largely due to a \$77 million realized gain recorded in 2004 that resulted from the sale of a common stock investment held by MBIA Corp. Additionally, the Company recorded a \$16 million impairment loss in the third quarter of 2005 on a receivable the Company held through salvage and subrogation rights it obtained as a result of a claim payment it previously made on an insured credit.

Net gains (losses) on derivative instruments and foreign exchange from the insurance operations were net gains of \$3 million in the third quarter of 2005 compared with net gains of \$2 million in the third quarter of 2004. The change was largely due to \$4 million of foreign currency gains recorded in the third quarter of 2005 related to non-U.S. dollar holdings partially offset by a reduction in gains on insured credit derivatives. For the first nine months of 2005, net gains on derivative instruments and foreign exchange from the insurance operations were \$415 thousand compared with net gains of \$3 million for the first nine months of 2004. An unfavorable variance related to net gains on insured credit derivatives was partially offset by foreign currency gains in 2005.

**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 2005 and 2004, as well as its loss provision and loss ratio for the first nine months of 2005 and 2004.

**MBIA Inc. and Subsidiaries**

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

| <u>In millions</u>                       | <u>September 30,</u> |                          | <u>Percent Change</u> |
|--|----------------------|--------------------------|-----------------------|
|  | <u>2005</u>          | <u>Restated<br/>2004</u> | <u>2005 vs. 2004</u>  |
| <b>Case-specific:</b>                    |                      |                          |                       |
| Gross                                    | \$ 425               | \$ 431                   | (2)%                  |
| Reinsurance recoverable on unpaid losses | 46                   | 34                       | 35%                   |
| Net case basis reserves                  | \$ 379               | \$ 397                   | (5)%                  |
| Unallocated                              | 287                  | 313                      | (8)%                  |
| Net loss and LAE reserves                | \$ 666               | \$ 710                   | (6)%                  |
| Gross loss and LAE reserves              | \$ 711               | \$ 744                   | (4)%                  |
| Losses and LAE <sup>(1)</sup>            | \$ 63                | \$ 63                    | 0%                    |
| Loss ratio <sup>(2)</sup>                | 10.1%                | 9.9%                     |                       |

(1) Calculated as 12% of scheduled net earned premium.

(2) Calculated as losses and LAE divided by total net earned premium. This ratio differs from the Company's loss factor of 12% as total net earned premium includes premium earnings that have been accelerated as a result of the refunding or defeasance of insured obligations, while the loss factor is applied only to scheduled net earned premium.

The Company recorded \$21 million of loss and loss adjustment expenses in the three months ended September 30, 2005, which was flat with the same period of 2004. Similarly, loss and loss adjustment expenses in the first nine months of 2005 of \$63 million was flat with the first nine months of 2004. Loss and loss adjustment expenses reflect flat scheduled net earned premium comparing 2005 to 2004, as scheduled net earned premium is the base upon which the Company's 12% loss factor is applied. At September 30, 2005, the Company had \$287 million in unallocated loss reserves, which represent the Company's estimate of losses associated with credit deterioration that has occurred in the Company's insured portfolio and are available for future case-specific activity. Total case basis activity transferred from the Company's unallocated loss reserve was \$89 million and \$111 million in the first nine months of 2005 and 2004, respectively. Case basis activity during the first nine months of 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 2005, the Company paid \$59 million related to its guarantee of the obligations issued by Fort Worth Osteopathic Hospital, which was charged against the case basis reserve established for these obligations.

The Company has significant exposures in its insured portfolio relating to regions impacted by hurricanes Katrina, Rita and Wilma. 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 efforts with issuers, trustees and relevant state officials to evaluate the actual and potential impact that the hurricanes may have on its insured credits. Based on available information, the Company does not currently expect there to be material cases of prolonged nonpayment that would result in unreimbursed losses. As a result, during the third quarter of 2005, MBIA did not establish specific reserves for its exposure to the regions impacted by these hurricanes. To date, MBIA has paid \$2 million in

claim payments, for which it has been fully reimbursed.

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 an 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, 2005, MBIA had 42 open case basis issues on its Classified List that had \$379 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.

---

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

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. Such amounts as of September 30, 2005 are as follows:

| <u>Dollars in millions</u>   | <u>Number of Case<br/>Basis Issues</u> | <u>Loss<br/>Reserve</u> | <u>Par<br/>Outstanding</u> |
|------------------------------|--|-------------------------|----------------------------|
| <b>Gross of reinsurance:</b> |  |                         |                            |
| Issues with defaults         | 31                                     | \$ 333                  | \$ 2,107                   |
| Issues without defaults      | 11                                     | 92                      | 1,136                      |
| <b>Total gross</b>           | <b>42</b>                              | <b>\$ 425</b>           | <b>\$ 3,243</b>            |
| <b>Net of reinsurance:</b>   |  |                         |                            |
| Issues with defaults         | 31                                     | \$ 309                  | \$ 1,761                   |
| Issues without defaults      | 11                                     | 70                      | 1,051                      |
| <b>Total net</b>             | <b>42</b>                              | <b>\$ 379</b>           | <b>\$ 2,812</b>            |

When MBIA becomes entitled to a reimbursement of a claim payment or LAE under salvage and subrogation rights, it records the amount that it estimates it will recover as salvage and subrogation as an asset. Such amounts are included in the Company's balance sheet within Other assets. As of September 30, 2005 and December 31, 2004, the Company had recorded salvage and subrogation of \$146 million and \$154 million, respectively. The decrease was principally due to a \$16 million impairment loss in the third quarter of 2005 on a receivable the Company held as a result of a claim payment it previously made on an insured credit.

As a result of discussions in January and February 2005 between the Securities and Exchange Commission (SEC) staff and several financial guarantee industry participants, including MBIA, the Company understood that the Financial Accounting Standards Board (FASB) staff would consider 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 will consider several aspects of the insurance accounting model for financial guarantee insurers, including claims liability recognition, premium recognition and the related amortization of deferred policy acquisition costs. 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 policy with respect to the establishment of both case basis and unallocated loss reserves and the recognition of premium revenue and policy acquisition costs. A further 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/A for the year ended December 31, 2004.

**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

## Edgar Filing: MBIA INC - Form 10-Q

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 accordingly.

**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, many 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. MBIA generally retains the right to reassume the business

---

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

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, 2005, the aggregate amount of insured par ceded by MBIA to reinsurers under reinsurance agreements was \$73.4 billion. The following table shows the percentage ceded to and reinsurance recoverable on unpaid losses from reinsurers by S&P's rating levels:

| <b>Reinsurers</b>   | <b>S&amp;P Rating Range</b> | <b>Percent of<br/>Total Par Ceded</b> | <b>Reinsurance<br/>Recoverable on<br/>Unpaid<br/>Losses<br/>(in thousands)</b> |
|---------------------|-----------------------------|---------------------------------------|--|
| AAA                 |                             | 85.45%                                | \$ 19,634  |
| AA                  |                             | 13.98%                                | 10,352   |
| A                   |                             | 0.49%                                 | 15,392   |
| Not Currently Rated |                             | 0.08%                                 | 299  |
| <b>Total</b>        |                             | <b>100%</b>                           | <b>\$ 45,677</b>   |

The top two reinsurers within the AAA rating category represented approximately 64% of total par ceded by MBIA; the top two reinsurers within the AA rating category represented approximately 9% of total par ceded by MBIA; and the top two reinsurers within the A rating category represented approximately 0.4% of total par ceded by MBIA. While Channel Reinsurance Ltd. (Channel Re) continues to be a Triple-A rated reinsurer of MBIA, S&P has revised their outlook on Channel Re from stable to negative. MBIA does not expect S&P's revised outlook on Channel Re to have a material negative impact on the Company's financial condition or results of operations. Additionally, the Company has other reimbursement agreements, primarily with a Single-A rated reinsurer, covering up to \$7.7 billion of insured par.

**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 insured bond issue is refunded and the related premium is earned early, the associated acquisition costs previously deferred are also recognized early.

Periodically, MBIA conducts a policy acquisition cost study to determine the amount of insurance costs that relate to acquiring new insurance policies and that are deferrable under GAAP. MBIA completed its latest study in July 2005. The current policy acquisition cost study, which was effective for the third quarter of 2005, resulted in a decrease of approximately \$4.8 million in deferred policy acquisition costs for the quarter with a corresponding increase in insurance operating expenses. The change was principally driven by a reduction in the rate at which compensation costs associated with acquiring new insurance policies are deferred. The Company expects the quarterly change to be in the \$5 million range going forward. However, policy acquisition costs and operating expenses will be influenced by the level of actual future expenses that qualify for deferral.



MBIA will recognize a premium deficiency if the sum of the expected loss and loss adjustment expenses, maintenance costs and unamortized policy acquisition costs exceed the related unearned premiums. If MBIA was to have a premium deficiency that is greater than unamortized acquisition costs, the unamortized acquisition costs would be reduced by a charge to expense and a liability would be established for any remaining deficiency. Although GAAP permits the inclusion of anticipated investment income when determining a premium deficiency, MBIA currently does not include this in making its determination.

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

The Company's policy acquisition costs, operating expenses and total insurance operating expenses, as well as its expense ratio, are shown in the following table:

|  |                    |             |                     |             | <u>Percent Change</u> |                     |
|--|--------------------|-------------|---------------------|-------------|-----------------------|---------------------|
|  |                    |             |                     |             | <u>3rd</u>            | <u>Year-to-date</u> |
|  | <u>3rd Quarter</u> |             | <u>Year-to-date</u> |             | <u>Quarter</u>        | <u>Year-to-date</u> |
|  |                    |             |                     |             | <u>2005</u>           | <u>2005</u>         |
|  |                    |             |                     |             | <u>vs.</u>            | <u>vs.</u>          |
| <u>In millions</u>                         | <u>2005</u>        | <u>2004</u> | <u>2005</u>         | <u>2004</u> | <u>2004</u>           | <u>2004</u>         |
| Gross expenses                             | \$ 66              | \$ 61       | \$ 198              | \$ 190      | 8%                    | 4%                  |
| Amortization of deferred acquisition costs | \$ 16              | \$ 16       | \$ 50               | \$ 49       | 0%                    | 0%                  |
| Operating                                  | 40                 | 28          | 103                 | 88          | 42%                   | 17%                 |
| Total insurance operating expenses         | \$ 56              | \$ 44       | \$ 153              | \$ 137      | 26%                   | 11%                 |
| Expense ratio                              | 27.4%              | 21.0%       | 24.4%               | 21.5%       |                       |                     |

In the third quarter of 2005, the amortization of deferred acquisition costs remained flat compared with the same period in 2004, which was consistent with the change in insurance premiums earned for the same periods. Operating expenses increased 42% over the third quarter of 2004 primarily due to the decrease in the rate at which compensation costs are deferred as policy acquisition costs, as well as an increase in loss prevention costs and the addition of costs associated with the Company's CPCT securities.

In the first nine months of 2005, the amortization of deferred acquisition costs was relatively flat with the same period of 2004, which was in line with the change in the Company's insurance premiums earned. The ratio of policy acquisition costs amortized to expense, net of deferrals, to earned premiums has remained steady at approximately 8% over the last several years. Operating expenses increased 17% from \$88 million for the nine months ended September 30, 2004 to \$103 million for the nine months ended September 30, 2005. This increase was largely due to loss prevention costs, costs associated with the Company's CPCT securities, consulting services and a decrease in the rate at which compensation costs are deferred as policy acquisition costs.

Financial guarantee insurance companies use the expense ratio (expenses divided by net premiums earned) as a measure of expense management. The Company's expense ratio for the third quarter of 2005 was 27.4% compared to 21.0% in the third quarter of 2004. The increase in the ratio from 2004 to 2005 was the result of slower growth in premium earnings relative to the increase in expenses. For the nine months ended September 30, 2005, the Company's expense ratio of 24.4% increased from the ratio in the first nine months of 2004 of 21.5%.

**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. 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 variable interest entity (VIE) under FASB Interpretation No. (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 MBIA's consolidated balance sheet, totaled \$9 million at September 30, 2005 and \$17 million at December 31, 2004. Liabilities of the securitizations substantially represented amounts due to MBIA, which were eliminated in consolidation. Additionally, the Company began consolidating a third-party VIE in 2003 as a result of providing a financial guarantee to this entity. The assets and liabilities of this VIE are primarily reported in Investments held-to-maturity and Variable interest entity floating rate notes, respectively, on the face of the Company's balance sheet and each totaled approximately \$801 million at September 30, 2005 and \$601 million at December 31, 2004. Consolidation of such VIEs does not increase MBIA's exposure above that already committed to in its insurance policies.

---

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

**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 the origination of assets 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; investment advisory services, which include third-party and related-party advisory services; and conduit programs. During the third quarter of 2004, the Company completed the sale of the assets of 1838 Investment Advisors, LLC, which comprised the Company's equity advisory services segment. This segment has been reported as a discontinued operation in the Company's financial statements.

Investment management services' revenues for the third quarter of 2005 totaled \$268.6 million, increasing over 100% compared to the third quarter of 2004. Excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, total revenues increased \$83 million or 59% over the third quarter of 2004. For the first nine months of 2005, total revenues of \$663 million increased 78% over the same period in 2004. Excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, revenues of \$618 million increased 59% over 2004. This growth is primarily attributable to increased activity in the Company's asset/liability products, particularly the investment agreements and MTNs. Advisory services' revenues were also favorable compared to 2004 due to growth in managed assets. Total expenses in the third quarter of 2005 were \$203 million, up 61% compared to the third quarter of 2004. For the nine months ended September 30, 2005, total expenses increased 59% over the same period in 2004 to \$553 million. This increase was primarily driven by higher interest expense from increased asset/liability products activity, which was consistent with the growth in revenues.

Net realized losses from investment securities in the investment management services operations were \$1 million in the third quarter of 2005, compared to \$0.4 million in the third quarter of 2004. For the nine months ended September 30, 2005, net realized gains were \$3 million compared to net realized losses of \$3 million in the same period of 2004. Realized gains and losses were generated from the ongoing management of the investment portfolios. Net gains on derivative instruments and foreign exchange related to the investment management services operations were \$42 million in the third quarter of 2005 compared to net losses of \$14 million in the third quarter of 2004. The net gains in 2005 were primarily generated from an increase in U.S. dollar interest rates resulting in higher market values on pay fixed/receive floating U.S. dollar interest rate swaps associated with the asset/liability products and conduit programs. Similarly, the net losses on derivative instruments and foreign exchange in 2004 were largely due to movements in interest rates on interest rate swaps associated with the asset/liability products and conduit programs. For the first nine months of 2005, net gains on derivative instruments and foreign exchange totaled \$42 million compared to net losses of \$14 million in 2004. The increase in net gains was primarily attributable to changes in the value of interest rate swaps affected by overall higher interest rates for the first nine months of 2005 versus the first nine months of 2004. These interest rate swaps economically hedge against interest rate movements but do not qualify for hedge accounting treatment under SFAS 133, Accounting for Derivative Instruments and Hedging Activities.

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

Fixed-income ending assets under management as of September 30, 2005, which do not include conduit program assets, were \$44 billion, 13% above the 2004 year-end level and 17% above the September 30, 2004 level. 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 for the third quarter and first nine months of 2005 and 2004:

| <u>In millions</u>  | <u>3rd Quarter</u> |             | <u>Year-to-date</u> |             | <u>Percent Change</u> |                     |
|---|--------------------|-------------|---------------------|-------------|-----------------------|---------------------|
|   | <u>2005</u>        | <u>2004</u> | <u>2005</u>         | <u>2004</u> | <u>3rd Quarter</u>    | <u>Year-to-date</u> |
| Interest and fees   | \$ 226             | \$ 142      | \$ 618              | \$ 390      | 59%                   | 59%                 |
| Net realized gains (losses)                                       | 1                  | 0           | 3                   | (3)         | 240%                  | (217)%              |
| Net gains (losses) on derivative instruments and foreign exchange | 42                 | (14)        | 42                  | (14)        | (390)%                | (390)%              |
| Total revenues  | 269                | 128         | 663                 | 373         | 109%                  | 78%                 |
| Interest expense  | 185                | 106         | 501                 | 290         | 73%                   | 73%                 |
| Operating expenses  | 18                 | 20          | 52                  | 57          | (7)%                  | (9)%                |
| Total expenses  | 203                | 126         | 553                 | 347         | 61%                   | 59%                 |
| Pre-tax income  | \$ 66              | \$ 2        | \$ 110              | \$ 26       | 2,730%                | 320%                |
| Fixed-income ending assets under management                       |                    |             | \$ 44,289           | \$ 37,977   |                       | 17%                 |

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

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 \$14 million in the third quarter of 2005 compared to \$10 million in the third quarter of 2004, resulting in an increase of 44%. For the first nine months of 2005, pre-tax income of \$41 million, excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, increased 48% over 2004. At September 30, 2005, principal and accrued interest outstanding on investment agreement and medium-term note obligations and securities sold under agreements to repurchase totaled \$15.0 billion compared to \$12.5 billion at December 31, 2004. Assets supporting these agreements had market values of \$15.6 billion and \$12.6 billion at September 30, 2005 and December 31, 2004, 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 \$5 million in the third quarter of 2005 compared to \$4 million in the third quarter of 2004. For the first nine months of 2005, pre-tax income of \$16 million, excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, increased 30% over 2004. Third-party ending assets under management were \$18.3 billion and \$16.0 billion

## Edgar Filing: MBIA INC - Form 10-Q

at September 30, 2005 and December 31, 2004, 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, 2005 were \$10.2 billion, consistent with the balance at December 31, 2004 of \$10.3 billion.

Conduit program pre-tax income, excluding gains and losses on derivative instruments and foreign exchange, totaled \$3 million in the third quarter of 2005 compared to \$2 million in the third quarter of 2004. For the first nine months of 2005, pre-tax income of \$9 million, excluding gains and losses on derivative instruments and foreign exchange, increased \$5 million over 2004. 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 \$5.6 billion and \$5.3 billion, respectively, at September 30, 2005. 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 with a corresponding reduction of medium-term notes.

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. An underlying rating is the implied rating for the transaction without giving consideration to the MBIA guarantee. All transactions currently funded in the conduits had an underlying rating of at least investment grade by 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

**MBIA Inc. and Subsidiaries**

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

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, 2005.

**MUNICIPAL SERVICES**

MBIA's municipal services operations are consolidated under MuniServices Company (MBIA MuniServices) and provides revenue enhancement services and products to public-sector clients nationwide consisting of discovery, audit, collections/recovery and information (data) services. The municipal services operations also include Capital Asset Holdings GP, Inc. and certain affiliated entities (Capital Asset), a servicer of delinquent tax certificates.

In the third quarter of 2005, the municipal services operations reported pre-tax income of \$0.3 million compared to pre-tax income of \$0.6 million in the third quarter of 2004. Revenues decreased by 32% and expenses decreased by 30% due to a decline in the delinquent tax certificate portfolio serviced by Capital Asset as a result of tax certificate redemptions. For the nine months ended September 30, 2005 and 2004, pre-tax income was \$0.8 million and \$0.9 million, respectively.

**CORPORATE**

The corporate operations consist of net investment income, net realized gains and losses on holding company investment assets, interest expense and corporate expenses. The corporate operations incurred a loss of \$100 million in the third quarter of 2005 compared to a loss of \$20 million in the same period of 2004. For the nine months ended September 30, 2005 and 2004, the corporate operations incurred a loss of \$143 million and \$61 million, respectively.

Net investment income increased from \$1.9 million in the third quarter of 2004 to \$3.4 million in the third quarter of 2005. In the nine months ended September 30, 2005, net investment income increased to \$17 million from \$7 million in the nine months ended September 30, 2004. The increase was driven by substantially higher invested assets and a shift to longer term higher yielding investments. The increase in the invested assets resulted from additional debt issued by MBIA Inc. and dividends paid by MBIA Corp. to MBIA Inc. in the fourth quarter of 2004, somewhat offset by share repurchases of the Company's common stock.

The corporate operations incurred \$22 million of interest expense in the third quarter of 2005 compared to \$18 million in the third quarter of 2004, a 24% increase. For the first nine months of 2005 and 2004, the Company incurred interest expense of \$66 million and \$53 million, respectively. The increase in interest expense primarily resulted from the issuance of \$350 million of debt, partially offset by the retirement of \$50 million of debt, in the fourth quarter of 2004.

## Edgar Filing: MBIA INC - Form 10-Q

Corporate expenses were \$81 million in the third quarter of 2005 compared with \$4 million in the third quarter of 2004. For the nine months of 2005, corporate expenses were \$92 million compared with \$14 million in the first nine months of 2004. The increase in the third quarter and first nine months of 2005 was principally due to a \$75 million accrual of estimated penalties and disgorgement related to the potential settlement of regulatory investigations, as well as additional legal and consulting costs. Information on these investigations is provided in Note 7: Contingencies in the Notes to Consolidated Financial Statements.

### TAXES

MBIA's tax policy is to optimize after-tax income by maintaining the appropriate mix of taxable and tax-exempt investments. However, 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, including tax related to discontinued operations, for the third quarter of 2005 was 35.2%, up from 27.8% for the third quarter of 2004. The increase in the effective tax rate was primarily due to the accrual of regulatory penalties, which are not deductible for purposes of calculating the Company's Federal income taxes. For the nine months of 2005 and 2004 the effective tax rate was 30.1% and 28.1%, respectively, including tax related to discontinued operations.

### 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. Total shareholders' equity at September 30, 2005 was \$6.5 billion, with total long-term debt at \$1.3 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



---

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

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,<br>2005 | December 31,<br>2004 |
|---------------------------------|-----------------------|----------------------|
| Long-term debt (in millions)    | \$ 1,313              | \$ 1,333             |
| Long-term debt to total capital | 17%                   | 17%                  |

In August 1999, the Company announced that its board of directors had authorized the repurchase of 11.25 million shares of common stock of the Company, after adjusting for the 2001 stock split. The Company began the repurchase program in the fourth quarter of 1999. In July 2004, the Company completed the repurchase of all 11.25 million shares at an average price of \$44.08 per share and received authorization from its board of directors to repurchase 1 million shares under a new 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 the new repurchase program. As of September 30, 2005, the Company had repurchased a total of 10 million shares under the current plan at an average price of \$57.25 per share, of which 5.9 million shares were repurchased in 2005 at an average price of \$57.77 per share. However, no shares were repurchased in the three months ended September 30, 2005.

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, 2005, MBIA Corp. maintained a \$450 million limited recourse standby line of credit facility, reduced from \$700 million at December 31, 2004, 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 or 5% of average annual debt service with respect to public finance transactions. The agreement is for a ten-year term, amended from a seven-year term, which expires in March 2015.

MBIA Corp. has access to \$400 million of 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 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 utilizing a shelf registration process. In November 2004, the Company completed its \$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 flow needs at the parent company level are primarily for dividends to its shareholders and interest payments on its debt. Liquidity and operating cash requirements of the Company are met by its cash flows generated from operations, which were more than adequate in the first nine months of 2005. 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.

Cash requirements have historically been met by upstreaming dividend payments from MBIA Corp. to MBIA Inc. In the first nine months of 2005, the Company's operating cash flow from continuing operations totaled \$621 million compared with \$700 million in the first nine months of 2004. The majority of net cash provided by operating activities is generated from premium revenue and investment income in the Company's insurance operations.

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, dividends in any twelve-month period cannot be greater than 10% of policyholders' surplus as shown on MBIA Corp.'s latest filed statutory financial statements.

In addition to its regular dividends paid during 2004, in the fourth quarter of 2004 MBIA Corp. declared and paid a special dividend of \$375 million to MBIA Inc., which was approved by the New York State Department of Insurance. As a result of the payment of the special dividend and under the formula applicable to the payment of dividends, MBIA Corp. may

---

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

not pay any dividends without prior approval by the New York State Department of Insurance until the fourth quarter of 2005. In the first quarter of 2005, MBIA Corp. requested approval for the payment of additional special dividends as its capital position continues to exceed the capital required by New York State Insurance Law. Approval by the New York State Department of Insurance is still pending on this request.

The Company has significant liquidity supporting its businesses. At September 30, 2005, cash, cash equivalents and short-term investments were approximately \$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 the fixed-income investments in its investment portfolio, tapping existing liquidity facilities and new borrowings.

As part of MBIA's external borrowing capacity, it maintained two bank lines totaling \$500 million. These bank lines were maintained with a group of highly rated global banks and were comprised of a renewable \$167 million facility with a term of 364 days and a \$333 million facility with a five-year term maturing in April 2009. In April 2005, the \$167 million facility expired on its stated expiration date and the \$333 million facility was increased to \$500 million and the term was extended one year to April 2010. As of September 30, 2005, there were no balances outstanding under these agreements.

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, 2005, the fair value of the consolidated available-for-sale investment portfolio was \$26 billion, as shown in the following table:

| <u>In millions</u>                                | <u>September 30,</u><br><u>2005</u> | <u>December 31,</u><br><u>2004</u> | <u>Percent Change</u><br><u>2005 vs. 2004</u> |
|---|-------------------------------------|------------------------------------|---|
| <b>Available-for-sale investments:</b>            |                                     |                                    |   |
| <b>Insurance operations:</b>                      |                                     |                                    |   |
| Amortized cost                                    | \$ 9,812                            | \$ 9,205                           | 7%  |
| Unrealized net gain (loss)                        | 367                                 | 531                                | (31)%   |
| <b>Fair value</b>                                 | <b>\$ 10,179</b>                    | <b>\$ 9,736</b>                    | <b>5%</b>                                     |
| <b>Investment management services operations:</b> |                                     |                                    |   |
| Amortized cost                                    | \$ 15,284                           | \$ 12,209                          | 25%   |
| Unrealized net gain (loss)                        | 339                                 | 398                                | (15)%   |
| <b>Fair value</b>                                 | <b>\$ 15,623</b>                    | <b>\$ 12,607</b>                   | <b>24%</b>                                    |
| <b>Corporate operations:</b>                      |                                     |                                    |   |
| Amortized cost                                    | \$ 226                              | \$ 731                             | (69)%   |
| Unrealized net gain (loss)                        | 2                                   | 4                                  | (51)%   |
| <b>Fair value</b>                                 | <b>\$ 228</b>                       | <b>\$ 735</b>                      | <b>(69)%</b>                                  |

Edgar Filing: MBIA INC - Form 10-Q

Total available-for-sale portfolio:

|                            |                   |                   |                   |
|----------------------------|-------------------|-------------------|-------------------|
| Amortized cost             | \$ 25,322         | \$ 22,145         | 14%               |
| Unrealized net gain (loss) | 708               | 933               | (24)%             |
|                            | <u>          </u> | <u>          </u> | <u>          </u> |
| Fair value                 | \$ 26,030         | \$ 23,078         | 13%               |
|                            | <u>          </u> | <u>          </u> | <u>          </u> |

The increase in the amortized cost of insurance-related available-for-sale investments in 2005 was the result of positive cash flow from operations. 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. Corporate investments decreased in the first nine months of 2005 due to increased share repurchase activity by the Company.

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

**MBIA Inc. and Subsidiaries**

**Management's Discussion and Analysis**

**of Financial Condition and Results of Operations**

investments to their contractual maturity. Therefore, these portfolios are reported at amortized cost and are not adjusted to reflect unrealized changes in fair value.

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-income investment portfolios, excluding short-term investments, based on ratings from Moody's as of September 30, 2005 is presented in the following table:

| In millions            | Insurance       |                               | Investment Management Services |                               | Investments Held-to-Maturity |                               | Total            |                               |
|------------------------|-----------------|-------------------------------|--------------------------------|-------------------------------|------------------------------|-------------------------------|------------------|-------------------------------|
|                        | Fair Value      | % of Fixed-Income Investments | Fair Value                     | % of Fixed-Income Investments | Fair Value                   | % of Fixed-Income Investments | Fair Value       | % of Fixed-Income Investments |
|                        |                 |                               |                                |                               |                              |                               |                  |                               |
| Aaa                    | \$ 6,355        | 70%                           | \$ 9,077                       | 62%                           | \$ 5,544                     | 87%                           | \$ 20,976        | 70%                           |
| Aa                     | 1,732           | 19%                           | 2,786                          | 19%                           |                              |                               | 4,518            | 15%                           |
| A                      | 1,051           | 11%                           | 2,735                          | 19%                           | 800                          | 13%                           | 4,586            | 15%                           |
| Baa                    | 40              | 0%                            | 14                             | 0%                            |                              |                               | 54               | 0%                            |
| Below investment grade |                 |                               |                                |                               |                              |                               |                  |                               |
| Not rated              | 3               | 0%                            |                                |                               |                              |                               | 3                | 0%                            |
| <b>Total</b>           | <b>\$ 9,181</b> | <b>100%</b>                   | <b>\$ 14,612</b>               | <b>100%</b>                   | <b>\$ 6,344</b>              | <b>100%</b>                   | <b>\$ 30,137</b> | <b>100%</b>                   |

MBIA's consolidated investment portfolio includes investments that are insured by MBIA Corp. (MBIA Insured Investments). At September 30, 2005, MBIA Insured Investments, excluding conduit investments, at fair value represented \$4.8 billion or 16% of the total fixed-income investment portfolio. Conduit investments represented \$5.5 billion or 18% of the total fixed-income investment portfolio. Without giving effect to the MBIA guarantee of the MBIA Insured Investments in the consolidated investment portfolio, as of September 30, 2005, 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, 2005 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**

**Total**

Edgar Filing: MBIA INC - Form 10-Q

| In millions            | Insurance<br>Portfolio | Investment<br>Management<br>Services<br>Portfolio | Held-to-<br>Maturity<br>Investment<br>Portfolio | _____     |
|------------------------|------------------------|---|---|-----------|
| Aaa                    | \$ 44                  | \$ 548  | \$ 1,058  | \$ 1,650  |
| Aa                     | 272                    | 187   | 428   | 887       |
| A                      | 758                    | 792   | 2,600   | 4,150     |
| Baa                    | 301                    | 1,635   | 1,458   | 3,394     |
| Below investment grade | 108                    | 124   |   | 232       |
|                        | _____                  | _____   | _____   | _____     |
| Total                  | \$ 1,483               | \$ 3,286  | \$ 5,544  | \$ 10,313 |
|                        | _____                  | _____   | _____   | _____     |

The Company generates significant liquidity from its operations. 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.

---

## 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 first nine months ended September 30, 2005. For additional information on market risk, refer to page 37 of the Company's 2004 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/A for the year ended December 31, 2004.

### 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.

As disclosed in Note 2 to the consolidated financial statements, MBIA Inc. (the Company) is restating its previously issued consolidated financial statements for 1998 and subsequent years to correct and restate its accounting for the excess-of-loss and quota share agreements (the Reinsurance Transactions) entered into with AXA Re Finance S.A. (ARF) and Muenchener Rueckversicherungs-Gesellschaft (Munich Re) and certain derivatives not qualifying for shortcut method hedge accounting (the Derivative Transactions). In arriving at management's conclusion that internal control over financial reporting and disclosure controls and procedures were effective as of September 30, 2005, the Company completed an analysis under Staff Accounting Bulletin (SAB) 99 for purposes of determining whether the restatements referred to above were material to prior period financial statements. Upon consideration of the quantitative and qualitative factors in SAB 99, management concluded that (i) prior period financial statements taken as a whole were not materially misstated; (ii) the cumulative impact of the restatement adjustments on shareholders' equity was not material to the financial statements of any interim or annual periods; (iii) management decided to restate the Company's previously issued financial statements for the Reinsurance Transactions, as described herein, in connection with potential settlements of investigations by the Securities and Exchange Commission and the New York Attorney General's office, taking into account developments in the regulatory investigations and further related accounting analyses; and (iv) as it relates to the Derivative Transactions, the Company concluded that the control deficiency that gave rise to the error was not a material weakness, identified the error prior to September 30, 2005 and remediated the control deficiency as of September 30, 2005. Furthermore, the Reinsurance Transactions that gave rise to the related restatement were done in 1998 and, because the Company now has effective controls over these transactions, management has concluded that it has effective controls over the accounting for such transactions as of September 30, 2005.

## 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 \$351 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 has filed an action seeking a declaration that it is not obligated to pay on its policies. If Royal does not honor its policies, MBIA Corp. will be required to make

## Edgar Filing: MBIA INC - Form 10-Q

payment on the notes it insured, and will incur material losses under 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 pledged \$391 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. The Federal District Court has ordered Royal to comply with the pledge agreement. On October 3, 2005, the Court of Appeals for the Third Circuit upheld the decision of the United States District Court for the District of Delaware enforcing the Royal insurance policies and 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 cover losses resulting from the misappropriation rather than from defaults by students. MBIA Corp. believes that the Royal policies cover losses even if they result from misappropriations 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 made under its policies. Royal has appealed the Third Circuit's ruling and requested that the case be reheard *en banc*.

MBIA Corp. believes that it will prevail in the litigation with Royal and will have no ultimate loss on these policies, although there can be no assurance that MBIA Corp. will in fact prevail. If MBIA Corp. does not prevail in the litigation and Royal does not make payments on the Royal Policies, MBIA Corp. expects to incur material 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 Securities and Exchange Commission (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 the Pittsburgh-based Allegheny Health, Education and Research Foundation (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 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 to the Consolidated Financial Statements of MBIA Inc. and Subsidiaries included in Part I, Item 1 and Restatement of Consolidated Financial Statements in Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part I, Item 2. 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 New York State Insurance Department 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 a consolidated private securities litigation suit: *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 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. Elliot 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 act 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. The plaintiffs allege that, as a result of these misleading statements or omissions, the Company's stock traded at artificially inflated prices. These lawsuits 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 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.

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

From time to time, the Company repurchases shares of its common stock when, in the opinion of management, it is economically advantageous to do so. In August, 1999, the Company's board of directors authorized the repurchase of up to 11.25 million shares of the Company's common stock (after adjusting for the 2001 stock split). In July 2004, the Company completed the repurchase of all 11.25 million shares and received authorization from its board of directors to repurchase 1 million shares under a new repurchase program. On August 5, 2004, MBIA's board of directors authorized the repurchase of an additional 14 million shares of its common stock in connection with the new repurchase program. 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 following table sets forth repurchases made by the Company in each month during the third quarter of 2005:

| <u>Month</u> | <u>Total Number of<br/>Shares<br/>Purchased<sup>(1)</sup></u> | <u>Average Price<br/>Paid Per<br/>Share</u> | <u>Total Number of<br/>Shares Purchased<br/>as Part of Publicly<br/>Announced Plan<sup>(2)</sup></u> | <u>Maximum Number<br/>of Shares That<br/>May Yet Be<br/>Purchased Under<br/>the Plan</u> |
|--------------|---|---|--|--|
| July         | 42,233  | \$ 62.21                                    | 0  | 4,995,900  |
| August       | 47,751  | 59.14                                       | 0  | 4,995,900  |
| September    | 10,790  | 57.65                                       | 0  | 4,995,900  |

<sup>(1)</sup> 397,830 shares were purchased by the Company for settling awards under the Company's long-term incentive plans.

<sup>(2)</sup> Repurchased pursuant to stock repurchase plans authorized by the Company's board of directors in 2004.

**Item 6. Exhibits**

- 31.1 Chief Executive Officer Sarbanes-Oxley Act of 2002 Section 302
- 31.2 Chief Financial Officer Sarbanes-Oxley Act of 2002 Section 302
- 32.1 Chief Executive Officer Sarbanes-Oxley Act of 2002 Section 906
- 32.2 Chief Financial Officer Sarbanes-Oxley Act of 2002 Section 906
- 99.1 Additional Exhibits - MBIA Insurance Corporation and Subsidiaries Consolidated Financial Statements

**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 14, 2005

/s/ NICHOLAS FERRERI  
**Nicholas Ferreri**

**Chief Financial Officer**

Date: November 14, 2005

/s/ DOUGLAS C. HAMILTON  
**Douglas C. Hamilton**

**Controller (Principal Accounting Officer)**