MBIA INC
Form 10-Q
November 06, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the Quarter Ended September 30, 2006

or

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

For the transition period from ______ to ______

Commission file number 1-9583

MBIA INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In thousands except per share amounts)

	September 30, 2006	December 31, 2005
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $26,786,671 and $23,189,684)	$ 27,209,053	$ 23,747,204
Investments held-to-maturity, at amortized cost (fair value $5,042,568 and $5,734,335)	5,070,668	5,765,182
Investment agreement portfolio pledged as collateral, at fair value (amortized cost $822,230 and $712,054)	821,417	729,072
Short-term investments, at amortized cost (which approximates fair value)	2,000,179	1,673,697
Other investments	200,963	234,927
Total investments	35,302,280	32,150,082
Cash and cash equivalents	341,330	230,965
Accrued investment income	497,668	396,048
Deferred acquisition costs	437,648	427,111
Prepaid reinsurance premiums	373,463	407,614
Reinsurance recoverable on unpaid losses	47,002	58,965
Goodwill	79,406	79,406
Property and equipment, at cost (less accumulated depreciation of $125,598 and $116,275)	106,015	107,938
Receivable for investments sold	127,136	74,787
Derivative assets	441,540	326,867
Other assets	186,096	301,611
Total assets	**$ 37,939,584**	**$ 34,561,394**
Liabilities and Shareholders Equity		
Liabilities:		
Deferred premium revenue	$ 3,084,419	$ 3,185,200
Loss and loss adjustment expense reserves	725,629	721,502
Investment agreements	11,811,231	10,806,277
Commercial paper	755,234	859,997
Medium-term notes	9,005,718	7,542,416
Variable interest entity floating rate notes	1,475,750	1,280,160
Securities sold under agreements to repurchase	757,260	646,343
Short-term debt	40,898	58,745
Long-term debt	1,216,403	1,210,405
Current income taxes	38,610	
Deferred income taxes, net	510,843	569,536
Deferred fee revenue	16,891	20,379
Payable for investments purchased	426,522	83,369
Derivative liabilities	390,435	384,611
Other liabilities	626,983	600,810
Total liabilities	**30,882,826**	**27,969,750**
Commitments and contingencies (See Note 11)		
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 157,812,430 and 156,601,779	157,812	156,602
Additional paid-in capital	1,490,066	1,435,590
Retained earnings	6,260,164	5,747,171
Accumulated other comprehensive income, net of deferred income tax of $177,319 and $238,881	323,692	399,381
Treasury stock, at cost 23,010,663 and 22,554,528 shares	(1,174,976)	(1,147,100)
Total shareholders equity	**7,056,758**	**6,591,644**
Total liabilities and shareholders equity	**$ 37,939,584**	**$ 34,561,394**

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

(In thousands except per share amounts)

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

Corporate

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

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

For the nine months ended September 30, 2006

(In thousands except per share amounts)

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

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

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

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MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)

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

Cash flows from financing activities of continuing operations:		
Proceeds from issuance of investment agreements	4,289,445	5,307,982
Payments for drawdowns of investment agreements	(3,406,739)	(3,908,350)
Net payments of commercial paper	(135,458)	(851,921)
Issuance of medium-term notes	3,647,592	2,018,408
Principal paydown of medium-term notes	(2,145,301)	(1,061,466)
Issuance of variable interest entity floating rate notes	300,000	200,000
Principal paydown of variable interest entity floating rate notes	(107,053)	
Securities sold under agreements to repurchase, net	110,917	(43,452)
Dividends paid	(121,064)	(109,708)
Capital issuance costs	(1,727)	(2,184)
Net repayment of short term debt	(17,847)	
Purchase of treasury stock	(28,259)	(363,410)
Exercise of stock options	22,243	18,132
Excess tax benefit on share-based payment	1,181	
Other, financing	(709)	(5,907)
Net cash provided by financing activities of continuing operations	2,407,221	1,198,124
Discontinued operations (Revised - See Note 1):		
Net cash provided by operating activities	1,542	943
Net cash provided (used) by investing activities	6	(1,936)
Net cash (used) provided by financing activities	(17)	52
Net cash provided (used) by discontinued operations	1,531	(941)
Net increase (decrease) in cash and cash equivalents	110,365	(54,195)
Cash and cash equivalents - beginning of period	230,965	364,784
Cash and cash equivalents - end of period	$ 341,330	$ 310,589
Supplemental cash flow disclosures:		
Income taxes paid	$ 153,024	$ 195,327
Interest paid:		
Investment agreements	$ 370,730	$ 251,493
Commercial paper	30,966	46,423
Medium-term notes	287,123	172,916
Variable interest entity floating rate notes	39,877	16,218
Securities sold under agreements to repurchase	29,765	14,226
Other, financing	6,153	3,769
Long-term debt	52,418	54,661
Non cash items:		
Stock compensation	$ 10,962	$ 15,048
Dividends declared but not paid	41,788	37,537

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MBIA Inc. and Subsidiaries

NOTE 1: Basis of Presentation

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

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

NOTE 2: Significant Accounting Policies

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

PREMIUM REVENUE RECOGNITION

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

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

NOTE 3: Recent Accounting Pronouncements

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MBIA Inc. and Subsidiaries

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

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

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

NOTE 4: Dividends Declared

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

NOTE 5: Earnings Per Share

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

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

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

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

* May not add due to rounding.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MBIA Inc. and Subsidiaries

NOTE 6: Business Segments

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

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

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

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

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

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

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

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

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

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

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

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

Income (loss) before taxes	$ 254,185	$ 65,824	$ (99,779)	$ 220,230
Identifiable assets [c]	$ 12,536,675	$ 21,892,776	$ 489,247	$ 34,918,698

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

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

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

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

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

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

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

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

	Three months ended September 30, 2005				
In thousands	Asset/ Liability Products	Advisory Services	Conduits	Eliminations	Total Investment Management Services
Revenues[(a)]	$ 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

	Nine months ended September 30, 2006				
In thousands	Asset/ Liability	Advisory Services	Conduits	Eliminations	Total Investment

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

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

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	Nine months ended September 30, 2005				
In thousands	Asset/ Liability Products	Advisory Services	Conduits	Eliminations	Total Investment Management Services
Revenues[a]	$ 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

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

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

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

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MBIA Inc. and Subsidiaries

NOTE 7: Loss and Loss Adjustment Expense Reserves (LAE)

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

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

(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.

During the nine months ended September 30, 2006, total net case basis activity transferred from the Company s unallocated loss reserve was $9 million. Net case basis activity during 2006 consisted of loss reserves for insured obligations within the CDO, equipment lease pools and home equity loan sectors, MBIA s guaranteed tax lien portfolio and insured obligations issued by Allegheny Health, Education and Research Foundation (AHERF). Largely offsetting these loss reserves were reversals of previously established case basis reserves within the aircraft enhanced equipment trust certificates (EETCs) and manufactured housing sectors. The unallocated loss reserve approximated $259 million at September 30, 2006, which represents the Company s estimate of losses associated with credit deterioration that has occurred in the Company s insured portfolio but have not been specifically identified and is available for future case-specific activity. The Company recorded $61 million in losses and loss adjustment expenses in the nine months ended September 30, 2006 based on 12% of scheduled net earned premium. See Note 3: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company s Form 10-K for the year ended December 31, 2005 for a description of the Company s loss reserving policy.

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NOTE 8: Long-Term Incentive Plans

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

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

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

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

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

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

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

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

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

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

A summary of the Company s stock option plan as of September 30, 2006 and changes during the first nine months of the year, are set fort