

## Section 1: 10-Q (FORM 10-Q)

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**United States**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**Form 10-Q**

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-9583

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**MBIA INC.**

(Exact name of registrant as specified in its charter)

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**Connecticut**  
(State of incorporation)

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

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

**10504**  
(Zip Code)

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

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

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

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

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

As of July 31, 2014, 193,195,022 shares of Common Stock, par value \$1 per share, were outstanding.

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### **FORWARD-LOOKING AND CAUTIONARY STATEMENTS**

This quarterly report of MBIA Inc. ("MBIA", the "Company", "we", "us" or "our") includes statements that are not historical or current facts and are "forward-looking statements" made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words "believe", "anticipate", "project", "plan", "expect", "estimate", "intend", "will likely result", "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. We undertake no obligation to publicly correct or update any forward-looking statement if the Company later becomes aware that such result is not likely to be achieved.

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

- increased credit losses or impairments on public finance obligations we insure issued by state, local and territorial governments and finance authorities that are experiencing unprecedented fiscal stress;
- the possibility that MBIA Corp. will have inadequate liquidity to pay expected claims as a result of increased losses on certain structured finance transactions, in particular residential mortgage-backed securities transactions that include a substantial number of ineligible mortgage loans, or a delay or failure in collecting expected recoveries;
- the possibility that loss reserve estimates are not adequate to cover potential claims;
- a disruption in the cash flow from our subsidiaries or an inability to access capital and our exposure to significant fluctuations in liquidity and asset values within the global credit markets as a result of collateral posting requirements;
- our ability to fully implement our strategic plan, including our ability to maintain high stable ratings for National Public Finance Guarantee Corporation and generate investor demand for our financial guarantees;
- deterioration in the economic environment and financial markets in the United States ("U.S.") or abroad, and adverse developments in European sovereign credit performance, real estate market performance, credit spreads, interest rates and foreign currency levels;
- the effects of governmental regulation, including insurance laws, securities laws, tax laws, legal precedents and accounting rules; and
- uncertainties that have not been identified at this time.

The above factors provide a summary of and are qualified in their entirety by the risk factors discussed under "Risk Factors" in Part I, Item 1A of MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013. In addition, refer to "Note 1: Business Developments and Risks and Uncertainties" in the Notes to Consolidated Financial Statements for a discussion of certain risks and uncertainties related to our financial statements.

# PART 1 FINANCIAL INFORMATION

## Item 1. Financial Statements

### **MBIA INC. AND SUBSIDIARIES** **CONSOLIDATED BALANCE SHEETS (Unaudited)** (In millions except share and per share amounts)

|                                                                                                                 | June 30, 2014    | December 31, 2013 |
|-----------------------------------------------------------------------------------------------------------------|------------------|-------------------|
| <b>Assets</b>                                                                                                   |                  |                   |
| Investments:                                                                                                    |                  |                   |
| Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$5,235 and \$5,064)        | \$ 5,340         | \$ 4,987          |
| Investments carried at fair value                                                                               | 244              | 204               |
| Investments pledged as collateral, at fair value (amortized cost \$370 and \$483)                               | 341              | 424               |
| Short-term investments held as available-for-sale, at fair value (amortized cost \$1,218 and \$1,203)           | 1,219            | 1,204             |
| Other investments (includes investments at fair value of \$13 and \$11)                                         | 17               | 16                |
| Total investments                                                                                               | 7,161            | 6,835             |
| Cash and cash equivalents                                                                                       | 534              | 1,161             |
| Premiums receivable                                                                                             | 975              | 1,051             |
| Deferred acquisition costs                                                                                      | 243              | 260               |
| Insurance loss recoverable                                                                                      | 624              | 694               |
| Assets held for sale                                                                                            | 29               | 29                |
| Deferred income taxes, net                                                                                      | 986              | 1,109             |
| Other assets                                                                                                    | 243              | 222               |
| Assets of consolidated variable interest entities:                                                              |                  |                   |
| Cash                                                                                                            | 66               | 97                |
| Investments held-to-maturity, at amortized cost (fair value \$2,780 and \$2,651)                                | 2,787            | 2,801             |
| Investments held as available-for-sale, at fair value (amortized cost \$0 and \$136)                            | -                | 136               |
| Fixed-maturity securities at fair value                                                                         | 474              | 587               |
| Loans receivable at fair value                                                                                  | 1,539            | 1,612             |
| Loan repurchase commitments                                                                                     | 363              | 359               |
| <b>Total assets</b>                                                                                             | <b>\$ 16,024</b> | <b>\$ 16,953</b>  |
| <b>Liabilities and Equity</b>                                                                                   |                  |                   |
| Liabilities:                                                                                                    |                  |                   |
| Unearned premium revenue                                                                                        | \$ 2,251         | \$ 2,441          |
| Loss and loss adjustment expense reserves                                                                       | 554              | 641               |
| Investment agreements                                                                                           | 660              | 700               |
| Medium-term notes (includes financial instruments carried at fair value of \$217 and \$203)                     | 1,286            | 1,427             |
| Long-term debt                                                                                                  | 1,755            | 1,702             |
| Derivative liabilities                                                                                          | 449              | 1,152             |
| Other liabilities                                                                                               | 313              | 294               |
| Liabilities of consolidated variable interest entities:                                                         |                  |                   |
| Variable interest entity notes (includes financial instruments carried at fair value of \$2,150 and \$2,356)    | 4,937            | 5,286             |
| Derivative liabilities                                                                                          | 11               | 11                |
| <b>Total liabilities</b>                                                                                        | <b>12,216</b>    | <b>13,654</b>     |
| Commitments and contingencies (See Note 13)                                                                     |                  |                   |
| 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—281,359,451 and 277,812,430 | 281              | 278               |
| Additional paid-in capital                                                                                      | 3,118            | 3,115             |
| Retained earnings                                                                                               | 2,665            | 2,289             |
| Accumulated other comprehensive income (loss), net of tax of \$20 and \$54                                      | 56               | (86)              |
| Treasury stock, at cost—86,924,313 and 85,562,546 shares                                                        | (2,333)          | (2,318)           |
| Total shareholders' equity of MBIA Inc.                                                                         | 3,787            | 3,278             |
| Preferred stock of subsidiary and noncontrolling interest                                                       | 21               | 21                |
| <b>Total equity</b>                                                                                             | <b>3,808</b>     | <b>3,299</b>      |
| <b>Total liabilities and equity</b>                                                                             | <b>\$ 16,024</b> | <b>\$ 16,953</b>  |

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

**MBIA INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**  
(In millions except share and per share amounts)

|                                                                                | Three Months Ended June 30, |                 | Six Months Ended June 30, |                |
|--------------------------------------------------------------------------------|-----------------------------|-----------------|---------------------------|----------------|
|                                                                                | 2014                        | 2013            | 2014                      | 2013           |
| <b>Revenues:</b>                                                               |                             |                 |                           |                |
| Premiums earned:                                                               |                             |                 |                           |                |
| Scheduled premiums earned                                                      | \$ 63                       | \$ 77           | \$ 132                    | \$ 156         |
| Refunding premiums earned                                                      | 26                          | 47              | 45                        | 88             |
| Premiums earned (net of ceded premiums of \$2, \$2, \$5 and \$5)               | 89                          | 124             | 177                       | 244            |
| Net investment income                                                          | 42                          | 38              | 92                        | 76             |
| Fees and reimbursements                                                        | 4                           | 6               | 8                         | 12             |
| Change in fair value of insured derivatives:                                   |                             |                 |                           |                |
| Realized gains (losses) and other settlements on insured derivatives           | (24)                        | (1,532)         | (393)                     | (1,520)        |
| Unrealized gains (losses) on insured derivatives                               | (23)                        | 1,350           | 815                       | 1,277          |
| Net change in fair value of insured derivatives                                | (47)                        | (182)           | 422                       | (243)          |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 61                          | (6)             | 6                         | 57             |
| Net gains (losses) on extinguishment of debt                                   | 2                           | 39              | 3                         | 43             |
| Other net realized gains (losses)                                              | -                           | -               | 1                         | -              |
| Revenues of consolidated variable interest entities:                           |                             |                 |                           |                |
| Net investment income                                                          | 13                          | 14              | 25                        | 30             |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 23                          | 78              | 26                        | 111            |
| Net gains (losses) on extinguishment of debt                                   | -                           | -               | 4                         | -              |
| Other net realized gains (losses)                                              | -                           | 1               | -                         | 1              |
| Total revenues                                                                 | 187                         | 112             | 764                       | 331            |
| <b>Expenses:</b>                                                               |                             |                 |                           |                |
| Losses and loss adjustment                                                     | 12                          | 188             | 62                        | (6)            |
| Amortization of deferred acquisition costs                                     | 8                           | 11              | 18                        | 27             |
| Operating                                                                      | 49                          | 103             | 95                        | 209            |
| Interest                                                                       | 52                          | 60              | 106                       | 120            |
| Expenses of consolidated variable interest entities:                           |                             |                 |                           |                |
| Operating                                                                      | 1                           | 2               | 4                         | 6              |
| Interest                                                                       | 10                          | 12              | 20                        | 24             |
| Total expenses                                                                 | 132                         | 376             | 305                       | 380            |
| Income (loss) before income taxes                                              | 55                          | (264)           | 459                       | (49)           |
| Provision (benefit) for income taxes                                           | (65)                        | (86)            | 83                        | (35)           |
| <b>Net income (loss)</b>                                                       | <b>\$ 120</b>               | <b>\$ (178)</b> | <b>\$ 376</b>             | <b>\$ (14)</b> |
| <b>Net income (loss) per common share:</b>                                     |                             |                 |                           |                |
| Basic                                                                          | \$ 0.61                     | \$ (0.94)       | \$ 1.93                   | \$ (0.07)      |
| Diluted                                                                        | \$ 0.45                     | \$ (0.94)       | \$ 1.83                   | \$ (0.07)      |
| <b>Weighted average number of common shares outstanding:</b>                   |                             |                 |                           |                |
| Basic                                                                          | 189,169,042                 | 189,163,527     | 189,101,884               | 189,135,587    |
| Diluted                                                                        | 192,906,871                 | 189,163,527     | 193,051,436               | 189,135,587    |

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

**MBIA INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)**  
(In millions)

|                                                                                          | <u>Three Months Ended June 30,</u> |                 | <u>Six Months Ended June 30,</u> |                 |
|------------------------------------------------------------------------------------------|------------------------------------|-----------------|----------------------------------|-----------------|
|                                                                                          | <u>2014</u>                        | <u>2013</u>     | <u>2014</u>                      | <u>2013</u>     |
| Net income (loss)                                                                        | \$ 120                             | \$ (178)        | \$ 376                           | \$ (14)         |
| Other comprehensive income (loss):                                                       |                                    |                 |                                  |                 |
| Unrealized gains (losses) on available-for-sale securities:                              |                                    |                 |                                  |                 |
| Unrealized gains (losses) arising during the period                                      | 79                                 | (153)           | 184                              | (140)           |
| Provision (benefit) for income taxes                                                     | 26                                 | (53)            | 64                               | (49)            |
| Total                                                                                    | 53                                 | (100)           | 120                              | (91)            |
| Reclassification adjustments for (gains) losses included in net income (loss)            | 13                                 | 6               | 15                               | (19)            |
| Provision (benefit) for income taxes                                                     | 5                                  | 2               | 6                                | (7)             |
| Total                                                                                    | 8                                  | 4               | 9                                | (12)            |
| Available-for-sale securities with other-than-temporary impairments:                     |                                    |                 |                                  |                 |
| Other-than-temporary impairments and unrealized gains (losses) arising during the period | (4)                                | 2               | (1)                              | 7               |
| Provision (benefit) for income taxes                                                     | (1)                                | 2               | (1)                              | 4               |
| Total                                                                                    | (3)                                | -               | -                                | 3               |
| Reclassification adjustments for (gains) losses included in net income (loss)            | 7                                  | (4)             | 7                                | (4)             |
| Provision (benefit) for income taxes                                                     | 2                                  | (1)             | 2                                | (1)             |
| Total                                                                                    | 5                                  | (3)             | 5                                | (3)             |
| Foreign currency translation:                                                            |                                    |                 |                                  |                 |
| Foreign currency translation gains (losses)                                              | 9                                  | 4               | 7                                | (39)            |
| Provision (benefit) for income taxes                                                     | 3                                  | -               | 3                                | -               |
| Total                                                                                    | 6                                  | 4               | 4                                | (39)            |
| Reclassification adjustments for (gains) losses included in net income (loss)            | -                                  | -               | 4                                | -               |
| Total other comprehensive income (loss)                                                  | 69                                 | (95)            | 142                              | (142)           |
| <b>Comprehensive income (loss)</b>                                                       | <b>\$ 189</b>                      | <b>\$ (273)</b> | <b>\$ 518</b>                    | <b>\$ (156)</b> |

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 Six Months Ended June 30, 2014**  
(In millions except share amounts)

|                                                         | Common Stock       |               | Additional      | Retained        | Accumulated    | Treasury Stock      |                  | Total           | Preferred Stock         |                         | Total           |
|---------------------------------------------------------|--------------------|---------------|-----------------|-----------------|----------------|---------------------|------------------|-----------------|-------------------------|-------------------------|-----------------|
|                                                         | Shares             | Amount        | Paid-in         | Earnings        | Other          | Shares              | Amount           | Shareholders'   | of Subsidiary and       | Noncontrolling Interest | Equity          |
|                                                         |                    |               | Capital         |                 | Comprehensive  |                     |                  | Equity          | Noncontrolling Interest |                         |                 |
|                                                         |                    |               |                 |                 | Income (Loss)  |                     |                  | of MBIA Inc.    | Shares                  | Amount                  |                 |
| <b>Balance, December 31, 2013</b>                       | <b>277,812,430</b> | <b>\$ 278</b> | <b>\$ 3,115</b> | <b>\$ 2,289</b> | <b>\$ (86)</b> | <b>(85,562,546)</b> | <b>\$(2,318)</b> | <b>\$ 3,278</b> | <b>1,315</b>            | <b>\$ 21</b>            | <b>\$ 3,299</b> |
| Net income (loss)                                       | -                  | -             | -               | 376             | -              | -                   | -                | 376             | -                       | -                       | 376             |
| Other comprehensive income (loss)                       | -                  | -             | -               | -               | 142            | -                   | -                | 142             | -                       | -                       | 142             |
| Share-based compensation net of tax of \$2              | 3,547,021          | 3             | 3               | -               | -              | (519,695)           | (6)              | -               | -                       | -                       | -               |
| Treasury shares acquired under share repurchase program | -                  | -             | -               | -               | -              | (842,072)           | (9)              | (9)             | -                       | -                       | (9)             |
| <b>Balance, June 30, 2014</b>                           | <b>281,359,451</b> | <b>\$ 281</b> | <b>\$ 3,118</b> | <b>\$ 2,665</b> | <b>\$ 56</b>   | <b>(86,924,313)</b> | <b>\$(2,333)</b> | <b>\$ 3,787</b> | <b>1,315</b>            | <b>\$ 21</b>            | <b>\$ 3,808</b> |

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

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**MBIA INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**  
(In millions)

|                                                                                                 | <u>Six Months Ended June 30,</u> |                 |
|-------------------------------------------------------------------------------------------------|----------------------------------|-----------------|
|                                                                                                 | <u>2014</u>                      | <u>2013</u>     |
| Cash flows from operating activities:                                                           |                                  |                 |
| Premiums, fees and reimbursements received                                                      | \$ 72                            | \$ 107          |
| Investment income received                                                                      | 214                              | 223             |
| Insured derivative commutations and losses paid                                                 | (371)                            | (419)           |
| Financial guarantee losses and loss adjustment expenses paid                                    | (139)                            | (227)           |
| Proceeds from recoveries and reinsurance                                                        | 60                               | 1,781           |
| Operating and employee related expenses paid                                                    | (142)                            | (176)           |
| Interest paid, net of interest converted to principal                                           | (95)                             | (118)           |
| Income taxes (paid) received                                                                    | 5                                | -               |
| Net cash provided (used) by operating activities                                                | <u>(396)</u>                     | <u>1,171</u>    |
| Cash flows from investing activities:                                                           |                                  |                 |
| Purchases of available-for-sale investments                                                     | (975)                            | (928)           |
| Sales of available-for-sale investments                                                         | 463                              | 1,301           |
| Paydowns and maturities of available-for-sale investments                                       | 255                              | 377             |
| Purchases of investments at fair value                                                          | (259)                            | (245)           |
| Sales, paydowns and maturities of investments at fair value                                     | 343                              | 338             |
| Sales, paydowns and maturities (purchases) of short-term investments, net                       | 309                              | (1,242)         |
| Sales, paydowns and maturities of held-to-maturity investments                                  | 14                               | 12              |
| Paydowns and maturities of loans                                                                | 112                              | 137             |
| Consolidation (deconsolidation) of variable interest entities, net                              | (1)                              | (26)            |
| (Payments) proceeds for derivative settlements                                                  | (15)                             | (39)            |
| Collateral (to) from swap counterparty                                                          | 81                               | 63              |
| Capital expenditures                                                                            | (3)                              | (1)             |
| Net cash provided (used) by investing activities                                                | <u>324</u>                       | <u>(253)</u>    |
| Cash flows from financing activities:                                                           |                                  |                 |
| Proceeds from investment agreements                                                             | 11                               | 15              |
| Principal paydowns of investment agreements                                                     | (57)                             | (190)           |
| Principal paydowns of medium-term notes                                                         | (166)                            | (40)            |
| Principal paydowns of variable interest entity notes                                            | (377)                            | (685)           |
| Payments for retirement of debt                                                                 | -                                | (2)             |
| Net cash provided (used) by financing activities                                                | <u>(589)</u>                     | <u>(902)</u>    |
| Effect of exchange rate changes on cash and cash equivalents                                    | 3                                | -               |
| Net increase (decrease) in cash and cash equivalents                                            | (658)                            | 16              |
| Cash and cash equivalents—beginning of period                                                   | 1,258                            | 990             |
| Cash and cash equivalents—end of period                                                         | <u>\$ 600</u>                    | <u>\$ 1,006</u> |
| Reconciliation of net income (loss) to net cash provided (used) by operating activities:        |                                  |                 |
| Net income (loss)                                                                               | \$ 376                           | \$ (14)         |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: |                                  |                 |
| Change in:                                                                                      |                                  |                 |
| Premiums receivable                                                                             | 83                               | 91              |
| Deferred acquisition costs                                                                      | 17                               | 24              |
| Unearned premium revenue                                                                        | (204)                            | (265)           |
| Loss and loss adjustment expense reserves                                                       | (87)                             | (79)            |
| Insurance loss recoverable                                                                      | 70                               | 2,754           |
| Accrued interest payable                                                                        | 51                               | 56              |
| Accrued expenses                                                                                | (27)                             | 39              |
| Realized (gains) losses and other settlements on insured derivatives                            | 30                               | -               |
| Unrealized (gains) losses on insured derivatives                                                | (815)                            | (1,277)         |
| Net (gains) losses on financial instruments at fair value and foreign exchange                  | (32)                             | (168)           |
| Deferred income tax provision (benefit)                                                         | 76                               | (37)            |
| (Gains) losses on extinguishment of debt                                                        | (7)                              | (43)            |
| Interest on variable interest entities, net                                                     | 37                               | 49              |
| Other operating                                                                                 | 36                               | 41              |
| Total adjustments to net income (loss)                                                          | <u>(772)</u>                     | <u>1,185</u>    |
| Net cash provided (used) by operating activities                                                | <u>\$ (396)</u>                  | <u>\$ 1,171</u> |

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

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 1: Business Developments and Risks and Uncertainties**

###### **Summary**

MBIA Inc., together with its consolidated subsidiaries, (collectively, "MBIA" or the "Company") operates one of the largest financial guarantee insurance businesses in the industry and is a provider of asset management and advisory services. These activities are managed through three business segments: United States ("U.S.") public finance insurance; structured finance and international insurance; and advisory services. The Company's U.S. public finance insurance business is primarily operated through National Public Finance Guarantee Corporation and its subsidiaries ("National"), its structured finance and international insurance business is primarily operated through MBIA Insurance Corporation and its subsidiaries ("MBIA Corp."), and its asset management and advisory services business is primarily operated through Cutwater Holdings, LLC and its subsidiaries ("Cutwater"). Unless otherwise indicated or the context otherwise requires, references to "MBIA Corp." are to MBIA Insurance Corporation, together with its subsidiaries, MBIA UK Insurance Limited ("MBIA UK") and MBIA Mexico S.A. de C.V. MBIA Inc. and certain of its subsidiaries also manage certain other business activities, the results of which are reported in the corporate, asset/liability products, and conduit segments. The corporate segment includes revenues and expenses that arise from general corporate activities. While the asset/liability products and conduit businesses represent separate business segments, they may be referred to collectively as "wind-down operations" as the funding programs managed through those businesses are in wind-down. Refer to "Note 10: Business Segments" for further information about the Company's reporting segments.

###### **Business Developments**

###### *National Ratings and New Business Opportunities*

National's ability to write new business and compete with other financial guarantors is largely dependent on the financial strength ratings assigned to National by major rating agencies. During the first six months of 2014, Standard & Poor's Financial Services LLC ("S&P") upgraded National to a rating of AA- with a stable outlook, Moody's Investors Service, Inc. ("Moody's") upgraded National to a rating of A3 with a stable outlook, and subsequent to June 30, 2014, Moody's affirmed National's A3 rating and changed the outlook to negative. In addition, Kroll Bond Rating Agency assigned National a AA+ insurer financial strength rating with a stable outlook.

National seeks to generate shareholder value through appropriate risk adjusted pricing; however, current market conditions and the competitive landscape may limit National's new business opportunities and its abilities to price and underwrite risk with attractive returns. Refer to "Risks and Uncertainties" below for a discussion of business risks related to National's strategy.

###### *MBIA Corp. Strategic Initiatives*

During the six months ended June 30, 2014, the Company continued to focus on the collection of excess spread and put-back recoveries and the mitigation of MBIA Corp.'s high risk insurance exposure, primarily through terminations of insurance policies. During the six months ended June 30, 2014, MBIA Corp. commuted \$3.9 billion of gross par exposure, primarily comprising structured commercial mortgage-backed securities ("CMBS") pools, commercial real estate ("CRE") collateralized debt obligations ("CDOs"), and first-lien residential mortgage-backed securities ("RMBS"). The difference between the fair values of the Company's derivative liabilities for the commuted policies and the aggregate cost of the commutation was reflected in earnings for the six months ended June 30, 2014.

###### **Risks and Uncertainties**

The Company's financial statements include estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The outcome of certain significant risks and uncertainties could cause the Company to revise its estimates and assumptions or could cause actual results to differ from the Company's estimates. While the Company believes it continues to have sufficient capital and liquidity to meet all of its expected obligations, if one or more possible adverse outcomes were to be realized, its financial position, results of operations and cash flows, and its insurance companies' statutory capital, could be materially and adversely affected. The discussion below highlights the significant risks and uncertainties that could have a material effect on the Company's financial statements and business objectives in future periods.

###### *U.S. Public Finance Market Conditions*

The majority of National's new business is expected to be in the general obligation, tax-backed and revenue bond sectors. In addition to the new issue market, there are attractive opportunities in the secondary market with respect to bonds issued in recent years which were not insured upon issuance and which currently meet National's underwriting criteria. Nonetheless, as a result of intense competition and the diminished use of financial guarantee insurance in the municipal finance market, among other factors, there can be no assurance that National will be able to write business that generates attractive returns. Financial guarantee insurance competes in nearly all instances with the issuer's alternative of foregoing insurance and paying a higher interest rate. If the interest savings from insurance are not greater than the cost, the issuer will generally choose to issue bonds without insurance.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

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

Prevailing interest rate levels can affect demand for financial guarantee insurance. Higher interest rates and higher levels of issuance of new municipal debt would present new business opportunities for National in the U.S. public finance market. Lower interest rates are typically accompanied by narrower spreads between insured and uninsured obligations. This is, in part, due to the fact that investors may choose to forego insurance to increase the yield on their investment. Therefore, the purchase of insurance during periods of relatively narrower interest rate spreads will generally provide lower cost savings to the issuer than during periods of relatively wider spreads.

National's insured portfolio continued to perform satisfactorily on the whole, however portions of the obligations that the Company insures were issued by a few of the state and local governments and territories that remain under extreme financial and budgetary stress. In addition, a few of these local governments have filed for protection under the United States Bankruptcy Code or have entered into state statutory proceedings established to assist municipalities in managing through periods of severe fiscal stress. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments on a greater number of the Company's insured transactions. The Company monitors and analyzes each situation closely, and the overall extent and duration of this stress is uncertain.

##### *MBIA Inc. Liquidity*

As of June 30, 2014, the liquidity position of MBIA Inc., which consists of the liquidity positions of its corporate and asset/liability products segments, was \$365 million, and comprised cash and liquid assets of \$317 million available for general liquidity purposes and \$48 million not pledged directly as collateral for its asset/liability products segment. As of December 31, 2013, MBIA Inc. had \$359 million of cash and liquid assets comprising \$307 million available for general corporate liquidity purposes and \$52 million not pledged directly as collateral for its asset/liability products segment. During the six months ended June 30, 2014, \$202 million was released to MBIA Inc. under the MBIA group's tax sharing agreement (the "Tax Escrow Account"). While MBIA Inc.'s liquidity position slightly improved during the six months ended June 30, 2014 due to this release, MBIA Inc. continues to have liquidity risk. If invested asset performance deteriorates or the flow of dividends from subsidiaries is interrupted and/or access to the capital markets is impaired, its liquidity position could be eroded over time. While the Company expects that MBIA Inc. will generate sufficient cash to satisfy its debt obligations and its general corporate needs over time from distributions from its operating subsidiaries and payments under the Tax Escrow Account once the payments become unrestricted, there can be no assurance that such sources will generate sufficient cash. In addition, a failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp.

##### *MBIA Corp. Recoveries and Insured Portfolio*

The amount and timing of projected collections from excess spread and put-back recoverable from Credit Suisse Securities (USA) LLC, DLJ Mortgage Capital, Inc., and Select Portfolio Servicing Inc. (collectively, "Credit Suisse") and the potential of claims from MBIA Corp.'s remaining insured CMBS pools and second-lien RMBS are uncertain. Further, the remaining insured portfolio, aside from these exposures, could deteriorate and result in additional significant loss reserves and claim payments. Management's expected liquidity and capital forecasts for MBIA Corp., which include expected excess spread recoveries and put-back recoveries from Credit Suisse, reflect adequate resources to pay claims when due. However, if MBIA Corp. experiences higher than expected claim payments or is unable to terminate the remaining exposures that represent substantial risk to the Company, MBIA Corp. may ultimately have insufficient resources to continue to pay claims, which could cause the New York State Department of Financial Services ("NYSDFS") to put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding. Such a proceeding could have an adverse impact on MBIA Inc. and would result in material adverse consequences for MBIA Corp., including the termination of insured credit default swaps ("CDS") contracts for which counterparties may assert market-based claims, the acceleration of debt obligations issued by affiliates and insured by MBIA Corp., the loss of control of MBIA Insurance Corporation to a rehabilitator or liquidator, and unplanned costs.

Refer to "Note 5: Loss and Loss Adjustment Expense Reserves" for information about MBIA Corp.'s loss reserves and recoveries.

Management does not believe that a rehabilitation or liquidation proceeding of MBIA Insurance Corporation by the NYSDFS will have any significant long-term liquidity impact on MBIA Inc. or result in a liquidation or similar proceeding of MBIA UK Insurance Limited.

##### **Note 2: Significant Accounting Policies**

The Company has disclosed its significant accounting policies in "Note 2: Significant Accounting Policies" in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The following significant accounting policies provide an update to those included in the Company's Annual Report on Form 10-K.

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### **MBIA Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements (Unaudited)**

#### **Note 2: Significant Accounting Policies (continued)**

##### ***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America ("GAAP") for annual periods. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2013. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the Company's consolidated financial position and results of operations. All material intercompany balances and transactions have been eliminated.

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

The results of operations for the three and six months ended June 30, 2014 may not be indicative of the results that may be expected for the year ending December 31, 2014. The December 31, 2013 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. Certain amounts have been reclassified in the prior year's financial statements to conform to the current presentation. Such reclassifications had no impact on total revenues, expenses, assets, liabilities, shareholders' equity, operating cash flows, investing cash flows, or financing cash flows for all periods presented.

#### **Note 3: Recent Accounting Pronouncements**

##### ***Recently Adopted Accounting Standards***

*Income Taxes (Topic 740)—Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (ASU 2013-11)*

In July of 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-11, "Income Taxes (Topic 740)—Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." ASU 2013-11 requires presentation of an unrecognized tax benefit ("UTB") as a reduction to a deferred tax asset when a net operating loss ("NOL") carryforward, a similar tax loss, or a tax credit carryforward exists in the same tax year and jurisdiction as the UTB. ASU 2013-11 does not affect the recognition or measurement of uncertain tax positions under "Income Taxes (Topic 740)" and does not affect any related tax disclosures. ASU 2013-11 is effective for interim and annual periods beginning January 1, 2014 with early adoption permitted. The Company previously presented any UTBs as a reduction to a deferred tax asset in accordance with ASU 2013-11 as all of its UTBs relate to the same tax years and jurisdictions in which NOLs exist, therefore, this accounting pronouncement did not affect the Company's consolidated financial statements.

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

##### ***Recent Accounting Developments***

*Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) —Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*

In April of 2014, the FASB issued ASU 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360)-Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." ASU 2014-08 changes the criteria for determining whether a disposal of a component or group of components of an entity qualifies for discontinued operations presentation and requires new disclosures. ASU 2014-08 amends the definition of discontinued operation to a disposal of components of an entity that represent strategic shifts that have, or will have, a major effect on an entity's operations and financial results. ASU 2014-08 is effective for interim and annual periods beginning January 1, 2015 with early adoption permitted. The adoption of ASU 2014-08 is not expected to materially impact the Company's consolidated financial statements.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 3: Recent Accounting Pronouncements (continued)**

*Revenue from Contracts with Customers (Topic 606) (ASU 2014-09)*

In May of 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 amends the accounting guidance for recognizing revenue for the transfer of goods or services from contracts with customers unless those contracts are within the scope of other accounting standards. ASU 2014-09 is effective for interim and annual periods beginning January 1, 2017, and is applied on a retrospective or modified retrospective basis. The Company is evaluating the impact of adopting ASU 2014-09.

*Transfers and Servicing (Topic 860)—Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures (ASU 2014-11)*

In June of 2014, the FASB issued ASU 2014-11, "Transfers and Servicing (Topic 860)-Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." The repurchase agreements and similar transactions guidance is amended by ASU 2014-11 to change the accounting for i.) repurchase-to-maturity transactions to secured borrowing accounting and ii.) linked repurchase financing transactions to secured borrowing accounting. ASU 2014-11 amends disclosure requirements for transfers accounted for as sales, and for repurchase transactions accounted for as secured borrowings. ASU 2014-11 is effective for interim and annual periods beginning January 1, 2015, and is applied on a prospective basis. The adoption of ASU 2014-11 is not expected to materially impact the Company's consolidated financial statements.

*Compensation-Stock Compensation (Topic 718)—Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (A Consensus of the FASB Emerging Issues Task Force) (ASU 2014-12)*

In June of 2014, the FASB issued ASU 2014-12, "Compensation-Stock Compensation (Topic 718)-Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." ASU 2014-12 requires that a performance target that affects vesting of share-based payment awards and that could be achieved after an employee's requisite service period be accounted for as a performance condition. ASU 2014-12 is effective for interim and annual periods beginning January 1, 2016 with early adoption permitted, and is applied on a prospective basis or retrospective basis. The adoption of ASU 2014-12 is not expected to materially impact the Company's consolidated financial statements.

**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 4: Variable Interest Entities**

***Structured Finance and International Insurance***

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

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

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

***Wind-down Operations***

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

In the conduit segment, the Company has managed and administered a conduit that invested primarily in debt securities and was funded through the issuance of VIE notes. The Company consolidated the conduit as a primary beneficiary. In 2014, all outstanding VIE notes were repaid by the conduit, and the conduit was subsequently dissolved. The Company no longer provides any related credit protection.

***Nonconsolidated VIEs***

***Insurance***

The following tables present the total assets of nonconsolidated VIEs in which the Company holds a variable interest as of June 30, 2014 and December 31, 2013, through its insurance operations. The following tables also present the Company's maximum exposure to loss for nonconsolidated VIEs and carrying values of the assets and liabilities for its interests in these VIEs as of June 30, 2014 and December 31, 2013. The Company has aggregated nonconsolidated VIEs based on the underlying credit exposure of the insured obligation. The nature of the Company's variable interests in nonconsolidated VIEs is related to financial guarantees, insured CDS contracts and any investments in obligations issued by nonconsolidated VIEs.

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 4: Variable Interest Entities (continued)**

| In millions                     | June 30, 2014            |                          |                            |                                    |                                           |                                         |                                                          |                                       |
|---------------------------------|--------------------------|--------------------------|----------------------------|------------------------------------|-------------------------------------------|-----------------------------------------|----------------------------------------------------------|---------------------------------------|
|                                 | Carrying Value of Assets |                          |                            |                                    |                                           | Carrying Value of Liabilities           |                                                          |                                       |
|                                 | VIE Assets               | Maximum Exposure to Loss | Investments <sup>(1)</sup> | Premiums Receivable <sup>(2)</sup> | Insurance Loss Recoverable <sup>(3)</sup> | Unearned Premium Revenue <sup>(4)</sup> | Loss and Loss Adjustment Expense Reserves <sup>(5)</sup> | Derivative Liabilities <sup>(6)</sup> |
| <b>Insurance:</b>               |                          |                          |                            |                                    |                                           |                                         |                                                          |                                       |
| Global structured finance:      |                          |                          |                            |                                    |                                           |                                         |                                                          |                                       |
| Collateralized debt obligations | \$ 8,399                 | \$ 6,267                 | \$ 117                     | \$ 30                              | \$ -                                      | \$ 25                                   | \$ 8                                                     | \$ 96                                 |
| Mortgage-backed residential     | 15,622                   | 8,274                    | 9                          | 48                                 | 587                                       | 46                                      | 322                                                      | 5                                     |
| Mortgage-backed commercial      | 617                      | 322                      | -                          | 1                                  | -                                         | 1                                       | -                                                        | -                                     |
| Consumer asset-backed           | 6,372                    | 2,450                    | -                          | 18                                 | -                                         | 16                                      | 10                                                       | -                                     |
| Corporate asset-backed          | 10,414                   | 6,414                    | 1                          | 62                                 | 18                                        | 75                                      | -                                                        | -                                     |
| Total global structured finance | 41,424                   | 23,727                   | 127                        | 159                                | 605                                       | 163                                     | 340                                                      | 101                                   |
| Global public finance           | 56,176                   | 20,609                   | -                          | 203                                | -                                         | 243                                     | 5                                                        | -                                     |
| Total insurance <sup>(7)</sup>  | <u>\$97,600</u>          | <u>\$ 44,336</u>         | <u>\$ 127</u>              | <u>\$ 362</u>                      | <u>\$ 605</u>                             | <u>\$ 406</u>                           | <u>\$ 345</u>                                            | <u>\$ 101</u>                         |

(1) - Reported within "Investments" on MBIA's consolidated balance sheets.

(2) - Reported within "Premiums receivable" on MBIA's consolidated balance sheets.

(3) - Reported within "Insurance loss recoverable" on MBIA's consolidated balance sheets.

(4) - Reported within "Unearned premium revenue" on MBIA's consolidated balance sheets.

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

(6) - Reported within "Derivative liabilities" on MBIA's consolidated balance sheets.

(7) - In addition, the Company holds a \$4 million variable interest in a non-insurance VIE that invested in loans that totaled \$179 million.

| In millions                     | December 31, 2013        |                          |                            |                                    |                                           |                                         |                                                          |                                       |
|---------------------------------|--------------------------|--------------------------|----------------------------|------------------------------------|-------------------------------------------|-----------------------------------------|----------------------------------------------------------|---------------------------------------|
|                                 | Carrying Value of Assets |                          |                            |                                    |                                           | Carrying Value of Liabilities           |                                                          |                                       |
|                                 | VIE Assets               | Maximum Exposure to Loss | Investments <sup>(1)</sup> | Premiums Receivable <sup>(2)</sup> | Insurance Loss Recoverable <sup>(3)</sup> | Unearned Premium Revenue <sup>(4)</sup> | Loss and Loss Adjustment Expense Reserves <sup>(5)</sup> | Derivative Liabilities <sup>(6)</sup> |
| <b>Insurance:</b>               |                          |                          |                            |                                    |                                           |                                         |                                                          |                                       |
| Global structured finance:      |                          |                          |                            |                                    |                                           |                                         |                                                          |                                       |
| Collateralized debt obligations | \$ 12,565                | \$ 7,693                 | \$ 120                     | \$ 43                              | \$ -                                      | \$ 37                                   | \$ 21                                                    | \$ 108                                |
| Mortgage-backed residential     | 21,738                   | 9,251                    | 10                         | 53                                 | 658                                       | 51                                      | 327                                                      | 5                                     |
| Mortgage-backed commercial      | 1,367                    | 447                      | -                          | 1                                  | -                                         | 1                                       | -                                                        | -                                     |
| Consumer asset-backed           | 7,830                    | 2,740                    | 9                          | 19                                 | -                                         | 19                                      | 13                                                       | -                                     |
| Corporate asset-backed          | 13,028                   | 7,248                    | 2                          | 80                                 | 18                                        | 96                                      | -                                                        | -                                     |
| Total global structured finance | 56,528                   | 27,379                   | 141                        | 196                                | 676                                       | 204                                     | 361                                                      | 113                                   |
| Global public finance           | 52,317                   | 20,162                   | -                          | 206                                | -                                         | 248                                     | 5                                                        | -                                     |
| Total insurance                 | <u>\$108,845</u>         | <u>\$ 47,541</u>         | <u>\$ 141</u>              | <u>\$ 402</u>                      | <u>\$ 676</u>                             | <u>\$ 452</u>                           | <u>\$ 366</u>                                            | <u>\$ 113</u>                         |

(1) - Reported within "Investments" on MBIA's consolidated balance sheets.

(2) - Reported within "Premiums receivable" on MBIA's consolidated balance sheets.

(3) - Reported within "Insurance loss recoverable" on MBIA's consolidated balance sheets.

(4) - Reported within "Unearned premium revenue" on MBIA's consolidated balance sheets.

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

(6) - Reported within "Derivative liabilities" on MBIA's consolidated balance sheets.

The maximum exposure to loss as a result of MBIA's variable interests in VIEs is represented by insurance in force. Insurance in force is the maximum future payments of principal and interest which may be required under commitments to make payments on insured obligations issued by nonconsolidated VIEs.

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### **MBIA Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements (Unaudited)**

#### **Note 4: Variable Interest Entities (continued)**

##### ***Consolidated VIEs***

The carrying amounts of assets and liabilities of consolidated VIEs were \$5.2 billion and \$4.9 billion, respectively, as of June 30, 2014, and \$5.6 billion and \$5.3 billion, respectively, as of December 31, 2013. The carrying amounts of assets and liabilities are presented separately in "Assets of consolidated variable interest entities" and "Liabilities of consolidated variable interest entities" on the Company's consolidated balance sheets. Additional VIEs are consolidated or deconsolidated based on an ongoing reassessment of controlling financial interest, when events occur or circumstances arise, and whether the ability to exercise rights that constitute power to direct activities of any VIEs are present according to the design and characteristics of these entities. No additional VIEs were consolidated during the six months ended June 30, 2014 and 2013. There was an immaterial amount of net realized gains recorded for the three and six months ended June 30, 2014 and net realized gains related to the deconsolidation of VIEs were \$1 million for the three and six months ended June 30, 2013.

Holders of insured obligations of issuer-sponsored VIEs related to the Company's structured finance and international insurance segment do not have recourse to the general assets of MBIA. In the event of nonpayment of an insured obligation issued by a consolidated VIE, the Company is obligated to pay principal and interest, when due, on the respective insured obligation only. The Company's exposure to consolidated VIEs is limited to the credit protection provided on insured obligations and any additional variable interests held by MBIA.

#### **Note 5: Loss and Loss Adjustment Expense Reserves**

##### ***Loss and Loss Adjustment Expense Process***

##### **U.S. Public Finance**

U.S. public finance insured transactions consist of municipal bonds, including tax-exempt and taxable indebtedness of U.S. political subdivisions, as well as utility districts, airports, health care institutions, higher educational facilities, student loan issuers, housing authorities and other similar agencies and obligations issued by private entities that finance projects that serve a substantial public purpose. The Company estimates future losses by using probability-weighted scenarios that are customized to each insured transaction. Future loss estimates consider debt service due for each insured transaction, which includes par outstanding and interest due.

As of June 30, 2014 and December 31, 2013, the Company established loss and loss adjustment expense ("LAE") reserves totaling \$70 million and \$87 million, respectively, and insurance loss recoverable of \$14 million and \$13 million, respectively, related to U.S. public finance issues. For the six months ended June 30, 2014, losses and LAE incurred of \$3 million primarily related to Puerto Rico exposures, partially offset by decreases in reserves from certain general obligation bonds.

Certain local governments remain under financial and budgetary stress and a few have filed for protection under the United States Bankruptcy Code, or have entered into state statutory proceedings established to assist municipalities in managing through periods of severe fiscal stress. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments on a greater number of the Company's insured transactions. The Company monitors and analyzes these situations closely, however, the overall extent and duration of such events are uncertain and the filing for protection under the United States Bankruptcy Code or entering state statutory proceedings does not result in a default or indicate that an ultimate loss will occur. As of June 30, 2014 and December 31, 2013, the Company had \$113.2 billion and \$124.9 billion, respectively, of gross par outstanding on general obligations, of which \$154 million and \$161 million, respectively, were reflected on the Company's "Classified List." Capital appreciation bonds are reported at the par amount at the time of issuance of the insurance policy.

##### **Structured Finance and International**

As of June 30, 2014, the majority of the structured finance and international insurance segment's case basis reserves and insurance loss recoveries recorded in accordance with GAAP were related to insured second and first-lien RMBS transactions. These reserves and recoveries do not include estimates for policies insuring credit derivatives or losses and recoveries on financial guarantee VIEs that are eliminated in consolidation. Policies insuring credit derivative contracts are accounted for as derivatives and carried at fair value under GAAP. The fair values of insured derivative contracts are influenced by a variety of market and transaction-specific factors that may be unrelated to potential future claim payments under the Company's insurance policies. In the absence of credit impairments on insured derivative contracts or the early termination of such contracts at a loss, the cumulative unrealized losses recorded from these contracts should reverse before or at the maturity of the contracts.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

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

Notwithstanding the difference in accounting under GAAP for financial guarantee policies and the Company's insured derivatives, insured derivatives have similar terms, conditions, risks, and economic profiles to financial guarantee insurance policies, and therefore, are evaluated by the Company for loss (referred to as credit impairment herein) and LAE periodically in a manner similar to the way that loss and LAE reserves are estimated for financial guarantee insurance policies. Credit impairments represent actual payments and collections plus the present value of estimated expected future claim payments, net of recoveries. MBIA Insurance Corporation's expected future claim payments for insured derivatives were discounted using a rate of 5.09%, the same rate it used to calculate its statutory loss reserves as of June 30, 2014. MBIA UK used a rate of 2.50% to discount its expected future claim payments and statutory loss reserves. These credit impairments, calculated in accordance with statutory accounting principles ("U.S. STAT") differ from the fair values recorded in the Company's consolidated financial statements. The Company considers its credit impairment estimates as critical information for investors as it provides information about loss payments the Company expects to make on insured derivative contracts. As a result, the following loss and LAE process discussion includes information about loss and LAE activity recorded in accordance with GAAP for financial guarantee insurance policies and credit impairments estimated in accordance with U.S. STAT for insured derivative contracts. Refer to "Note 6: Fair Value of Financial Instruments" included herein for additional information about the Company's insured credit derivative contracts.

##### *RMBS Case Basis Reserves and Recoveries (Financial Guarantees)*

The Company's RMBS reserves and recoveries relate to financial guarantee insurance policies. The Company calculated RMBS case basis reserves as of June 30, 2014 for both second and first-lien RMBS transactions using a process called the "Roll Rate Methodology." The Roll Rate Methodology is a multi-step process using a database of loan level information, a proprietary internal cash flow model, and a commercially available model to estimate losses on insured bonds. "Roll Rate" is defined as the probability that current loans become delinquent and that loans in the delinquent pipeline are charged-off or liquidated. Generally, Roll Rates are calculated for the previous three months and averaged. The loss reserve estimates are based on a probability-weighted average of three scenarios of loan losses (base case, stress case, and an additional stress case).

In calculating ultimate cumulative losses for RMBS, the Company estimates the amount of loans that are expected to be charged-off (deemed uncollectible by servicers of the transactions) or liquidated in the future.

##### Second-lien RMBS Reserves

The Company's second-lien RMBS case basis reserves as of June 30, 2014 relate to RMBS backed by home equity lines of credit ("HELOC") and closed-end second mortgages ("CES").

The Roll Rates for 30-59 day delinquent loans and 60-89 day delinquent loans are calculated on a transaction-specific basis. The Company assumes that the Roll Rate for 90+ day delinquent loans, excluding foreclosures and Real Estate Owned ("REO") is 95%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of May 31, 2014 to estimate future losses from loans that are delinquent as of the current reporting period.

Roll Rates for loans that are current as of May 31, 2014 ("Current Roll to Loss") are also calculated on a transaction-specific basis. A proportion of loans reported current as of May 31, 2014 is assumed to become delinquent every month, at a Current Roll to Loss rate that persists at a high level for a time and subsequently starts to decline. A key assumption in the model is the period of time in which the Company projects high levels of Current Roll to Loss to persist. The Company runs multiple scenarios, each with varying periods of time, for which the high levels of Current Roll to Loss rates persist. Loss reserves are calculated by using a weighted average of these scenarios, with the majority of the probability assigned to stressful scenarios where the high levels of Current Roll to Loss rates persist for six or twenty four months before reverting to historic levels. For example, in the base case scenario, the Company assumes that the Current Roll to Loss begins to decline immediately and continues to decline over the next six months to 25% of their levels as of May 31, 2014. If the amount of current loans which become 30-59 days delinquent is 10%, and recent performance suggests that 30% of those loans will be charged-off, the Current Roll to Loss for the transaction is 3%. In the base case, the Current Roll to Loss will then reduce linearly to 25% of its original value over the next six months (i.e., 3% will linearly reduce to 0.75% over the six months from June 2014 to November 2014). After that six-month period, the Company further reduces the Current Roll to Loss to 0% by early 2015 with the expectation that the performing seasoned loans will eventually result in loan performance reverting to lower levels of default consistent with history. In developing multiple loss scenarios, stress is applied by elongating the Current Roll to Loss rate for various periods, simulating a slower improvement in the transaction performance.

**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

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

In addition, in the Company's loss reserve models for transactions secured by HELOCs, the Company considers borrower draw and prepayment rates and factors that could affect the excess spread generated by current loans, which offsets losses and reduces payments. For HELOCs, the current three-month average draw rate is generally used to project future draws on the line. For HELOCs and transactions secured by fixed-rate CES, the Company uses historical average voluntary prepayment rates to model its loss reserves. For HELOCs, projected cash flows are also based on an assumed constant basis spread between floating rate assets and floating rate insured debt obligations (the difference between prime and London Interbank Offered Rate ("LIBOR") interest rates, minus any applicable fees). For all transactions, cash flow models consider allocations and other structural aspects, including managed amortization periods, rapid amortization periods and claims against MBIA Corp.'s insurance policy consistent with such policy's terms and conditions. The estimated net claims from the procedure above are then discounted using a risk-free rate to a net present value reflecting MBIA's general obligation to pay claims over time and not on an accelerated basis. The above assumptions represent MBIA's probability-weighted estimates of how transactions will perform over time.

As of June 30, 2014 and December 31, 2013, the Company established loss and LAE reserves totaling \$118 million and \$126 million, respectively, related to second-lien RMBS issues after the elimination of \$18 million and \$43 million, respectively, as a result of consolidating VIEs. For the six months ended June 30, 2014, the Company incurred \$72 million of losses and LAE recorded in earnings related to second-lien RMBS issues after the elimination of a \$1 million benefit as a result of consolidating VIEs.

The Company monitors portfolio performance on a monthly basis against projected performance, reviewing delinquencies, Roll Rates, and prepayment rates (including voluntary and involuntary). However, loan performance remains difficult to predict and losses may exceed expectations. In the event of a material deviation in actual performance from projected performance, the Company would increase or decrease the case basis reserves accordingly. If actual performance were to remain at the peak levels for six additional months compared to the probability-weighted outcome currently used by the Company, the addition to the case basis reserves would be approximately \$60 million.

Second-lien RMBS Recoveries

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

*Excess Spread*

As of June 30, 2014 and December 31, 2013, the Company recorded estimated recoveries of \$577 million and \$681 million, respectively, for the reimbursement of past and future expected claims through excess spread in insured second-lien RMBS transactions after the elimination of \$173 million and \$190 million, respectively, as a result of consolidating VIEs. As of June 30, 2014, \$569 million and \$8 million were included in "Insurance loss recoverable" and "Loss and loss adjustment expense reserves" on the Company's consolidated balance sheets, respectively, after the elimination of \$168 million and \$5 million, respectively, as a result of consolidating VIEs. As of December 31, 2013, \$647 million and \$34 million were included in "Insurance loss recoverable" and "Loss and loss adjustment expense reserves" on the Company's consolidated balance sheets, respectively, after the elimination of \$183 million and \$7 million, respectively, as a result of consolidating VIEs.

Excess spread is generated by performing loans within insured second-lien RMBS securitizations and is the difference between interest inflows on mortgage loan collateral and interest outflows on insured beneficial interests. The amount of excess spread depends on the future loss trends (which include future delinquency trends, average time to charge-off delinquent loans, and the availability of pool mortgage insurance), the future spread between prime and LIBOR interest rates; and borrower refinancing behavior which results in voluntary prepayments. Minor deviations in loss trends and voluntary prepayments may substantially impact the amounts collected from excess spread and caused the reduction in estimated recoveries during the first six months of 2014.

*Ineligible Mortgage Loans*

To date, MBIA has settled the majority of the Company's put-back claims, with its claims against only Credit Suisse remaining as outstanding. The settlement amounts have been consistent with the put-back recoveries previously included in the Company's financial statements. Additional information on the status of the litigation against Credit Suisse can be found within "Note 13: Commitments and Contingencies."

The contract claim remaining with Credit Suisse is related to the inclusion of ineligible mortgage loans in the 2007-2 Home Equity Mortgage Trust ("HEMT") securitization. Credit Suisse has challenged the Company's assessment of the ineligibility of individual mortgage loans and the dispute is the subject of litigation for which there is no assurance that the Company will prevail.

**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

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

As of June 30, 2014 and December 31, 2013, the Company recorded estimated recoveries of \$363 million and \$359 million, respectively, related to second-lien RMBS put-back claims on ineligible mortgage loans, reflected in "Loan repurchase commitments" presented under the heading "Assets of consolidated variable interest entities" on the Company's consolidated balance sheets.

The Company believes that it will prevail in enforcing its contractual put-back rights against Credit Suisse. Based on the Company's assessment of the strength of these claims, the Company believes it is entitled to collect the full amount of its incurred losses, which totaled \$424 million through June 30, 2014. The Company is entitled to collect interest on amounts paid. However, uncertainty remains with respect to the ultimate outcome of the litigation with Credit Suisse, which is contemplated in the scenario based-modeling the Company uses. The Credit Suisse recovery scenarios are based on the amount of incurred losses measured against certain probabilities of ultimate resolution of the dispute with Credit Suisse over the inclusion of ineligible mortgage loans in the HEMT securitization. Most of the probability weight is assigned to partial recovery scenarios and are discounted using the current risk-free discount rates associated with the underlying transaction's cash flows.

The Company frequently reviews the approach and assumptions it applies to calculate put-back recoveries. Refer to "Note 6: Loss and Loss Adjustment Expense Reserves" in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, for the Company's assessment of the remaining unsettled recoveries related to insured Credit Suisse second-lien RMBS.

First-lien RMBS Reserves

The Company's first-lien RMBS case basis reserves as of June 30, 2014, which primarily relate to RMBS backed by alternative A-paper and subprime mortgage loans, were determined using the Roll Rate Methodology. The Company assumes that the Roll Rate for loans in foreclosure, REO and bankruptcy are 90%, 90% and 75%, respectively. Roll Rates for current, 30-59 day delinquent loans, 60-89 day delinquent loans and 90+ day delinquent loans are calculated on a transaction-specific basis. The Current Roll to Loss rates stay at the May 31, 2014 level for one month before declining to 25% of this level over a 24-month period.

The Company estimates future losses by using three different probability-weighted scenarios: base; stress; and additional stress. The three scenarios differ in the Roll Rates to loss of 90+ day delinquent loans. In the base scenario, the Company uses deal-specific Roll Rates obtained from historic loan level Roll Rate data for 90+ day delinquent loans. In the stress scenario, the Company assumes a 90% Roll Rate for all 90+ day delinquent loans. In the additional stress scenario, the Roll Rates for each deal are an average of the deal-specific Roll Rate used in the base scenario and the 90% rate. The Roll Rates are applied to the amounts in each deal's respective 90+ delinquency bucket based on delinquencies as of May 31, 2014 in order to estimate future losses from loans that are delinquent as of June 30, 2014.

In calculating ultimate cumulative losses for first-lien RMBS, the Company estimates the amount of loans that are expected to be liquidated through foreclosure or short sale. The time to liquidation for a defaulted loan is specific to the loan's delinquency bucket, with the latest three-month average loss severities generally used to start the projection for trends in loss severities at loan liquidation. The loss severities are reduced over time to account for reduction in the amount of foreclosure inventory, anticipated future increases in home prices, principal amortization of the loan and government foreclosure moratoriums.

As of June 30, 2014, the Company established loss and LAE reserves totaling \$237 million related to first-lien RMBS issues. As of December 31, 2013, the Company established loss and LAE reserves totaling \$241 million related to first-lien RMBS issues after the elimination of \$2 million as a result of consolidating VIEs. For the six months ended June 30, 2014, the Company incurred \$27 million of losses and LAE recorded in earnings related to first-lien RMBS issues after the elimination of a \$1 million benefit as a result of consolidating VIEs.

*ABS CDOs (Financial Guarantees and Insured Derivatives)*

MBIA's insured asset-backed securities ("ABS") CDOs are transactions that include a variety of collateral ranging from corporate bonds to structured finance assets (which includes but are not limited to RMBS related collateral, ABS CDOs, corporate CDOs and collateralized loan obligations). These transactions were insured as either financial guarantee insurance policies or credit derivatives with the majority currently insured in the form of financial guarantees. Since the fourth quarter of 2007, MBIA's insured par exposure within the ABS CDO portfolio has been substantially reduced through a combination of terminations and commutations. Accordingly, as of June 30, 2014, the insured par exposure of the ABS CDO financial guarantee insurance policies and credit derivatives portfolio has declined by approximately 97% of the insured amount as of December 31, 2007.

**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

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

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

As of June 30, 2014 and December 31, 2013, the Company established loss and LAE reserves totaling \$92 million and \$115 million, respectively, related to ABS CDO financial guarantee insurance policies after the elimination of \$235 million and \$226 million, respectively, as a result of consolidating VIEs. For the six months ended June 30, 2014, the Company had a benefit of \$17 million of losses and LAE recorded in earnings related to ABS CDO financial guarantee insurance policies after the elimination of a \$9 million expense as a result of consolidating VIEs. In the event of further deteriorating performance of the collateral referenced or held in ABS CDO transactions, the amount of losses estimated by the Company could increase substantially.

*Credit Impairments Related to Structured CMBS Pools, CRE CDOs and CRE Loan Pools (Financial Guarantees and Insured Derivatives)*

MBIA's insured CRE transactions comprise structured CMBS pools, CRE CDOs and CRE loan pools. The majority of this portfolio is accounted for as insured credit derivatives and carried at fair value in the Company's consolidated financial statements. Refer to "Note 8: Derivative Instruments" for a further discussion of the Company's use of derivatives and their impact on the Company's consolidated financial statements. Since the Company's insured credit derivatives have similar terms, conditions, risks, and economic profiles to its financial guarantee insurance policies, the Company evaluates them for impairment in the same way that it estimates loss and LAE for its financial guarantee policies. The following discussion provides information about the Company's process for estimating credit impairments on these contracts using its statutory loss reserve methodology, determined as the present value of the probability-weighted potential future losses, net of estimated recoveries, across multiple scenarios, plus actual payments and collections.

The Company considers several factors when developing the range of potential outcomes in the CRE market and their impact on MBIA. The following approaches require substantial judgments about the future performance of the underlying loans:

1. Each transaction is evaluated for its commutation potential, which is customized by counterparty and considers historical commutation prices, the level of dialogue with the counterparty and the credit quality and payment profile of the underlying exposure.
2. Delinquency rates, net operating income ("NOI") and capitalization rates ("Cap Rates") are used to project losses under two scenarios. These scenarios assume that property performance remains flat for the near term and then improves gradually. Additionally, certain large loans are reviewed individually so that performance and loss severity can be more accurately determined, while other loans are also reviewed for factors that may impact potential performance.
3. A proprietary model was developed by reviewing performance data on over 80,000 securitized CRE loans originated between 1992 and 2011. The Company found property type and the debt service coverage ratio to be the most significant determinants of a loan's average annual default probability, and developed a model based on these factors. The Company then ran Monte Carlo simulations to estimate the timing of defaults and losses at the property level by applying property type-based Cap Rates to estimate the property's NOI.

The loss severities projected by these approaches vary widely. Actual losses will be a function of the proportion of loans in the pools that are foreclosed and liquidated and the loss severities associated with those liquidations.

For the six months ended June 30, 2014, additional credit impairments and LAE for insured derivatives on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be \$82 million as a result of additional delinquencies and loan level liquidations, as well as MBIA's continued assessment of various commutation possibilities. Since 2013, the Company has been paying claims on a CMBS pool transaction that had experienced deterioration such that all remaining deductible was eliminated.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

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

**Loss and LAE Activity**

Financial Guarantee Insurance Losses (Non-Derivative and Non-Consolidated VIEs)

The Company's financial guarantee insurance losses and LAE for the six months ended June 30, 2014 are presented in the following table:

| In millions                                 | Six Months Ended June 30, 2014 |                    |                      |              |
|---------------------------------------------|--------------------------------|--------------------|----------------------|--------------|
|                                             | Second-lien<br>RMBS            | First-lien<br>RMBS | Other <sup>(1)</sup> | Total        |
| Losses and LAE related to expected payments | \$ 19                          | \$ 33              | \$ (50)              | \$ 2         |
| Recoveries of expected payments             | 53                             | (6)                | 13                   | 60           |
| Gross losses incurred                       | 72                             | 27                 | (37)                 | 62           |
| Reinsurance                                 | -                              | -                  | -                    | -            |
| Losses and LAE                              | <u>\$ 72</u>                   | <u>\$ 27</u>       | <u>\$ (37)</u>       | <u>\$ 62</u> |

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

The losses and LAE related to expected payments in the preceding table primarily related to increases in previously established reserves on insured first and second-lien RMBS transactions, partially offset by a decrease in previously established reserves on an international road transaction and ABS CDOs. The recoveries of expected payments primarily related to decreases in projected collections from excess spread within the insured second-lien RMBS securitizations.

The following table provides information about the financial guarantees and related claim liability included in each of MBIA's surveillance categories as of June 30, 2014:

| \$ in millions                                                 | Surveillance Categories |                           |                         |                    |                 |
|----------------------------------------------------------------|-------------------------|---------------------------|-------------------------|--------------------|-----------------|
|                                                                | Caution<br>List<br>Low  | Caution<br>List<br>Medium | Caution<br>List<br>High | Classified<br>List | Total           |
| Number of policies                                             | 81                      | 110                       | 5                       | 201                | 397             |
| Number of issues <sup>(1)</sup>                                | 24                      | 12                        | 4                       | 131                | 171             |
| Remaining weighted average contract period (in years)          | 10.9                    | 10.9                      | 8.3                     | 8.8                | 9.7             |
| Gross insured contractual payments outstanding: <sup>(2)</sup> |                         |                           |                         |                    |                 |
| Principal                                                      | \$5,025                 | \$1,869                   | \$ 43                   | \$ 8,658           | \$15,595        |
| Interest                                                       | 3,642                   | 1,018                     | 21                      | 4,592              | 9,273           |
| Total                                                          | <u>\$8,667</u>          | <u>\$2,887</u>            | <u>\$ 64</u>            | <u>\$13,250</u>    | <u>\$24,868</u> |
| Gross Claim Liability                                          | \$ -                    | \$ -                      | \$ -                    | \$ 984             | \$ 984          |
| Less:                                                          |                         |                           |                         |                    |                 |
| Gross Potential Recoveries                                     | -                       | -                         | -                       | 950                | 950             |
| Discount, net <sup>(3)</sup>                                   | -                       | -                         | -                       | 122                | 122             |
| Net claim liability (recoverable)                              | <u>\$ -</u>             | <u>\$ -</u>               | <u>\$ -</u>             | <u>\$ (88)</u>     | <u>\$ (88)</u>  |
| Unearned premium revenue                                       | \$ 99                   | \$ 35                     | \$ -                    | \$ 104             | \$ 238          |

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

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

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

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

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

The following table provides information about the financial guarantees and related claim liability included in each of MBIA's surveillance categories as of December 31, 2013:

| \$ in millions                                                 | Surveillance Categories |                           |                         |                    |                 |
|----------------------------------------------------------------|-------------------------|---------------------------|-------------------------|--------------------|-----------------|
|                                                                | Caution<br>List<br>Low  | Caution<br>List<br>Medium | Caution<br>List<br>High | Classified<br>List | Total           |
| Number of policies                                             | 83                      | 19                        | 5                       | 192                | 299             |
| Number of issues <sup>(1)</sup>                                | 26                      | 14                        | 4                       | 136                | 180             |
| Remaining weighted average contract period (in years)          | 11.0                    | 4.9                       | 11.5                    | 9.5                | 9.7             |
| Gross insured contractual payments outstanding: <sup>(2)</sup> |                         |                           |                         |                    |                 |
| Principal                                                      | \$5,290                 | \$1,073                   | \$ 40                   | \$ 7,861           | \$14,264        |
| Interest                                                       | 3,829                   | 253                       | 24                      | 4,526              | 8,632           |
| Total                                                          | <u>\$9,119</u>          | <u>\$1,326</u>            | <u>\$ 64</u>            | <u>\$12,387</u>    | <u>\$22,896</u> |
| Gross Claim Liability                                          | \$ -                    | \$ -                      | \$ -                    | \$ 1,235           | \$ 1,235        |
| Less:                                                          |                         |                           |                         |                    |                 |
| Gross Potential Recoveries                                     | -                       | -                         | -                       | 1,085              | 1,085           |
| Discount, net <sup>(3)</sup>                                   | -                       | -                         | -                       | 205                | 205             |
| Net claim liability (recoverable)                              | <u>\$ -</u>             | <u>\$ -</u>               | <u>\$ -</u>             | <u>\$ (55)</u>     | <u>\$ (55)</u>  |
| Unearned premium revenue                                       | \$ 112                  | \$ 19                     | \$ -                    | \$ 96              | \$ 227          |

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

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

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

The gross claim liability in the preceding tables represents the Company's estimate of undiscounted probability-weighted future claim payments. As of June 30, 2014 and December 31, 2013, the gross claim liability primarily related to insured first and second-lien RMBS issues, ABS CDOs and an international road transaction.

The gross potential recoveries represent the Company's estimate of undiscounted probability-weighted recoveries of actual claim payments and recoveries of estimated future claim payments. As of June 30, 2014 and December 31, 2013, the gross potential recoveries principally related to insured second-lien RMBS and U.S. public finance issues. The Company's recoveries have been, and remain based on either salvage rights, the rights conferred to MBIA through the transactional documents (inclusive of the insurance agreement), or subrogation rights embedded within financial guarantee insurance policies. Expected salvage and subrogation recoveries, as well as recoveries from other remediation efforts, reduce the Company's claim liability. Once a claim payment has been made, the claim liability has been satisfied and MBIA's right to recovery is no longer considered an offset to future expected claim payments, it is recorded as a salvage asset. The amount of recoveries recorded by the Company is limited to paid claims plus the present value of projected future claim payments. As claim payments are made, the recorded amount of potential recoveries may exceed the remaining amount of the claim liability for a given policy. The gross claim liability and gross potential recoveries reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by the Company.

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 5: Loss and Loss Adjustment Expense Reserves (continued)**

The following table presents the components of the Company's loss and LAE reserves and insurance loss recoverable as reported on the Company's consolidated balance sheets as of June 30, 2014 and December 31, 2013 for insured obligations within MBIA's "Classified List." The loss reserves (claim liability) and insurance claim loss recoverable included in the following table represent the present value of the probability-weighted future claim payments and recoveries reported in the preceding tables.

| In millions                                       | As of<br>June 30, 2014 | As of<br>December 31, 2013 |
|---------------------------------------------------|------------------------|----------------------------|
| Loss reserves (claim liability)                   | \$ 482                 | \$ 580                     |
| LAE reserves                                      | 72                     | 61                         |
| Loss and LAE reserves                             | \$ 554                 | \$ 641                     |
| Insurance claim loss recoverable                  | \$ (619)               | \$ (694)                   |
| LAE insurance loss recoverable                    | (5)                    | -                          |
| Insurance loss recoverable                        | \$ (624)               | \$ (694)                   |
| Reinsurance recoverable on unpaid losses          | \$ 6                   | \$ 7                       |
| Reinsurance recoverable on unpaid LAE reserves    | 1                      | 1                          |
| Reinsurance recoverable on paid and unpaid losses | \$ 7                   | \$ 8                       |

As of June 30, 2014, loss and LAE reserves include \$713 million of reserves for expected future payments offset by expected recoveries of such future payments of \$159 million. As of December 31, 2013, loss and LAE reserves included \$847 million of reserves for expected future payments offset by expected recoveries of such future payments of \$206 million. As of June 30, 2014 and December 31, 2013, the insurance loss recoverable primarily related to expected future recoveries on second-lien RMBS transactions resulting from excess spread generated by performing loans in such transactions.

The decrease in insurance loss recoverable was primarily due to decreases in projected collections from excess spread within insured second-lien RMBS securitizations.

The following table presents the amounts of the Company's second-lien RMBS exposure, gross undiscounted claim liability and potential recoveries related to non-consolidated VIEs and consolidated VIEs, included in the Company's "Classified List," as of June 30, 2014:

**Second-lien RMBS Exposure**

| \$ in billions        | Issues | Outstanding     |                | Gross Undiscounted |                      |
|-----------------------|--------|-----------------|----------------|--------------------|----------------------|
|                       |        | Gross Principal | Gross Interest | Claim Liability    | Potential Recoveries |
| Non-consolidated VIEs | 24     | \$ 3.2          | \$ 1.1         | \$ 0.1             | \$ 0.6               |
| Consolidated VIEs     | 11     | \$ 1.6          | \$ 0.6         | \$ -               | \$ 0.6               |

The following table presents changes in the Company's loss and LAE reserves for the six months ended June 30, 2014. Changes in the loss and LAE reserves attributable to the accretion of the claim liability discount, changes in discount rates, changes in amount and timing of estimated payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in "Losses and loss adjustment" expenses in the Company's consolidated statements of operations. As of June 30, 2014, the weighted average risk-free rate used to discount the Company's loss reserves (claim liability) was 2.01%. LAE reserves are expected to be settled within a one-year period and are not discounted.

| In millions                                         | Changes in Loss and LAE Reserves for the Six Months Ended June 30, 2014 |                                       |                           |                        |                                     |                         |                      | Gross Loss and LAE Reserves as of June 30, 2014 |
|-----------------------------------------------------|-------------------------------------------------------------------------|---------------------------------------|---------------------------|------------------------|-------------------------------------|-------------------------|----------------------|-------------------------------------------------|
| Gross Loss and LAE Reserves as of December 31, 2013 | Loss Payments for Cases with Reserves                                   | Accretion of Claim Liability Discount | Changes in Discount Rates | Changes in Assumptions | Changes in Unearned Premium Revenue | Changes in LAE Reserves | Other <sup>(1)</sup> |                                                 |
| \$ 641                                              | \$ (108)                                                                | \$ 8                                  | \$ 37                     | \$ (37)                | \$ 10                               | \$ 11                   | \$ (8)               | \$ 554                                          |

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

The decrease in the Company's gross loss and LAE reserves reflected in the preceding table was primarily related to loss payments, partially offset by increases in reserves due to changes in discount rate on ABS CDOs and insured first and second-lien RMBS issues outstanding as of December 31, 2013.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

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

Current period changes in the Company's estimate of potential recoveries may be recorded as an insurance loss recoverable asset, netted against the gross loss and LAE reserve liability, or both. The following tables present changes in the Company's insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company's claim liability for the six months ended June 30, 2014. Changes in insurance loss recoverable attributable to the accretion of the discount on the recoverable, changes in discount rates, changes in amount and timing of estimated collections, changes in assumptions and changes in LAE recoveries are recorded in "Losses and loss adjustment" expenses in the Company's consolidated statements of operations.

| In millions                 | Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses<br>for the Six Months Ended June 30, 2014 |                                                |                               |                                    |                           |                                 |              | As of<br>June 30,<br>2014 |
|-----------------------------|-----------------------------------------------------------------------------------------------------------------|------------------------------------------------|-------------------------------|------------------------------------|---------------------------|---------------------------------|--------------|---------------------------|
|                             | As of<br>December 31,<br>2013                                                                                   | Collections<br>for Cases<br>with<br>Recoveries | Accretion<br>of<br>Recoveries | Changes<br>in<br>Discount<br>Rates | Changes in<br>Assumptions | Changes in<br>LAE<br>Recoveries | Other<br>(1) |                           |
| Insurance loss recoverable  | \$ 694                                                                                                          | \$ (55)                                        | \$ 7                          | \$ 10                              | \$ (45)                   | \$ 5                            | \$ 8         | \$ 624                    |
| Recoveries on unpaid losses | 206                                                                                                             | -                                              | 2                             | 11                                 | (60)                      | -                               | -            | 159                       |
| <b>Total</b>                | <b>\$ 900</b>                                                                                                   | <b>\$ (55)</b>                                 | <b>\$ 9</b>                   | <b>\$ 21</b>                       | <b>\$ (105)</b>           | <b>\$ 5</b>                     | <b>\$ 8</b>  | <b>\$ 783</b>             |

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

The decrease in the Company's insurance loss recoverable and recoveries on unpaid losses during 2014 was primarily due to changes in assumptions associated with insured first and second-lien RMBS and collections associated with issues outstanding as of December 31, 2013.

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

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

| In millions                             | Six Months Ended June 30, |       |
|-----------------------------------------|---------------------------|-------|
|                                         | 2014                      | 2013  |
| Loss adjustment expense incurred, gross | \$ 34                     | \$ 33 |

**Note 6: Fair Value of Financial Instruments**

**Fair Value Measurement**

Fair value is a market-based measure considered from the perspective of a market participant. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those which it believes market participants would use in pricing an asset or liability at the measurement date. The fair value measurements of financial instruments held or issued by the Company are determined through the use of observable market data when available. Market data is obtained from a variety of third-party sources, including dealer quotes. If dealer quotes are not available for an instrument that is infrequently traded, the Company uses alternate valuation methods, including either dealer quotes for similar instruments or modeling using market data inputs. The use of alternate valuation methods generally requires considerable judgment in the application of estimates and assumptions and changes to such estimates and assumptions may produce materially different fair values.

**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

The accounting guidance for fair value measurement establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available and reliable. Observable inputs are those the Company believes that market participants would use in pricing an asset or liability based on available market data. Unobservable inputs are those that reflect the Company's beliefs about the assumptions market participants would use in pricing an asset or liability based on the best information available. The fair value hierarchy is broken down into three levels based on the observability and reliability of inputs, as follows:

- Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities that the Company can access. Valuations are based on quoted prices that are readily and regularly available in an active market, with significant trading volumes.
- Level 2—Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. Level 2 assets include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, securities which are priced using observable inputs and derivative contracts whose values are determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3—Valuations based on inputs that are unobservable and supported by little or no market activity and that are significant to the overall fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques where significant inputs are unobservable, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The availability of observable inputs can vary from product to product and period to period and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, and other characteristics particular to the product. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the Company assigns the level in the fair value hierarchy for which the fair value measurement in its entirety falls, based on the least observable input that is significant to the fair value measurement.

*Financial Assets (excluding derivative assets)*

Financial assets, excluding derivative assets, held by the Company primarily consist of investments in debt securities. Substantially all of the Company's investments are priced by independent third parties, including pricing services and brokers. Typically, the Company receives one pricing service value or broker quote for each instrument, which represents a non-binding indication of value. The Company reviews the assumptions, inputs and methodologies used by pricing services and brokers to obtain reasonable assurance that the prices used in its valuations reflect fair value. When the Company believes a third-party quotation differs significantly from its internally developed expectation of fair value, whether higher or lower, the Company reviews its data or assumptions with the provider. This review includes comparing significant assumptions such as prepayment speeds, default ratios, forward yield curves, credit spreads and other significant quantitative inputs to internal assumptions, and working with the price provider to reconcile the differences. The price provider may subsequently provide an updated price. In the event that the price provider does not update its price, and the Company still does not agree with the price provided, the Company will obtain a price from another third-party provider, such as a broker, or use an internally developed price which it believes represents the fair value of the investment. The fair values of investments for which internal prices were used were not significant to the aggregate fair value of the Company's investment portfolio as of June 30, 2014 or December 31, 2013. All challenges to third-party prices are reviewed by staff of the Company with relevant expertise to ensure reasonableness of assumptions.

*Financial Liabilities (excluding derivative liabilities)*

Financial liabilities, excluding derivative liabilities, issued by the Company primarily consist of investment agreements and Medium-term notes ("MTNs") within its wind-down operations, debt issued for general corporate purposes, debt in VIEs and warrants. Investment agreements, MTNs, and corporate debt are typically recorded at face value adjusted for premiums or discounts. The majority of the financial liabilities that the Company has elected to fair value or that require fair value reporting or disclosures are valued based on the estimated value of the underlying collateral, the Company's or a third-party's estimate of discounted cash flow model estimates, or quoted market values for similar products. These valuations include adjustments for expected nonperformance risk of the Company.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 6: Fair Value of Financial Instruments (continued)**

###### *Derivative Liabilities*

The Company's derivative liabilities are primarily insured credit derivatives that reference structured pools of cash securities and CDSs. The Company generally insured the most senior liabilities of such transactions, and at the inception of transactions its exposure generally had more subordination than needed to achieve triple-A ratings from credit rating agencies. The types of collateral underlying its insured derivatives consist of cash securities and CDSs referencing primarily corporate obligations, ABS, RMBS, CMBS, CRE loans, and CDOs.

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

The Company may from time to time make changes in its valuation techniques if the change results in a measurement that it believes is equally or more representative of fair value under current circumstances.

###### *Internal Review Process*

All significant financial assets and liabilities, including derivative assets and liabilities, are reviewed by committees created by the Company to ensure compliance with the Company's policies and risk procedures in the development of fair values of financial assets and liabilities. These valuation committees review, among other things, key assumptions used for internally developed prices, significant changes in sources and uses of inputs, including changes in model approaches, and any adjustments from third-party inputs or prices to internally developed inputs or prices. The committees also review any significant impairment or improvements in fair values of the financial instruments from prior periods. From time to time, these committees will consult with the Company's valuation experts to better understand key methods and assumptions used for the determination of fair value, including understanding significant changes in fair values. These committees are comprised of senior finance team members with the relevant experience in the financial instruments their committee is responsible for. For each quarter, these committees document their agreement with the fair values developed by management of the Company as reported in the quarterly and annual financial statements.

###### **Valuation Techniques**

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

###### *Fixed-Maturity Securities (including short-term investments) Held as Available-For-Sale, Investments Carried at Fair Value, Investments Pledged as Collateral, Investments Held-to-Maturity, and Other Investments*

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

These investments are generally valued based on recently executed transaction prices or quoted market prices. When quoted market prices are not available, fair value is generally determined using quoted prices of similar investments or a valuation model based on observable and unobservable inputs. Inputs vary depending on the type of investment. Observable inputs include contractual cash flows, interest rate yield curves, CDS spreads, prepayment and volatility scores, diversity scores, cross-currency basis index spreads, and credit spreads for structures similar to the financial instrument in terms of issuer, maturity and seniority. Unobservable inputs include cash flow projections and the value of any credit enhancement.

The fair value of the held-to-maturity ("HTM") investments is determined using discounted cash flow models. Key inputs include unobservable cash flows projected over the expected term of the investment discounted using observable interest rate yield curves of similar securities.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 6: Fair Value of Financial Instruments (continued)**

Investments based on quoted market prices of identical investments in active markets are classified as Level 1 of the fair value hierarchy. Level 1 investments generally consist of U.S. Treasury and government agency, foreign government and money market investments. Quoted market prices of investments in less active markets, as well as investments which are valued based on other than quoted prices for which the inputs are observable, such as interest rate yield curves, are categorized in Level 2 of the fair value hierarchy. Investments that contain significant inputs that are not observable are categorized as Level 3.

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

The carrying amounts of cash and cash equivalents, receivable for investments sold, net cash collateral pledged to swap counterparties, payable for investments purchased, and accrued investment income approximate fair values due to the short-term nature and credit worthiness of these instruments. These items are categorized in Level 1 or Level 2 of the fair value hierarchy.

##### *Loans Receivable at Fair Value*

Loans receivable at fair value are comprised of loans held by consolidated VIEs consisting of residential mortgage loans. Fair values of residential mortgage loans are determined using quoted prices for MBS issued by the respective VIE and adjustments for the fair values of the financial guarantees provided by MBIA Corp. on the related MBS. Loans receivable at fair value are categorized in Level 3 of the fair value hierarchy.

##### *Loan Repurchase Commitments*

Loan repurchase commitments are obligations owed by the sellers/servicers of mortgage loans to either MBIA as reimbursement of paid claims or to the RMBS trusts as defined in the transaction documents. Loan repurchase commitments are assets of the consolidated VIEs. This asset represents the rights of MBIA against the sellers/servicers for breaches of representations and warranties that the securitized residential mortgage loans sold to the trust to comply with stated underwriting guidelines and for the sellers/servicers to cure, replace, or repurchase mortgage loans. Fair value measurements of loan repurchase commitments represent the amounts owed by the sellers/servicers to MBIA as reimbursement of paid claims. Loan repurchase commitments are not securities and no quoted prices or comparable market transaction information are observable or available. Loan repurchase commitments at fair value are categorized in Level 3 of the fair value hierarchy. Fair values of loan repurchase commitments are determined using discounted cash flow techniques based on inputs including:

- breach rates representing the rate at which the sellers/servicers failed to comply with stated representations and warranties;
- recovery rates representing the estimates of future cash flows for the asset, including estimates about possible variations in the amount of cash flows expected to be collected;
- expectations about possible variations in the timing of collections of the cash flows; and
- time value of money, represented by the rate on risk-free monetary assets.

##### *Investment Agreements*

The fair values of investment agreements are determined using discounted cash flow techniques based on contractual cash flows and observable interest rates currently being offered for similar agreements with comparable maturity dates. Investment agreements contain collateralization and termination agreements that substantially mitigate the nonperformance risk of the Company. As the terms of the notes are private, and the timing and amount of contract cash flows are not observable, these investment agreements are categorized as Level 3 of the fair value hierarchy.

##### *Medium-Term Notes*

The fair values of certain MTNs are based on quoted market prices provided by third-party sources, where available. When quoted market prices are not available, the Company applies a matrix pricing grid based on the quoted market prices received and the MTNs' stated maturity and interest rate to determine fair value. Nonperformance risk is included in the quoted market prices and the matrix pricing grid. The Company has elected to record these MTNs at fair value as they contain embedded derivatives which cannot accurately be separated from the host debt instrument and fair valued separately, therefore, these MTNs are carried at fair value with changes in fair value reflected in earnings. The remaining MTNs, which are not carried at fair value, do not contain embedded derivatives. As these MTNs are illiquid and the prices reflect significant unobservable inputs, they are categorized as Level 3 of the fair value hierarchy.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 6: Fair Value of Financial Instruments (continued)**

###### *Variable Interest Entity Notes*

The fair values of VIE notes are determined based on recently executed transaction prices or quoted prices where observable. When position-specific quoted prices are not observable, fair values are based on quoted prices of similar securities. Fair values based on quoted prices of similar securities may be adjusted for factors unique to the securities, including any credit enhancement. When observable quoted prices are not available, fair value is determined based on discounted cash flow techniques of the underlying collateral using observable and unobservable inputs. Observable inputs include interest rate yield curves and bond spreads of similar securities. Unobservable inputs include the value of any credit enhancement. VIE notes are categorized in Level 2 or Level 3 of the fair value hierarchy based on the lowest level input that is significant to the fair value measurement in its entirety.

###### *Variable Interest Entity Derivatives*

The VIEs have entered into derivative transactions consisting of cross currency swaps and interest rate caps. Fair values of over-the-counter ("OTC") derivatives are determined using valuation models based on observable and/or unobservable inputs. These observable and market-based inputs include interest rates and volatilities. These derivatives are categorized in Level 2 or Level 3 of the fair value hierarchy based on the input that is significant to the fair value measurement in its entirety.

###### *Long-term Debt*

Long-term debt consists of notes, debentures, surplus notes and accrued interest on this debt. The fair value of long-term notes, debentures and surplus notes are estimated based on quoted prices for the identical or similar securities. The fair value of the accrued interest expense on the surplus notes due 2033 is determined based on the scheduled interest payments discounted by the market's perception of the credit risk related to the repayment of the surplus notes. The credit risk related to the repayment of the surplus notes is based on recent trades of the surplus notes. The deferred interest payment will be due on the first business day on or after which the Company obtains approval to make such payment.

The carrying amounts of accrued interest expense on all other long-term debt approximate fair value due to the short-term nature of these instruments. Long-term debt is categorized as Level 2 of the fair value hierarchy.

###### *Derivatives—Asset/Liability Products*

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

The Company has policies and procedures in place regarding counterparties, including review and approval of the counterparty and the Company's exposure limit, collateral posting requirements, collateral monitoring and margin calls on collateral. The Company manages counterparty credit risk on an individual counterparty basis through master netting arrangements covering derivative transactions in the asset/liability products segment as of June 30, 2014. These agreements allow the Company to contractually net amounts due from a counterparty with those amounts due to such counterparty when certain triggering events occur. The Company only executes swaps under master netting agreements, which typically contain mutual credit downgrade provisions that generally provide the ability to require assignment or termination in the event either the Company or the counterparty is downgraded below a specified credit rating. The netting agreements minimize the potential for losses related to credit exposure and thus serve to mitigate the Company's nonperformance risk under these derivatives.

In certain cases, the Company also manages credit risk through collateral agreements that give the Company the right to hold or the obligation to provide collateral when the current market value of derivative contracts exceeds an exposure threshold. Under these arrangements, the Company may provide U.S. Treasury and other highly rated securities or cash to secure the derivative. The delivery of high-quality collateral can minimize credit exposure and mitigate the potential for nonperformance risk impacting the fair values of the derivatives.

**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

*Derivatives—Insurance*

The derivative contracts insured by the Company cannot be legally traded and generally do not have observable market prices. The Company determines the fair values of insured credit derivatives using valuation models. The valuation models are consistently applied from period to period, with refinements to the fair value estimation approach being applied as and when the information becomes available. Negotiated settlements are also considered when determining fair value to provide the best estimate of how another market participant would evaluate fair value.

Approximately 93% of the balance sheet fair value of insured credit derivatives as of June 30, 2014 was valued based on the Binomial Expansion Technique ("BET") Model. Approximately 7% of the balance sheet fair value of insured credit derivatives as of June 30, 2014 was valued based on the internally developed Direct Price Model and the Dual Default model. The valuation of insured derivatives includes the impact of its credit standing. All of these derivatives are categorized as Level 3 of the fair value hierarchy as their fair value is derived using significant unobservable inputs.

The Company has also entered into a derivative contract as a result of a commutation. The fair value of the derivative is determined using a discounted cash flow model. Key inputs include unobservable cash flows projected over the expected term of the derivative, discounted using observable discount rates and CDS spreads.

Description of the BET Model

1. Valuation Model Overview

The BET Model estimates what a bond insurer would charge to guarantee a transaction at the measurement date, based on the market-implied default risk of the underlying collateral and the remaining structural protection in a deductible or subordination.

Inputs to the process of determining fair value for structured transactions using the BET Model include estimates of collateral loss, allocation of loss to separate tranches of the capital structure, and calculation of the change in value.

- Estimates of aggregated collateral losses are calculated by reference to the following (described in further detail under "BET Model Inputs" below):
  - credit spreads of underlying collateral based on actual spreads or spreads on similar collateral with similar ratings, or in some cases, are benchmarked; for collateral pools where the spread distribution is characterized by extremes, each segment of the pool is modeled separately instead of using an overall pool average;
  - diversity score of the collateral pool as an indication of correlation of collateral defaults; and
  - recovery rate for all defaulted collateral.
- Allocation of losses to separate tranches of the capital structure according to priority of payments in a transaction.
- The inception-to-date unrealized gain or loss on a transaction is the difference between the original price of the risk (the original market-implied expected loss) and the current price of the risk based on the assumed market-implied expected losses derived from the model.

Additional structural assumptions of the BET Model are:

- Default probabilities are determined by three factors: MBIA Corp.'s credit spread, MBIA Corp.'s recovery rate after default, and the time period under risk;
- Frequencies of defaults are modeled evenly over time;
- Collateral assets are generally considered on an average basis rather than being modeled on an individual basis; and
- Collateral asset correlation is modeled using a diversity score which is calculated based on industry or sector concentrations. Recovery rates are based on historical averages and updated based on market evidence.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 6: Fair Value of Financial Instruments (continued)**

###### **2. BET Model Inputs**

###### **a. Credit spreads**

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

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

Spread Hierarchy:

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

There were some transactions where the Company incorporated multiple levels within the hierarchy, including using actual collateral-specific credit spreads in combination with a calculated spread based on an assumed relationship. In those cases, MBIA classified the transaction as being benchmarked from the most relevant spread source even though the majority of the average spread was from actual collateral-specific spreads. As of June 30, 2014, sector-specific spreads were used in 6% of the transactions valued using the BET Model. Corporate spreads were used in 50% of the transactions and spreads benchmarked from the most relevant spread source were used for 44% of the transactions. The spread source can also be identified by whether or not it is based on collateral weighted average rating factor ("WARF"). No collateral-specific spreads are based on WARF. Sector-specific spreads, corporate spreads and some benchmarked spreads are based on WARF. WARF-sourced and/or ratings-sourced credit spreads were used for 72% of the transactions.

Over time, the data inputs change as new sources become available, existing sources are discontinued or are no longer considered to be reliable or the most appropriate. It is always the Company's objective to use more observable spread inputs defined above. However, the Company may on occasion move to less observable spread inputs due to the discontinuation of data sources or due to the Company considering certain spread inputs no longer representative of market spreads.

###### **b. Diversity Scores**

Diversity scores are a means of estimating the diversification in a portfolio. The diversity score estimates the number of uncorrelated assets that are assumed to have the same loss distribution as the actual portfolio of correlated assets. While diversity score is a required input into the BET model, due to current high levels of default within the collateral of the structures, diversity score does not have a significant impact on valuation.

###### **c. Recovery Rate**

The recovery rate represents the percentage of par expected to be recovered after an asset defaults, indicating the severity of a potential loss. MBIA generally uses rating agency recovery assumptions which may be adjusted to account for differences between the characteristics and performance of the collateral used by the rating agencies and the actual collateral in MBIA-insured transactions. The Company may also adjust rating agency assumptions based on the performance of the collateral manager and on empirical market data.

###### **d. Nonperformance Risk**

The Company's valuation methodology for insured credit derivative liabilities incorporates MBIA Corp.'s own nonperformance risk. The Company calculates the fair value by discounting the market value loss estimated through the BET Model at discount rates which include MBIA Corp.'s CDS spreads as of June 30, 2014. The CDS spreads assigned to each deal are based on the weighted average life of the deal. The Company limits the nonperformance impact so that the derivative liability could not be lower than MBIA Corp.'s recovery derivative price multiplied by the unadjusted derivative liability.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 6: Fair Value of Financial Instruments (continued)**

###### *Overall Model Results*

As of June 30, 2014 and December 31, 2013, the Company's net insured CDS derivative liability was \$332 million and \$1.2 billion, respectively, based on the results of the aforementioned models. A significant driver of changes in fair value is MBIA Corp.'s nonperformance risk. In aggregate, the nonperformance calculation resulted in a pre-tax net insured derivative liability that was \$84 million and \$394 million lower than the net liability that would have been estimated if MBIA Corp. excluded nonperformance risk in its valuation as of June 30, 2014 and December 31, 2013, respectively. Nonperformance risk is a fair value concept and does not contradict MBIA Corp.'s internal view, based on fundamental credit analysis of MBIA Corp.'s economic condition, that MBIA Corp. will be able to pay all claims when due.

###### *Warrants*

Stock warrants issued by the Company are valued using the Black-Scholes model and are recorded at fair value. Inputs into the warrant valuation include the Company's stock price, a volatility parameter, interest rates, and dividend data. As all significant inputs are market-based and observable, warrants are categorized in Level 2 of the fair value hierarchy.

###### *Financial Guarantees*

Gross Financial Guarantees—The fair value of gross financial guarantees is determined using discounted cash flow techniques based on inputs that include (i) assumptions of expected losses on financial guarantee policies where loss reserves have not been recognized, (ii) amount of losses expected on financial guarantee policies where loss reserves have been established, net of expected recoveries, (iii) the cost of capital reserves required to support the financial guarantee liability, (iv) operating expenses, and (v) discount rates. The MBIA Corp. CDS spread and recovery rate are used as the discount rate for MBIA Corp., while the CDS spread and recovery rate of a similar municipal bond insurance company are used as the discount rate for National, as National does not have a published CDS spread and recovery rate.

The carrying value of the Company's gross financial guarantees consists of unearned premium revenue and loss and LAE reserves, net of the insurance loss recoverable as reported on MBIA's consolidated balance sheets.

Ceded Financial Guarantees—The fair value of ceded financial guarantees is determined by applying the percentage ceded to reinsurers to the related fair value of the gross financial guarantees. The carrying value of ceded financial guarantees consists of prepaid reinsurance premiums and reinsurance recoverable on paid and unpaid losses as reported within "Other assets" on the Company's consolidated balance sheets.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

**Significant Unobservable Inputs**

The following tables provide quantitative information regarding the significant unobservable inputs used by the Company for assets and liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013. These tables exclude inputs used to measure fair value that are not developed by the Company, such as broker prices and other third-party pricing service valuations.

| In millions                                | Fair Value as of<br>June 30, 2014 | Valuation Techniques                                                        | Unobservable Input                                           | Range<br>(Weighted Average)       |
|--------------------------------------------|-----------------------------------|-----------------------------------------------------------------------------|--------------------------------------------------------------|-----------------------------------|
| <b>Assets of consolidated VIEs:</b>        |                                   |                                                                             |                                                              |                                   |
| Loans receivable at fair value             | \$ 1,539                          | Market prices adjusted for financial guarantees provided to VIE obligations | Impact of financial guarantee                                | 0% - 9% (2%)                      |
| Loan repurchase commitments                | 363                               | Discounted cash flow                                                        | Recovery rates <sup>(1)</sup><br>Breach rates <sup>(1)</sup> |                                   |
| <b>Liabilities of consolidated VIEs:</b>   |                                   |                                                                             |                                                              |                                   |
| Variable interest entity notes             | 802                               | Market prices of VIE assets adjusted for financial guarantees provided      | Impact of financial guarantee                                | 0% - 32% (14%)                    |
| <b>Credit derivative liabilities, net:</b> |                                   |                                                                             |                                                              |                                   |
| CMBS                                       | 277                               | BET Model                                                                   | Recovery rates                                               | 25% - 90% (74%)                   |
|                                            |                                   |                                                                             | Nonperformance risk                                          | 4% - 19% (17%)                    |
|                                            |                                   |                                                                             | Weighted average life (in years)                             | 0.7 - 3.1 (2.7)                   |
|                                            |                                   |                                                                             | CMBS spreads                                                 | 0% - 35% (10%)                    |
| Multi-sector CDO                           | 12                                | Direct Price Model                                                          | Nonperformance risk                                          | 54% - 54% (54%)                   |
| Other                                      | 43                                | BET Model and Dual Default                                                  | Recovery rates                                               | 42% - 45% (45%)                   |
|                                            |                                   |                                                                             | Nonperformance risk                                          | 7% - 46% (22%)                    |
|                                            |                                   |                                                                             | Weighted average life (in years)                             | 0.7 - 8.3 (2.0)                   |
| Other derivative liabilities               | 33                                | Discounted cash flow                                                        | Cash flows                                                   | \$ 0 - \$83 (\$42) <sup>(2)</sup> |

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

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

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

| In millions                                | Fair Value as of<br>December 31, 2013 | Valuation Techniques                                                        | Unobservable Input                                           | Range<br>(Weighted Average) |
|--------------------------------------------|---------------------------------------|-----------------------------------------------------------------------------|--------------------------------------------------------------|-----------------------------|
| <b>Assets of consolidated VIEs:</b>        |                                       |                                                                             |                                                              |                             |
| Loans receivable at fair value             | \$ 1,612                              | Market prices adjusted for financial guarantees provided to VIE obligations | Impact of financial guarantee                                | 0% - 17% (3%)               |
| Loan repurchase commitments                | 359                                   | Discounted cash flow                                                        | Recovery rates <sup>(1)</sup><br>Breach rates <sup>(1)</sup> |                             |
| <b>Liabilities of consolidated VIEs:</b>   |                                       |                                                                             |                                                              |                             |
| Variable interest entity notes             | 940                                   | Market prices of VIE assets adjusted for financial guarantees provided      | Impact of financial guarantee                                | 0% - 25% (12%)              |
| <b>Credit derivative liabilities, net:</b> |                                       |                                                                             |                                                              |                             |
| CMBS                                       | 1,050                                 | BET Model                                                                   | Recovery rates                                               | 25% - 90% (60%)             |
|                                            |                                       |                                                                             | Nonperformance risk                                          | 8% - 57% (25%)              |
|                                            |                                       |                                                                             | Weighted average life<br>(in years)                          | 1.1 - 28.0 (3.3)            |
|                                            |                                       |                                                                             | CMBS spreads                                                 | 1% - 29% (13%)              |
| Multi-sector CDO                           | 12                                    | Direct Price Model                                                          | Nonperformance risk                                          | 57% - 57% (57%)             |
| Other                                      | 85                                    | BET Model and Dual Default                                                  | Recovery rates                                               | 42% - 90% (45%)             |
|                                            |                                       |                                                                             | Nonperformance risk                                          | 13% - 54% (25%)             |
|                                            |                                       |                                                                             | Weighted average life<br>(in years)                          | 0.2 - 8.7 (2.3)             |

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

**Sensitivity of Significant Unobservable Inputs**

The significant unobservable input used in the fair value measurement of the Company's loans receivable at fair value of consolidated VIEs is the impact of the financial guarantee. The fair value of loans receivable is calculated by subtracting the value of the financial guarantee from the market value of VIE liabilities. The value of a financial guarantee is estimated by the Company as the present value of expected cash payments under the policy. As expected cash payments provided by the Company under the insurance policy increase, there is a lower expected cash flow on the underlying loans receivable of the VIE. This results in a lower fair value of the loans receivable in relation to the obligations of the VIE.

The significant unobservable inputs used in the fair value measurement of the Company's loan repurchase commitments of consolidated VIEs are the recovery rates and breach rates. Recovery rates reflect the estimates of future cash flows reduced for litigation delays and risks and/or potential financial distress of the sellers/servicers. The estimated recoveries of the loan repurchase commitments may differ from the actual recoveries that may be received in the future. Breach rates represent the rate at which mortgages fail to comply with stated representations and warranties of the sellers/servicers. Significant increases or decreases in the recovery rates and the breach rates would result in significantly higher or lower fair values of the loan repurchase commitments, respectively. Additionally, changes in the legal environment and the ability of the counterparties to pay would impact the recovery rate assumptions, which could significantly impact the fair value measurement. Any significant challenges by the counterparties to the Company's determination of breaches of representations and warranties could significantly adversely impact the fair value measurement. Recovery rates and breach rates are determined independently. Changes in one input will not necessarily have any impact on the other input.

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

**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

The significant unobservable inputs used in the fair value measurement of MBIA Corp.'s CMBS credit derivatives, which are valued using the BET Model, are CMBS spreads, recovery rates, nonperformance risk and weighted average life. The CMBS spread is an indicator of credit risk of the collateral securities. The recovery rate represents the percentage of notional expected to be recovered after an asset defaults, indicating the severity of a potential loss. The nonperformance risk is an assumption of MBIA Corp.'s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Weighted average life is based on the Company's estimate of when the principal of the underlying collateral of the CMBS structure will be repaid. A significant increase or decrease in CMBS spreads would result in an increase or decrease in the fair value of the derivative liability, respectively. A significant increase in weighted average life can result in an increase or decrease in the fair value of the derivative liability, depending on the discount rate and the timing of significant losses. Any significant increase or decrease in recovery rates, or MBIA Corp.'s nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively. CMBS spreads, recovery rates, nonperformance risk and weighted average lives are determined independently. Changes in one input will not necessarily have any impact on the other inputs.

The significant unobservable input used in the fair value measurement of MBIA Corp.'s multi-sector CDO credit derivatives, which are valued using the Direct Price Model, is nonperformance risk. The nonperformance risk is an assumption of MBIA Corp.'s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Any significant increase or decrease in MBIA Corp.'s nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively.

The significant unobservable inputs used in the fair value measurement of MBIA Corp.'s other credit derivatives, which are valued using the BET Model and Dual Default, are recovery rates, nonperformance risk and weighted average life. The recovery rate represents the percentage of notional expected to be recovered after an asset defaults, indicating the severity of a potential loss. The nonperformance risk is an assumption of MBIA Corp.'s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Weighted average life is based on MBIA Corp.'s estimate of when the principal of the underlying collateral will be repaid. A significant increase in weighted average life can result in an increase or decrease in the fair value of the derivative liability, depending on the discount rate and the timing of significant losses. Any significant increase or decrease in recovery rates or MBIA Corp.'s nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively. Recovery rates, nonperformance risk and weighted average lives are determined independently. Changes in one input will not necessarily have any impact on the other inputs.

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

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 6: Fair Value of Financial Instruments (continued)**
**Fair Value Measurements**

The following tables present the fair value of the Company's assets (including short-term investments) and liabilities measured and reported at fair value on a recurring basis as of June 30, 2014 and December 31, 2013:

| In millions                            | Fair Value Measurements at Reporting Date Using                         |                                                           |                                                    |                                                   | Balance as of<br>June 30,<br>2014 |
|----------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|---------------------------------------------------|-----------------------------------|
|                                        | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Counterparty<br>and Cash<br>Collateral<br>Netting |                                   |
| Assets:                                |                                                                         |                                                           |                                                    |                                                   |                                   |
| Fixed-maturity investments:            |                                                                         |                                                           |                                                    |                                                   |                                   |
| U.S. Treasury and government agency    | \$ 486                                                                  | \$ 114                                                    | \$ -                                               | \$ -                                              | \$ 600                            |
| State and municipal bonds              | -                                                                       | 1,682                                                     | 57 <sup>(1)</sup>                                  | -                                                 | 1,739                             |
| Foreign governments                    | 225                                                                     | 83                                                        | 5 <sup>(1)</sup>                                   | -                                                 | 313                               |
| Corporate obligations                  | -                                                                       | 2,373                                                     | 34 <sup>(1)</sup>                                  | -                                                 | 2,407                             |
| Mortgage-backed securities:            |                                                                         |                                                           |                                                    |                                                   |                                   |
| Residential mortgage-backed agency     | -                                                                       | 1,184                                                     | 8 <sup>(1)</sup>                                   | -                                                 | 1,192                             |
| Residential mortgage-backed non-agency | -                                                                       | 59                                                        | -                                                  | -                                                 | 59                                |
| Commercial mortgage-backed             | -                                                                       | 30                                                        | 1 <sup>(1)</sup>                                   | -                                                 | 31                                |
| Asset-backed securities:               |                                                                         |                                                           |                                                    |                                                   |                                   |
| Collateralized debt obligations        | -                                                                       | 11                                                        | 95 <sup>(1)</sup>                                  | -                                                 | 106                               |
| Other asset-backed                     | -                                                                       | 168                                                       | 82 <sup>(1)</sup>                                  | -                                                 | 250                               |
| Total fixed-maturity investments       | 711                                                                     | 5,704                                                     | 282                                                | -                                                 | 6,697                             |
| Money market securities                | 392                                                                     | -                                                         | -                                                  | -                                                 | 392                               |
| Perpetual debt and equity securities   | 27                                                                      | 28                                                        | 13 <sup>(1)</sup>                                  | -                                                 | 68                                |
| Cash and cash equivalents              | 534                                                                     | -                                                         | -                                                  | -                                                 | 534                               |
| Derivative assets:                     |                                                                         |                                                           |                                                    |                                                   |                                   |
| Non-insured derivative assets:         |                                                                         |                                                           |                                                    |                                                   |                                   |
| Interest rate derivatives              | -                                                                       | 66                                                        | -                                                  | (62)                                              | 4                                 |

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 6: Fair Value of Financial Instruments (continued)**

|                                        | Fair Value Measurements at Reporting Date Using                         |                                                           |                                                    |                                                   |                                   |
|----------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|---------------------------------------------------|-----------------------------------|
|                                        | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Counterparty<br>and Cash<br>Collateral<br>Netting | Balance as of<br>June 30,<br>2014 |
| In millions                            |                                                                         |                                                           |                                                    |                                                   |                                   |
| Assets of consolidated VIEs:           |                                                                         |                                                           |                                                    |                                                   |                                   |
| Corporate obligations                  | -                                                                       | 24                                                        | 62 <sup>(1)</sup>                                  | -                                                 | 86                                |
| Mortgage-backed securities:            |                                                                         |                                                           |                                                    |                                                   |                                   |
| Residential mortgage-backed non-agency | -                                                                       | 205                                                       | 4 <sup>(1)</sup>                                   | -                                                 | 209                               |
| Commercial mortgage-backed             | -                                                                       | 91                                                        | -                                                  | -                                                 | 91                                |
| Asset-backed securities:               |                                                                         |                                                           |                                                    |                                                   |                                   |
| Collateralized debt obligations        | -                                                                       | 10                                                        | 6 <sup>(1)</sup>                                   | -                                                 | 16                                |
| Other asset-backed                     | -                                                                       | 46                                                        | 26 <sup>(1)</sup>                                  | -                                                 | 72                                |
| Cash                                   | 66                                                                      | -                                                         | -                                                  | -                                                 | 66                                |
| Loans receivable                       | -                                                                       | -                                                         | 1,539                                              | -                                                 | 1,539                             |
| Loan repurchase commitments            | -                                                                       | -                                                         | 363                                                | -                                                 | 363                               |
| Total assets                           | \$ 1,730                                                                | \$ 6,174                                                  | \$ 2,295                                           | \$ (62)                                           | \$ 10,137                         |
| Liabilities:                           |                                                                         |                                                           |                                                    |                                                   |                                   |
| Medium-term notes                      | \$ -                                                                    | \$ -                                                      | \$ 217 <sup>(1)</sup>                              | \$ -                                              | \$ 217                            |
| Derivative liabilities:                |                                                                         |                                                           |                                                    |                                                   |                                   |
| Insured derivatives:                   |                                                                         |                                                           |                                                    |                                                   |                                   |
| Credit derivatives                     | -                                                                       | 3                                                         | 332                                                | -                                                 | 335                               |
| Non-insured derivatives:               |                                                                         |                                                           |                                                    |                                                   |                                   |
| Interest rate derivatives              | -                                                                       | 208                                                       | -                                                  | (127)                                             | 81                                |
| Other                                  | -                                                                       | -                                                         | 33                                                 | -                                                 | 33                                |
| Other liabilities:                     |                                                                         |                                                           |                                                    |                                                   |                                   |
| Warrants                               | -                                                                       | 42                                                        | -                                                  | -                                                 | 42                                |
| Liabilities of consolidated VIEs:      |                                                                         |                                                           |                                                    |                                                   |                                   |
| Variable interest entity notes         | -                                                                       | 1,348                                                     | 802                                                | -                                                 | 2,150                             |
| Derivative liabilities:                |                                                                         |                                                           |                                                    |                                                   |                                   |
| Currency derivatives                   | -                                                                       | -                                                         | 11 <sup>(1)</sup>                                  | -                                                 | 11                                |
| Total liabilities                      | \$ -                                                                    | \$ 1,601                                                  | \$ 1,395                                           | \$ (127)                                          | \$ 2,869                          |

(1) - Unobservable inputs are either not developed by the Company or do not significantly impact the overall fair values of the aggregate financial assets and liabilities.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

| In millions                            | Fair Value Measurements at Reporting Date Using                         |                                                           |                                                    |                                                   | Balance as of<br>December 31,<br>2013 |
|----------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|---------------------------------------------------|---------------------------------------|
|                                        | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Counterparty<br>and Cash<br>Collateral<br>Netting |                                       |
| Assets:                                |                                                                         |                                                           |                                                    |                                                   |                                       |
| Fixed-maturity investments:            |                                                                         |                                                           |                                                    |                                                   |                                       |
| U.S. Treasury and government agency    | \$ 397                                                                  | \$ 156                                                    | \$ -                                               | \$ -                                              | \$ 553                                |
| State and municipal bonds              | -                                                                       | 1,765                                                     | 19 <sup>(1)</sup>                                  | -                                                 | 1,784                                 |
| Foreign governments                    | 112                                                                     | 65                                                        | 12 <sup>(1)</sup>                                  | -                                                 | 189                                   |
| Corporate obligations                  | -                                                                       | 1,776                                                     | 48 <sup>(1)</sup>                                  | -                                                 | 1,824                                 |
| Mortgage-backed securities:            |                                                                         |                                                           |                                                    |                                                   |                                       |
| Residential mortgage-backed agency     | -                                                                       | 1,173                                                     | -                                                  | -                                                 | 1,173                                 |
| Residential mortgage-backed non-agency | -                                                                       | 86                                                        | 6 <sup>(1)</sup>                                   | -                                                 | 92                                    |
| Commercial mortgage-backed             | -                                                                       | 25                                                        | 14 <sup>(1)</sup>                                  | -                                                 | 39                                    |
| Asset-backed securities:               |                                                                         |                                                           |                                                    |                                                   |                                       |
| Collateralized debt obligations        | -                                                                       | 72                                                        | 82 <sup>(1)</sup>                                  | -                                                 | 154                                   |
| Other asset-backed                     | -                                                                       | 130                                                       | 58 <sup>(1)</sup>                                  | -                                                 | 188                                   |
| Total fixed-maturity investments       | 509                                                                     | 5,248                                                     | 239                                                | -                                                 | 5,996                                 |
| Money market securities                | 783                                                                     | -                                                         | -                                                  | -                                                 | 783                                   |
| Perpetual debt and equity securities   | 27                                                                      | 13                                                        | 11 <sup>(1)</sup>                                  | -                                                 | 51                                    |
| Cash and cash equivalents              | 1,161                                                                   | -                                                         | -                                                  | -                                                 | 1,161                                 |
| Derivative assets:                     |                                                                         |                                                           |                                                    |                                                   |                                       |
| Non-insured derivative assets:         |                                                                         |                                                           |                                                    |                                                   |                                       |
| Interest rate derivatives              | -                                                                       | 46                                                        | -                                                  | (42)                                              | 4                                     |

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 6: Fair Value of Financial Instruments (continued)**

|                                        | Fair Value Measurements at Reporting Date Using                         |                                                           |                                                    |                                                   |                                       |
|----------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|---------------------------------------------------|---------------------------------------|
|                                        | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Counterparty<br>and Cash<br>Collateral<br>Netting | Balance as of<br>December 31,<br>2013 |
| In millions                            |                                                                         |                                                           |                                                    |                                                   |                                       |
| Assets of consolidated VIEs:           |                                                                         |                                                           |                                                    |                                                   |                                       |
| Corporate obligations                  | -                                                                       | 41                                                        | 48 <sup>(1)</sup>                                  | -                                                 | 89                                    |
| Mortgage-backed securities:            |                                                                         |                                                           |                                                    |                                                   |                                       |
| Residential mortgage-backed non-agency | -                                                                       | 255                                                       | 4 <sup>(1)</sup>                                   | -                                                 | 259                                   |
| Commercial mortgage-backed             | -                                                                       | 102                                                       | 3 <sup>(1)</sup>                                   | -                                                 | 105                                   |
| Asset-backed securities:               |                                                                         |                                                           |                                                    |                                                   |                                       |
| Collateralized debt obligations        | -                                                                       | 14                                                        | 22 <sup>(1)</sup>                                  | -                                                 | 36                                    |
| Other asset-backed                     | -                                                                       | 44                                                        | 54 <sup>(1)</sup>                                  | -                                                 | 98                                    |
| Money market securities                | 136                                                                     | -                                                         | -                                                  | -                                                 | 136                                   |
| Cash                                   | 97                                                                      | -                                                         | -                                                  | -                                                 | 97                                    |
| Loans receivable                       | -                                                                       | -                                                         | 1,612                                              | -                                                 | 1,612                                 |
| Loan repurchase commitments            | -                                                                       | -                                                         | 359                                                | -                                                 | 359                                   |
| Total assets                           | \$ 2,713                                                                | \$ 5,763                                                  | \$ 2,352                                           | \$ (42)                                           | \$ 10,786                             |
| Liabilities:                           |                                                                         |                                                           |                                                    |                                                   |                                       |
| Medium-term notes                      | \$ -                                                                    | \$ -                                                      | \$ 203 <sup>(1)</sup>                              | \$ -                                              | \$ 203                                |
| Derivative liabilities:                |                                                                         |                                                           |                                                    |                                                   |                                       |
| Insured derivatives:                   |                                                                         |                                                           |                                                    |                                                   |                                       |
| Credit derivatives                     | -                                                                       | 5                                                         | 1,147                                              | -                                                 | 1,152                                 |
| Non-insured derivatives:               |                                                                         |                                                           |                                                    |                                                   |                                       |
| Interest rate derivatives              | -                                                                       | 165                                                       | -                                                  | (165)                                             | -                                     |
| Other liabilities:                     |                                                                         |                                                           |                                                    |                                                   |                                       |
| Warrants                               | -                                                                       | 59                                                        | -                                                  | -                                                 | 59                                    |
| Liabilities of consolidated VIEs:      |                                                                         |                                                           |                                                    |                                                   |                                       |
| Variable interest entity notes         | -                                                                       | 1,416                                                     | 940                                                | -                                                 | 2,356                                 |
| Derivative liabilities:                |                                                                         |                                                           |                                                    |                                                   |                                       |
| Currency derivatives                   | -                                                                       | -                                                         | 11 <sup>(1)</sup>                                  | -                                                 | 11                                    |
| Total liabilities                      | \$ -                                                                    | \$ 1,645                                                  | \$ 2,301                                           | \$ (165)                                          | \$ 3,781                              |

(1) - Unobservable inputs are either not developed by the Company or do not significantly impact the overall fair values of the aggregate financial assets and liabilities.

Level 3 assets at fair value as of June 30, 2014 and December 31, 2013 represented approximately 23% and 22%, respectively, of total assets measured at fair value. Level 3 liabilities at fair value as of June 30, 2014 and December 31, 2013 represented approximately 49% and 61%, respectively, of total liabilities measured at fair value.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

The following tables present the fair values and carrying values of the Company's assets and liabilities that are disclosed at fair value but not reported at fair value on the Company's consolidated balance sheets as of June 30, 2014 and December 31, 2013:

| In millions                                      | Fair Value Measurements at Reporting Date Using                         |                                                     |                                                 | Fair Value<br>Balance as of<br>June 30, 2014 | Carry Value<br>Balance as of<br>June 30, 2014 |
|--------------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------|-------------------------------------------------|----------------------------------------------|-----------------------------------------------|
|                                                  | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |                                              |                                               |
| Assets:                                          |                                                                         |                                                     |                                                 |                                              |                                               |
| Other investments                                | \$ -                                                                    | \$ -                                                | \$ 4                                            | \$ 4                                         | \$ 4                                          |
| Accrued investment income <sup>(1)</sup>         | -                                                                       | 51                                                  | -                                               | 51                                           | 51                                            |
| Receivable for investments sold <sup>(1)</sup>   | -                                                                       | 75                                                  | -                                               | 75                                           | 75                                            |
| Assets of consolidated VIEs:                     |                                                                         |                                                     |                                                 |                                              |                                               |
| Investments held-to-maturity                     | -                                                                       | -                                                   | 2,780                                           | 2,780                                        | 2,787                                         |
| Total assets                                     | \$ -                                                                    | \$ 126                                              | \$ 2,784                                        | \$ 2,910                                     | \$ 2,917                                      |
| Liabilities:                                     |                                                                         |                                                     |                                                 |                                              |                                               |
| Investment agreements                            | \$ -                                                                    | \$ -                                                | \$ 801                                          | \$ 801                                       | \$ 660                                        |
| Medium-term notes                                | -                                                                       | -                                                   | 832                                             | 832                                          | 1,069                                         |
| Long-term debt                                   | -                                                                       | 1,516                                               | -                                               | 1,516                                        | 1,755                                         |
| Payable for investments purchased <sup>(2)</sup> | -                                                                       | 34                                                  | -                                               | 34                                           | 34                                            |
| Liabilities of consolidated VIEs:                |                                                                         |                                                     |                                                 |                                              |                                               |
| Variable interest entity notes                   | -                                                                       | -                                                   | 2,780                                           | 2,780                                        | 2,787                                         |
| Total liabilities                                | \$ -                                                                    | \$ 1,550                                            | \$ 4,413                                        | \$ 5,963                                     | \$ 6,305                                      |
| Financial Guarantees:                            |                                                                         |                                                     |                                                 |                                              |                                               |
| Gross                                            | \$ -                                                                    | \$ -                                                | \$ 4,487                                        | \$ 4,487                                     | \$ 2,181                                      |
| Ceded                                            | -                                                                       | -                                                   | 116                                             | 116                                          | 72                                            |

(1) - Reported within "Other assets" on MBIA's consolidated balance sheets.

(2) - Reported within "Other liabilities" on MBIA's consolidated balance sheets.

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 6: Fair Value of Financial Instruments (continued)**

| In millions                                      | Fair Value Measurements at Reporting Date Using                         |                                                     |                                                 | Fair Value<br>Balance as of<br>December 31,<br>2013 | Carry Value<br>Balance as of<br>December 31,<br>2013 |
|--------------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------|-------------------------------------------------|-----------------------------------------------------|------------------------------------------------------|
|                                                  | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |                                                     |                                                      |
| Assets:                                          |                                                                         |                                                     |                                                 |                                                     |                                                      |
| Other investments                                | \$ -                                                                    | \$ -                                                | \$ 4                                            | \$ 4                                                | \$ 5                                                 |
| Accrued investment income <sup>(1)</sup>         | -                                                                       | 52                                                  | -                                               | 52                                                  | 52                                                   |
| Receivable for investments sold <sup>(1)</sup>   | -                                                                       | 22                                                  | -                                               | 22                                                  | 22                                                   |
| Net cash collateral pledged <sup>(1)</sup>       | 24                                                                      | -                                                   | -                                               | 24                                                  | 24                                                   |
| Assets of consolidated VIEs:                     |                                                                         |                                                     |                                                 |                                                     |                                                      |
| Investments held-to-maturity                     | -                                                                       | -                                                   | 2,651                                           | 2,651                                               | 2,801                                                |
| Total assets                                     | \$ 24                                                                   | \$ 74                                               | \$ 2,655                                        | \$ 2,753                                            | \$ 2,904                                             |
| Liabilities:                                     |                                                                         |                                                     |                                                 |                                                     |                                                      |
| Investment agreements                            | \$ -                                                                    | \$ -                                                | \$ 814                                          | \$ 814                                              | \$ 700                                               |
| Medium-term notes                                | -                                                                       | -                                                   | 927                                             | 927                                                 | 1,224                                                |
| Long-term debt                                   | -                                                                       | 1,412                                               | -                                               | 1,412                                               | 1,702                                                |
| Payable for investments purchased <sup>(2)</sup> | -                                                                       | 31                                                  | -                                               | 31                                                  | 31                                                   |
| Liabilities of consolidated VIEs:                |                                                                         |                                                     |                                                 |                                                     |                                                      |
| Variable interest entity notes                   | -                                                                       | -                                                   | 2,751                                           | 2,751                                               | 2,930                                                |
| Total liabilities                                | \$ -                                                                    | \$ 1,443                                            | \$ 4,492                                        | \$ 5,935                                            | \$ 6,587                                             |
| Financial Guarantees:                            |                                                                         |                                                     |                                                 |                                                     |                                                      |
| Gross                                            | \$ -                                                                    | \$ -                                                | \$ 2,843                                        | \$ 2,843                                            | \$ 2,388                                             |
| Ceded                                            | -                                                                       | -                                                   | 71                                              | 71                                                  | 76                                                   |

(1) - Reported within "Other assets" on MBIA's consolidated balance sheets.

(2) - Reported within "Other liabilities" on MBIA's consolidated balance sheets.

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 6: Fair Value of Financial Instruments (continued)**

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the three months ended June 30, 2014 and 2013:

**Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended June 30, 2014**

| In millions                                   | Balance,<br>Beginning<br>of Period | Realized<br>Gains /<br>(Losses) | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in<br>Earnings | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases    | Issuances   | Settlements    | Sales          | Transfers<br>into<br>Level 3<br>(1) | Transfers<br>out of<br>Level 3<br>(1) | Ending<br>Balance | Change in<br>Unrealized<br>Gains<br>(Losses) for<br>the Period<br>Included in<br>Earnings<br>for Assets<br>still held<br>as of<br>June 30,<br>2014 |
|-----------------------------------------------|------------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|--------------|-------------|----------------|----------------|-------------------------------------|---------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assets:</b>                                |                                    |                                 |                                                                 |                                                         |                                                            |              |             |                |                |                                     |                                       |                   |                                                                                                                                                    |
| Foreign governments                           | \$ 7                               | \$ -                            | \$ -                                                            | \$ -                                                    | \$ -                                                       | \$ -         | \$ -        | \$ (4)         | \$ -           | \$ 2                                | \$ -                                  | \$ 5              | \$ -                                                                                                                                               |
| Corporate obligations                         | 30                                 | 4                               | 2                                                               | (3)                                                     | -                                                          | 6            | -           | -              | (4)            | -                                   | (1)                                   | 34                | 2                                                                                                                                                  |
| Residential mortgage-<br>backed agency        | 29                                 | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -              | -              | 8                                   | (29)                                  | 8                 | -                                                                                                                                                  |
| Commercial mortgage-<br>backed                | 14                                 | -                               | -                                                               | -                                                       | -                                                          | -            | -           | (12)           | -              | -                                   | (1)                                   | 1                 | -                                                                                                                                                  |
| Collateralized debt<br>obligations            | 115                                | (2)                             | 1                                                               | 24                                                      | -                                                          | -            | -           | (3)            | (41)           | 2                                   | (1)                                   | 95                | -                                                                                                                                                  |
| Other asset-backed                            | 85                                 | -                               | -                                                               | 3                                                       | -                                                          | 11           | -           | (2)            | (1)            | 6                                   | (20)                                  | 82                | -                                                                                                                                                  |
| State and municipal<br>bonds                  | 62                                 | -                               | -                                                               | 1                                                       | -                                                          | -            | -           | -              | (4)            | -                                   | (2)                                   | 57                | -                                                                                                                                                  |
| Perpetual debt and<br>equity securities       | 15                                 | -                               | 2                                                               | -                                                       | -                                                          | -            | -           | -              | -              | -                                   | (4)                                   | 13                | 2                                                                                                                                                  |
| <b>Assets of consolidated<br/>VIEs:</b>       |                                    |                                 |                                                                 |                                                         |                                                            |              |             |                |                |                                     |                                       |                   |                                                                                                                                                    |
| Corporate obligations                         | 64                                 | -                               | -                                                               | -                                                       | -                                                          | -            | -           | (2)            | -              | -                                   | -                                     | 62                | -                                                                                                                                                  |
| Residential mortgage-<br>backed<br>non-agency | 5                                  | -                               | (1)                                                             | -                                                       | -                                                          | -            | -           | (1)            | -              | 1                                   | -                                     | 4                 | -                                                                                                                                                  |
| Commercial mortgage-<br>backed                | 3                                  | -                               | (3)                                                             | -                                                       | -                                                          | -            | -           | -              | -              | -                                   | -                                     | -                 | -                                                                                                                                                  |
| Collateralized debt<br>obligations            | 14                                 | -                               | (7)                                                             | -                                                       | -                                                          | -            | -           | (2)            | -              | 1                                   | -                                     | 6                 | -                                                                                                                                                  |
| Other asset-backed                            | 42                                 | -                               | (4)                                                             | -                                                       | -                                                          | -            | -           | (2)            | -              | -                                   | (10)                                  | 26                | -                                                                                                                                                  |
| Loans receivable                              | 1,557                              | -                               | 37                                                              | -                                                       | -                                                          | -            | -           | (55)           | -              | -                                   | -                                     | 1,539             | 37                                                                                                                                                 |
| Loan repurchase<br>commitments                | 364                                | -                               | (1)                                                             | -                                                       | -                                                          | -            | -           | -              | -              | -                                   | -                                     | 363               | (1)                                                                                                                                                |
| <b>Total assets</b>                           | <b>\$ 2,406</b>                    | <b>\$ 2</b>                     | <b>\$ 26</b>                                                    | <b>\$ 25</b>                                            | <b>\$ -</b>                                                | <b>\$ 17</b> | <b>\$ -</b> | <b>\$ (83)</b> | <b>\$ (50)</b> | <b>\$ 20</b>                        | <b>\$ (68)</b>                        | <b>\$ 2,295</b>   | <b>\$ 40</b>                                                                                                                                       |

| In millions                                  | Balance,<br>Beginning<br>of Period | Realized<br>(Gains) /<br>Losses | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in<br>Earnings | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases   | Issuances   | Settlements    | Sales       | Transfers<br>into<br>Level 3<br>(1) | Transfers<br>out of<br>Level 3<br>(1) | Ending<br>Balance | Change in<br>Unrealized<br>(Gains)<br>Losses for<br>the Period<br>Included in<br>Earnings<br>for Liabilities<br>still held as<br>of June 30,<br>2014 |
|----------------------------------------------|------------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-------------|-------------|----------------|-------------|-------------------------------------|---------------------------------------|-------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Liabilities:</b>                          |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                |             |                                     |                                       |                   |                                                                                                                                                      |
| Medium-term notes                            | \$ 215                             | \$ -                            | \$ 3                                                            | \$ -                                                    | \$ (1)                                                     | \$ -        | \$ -        | \$ -           | \$ -        | \$ -                                | \$ -                                  | \$ 217            | \$ 2                                                                                                                                                 |
| Credit derivatives, net                      | 309                                | 23                              | 23                                                              | -                                                       | -                                                          | -           | -           | (23)           | -           | -                                   | -                                     | 332               | 24                                                                                                                                                   |
| Other derivatives                            | 31                                 | -                               | 2                                                               | -                                                       | -                                                          | -           | -           | -              | -           | -                                   | -                                     | 33                | 2                                                                                                                                                    |
| <b>Liabilities of<br/>consolidated VIEs:</b> |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                |             |                                     |                                       |                   |                                                                                                                                                      |
| VIE notes                                    | 812                                | -                               | 18                                                              | -                                                       | -                                                          | -           | 3           | (31)           | -           | -                                   | -                                     | 802               | 18                                                                                                                                                   |
| Currency derivatives,<br>net                 | 5                                  | -                               | 6                                                               | -                                                       | -                                                          | -           | -           | -              | -           | -                                   | -                                     | 11                | 6                                                                                                                                                    |
| <b>Total liabilities</b>                     | <b>\$ 1,372</b>                    | <b>\$ 23</b>                    | <b>\$ 52</b>                                                    | <b>\$ -</b>                                             | <b>\$ (1)</b>                                              | <b>\$ -</b> | <b>\$ 3</b> | <b>\$ (54)</b> | <b>\$ -</b> | <b>\$ -</b>                         | <b>\$ -</b>                           | <b>\$ 1,395</b>   | <b>\$ 52</b>                                                                                                                                         |

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

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 6: Fair Value of Financial Instruments (continued)**
**Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended June 30, 2013**

| In millions                                   | Balance,<br>Beginning<br>of Period | Realized<br>Gains /<br>(Losses) | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in<br>Earnings | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases    | Issuances   | Settlements     | Sales           | Transfers<br>into<br>Level 3<br>(1) | Transfers<br>out of<br>Level 3<br>(1) | Ending<br>Balance | Change in<br>Unrealized<br>Gains<br>(Losses)<br>for the<br>Period<br>Included in<br>Earnings<br>for Assets<br>still held<br>as of<br>June 30,<br>2013 |
|-----------------------------------------------|------------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|--------------|-------------|-----------------|-----------------|-------------------------------------|---------------------------------------|-------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assets:</b>                                |                                    |                                 |                                                                 |                                                         |                                                            |              |             |                 |                 |                                     |                                       |                   |                                                                                                                                                       |
| Foreign governments                           | \$ 8                               | \$ -                            | \$ -                                                            | \$ -                                                    | \$ -                                                       | \$ -         | \$ -        | \$ -            | (8)             | \$ -                                | \$ 3                                  | \$ 3              | \$ -                                                                                                                                                  |
| Corporate obligations                         | 57                                 | -                               | 1                                                               | 3                                                       | -                                                          | 2            | -           | -               | -               | -                                   | -                                     | 63                | 1                                                                                                                                                     |
| Residential mortgage-<br>backed agency        | -                                  | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -               | -               | 3                                   | -                                     | 3                 | -                                                                                                                                                     |
| Residential mortgage-<br>backed<br>non-agency | 1                                  | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -               | -               | -                                   | -                                     | 1                 | -                                                                                                                                                     |
| Commercial mortgage-<br>backed                | 13                                 | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -               | -               | -                                   | -                                     | 13                | -                                                                                                                                                     |
| Collateralized debt<br>obligations            | 37                                 | (1)                             | -                                                               | 2                                                       | -                                                          | 61           | -           | (8)             | (5)             | 9                                   | (10)                                  | 85                | 1                                                                                                                                                     |
| Other asset-backed                            | 67                                 | -                               | -                                                               | (1)                                                     | -                                                          | 3            | -           | (3)             | -               | 2                                   | (4)                                   | 64                | -                                                                                                                                                     |
| State and municipal<br>bonds                  | 23                                 | -                               | -                                                               | -                                                       | -                                                          | -            | -           | (2)             | -               | 42                                  | -                                     | 63                | -                                                                                                                                                     |
| Perpetual debt and<br>equity securities       | 10                                 | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -               | -               | -                                   | -                                     | 10                | -                                                                                                                                                     |
| <b>Assets of consolidated<br/>VIEs:</b>       |                                    |                                 |                                                                 |                                                         |                                                            |              |             |                 |                 |                                     |                                       |                   |                                                                                                                                                       |
| Corporate obligations                         | 79                                 | (4)                             | (6)                                                             | 6                                                       | -                                                          | -            | -           | (2)             | (25)            | -                                   | -                                     | 48                | (1)                                                                                                                                                   |
| Residential mortgage-<br>backed non-agency    | 6                                  | -                               | (1)                                                             | -                                                       | -                                                          | -            | -           | -               | -               | -                                   | (3)                                   | 2                 | -                                                                                                                                                     |
| Commercial mortgage-<br>backed                | 28                                 | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -               | (24)            | -                                   | -                                     | 4                 | -                                                                                                                                                     |
| Collateralized debt<br>obligations            | 117                                | -                               | -                                                               | 5                                                       | -                                                          | -            | -           | (1)             | (86)            | -                                   | -                                     | 35                | 3                                                                                                                                                     |
| Other asset-backed                            | 47                                 | -                               | 14                                                              | -                                                       | -                                                          | -            | -           | (6)             | (2)             | 10                                  | -                                     | 63                | 11                                                                                                                                                    |
| Loans receivable                              | 1,819                              | -                               | 212                                                             | -                                                       | -                                                          | -            | -           | (68)            | (173)           | -                                   | -                                     | 1,790             | 212                                                                                                                                                   |
| Loan repurchase<br>commitments                | 1,176                              | -                               | 49                                                              | -                                                       | -                                                          | -            | -           | (110)           | -               | -                                   | -                                     | 1,115             | 49                                                                                                                                                    |
| <b>Total assets</b>                           | <b>\$ 3,488</b>                    | <b>\$ (5)</b>                   | <b>\$ 269</b>                                                   | <b>\$ 15</b>                                            | <b>\$ -</b>                                                | <b>\$ 66</b> | <b>\$ -</b> | <b>\$ (208)</b> | <b>\$ (315)</b> | <b>\$ 69</b>                        | <b>\$ (17)</b>                        | <b>\$ 3,362</b>   | <b>\$ 276</b>                                                                                                                                         |

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

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

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 6: Fair Value of Financial Instruments (continued)**

Transfers into and out of Level 3 were \$20 million and \$68 million, respectively, for the three months ended June 30, 2014. Transfers into and out of Level 2 were \$68 million and \$20 million, respectively, for the three months ended June 30, 2014. Transfers into Level 3 were principally related to RMBS agency and other ABS, where inputs, which are significant to their valuation, became unobservable during the quarter. RMBS non-agency and other ABS, comprised the majority of the transferred instruments out of Level 3 where inputs, which are significant to their valuation, became observable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

Transfers into and out of Level 3 were \$73 million and \$19 million, respectively, for the three months ended June 30, 2013. Transfers into and out of Level 2 were \$19 million and \$73 million, respectively, for the three months ended June 30, 2013. Transfers into Level 3 were principally related to state and municipal bonds, CDOs and other ABS where inputs, which are significant to their valuation, became unobservable during the quarter. CDOs, other ABS and RMBS non-agency comprised the majority of the transferred instruments out of Level 3 where inputs, which are significant to their valuation, became observable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

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

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the six months ended June 30, 2014 and 2013:

**Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Six Months Ended June 30, 2014**

| In millions                                | Balance,<br>Beginning<br>of Year | Realized<br>Gains /<br>(Losses) | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in<br>Earnings | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases    | Issuances   | Settlements     | Sales          | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance | Change in<br>Unrealized<br>Gains<br>(Losses) for<br>the Period<br>Included<br>in Earnings<br>for Assets<br>still held as of<br>June 30,<br>2014 |
|--------------------------------------------|----------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|--------------|-------------|-----------------|----------------|---------------------------------------------|-----------------------------------------------|-------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assets:</b>                             |                                  |                                 |                                                                 |                                                         |                                                            |              |             |                 |                |                                             |                                               |                   |                                                                                                                                                 |
| Foreign governments                        | \$ 12                            | \$ -                            | \$ -                                                            | \$ -                                                    | \$ -                                                       | \$ -         | \$ -        | \$ -            | (9)            | \$ -                                        | \$ 2                                          | \$ 5              | \$ -                                                                                                                                            |
| Corporate obligations                      | 48                               | 3                               | 3                                                               | (4)                                                     | -                                                          | 6            | -           | (2)             | (22)           | 3                                           | (1)                                           | 34                | 2                                                                                                                                               |
| Residential mortgage-<br>backed agency     | -                                | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -               | -              | 37                                          | (29)                                          | 8                 | -                                                                                                                                               |
| Residential mortgage-<br>backed non-agency | 6                                | -                               | -                                                               | (1)                                                     | -                                                          | -            | -           | -               | -              | -                                           | (5)                                           | -                 | -                                                                                                                                               |
| Commercial mortgage-<br>backed             | 14                               | -                               | -                                                               | -                                                       | -                                                          | -            | -           | (13)            | -              | 1                                           | (1)                                           | 1                 | -                                                                                                                                               |
| Collateralized debt<br>obligations         | 82                               | (2)                             | 1                                                               | 27                                                      | -                                                          | 5            | -           | (5)             | (41)           | 35                                          | (7)                                           | 95                | -                                                                                                                                               |
| Other asset-backed                         | 58                               | -                               | -                                                               | 8                                                       | -                                                          | 11           | -           | (4)             | (1)            | 30                                          | (20)                                          | 82                | -                                                                                                                                               |
| State and municipal<br>bonds               | 19                               | -                               | -                                                               | 1                                                       | -                                                          | -            | -           | (2)             | (3)            | 44                                          | (2)                                           | 57                | -                                                                                                                                               |
| Perpetual debt and<br>equity securities    | 11                               | -                               | 2                                                               | -                                                       | -                                                          | -            | -           | -               | -              | 4                                           | (4)                                           | 13                | 2                                                                                                                                               |
| <b>Assets of consolidated<br/>VIEs:</b>    |                                  |                                 |                                                                 |                                                         |                                                            |              |             |                 |                |                                             |                                               |                   |                                                                                                                                                 |
| Corporate obligations                      | 48                               | -                               | -                                                               | -                                                       | -                                                          | -            | -           | (3)             | -              | 17                                          | -                                             | 62                | 1                                                                                                                                               |
| Residential mortgage-<br>backed non-agency | 4                                | -                               | (1)                                                             | -                                                       | -                                                          | -            | -           | (1)             | -              | 2                                           | -                                             | 4                 | -                                                                                                                                               |
| Commercial mortgage-<br>backed             | 3                                | -                               | (3)                                                             | -                                                       | -                                                          | -            | -           | -               | -              | -                                           | -                                             | -                 | -                                                                                                                                               |
| Collateralized debt<br>obligations         | 22                               | -                               | (10)                                                            | -                                                       | -                                                          | -            | -           | (4)             | -              | 1                                           | (3)                                           | 6                 | 1                                                                                                                                               |
| Other asset-backed                         | 54                               | -                               | (16)                                                            | -                                                       | -                                                          | -            | -           | (6)             | -              | 4                                           | (10)                                          | 26                | -                                                                                                                                               |
| Loans receivable                           | 1,612                            | -                               | 36                                                              | -                                                       | -                                                          | -            | -           | (109)           | -              | -                                           | -                                             | 1,539             | 36                                                                                                                                              |
| Loan repurchase<br>commitments             | 359                              | -                               | 4                                                               | -                                                       | -                                                          | -            | -           | -               | -              | -                                           | -                                             | 363               | 4                                                                                                                                               |
| <b>Total assets</b>                        | <b>\$ 2,352</b>                  | <b>\$ 1</b>                     | <b>\$ 16</b>                                                    | <b>\$ 31</b>                                            | <b>\$ -</b>                                                | <b>\$ 22</b> | <b>\$ -</b> | <b>\$ (158)</b> | <b>\$ (67)</b> | <b>\$ 180</b>                               | <b>\$ (82)</b>                                | <b>\$ 2,295</b>   | <b>\$ 46</b>                                                                                                                                    |

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

|                                   |                                  |                                 |                                                                 |                                                         |                                                            |           |           |             |                        |                                             |                                               |                   |       | Change in<br>Unrealized<br>(Gains)<br>Losses for<br>the Period<br>Included<br>in<br>Earnings<br>for<br>Liabilities<br>still held<br>as of<br>June 30,<br>2014 |
|-----------------------------------|----------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-----------|-----------|-------------|------------------------|---------------------------------------------|-----------------------------------------------|-------------------|-------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|
| In millions                       | Balance,<br>Beginning<br>of Year | Realized<br>(Gains) /<br>Losses | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in<br>Earnings | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases | Issuances | Settlements | Sales                  | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance |       |                                                                                                                                                               |
| Liabilities:                      |                                  |                                 |                                                                 |                                                         |                                                            |           |           |             |                        |                                             |                                               |                   |       |                                                                                                                                                               |
| Medium-term notes                 | \$ 203                           | \$ -                            | \$ 15                                                           | \$ -                                                    | \$ (1)                                                     | \$ -      | \$ -      | \$ -        | \$ -                   | \$ -                                        | \$ -                                          | \$ 217            | \$ 14 |                                                                                                                                                               |
| Credit derivatives, net           | 1,147                            | 364                             | (815)                                                           | -                                                       | -                                                          | -         | -         | (364)       | -                      | -                                           | -                                             | 332               | (6)   |                                                                                                                                                               |
| Other derivatives, net            | -                                | 30                              | 3                                                               | -                                                       | -                                                          | -         | -         | -           | -                      | -                                           | -                                             | 33                | 3     |                                                                                                                                                               |
| Liabilities of consolidated VIEs: |                                  |                                 |                                                                 |                                                         |                                                            |           |           |             |                        |                                             |                                               |                   |       |                                                                                                                                                               |
| VIE notes                         | 940                              | -                               | 36                                                              | -                                                       | -                                                          | -         | 3         | (136)       | (41)                   | -                                           | -                                             | 802               | 33    |                                                                                                                                                               |
| Currency derivatives, net         | 11                               | -                               | -                                                               | -                                                       | -                                                          | -         | -         | -           | -                      | -                                           | -                                             | 11                | -     |                                                                                                                                                               |
| Total liabilities                 | \$ 2,301                         | \$ 394                          | \$ (761)                                                        | \$ -                                                    | \$ (1)                                                     | \$ -      | \$ 3      | \$ (500)    | \$ (41) <sup>(2)</sup> | \$ -                                        | \$ -                                          | \$ 1,395          | \$ 44 |                                                                                                                                                               |

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

(2) - Primarily relates to the deconsolidation of VIEs.

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

| In millions                                | Balance,<br>Beginning<br>of Year | Realized<br>Gains /<br>(Losses) | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in<br>Earnings | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases    | Issuances   | Settlements     | Sales           | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance | Change in<br>Unrealized<br>Gains<br>(Losses)<br>for the<br>Period<br>Included<br>in<br>Earnings<br>for Assets<br>still held<br>as of<br>June 30,<br>2013 |
|--------------------------------------------|----------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|--------------|-------------|-----------------|-----------------|---------------------------------------------|-----------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assets:</b>                             |                                  |                                 |                                                                 |                                                         |                                                            |              |             |                 |                 |                                             |                                               |                   |                                                                                                                                                          |
| Foreign governments                        | \$ 3                             | \$ -                            | \$ -                                                            | \$ -                                                    | \$ -                                                       | \$ -         | \$ -        | \$ -            | \$ (8)          | \$ -                                        | \$ 11                                         | \$ (3)            | \$ 3                                                                                                                                                     |
| Corporate obligations                      | 76                               | 2                               | 5                                                               | 4                                                       | (1)                                                        | 2            | -           | (1)             | (24)            | -                                           | -                                             | 63                | 5                                                                                                                                                        |
| Residential mortgage-<br>backed agency     | -                                | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -               | -               | 3                                           | -                                             | 3                 | -                                                                                                                                                        |
| Residential mortgage-<br>backed non-agency | 4                                | -                               | -                                                               | -                                                       | -                                                          | -            | -           | (3)             | -               | -                                           | -                                             | 1                 | -                                                                                                                                                        |
| Commercial mortgage-<br>backed             | 28                               | -                               | -                                                               | 4                                                       | -                                                          | -            | -           | -               | (19)            | 1                                           | (1)                                           | 13                | -                                                                                                                                                        |
| Collateralized debt<br>obligations         | 31                               | (2)                             | -                                                               | 4                                                       | -                                                          | 61           | -           | (12)            | (5)             | 19                                          | (11)                                          | 85                | 1                                                                                                                                                        |
| Other asset-backed                         | 26                               | -                               | -                                                               | (1)                                                     | -                                                          | 4            | -           | (5)             | -               | 44                                          | (4)                                           | 64                | -                                                                                                                                                        |
| State and municipal<br>bonds               | 103                              | 2                               | -                                                               | (1)                                                     | -                                                          | -            | -           | (3)             | (12)            | 42                                          | (68)                                          | 63                | -                                                                                                                                                        |
| Perpetual debt and<br>equity securities    | 14                               | -                               | -                                                               | -                                                       | (1)                                                        | -            | -           | -               | -               | -                                           | (3)                                           | 10                | -                                                                                                                                                        |
| <b>Assets of consolidated<br/>VIEs:</b>    |                                  |                                 |                                                                 |                                                         |                                                            |              |             |                 |                 |                                             |                                               |                   |                                                                                                                                                          |
| Corporate obligations                      | 78                               | (4)                             | (8)                                                             | 6                                                       | -                                                          | -            | -           | (3)             | (24)            | 3                                           | -                                             | 48                | (1)                                                                                                                                                      |
| Residential mortgage-<br>backed non-agency | 6                                | -                               | 6                                                               | -                                                       | -                                                          | -            | -           | (7)             | -               | 1                                           | (4)                                           | 2                 | -                                                                                                                                                        |
| Commercial mortgage-<br>backed             | 7                                | -                               | 1                                                               | -                                                       | -                                                          | -            | -           | -               | (24)            | 20                                          | -                                             | 4                 | 1                                                                                                                                                        |
| Collateralized debt<br>obligations         | 125                              | -                               | (9)                                                             | 5                                                       | -                                                          | -            | -           | (1)             | (85)            | 1                                           | (1)                                           | 35                | 4                                                                                                                                                        |
| Other asset-backed                         | 64                               | -                               | -                                                               | -                                                       | -                                                          | -            | -           | (9)             | (2)             | 10                                          | -                                             | 63                | 4                                                                                                                                                        |
| Loans receivable                           | 1,881                            | -                               | 221                                                             | -                                                       | -                                                          | -            | -           | (137)           | (175)           | -                                           | -                                             | 1,790             | 207                                                                                                                                                      |
| Loan repurchase<br>commitments             | 1,086                            | -                               | 139                                                             | -                                                       | -                                                          | -            | -           | (110)           | -               | -                                           | -                                             | 1,115             | 139                                                                                                                                                      |
| <b>Total assets</b>                        | <b>\$ 3,532</b>                  | <b>\$ (2)</b>                   | <b>\$ 355</b>                                                   | <b>\$ 21</b>                                            | <b>\$ (2)</b>                                              | <b>\$ 67</b> | <b>\$ -</b> | <b>\$ (299)</b> | <b>\$ (370)</b> | <b>\$ 155</b>                               | <b>\$ (95)</b>                                | <b>\$ 3,362</b>   | <b>\$ 360</b>                                                                                                                                            |

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 6: Fair Value of Financial Instruments (continued)**

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

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

(2) - Primarily relates to the deconsolidation of VIEs.

Transfers into and out of Level 3 were \$180 million and \$82 million, respectively, for the six months ended June 30, 2014. Transfers into and out of Level 2 were \$82 million and \$180 million, respectively, for the six months ended June 30, 2014. Transfers into Level 3 were principally related to state and municipal bonds, RMBS agency, CDOs, and other ABS where inputs, which are significant to their valuation, became unobservable during the period. RMBS agency and other ABS comprised the majority of the transferred instruments out of Level 3 where inputs, which are significant to their valuation, became observable during the period. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

Transfers into and out of Level 3 were \$159 million and \$97 million, respectively, for the six months ended June 30, 2013. Transfers into and out of Level 2 were \$97 million and \$159 million, respectively, for the six months ended June 30, 2013. Transfers into Level 3 were principally related to other ABS, state and municipal bonds, CDOs, and CMBS where inputs, which are significant to their valuation, became unobservable during the period. State and municipal bonds and CDOs comprised the majority of the transferred instruments out of Level 3 where inputs, which are significant to their valuation, became observable during the period. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

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

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

Gains and losses (realized and unrealized) included in earnings related to Level 3 assets and liabilities for the three months ended June 30, 2014 and 2013 are reported on the Company's consolidated statements of operations as follows:

| In millions                                                                    | Three Months Ended<br>June 30, 2014                |                                                                                                                                                                 | Three Months Ended<br>June 30, 2013                |                                                                                                                                                                 |
|--------------------------------------------------------------------------------|----------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                                                                | Total Gains<br>(Losses)<br>Included in<br>Earnings | Change in<br>Unrealized<br>Gains (Losses)<br>for the Period<br>Included in<br>Earnings for<br>Assets and<br>Liabilities still<br>held as of<br>June 30,<br>2014 | Total Gains<br>(Losses)<br>Included<br>in Earnings | Change in<br>Unrealized<br>Gains (Losses)<br>for the Period<br>Included in<br>Earnings for<br>Assets and<br>Liabilities still<br>held as of<br>June 30,<br>2013 |
| <b>Revenues:</b>                                                               |                                                    |                                                                                                                                                                 |                                                    |                                                                                                                                                                 |
| Unrealized gains (losses) on insured derivatives                               | \$ (23)                                            | \$ (24)                                                                                                                                                         | \$ 1,350                                           | \$ (162)                                                                                                                                                        |
| Realized gains (losses) and other settlements on insured derivatives           | (23)                                               | -                                                                                                                                                               | (1,532)                                            | -                                                                                                                                                               |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 3                                                  | -                                                                                                                                                               | (8)                                                | 1                                                                                                                                                               |
| <b>Revenues of consolidated VIEs:</b>                                          |                                                    |                                                                                                                                                                 |                                                    |                                                                                                                                                                 |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (3)                                                | 12                                                                                                                                                              | 244                                                | 257                                                                                                                                                             |
| <b>Total</b>                                                                   | <b>\$ (46)</b>                                     | <b>\$ (12)</b>                                                                                                                                                  | <b>\$ 54</b>                                       | <b>\$ 96</b>                                                                                                                                                    |

Gains and losses (realized and unrealized) included in earnings relating to Level 3 assets and liabilities for the six months ended June 30, 2014 and 2013 are reported on the Company's consolidated statements of operations as follows:

| In millions                                                                    | Six Months Ended<br>June 30, 2014                  |                                                                                                                                                                 | Six Months Ended<br>June 30, 2013                  |                                                                                                                                                                 |
|--------------------------------------------------------------------------------|----------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                                                                | Total Gains<br>(Losses)<br>Included in<br>Earnings | Change in<br>Unrealized<br>Gains (Losses)<br>for the Period<br>Included in<br>Earnings for<br>Assets and<br>Liabilities still<br>held as of<br>June 30,<br>2014 | Total Gains<br>(Losses)<br>Included<br>in Earnings | Change in<br>Unrealized<br>Gains (Losses)<br>for the Period<br>Included in<br>Earnings for<br>Assets and<br>Liabilities still<br>held as of<br>June 30,<br>2013 |
| <b>Revenues:</b>                                                               |                                                    |                                                                                                                                                                 |                                                    |                                                                                                                                                                 |
| Unrealized gains (losses) on insured derivatives                               | \$ 815                                             | \$ 6                                                                                                                                                            | \$ 1,277                                           | \$ (218)                                                                                                                                                        |
| Realized gains (losses) and other settlements on insured derivatives           | (394)                                              | -                                                                                                                                                               | (1,521)                                            | -                                                                                                                                                               |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (10)                                               | (13)                                                                                                                                                            | (18)                                               | (11)                                                                                                                                                            |
| <b>Revenues of consolidated VIEs:</b>                                          |                                                    |                                                                                                                                                                 |                                                    |                                                                                                                                                                 |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (26)                                               | 9                                                                                                                                                               | 205                                                | 300                                                                                                                                                             |
| <b>Total</b>                                                                   | <b>\$ 385</b>                                      | <b>\$ 2</b>                                                                                                                                                     | <b>\$ (57)</b>                                     | <b>\$ 71</b>                                                                                                                                                    |

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

**Fair Value Option**

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

The following table presents the changes in fair value included in the Company's consolidated statements of operations for the three and six months ended June 30, 2014 and 2013 for financial instruments for which the fair value option was elected:

| In millions                                                     | Three Months Ended June 30, |       | Six Months Ended June 30, |      |
|-----------------------------------------------------------------|-----------------------------|-------|---------------------------|------|
|                                                                 | 2014                        | 2013  | 2014                      | 2013 |
| Investments carried at fair value <sup>(1)</sup>                | \$ 1                        | \$ 2  | \$ 2                      | \$ 6 |
| Fixed-maturity securities held at fair value-VIE <sup>(2)</sup> | (30)                        | (16)  | (68)                      | 2    |
| Loans receivable at fair value:                                 |                             |       |                           |      |
| Residential mortgage loans <sup>(2)</sup>                       | (17)                        | 145   | (73)                      | 71   |
| Other loans <sup>(2)</sup>                                      | -                           | -     | -                         | 13   |
| Loan repurchase commitments <sup>(2)</sup>                      | -                           | 50    | 5                         | 139  |
| Medium-term notes <sup>(1)</sup>                                | (2)                         | (7)   | (14)                      | (23) |
| Variable interest entity notes <sup>(2)</sup>                   | 48                          | (160) | 169                       | (79) |

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

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

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding as of June 30, 2014 and December 31, 2013 for loans and notes for which the fair value option was elected:

| In millions                                           | As of June 30, 2014               |            |            | As of December 31, 2013           |            |            |
|-------------------------------------------------------|-----------------------------------|------------|------------|-----------------------------------|------------|------------|
|                                                       | Contractual Outstanding Principal | Fair Value | Difference | Contractual Outstanding Principal | Fair Value | Difference |
| Loans receivable at fair value:                       |                                   |            |            |                                   |            |            |
| Residential mortgage loans                            | \$ 1,729                          | \$1,510    | \$ 219     | \$ 1,846                          | \$1,562    | \$ 284     |
| Residential mortgage loans (90 days or more past due) | 243                               | 29         | 214        | 231                               | 50         | 181        |
| Total loans receivable at fair value                  | \$ 1,972                          | \$1,539    | \$ 433     | \$ 2,077                          | \$1,612    | \$ 465     |
| Variable interest entity notes                        | \$ 3,428                          | \$2,150    | \$ 1,278   | \$ 3,787                          | \$2,356    | \$ 1,431   |
| Medium-term notes                                     | \$ 274                            | \$ 217     | \$ 57      | \$ 276                            | \$ 203     | \$ 73      |

Substantially all gains and losses included in earnings during the periods ended June 30, 2014 and 2013 on loans receivable and VIE notes reported in the preceding table are attributable to credit risk. This is primarily due to the high rate of defaults on loans and the collateral supporting the VIE notes, resulting in depressed pricing of the financial instruments.

**Note 7: Investments**

Investments, excluding those elected under the fair value option, include debt and equity securities classified as either AFS or HTM. Other invested assets designated as AFS are primarily comprised of money market funds.

The following tables present the amortized cost, fair value, corresponding gross unrealized gains and losses and other-than-temporary impairments ("OTTI") for AFS and HTM investments in the Company's consolidated investment portfolio as of June 30, 2014 and December 31, 2013:

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 7: Investments (continued)**

| In millions                            | June 30, 2014   |                        |                         |                |                                                 |
|----------------------------------------|-----------------|------------------------|-------------------------|----------------|-------------------------------------------------|
|                                        | Amortized Cost  | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value     | Other-Than-Temporary Impairments <sup>(1)</sup> |
| <b>AFS Investments</b>                 |                 |                        |                         |                |                                                 |
| Fixed-maturity investments:            |                 |                        |                         |                |                                                 |
| U.S. Treasury and government agency    | \$ 556          | \$ 29                  | \$ (4)                  | \$ 581         | \$ -                                            |
| State and municipal bonds              | 1,687           | 67                     | (16)                    | 1,738          | -                                               |
| Foreign governments                    | 308             | 6                      | (1)                     | 313            | -                                               |
| Corporate obligations                  | 2,235           | 40                     | (21)                    | 2,254          | -                                               |
| Mortgage-backed securities:            |                 |                        |                         |                |                                                 |
| Residential mortgage-backed agency     | 1,157           | 16                     | (12)                    | 1,161          | -                                               |
| Residential mortgage-backed non-agency | 57              | 3                      | (4)                     | 56             | (4)                                             |
| Commercial mortgage-backed             | 28              | 1                      | -                       | 29             | -                                               |
| Asset-backed securities:               |                 |                        |                         |                |                                                 |
| Collateralized debt obligations        | 123             | -                      | (23)                    | 100            | -                                               |
| Other asset-backed                     | 236             | 4                      | (9)                     | 231            | -                                               |
| Total fixed-maturity investments       | 6,387           | 166                    | (90)                    | 6,463          | (4)                                             |
| Money market securities                | 385             | -                      | -                       | 385            | -                                               |
| Perpetual debt and equity securities   | 11              | 1                      | -                       | 12             | -                                               |
| Total AFS investments                  | <u>\$ 6,783</u> | <u>\$ 167</u>          | <u>\$ (90)</u>          | <u>\$6,860</u> | <u>\$ (4)</u>                                   |
| HTM Investments                        |                 |                        |                         |                |                                                 |
| Assets of consolidated VIEs:           |                 |                        |                         |                |                                                 |
| Corporate obligations                  | \$ 2,787        | \$ 123                 | \$ (130)                | \$2,780        | \$ -                                            |
| Total HTM investments                  | <u>\$ 2,787</u> | <u>\$ 123</u>          | <u>\$ (130)</u>         | <u>\$2,780</u> | <u>\$ -</u>                                     |

(1) - Represents unrealized gains or losses on other than temporarily impaired securities recognized in AOCI, which includes the non-credit component of impairments, as well as all subsequent changes in fair value of such impaired securities reported in AOCI.

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 7: Investments (continued)**

| In millions                            | December 31, 2013 |                        |                         |                |                                                 |
|----------------------------------------|-------------------|------------------------|-------------------------|----------------|-------------------------------------------------|
|                                        | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value     | Other-Than-Temporary Impairments <sup>(1)</sup> |
| <b>AFS Investments</b>                 |                   |                        |                         |                |                                                 |
| Fixed-maturity investments:            |                   |                        |                         |                |                                                 |
| U.S. Treasury and government agency    | \$ 528            | \$ 16                  | \$ (9)                  | \$ 535         | \$ -                                            |
| State and municipal bonds              | 1,831             | 22                     | (73)                    | 1,780          | -                                               |
| Foreign governments                    | 184               | 5                      | -                       | 189            | -                                               |
| Corporate obligations                  | 1,682             | 24                     | (38)                    | 1,668          | -                                               |
| Mortgage-backed securities:            |                   |                        |                         |                |                                                 |
| Residential mortgage-backed agency     | 1,167             | 10                     | (31)                    | 1,146          | -                                               |
| Residential mortgage-backed non-agency | 79                | 13                     | (5)                     | 87             | 4                                               |
| Commercial mortgage-backed             | 34                | 1                      | (1)                     | 34             | -                                               |
| Asset-backed securities:               |                   |                        |                         |                |                                                 |
| Collateralized debt obligations        | 205               | 3                      | (57)                    | 151            | (14)                                            |
| Other asset-backed                     | 187               | 2                      | (15)                    | 174            | -                                               |
| Total fixed-maturity investments       | 5,897             | 96                     | (229)                   | 5,764          | (10)                                            |
| Money market securities                | 781               | -                      | -                       | 781            | -                                               |
| Perpetual debt and equity securities   | 10                | 1                      | -                       | 11             | -                                               |
| Assets of consolidated VIEs:           |                   |                        |                         |                |                                                 |
| Money market securities                | 136               | -                      | -                       | 136            | -                                               |
| <b>Total AFS investments</b>           | <b>\$ 6,824</b>   | <b>\$ 97</b>           | <b>\$ (229)</b>         | <b>\$6,692</b> | <b>\$ (10)</b>                                  |
| <b>HTM Investments</b>                 |                   |                        |                         |                |                                                 |
| Assets of consolidated VIEs:           |                   |                        |                         |                |                                                 |
| Corporate obligations                  | \$ 2,801          | \$ 31                  | \$ (181)                | \$2,651        | \$ -                                            |
| <b>Total HTM investments</b>           | <b>\$ 2,801</b>   | <b>\$ 31</b>           | <b>\$ (181)</b>         | <b>\$2,651</b> | <b>\$ -</b>                                     |

(1) - Represents unrealized gains or losses on other than temporarily impaired securities recognized in AOCI, which includes the non-credit component of impairments, as well as all subsequent changes in fair value of such impaired securities reported in AOCI.

The following table presents the distribution by contractual maturity of AFS and HTM fixed-maturity securities at amortized cost and fair value as of June 30, 2014. Contractual maturity may differ from expected maturity as borrowers may have the right to call or prepay obligations.

| In millions                             | AFS Securities  |                 | HTM Securities<br>Consolidated VIEs |                 |
|-----------------------------------------|-----------------|-----------------|-------------------------------------|-----------------|
|                                         | Amortized Cost  | Fair Value      | Amortized Cost                      | Fair Value      |
| Due in one year or less                 | \$ 875          | \$ 875          | \$ -                                | \$ -            |
| Due after one year through five years   | 1,387           | 1,410           | -                                   | -               |
| Due after five years through ten years  | 1,000           | 1,019           | -                                   | -               |
| Due after ten years                     | 1,524           | 1,582           | 2,787                               | 2,780           |
| Mortgage-backed and asset-backed        | 1,601           | 1,577           | -                                   | -               |
| <b>Total fixed-maturity investments</b> | <b>\$ 6,387</b> | <b>\$ 6,463</b> | <b>\$ 2,787</b>                     | <b>\$ 2,780</b> |

**Deposited and Pledged Securities**

The fair value of securities on deposit with various regulatory authorities as of June 30, 2014 and December 31, 2013 was \$10 million for both periods. These deposits are required to comply with state insurance laws.

The Company enters into securities borrowing and lending contracts in connection with MBIA's collateralized investment agreement activities. Such contracts are only transacted with high-quality dealer firms. It is the Company's policy to take possession of securities borrowed under these contracts. The Company minimizes credit risk from counterparties that might be unable to fulfill their contractual obligations by monitoring customer credit exposure and collateral values and requiring additional collateral to be deposited with the Company when deemed necessary.

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 7: Investments (continued)**

Substantially all of the obligations under investment agreements require the Company to pledge securities as collateral. Securities pledged in connection with investment agreements may not be repledged by the investment agreement. As of June 30, 2014 and December 31, 2013, the fair value of securities pledged as collateral for these investment agreements approximated \$660 million and \$693 million, respectively. The Company's collateral as of June 30, 2014 consisted principally of RMBS and U.S. Treasury and government agency bonds, and was primarily held with major U.S. banks. Additionally, the Company pledged cash and money market securities as collateral under investment agreements in the amount of \$15 million and \$22 million as of June 30, 2014 and December 31, 2013, respectively.

**Impaired Investments**

The following tables present the gross unrealized losses related to AFS and HTM investments as of June 30, 2014 and December 31, 2013:

| In millions                            | Less than 12 Months |                   | June 30, 2014<br>12 Months or Longer |                   | Total          |                   |
|----------------------------------------|---------------------|-------------------|--------------------------------------|-------------------|----------------|-------------------|
|                                        | Fair Value          | Unrealized Losses | Fair Value                           | Unrealized Losses | Fair Value     | Unrealized Losses |
| <b>AFS Investments</b>                 |                     |                   |                                      |                   |                |                   |
| Fixed-maturity investments:            |                     |                   |                                      |                   |                |                   |
| U.S. Treasury and government agency    | \$ 98               | \$ -              | \$ 176                               | \$ (4)            | \$ 274         | \$ (4)            |
| State and municipal bonds              | 29                  | -                 | 477                                  | (16)              | 506            | (16)              |
| Foreign governments                    | 150                 | (1)               | -                                    | -                 | 150            | (1)               |
| Corporate obligations                  | 341                 | (12)              | 293                                  | (9)               | 634            | (21)              |
| Mortgage-backed securities:            |                     |                   |                                      |                   |                |                   |
| Residential mortgage-backed agency     | 18                  | -                 | 440                                  | (12)              | 458            | (12)              |
| Residential mortgage-backed non-agency | 2                   | -                 | 21                                   | (4)               | 23             | (4)               |
| Commercial mortgage-backed             | 8                   | -                 | 7                                    | -                 | 15             | -                 |
| Asset-backed securities:               |                     |                   |                                      |                   |                |                   |
| Collateralized debt obligations        | 2                   | -                 | 89                                   | (23)              | 91             | (23)              |
| Other asset-backed                     | 25                  | -                 | 48                                   | (9)               | 73             | (9)               |
| Total AFS investments                  | <u>\$ 673</u>       | <u>\$ (13)</u>    | <u>\$1,551</u>                       | <u>\$ (77)</u>    | <u>\$2,224</u> | <u>\$ (90)</u>    |
| <b>HTM Investments</b>                 |                     |                   |                                      |                   |                |                   |
| Assets of consolidated VIEs:           |                     |                   |                                      |                   |                |                   |
| Corporate obligations                  | \$ -                | \$ -              | \$ 445                               | \$ (130)          | \$ 445         | \$ (130)          |
| Total HTM investments                  | <u>\$ -</u>         | <u>\$ -</u>       | <u>\$ 445</u>                        | <u>\$ (130)</u>   | <u>\$ 445</u>  | <u>\$ (130)</u>   |

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 7: Investments (continued)**

| In millions                            | December 31, 2013   |                   |                     |                   |                |                   |
|----------------------------------------|---------------------|-------------------|---------------------|-------------------|----------------|-------------------|
|                                        | Less than 12 Months |                   | 12 Months or Longer |                   | Total          |                   |
|                                        | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value     | Unrealized Losses |
| <b>AFS Investments</b>                 |                     |                   |                     |                   |                |                   |
| Fixed-maturity investments:            |                     |                   |                     |                   |                |                   |
| U.S. Treasury and government agency    | \$ 269              | \$ (9)            | \$ 1                | \$ -              | \$ 270         | \$ (9)            |
| State and municipal bonds              | 1,112               | (65)              | 49                  | (8)               | 1,161          | (73)              |
| Foreign governments                    | 36                  | -                 | -                   | -                 | 36             | -                 |
| Corporate obligations                  | 788                 | (30)              | 82                  | (8)               | 870            | (38)              |
| Mortgage-backed securities:            |                     |                   |                     |                   |                |                   |
| Residential mortgage-backed agency     | 713                 | (23)              | 144                 | (8)               | 857            | (31)              |
| Residential mortgage-backed non-agency | 17                  | -                 | 22                  | (5)               | 39             | (5)               |
| Commercial mortgage-backed             | 11                  | (1)               | -                   | -                 | 11             | (1)               |
| Asset-backed securities:               |                     |                   |                     |                   |                |                   |
| Collateralized debt obligations        | 6                   | -                 | 124                 | (57)              | 130            | (57)              |
| Other asset-backed                     | 21                  | -                 | 57                  | (15)              | 78             | (15)              |
| Total fixed-maturity investments       | 2,973               | (128)             | 479                 | (101)             | 3,452          | (229)             |
| Perpetual debt and equity securities   | 5                   | -                 | -                   | -                 | 5              | -                 |
| Total AFS investments                  | <u>\$2,978</u>      | <u>\$ (128)</u>   | <u>\$ 479</u>       | <u>\$ (101)</u>   | <u>\$3,457</u> | <u>\$ (229)</u>   |
| <b>HTM Investments</b>                 |                     |                   |                     |                   |                |                   |
| Assets of consolidated VIEs:           |                     |                   |                     |                   |                |                   |
| Corporate obligations                  | \$ -                | \$ -              | \$1,244             | \$ (181)          | \$1,244        | \$ (181)          |
| Total HTM investments                  | <u>\$ -</u>         | <u>\$ -</u>       | <u>\$1,244</u>      | <u>\$ (181)</u>   | <u>\$1,244</u> | <u>\$ (181)</u>   |

Gross unrealized losses on AFS securities decreased as of June 30, 2014 compared with December 31, 2013 primarily due to market price appreciation caused by declining interest rates and to security sales. Gross unrealized losses on HTM securities decreased as of June 30, 2014 compared with December 31, 2013 primarily due to market price appreciation caused by the narrowing of credit spreads.

With the weighting applied on the fair value of each security relative to the total fair value, the weighted average contractual maturity of securities in an unrealized loss position as of June 30, 2014 and December 31, 2013 was 16 and 18 years, respectively. As of June 30, 2014 and December 31, 2013, there were 229 and 77 securities, respectively, that were in an unrealized loss position for a continuous twelve-month period or longer, of which the fair values of 37 and 50 securities, respectively, were below book value by more than 5%.

The following table presents the distribution of securities in an unrealized loss position for a continuous twelve-month period or longer by percentage of fair value below book value by more than 5% as of June 30, 2014:

| Percentage of Fair Value Below Book Value | AFS Securities       |                          |                          | HTM Securities       |                          |                          |
|-------------------------------------------|----------------------|--------------------------|--------------------------|----------------------|--------------------------|--------------------------|
|                                           | Number of Securities | Book Value (in millions) | Fair Value (in millions) | Number of Securities | Book Value (in millions) | Fair Value (in millions) |
| > 5% to 15%                               | 26                   | \$ 220                   | \$ 206                   | -                    | \$ -                     | \$ -                     |
| > 15% to 25%                              | 7                    | 90                       | 73                       | 1                    | 575                      | 445                      |
| > 25% to 50%                              | -                    | -                        | -                        | -                    | -                        | -                        |
| > 50%                                     | 3                    | 20                       | 3                        | -                    | -                        | -                        |
| Total                                     | <u>36</u>            | <u>\$ 330</u>            | <u>\$ 282</u>            | <u>1</u>             | <u>\$ 575</u>            | <u>\$ 445</u>            |

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 7: Investments (continued)**

The following table presents the fair values and gross unrealized losses by credit rating category of ABS, MBS and corporate obligations included in the Company's consolidated AFS investment portfolio as of June 30, 2014 for which fair value was less than amortized cost. The credit ratings are based on ratings from Moody's as of June 30, 2014 or an alternate ratings source, such as S&P, when a security is not rated by Moody's. For investments that are insured by various third-party guarantee insurers, the credit rating reflects the higher of the insurer's rating or the underlying bond's rating.

| In millions<br>Asset Type | Aaa           |                 | Aa            |                 | A             |                 | Baa          |                 | Below<br>Investment Grade |                 | Not Rated     |                 | Total          |                 |
|---------------------------|---------------|-----------------|---------------|-----------------|---------------|-----------------|--------------|-----------------|---------------------------|-----------------|---------------|-----------------|----------------|-----------------|
|                           | Fair Value    | Unrealized Loss | Fair Value    | Unrealized Loss | Fair Value    | Unrealized Loss | Fair Value   | Unrealized Loss | Fair Value                | Unrealized Loss | Fair Value    | Unrealized Loss | Fair Value     | Unrealized Loss |
| ABS                       | \$ 27         | \$ -            | \$ 62         | \$ (3)          | \$ 1          | \$ -            | \$ 1         | \$ -            | \$ 73                     | \$ (29)         | \$ -          | \$ -            | \$ 164         | \$ (32)         |
| MBS                       | 459           | (12)            | 8             | -               | 2             | -               | 4            | -               | 8                         | -               | 15            | (4)             | 496            | (16)            |
| Corporate obligation      | 68            | -               | 194           | (3)             | 220           | (4)             | 41           | (2)             | 1                         | -               | 110           | (12)            | 634            | (21)            |
| Total                     | <u>\$ 554</u> | <u>\$ (12)</u>  | <u>\$ 264</u> | <u>\$ (6)</u>   | <u>\$ 223</u> | <u>\$ (4)</u>   | <u>\$ 46</u> | <u>\$ (2)</u>   | <u>\$ 82</u>              | <u>\$ (29)</u>  | <u>\$ 125</u> | <u>\$ (16)</u>  | <u>\$1,294</u> | <u>\$ (69)</u>  |

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

| Asset Type            | Average Credit Rating with the<br>Effect of Guarantee | Average Credit Rating without the<br>Effect of Guarantee | Insured Securities Rated Below<br>Investment Grade without the<br>Effect of Guarantee |            |
|-----------------------|-------------------------------------------------------|----------------------------------------------------------|---------------------------------------------------------------------------------------|------------|
|                       |                                                       |                                                          | (in millions)<br>Fair Value                                                           | Percentage |
| ABS                   | Baa                                                   | Below Investment Grade                                   | \$70                                                                                  | 55%        |
| MBS                   | Below Investment Grade                                | Below Investment Grade                                   | 6                                                                                     | 100%       |
| Corporate obligations | Baa                                                   | Baa                                                      | -                                                                                     | - %        |

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

The Company concluded that it does not have the intent to sell securities in an unrealized loss position and it is more likely than not, that it would not have to sell these securities before recovery of their cost basis. In making this conclusion, the Company examined the cash flow projections for its investment portfolios, the potential sources and uses of cash in its businesses, and the cash resources available to its business other than sales of securities. It also considered the existence of any risk management or other plans as of June 30, 2014 that would require the sale of impaired securities. Impaired securities that the Company intends to sell before the expected recovery of such securities' fair values have been written down to fair value.

**Other-Than-Temporary Impairments**

*Evaluating AFS Securities for OTTI*

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

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

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 7: Investments (continued)**

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

##### *Determination of Credit Loss on ABS, MBS and Corporate Obligations*

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

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

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

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

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

The Company does not record OTTI related to credit concerns about issuers of securities insured by MBIA Corp. and National since investors in these securities, including MBIA, are guaranteed payment of principal and interest when due by MBIA. Securities insured by the Company, whether or not owned by the Company, are evaluated for impairment as part of its insurance surveillance process and, therefore, losses on securities insured by the Company are recorded in accordance with its loss reserving policy. Refer to "Note 2: Significant Accounting Policies" in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for information about the Company's loss reserving policy and "Note 5: Loss and Loss Adjustment Expense Reserves" for information about loss reserves.

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

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 7: Investments (continued)**

The following table provides information about securities held by the Company as of June 30, 2014 that were in an unrealized loss position and insured by a financial guarantor, along with the amount of insurance loss reserves corresponding to the par amount owned by the Company:

| In millions                   | Fair Value    | Unrealized Loss | Insurance Loss Reserve <sup>(2)</sup> |
|-------------------------------|---------------|-----------------|---------------------------------------|
| <b>Asset-backed:</b>          |               |                 |                                       |
| MBIA <sup>(1)</sup>           | \$ 120        | \$ (30)         | \$ 15                                 |
| Other                         | 8             | (2)             | -                                     |
| Total asset-backed            | 128           | (32)            | 15                                    |
| <b>Mortgage-backed:</b>       |               |                 |                                       |
| MBIA <sup>(1)</sup>           | 5             | -               | -                                     |
| Other                         | 1             | -               | -                                     |
| Total mortgage-backed         | 6             | -               | -                                     |
| <b>Corporate obligations:</b> |               |                 |                                       |
| Other                         | 6             | (1)             | -                                     |
| Total corporate obligations   | 6             | (1)             | -                                     |
| <b>Other:</b>                 |               |                 |                                       |
| MBIA <sup>(1)</sup>           | 41            | (5)             | -                                     |
| Total other                   | 41            | (5)             | -                                     |
| <b>Total</b>                  | <b>\$ 181</b> | <b>\$ (38)</b>  | <b>\$ 15</b>                          |

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

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

*Credit Loss Rollforward*

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

| In millions                                                                                             | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|---------------------------------------------------------------------------------------------------------|--------------------------------|--------|------------------------------|--------|
|                                                                                                         | 2014                           | 2013   | 2014                         | 2013   |
| <b>Credit Losses Recognized in Earnings Related to Other-Than-Temporary Impairments</b>                 |                                |        |                              |        |
| Beginning balance                                                                                       | \$ 173                         | \$ 195 | \$ 175                       | \$ 197 |
| Reductions for credit loss impairments previously recognized on securities sold during the period       | (173)                          | (8)    | (174)                        | (10)   |
| Reductions for increases in cash flows expected to be collected over the remaining life of the security | -                              | (1)    | (1)                          | (1)    |
| Ending balance                                                                                          | \$ -                           | \$ 186 | \$ -                         | \$ 186 |

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[Table of Contents](#)**MBIA Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Note 7: Investments (continued)****Sales of Available-for-Sale Investments**

Gross realized gains and losses are recorded within "Net gains (losses) on financial instruments at fair value and foreign exchange" on the Company's consolidated statements of operations. The proceeds and the gross realized gains and losses from sales of fixed-maturity securities held as AFS for the three and six months ended June 30, 2014 and 2013 are as follows:

| In millions           | Three Months Ended June 30, |        | Six Months Ended June 30, |          |
|-----------------------|-----------------------------|--------|---------------------------|----------|
|                       | 2014                        | 2013   | 2014                      | 2013     |
| Proceeds from sales   | \$ 439                      | \$ 681 | \$ 463                    | \$ 1,301 |
| Gross realized gains  | \$ 55                       | \$ 11  | \$ 57                     | \$ 47    |
| Gross realized losses | \$ (13)                     | \$ (7) | \$ (13)                   | \$ (10)  |

**Note 8: Derivative Instruments****Overview**

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

*U.S. Public Finance Insurance*

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

*Structured Finance and International Insurance*

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

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

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

The Company has also entered into a derivative contract as a result of a commutation occurring during the six months ended June 30, 2014. Changes in the fair value of the Company's non-insured derivative are included in "Net gains (losses) on financial instruments at fair value and foreign exchange" on the Company's consolidated statements of operations.

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 8: Derivative Instruments (continued)**
*Variable Interest Entities*

VIEs consolidated by the Company have entered into derivative instruments consisting of interest rate caps and cross currency swaps. Interest rate caps are entered into to mitigate the risks associated with fluctuations in interest rates or fair values of certain contracts. Cross currency swaps are entered into to hedge the variability in cash flows resulting from fluctuations in foreign currency rates.

*Asset/Liability Products*

The Company's asset/liability products business has entered into derivative instruments primarily consisting of interest rate swaps. Interest rate swaps are entered into to hedge the risks associated with fluctuations in interest rates or fair values of certain contracts.

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

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

**Credit Derivatives Sold**

The following tables present information about credit derivatives sold by the Company's insurance operations that were outstanding as of June 30, 2014 and December 31, 2013. Credit ratings represent the lower of underlying ratings assigned to the collateral by Moody's, S&P or MBIA.

| \$ in millions                 | As of June 30, 2014                          |                |               |                |                |                        |                 |                              |
|--------------------------------|----------------------------------------------|----------------|---------------|----------------|----------------|------------------------|-----------------|------------------------------|
|                                | Notional Value                               |                |               |                |                |                        |                 | Fair Value Asset (Liability) |
|                                | Weighted Average Remaining Expected Maturity | AAA            | AA            | A              | BBB            | Below Investment Grade | Total Notional  |                              |
| <b>Credit Derivatives Sold</b> |                                              |                |               |                |                |                        |                 |                              |
| Insured credit default swaps   | 2.3 Years                                    | \$6,938        | \$ 560        | \$ 968         | \$4,704        | \$ 2,816               | \$15,986        | \$ (332)                     |
| Insured swaps                  | 16.9 Years                                   | -              | 75            | 3,036          | 985            | -                      | 4,096           | (3)                          |
| <b>Total notional</b>          |                                              | <b>\$6,938</b> | <b>\$ 635</b> | <b>\$4,004</b> | <b>\$5,689</b> | <b>\$ 2,816</b>        | <b>\$20,082</b> |                              |
| <b>Total fair value</b>        |                                              | <b>\$ (2)</b>  | <b>\$ -</b>   | <b>\$ (2)</b>  | <b>\$ (31)</b> | <b>\$ (300)</b>        |                 | <b>\$ (335)</b>              |

| \$ in millions                 | As of December 31, 2013                      |                |                |                |                |                        |                 |                              |
|--------------------------------|----------------------------------------------|----------------|----------------|----------------|----------------|------------------------|-----------------|------------------------------|
|                                | Notional Value                               |                |                |                |                |                        |                 | Fair Value Asset (Liability) |
|                                | Weighted Average Remaining Expected Maturity | AAA            | AA             | A              | BBB            | Below Investment Grade | Total Notional  |                              |
| <b>Credit Derivatives Sold</b> |                                              |                |                |                |                |                        |                 |                              |
| Insured credit default swaps   | 2.6 Years                                    | \$7,406        | \$1,972        | \$1,068        | \$7,552        | \$ 5,956               | \$23,954        | \$ (1,132)                   |
| Insured swaps                  | 18.5 Years                                   | -              | 77             | 3,282          | 1,586          | -                      | 4,945           | (5)                          |
| All others                     | 28.0 Years                                   | -              | -              | -              | -              | 36                     | 36              | (15)                         |
| <b>Total notional</b>          |                                              | <b>\$7,406</b> | <b>\$2,049</b> | <b>\$4,350</b> | <b>\$9,138</b> | <b>\$ 5,992</b>        | <b>\$28,935</b> |                              |
| <b>Total fair value</b>        |                                              | <b>\$ (2)</b>  | <b>\$ -</b>    | <b>\$ (3)</b>  | <b>\$ (78)</b> | <b>\$ (1,069)</b>      |                 | <b>\$ (1,152)</b>            |

Internal credit ratings assigned by MBIA on the underlying collateral are derived by the Company's surveillance group. In assigning an internal rating, current status reports from issuers and trustees, as well as publicly available transaction-specific information, are reviewed. Also, where appropriate, cash flow analyses and collateral valuations are considered. The maximum potential amount of future payments (undiscounted) on CDS contracts are estimated as the notional value plus any additional debt service costs, such as interest or other amounts owing on CDS contracts. The maximum amount of future payments that MBIA may be required to make under these guarantees as of June 30, 2014 is \$16.4 billion. This amount is net of \$36 million of insured derivatives ceded under reinsurance agreements in which MBIA economically hedges a portion of the credit and market risk associated with its insured derivatives and offsetting agreements with a counterparty. The maximum potential amount of future payments (undiscounted) on insured swaps are estimated as the notional value of such contracts.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 8: Derivative Instruments (continued)**

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

##### **Counterparty Credit Risk**

The Company manages counterparty credit risk on an individual counterparty basis through master netting agreements covering derivative instruments in the asset/liability products segment. There are no master netting agreements in the structured finance and international insurance or the U.S. public finance insurance segments. The master netting agreements in the asset/liability products segment allow the Company to contractually net amounts due from a counterparty with those amounts due to such counterparty when certain triggering events occur. The Company only executes swaps under master netting agreements, which typically contain mutual credit downgrade provisions that generally provide the ability to require assignment or termination in the event either MBIA or the counterparty is downgraded below a specified credit rating.

Under these arrangements, the Company may receive or provide U.S. Treasury and other highly rated securities or cash to secure counterparties' exposure to the Company or its exposure to counterparties, respectively. Such collateral is available to the holder to pay for replacing the counterparty in the event that the counterparty defaults. As of June 30, 2014, the Company did not hold cash collateral to derivative counterparties but posted cash collateral to derivative counterparties of \$82 million. Of this amount, \$65 million is netted within "Derivative liabilities" and \$17 million is included within "Other liabilities" as cash collateral netted against accrued interest on derivative liabilities. As of December 31, 2013, the Company did not hold cash collateral to derivative counterparties but posted cash collateral to derivative counterparties of \$160 million. Of this amount, \$123 million is netted within "Derivative liabilities", \$16 million is included within "Other liabilities" as cash collateral netted against accrued interest on derivative liabilities and an additional \$21 million is included in "Other assets" on the Company's consolidated balance sheets. As of June 30, 2014, the Company had securities with a fair value of \$108 million posted to derivative counterparties and this amount is included within "Fixed-maturity securities held as available-for-sale, at fair value" on the Company's consolidated balance sheet. As of December 31, 2013, the Company had securities with a fair value of \$42 million posted to derivative counterparties and this amount is included within "Fixed-maturity securities held as available-for-sale, at fair value" on the Company's consolidated balance sheet.

As of June 30, 2014 and December 31, 2013, the fair value on one Credit Support Annex ("CSA") was \$4 million. This CSA governs collateral posting requirements between MBIA and its derivative counterparties. The Company did not receive collateral due to the Company's credit rating, which was below the CSA minimum credit ratings level for holding counterparty collateral. As of June 30, 2014 and December 31, 2013, the counterparty was rated A2 by Moody's and A by S&P.

##### **Financial Statement Presentation**

The fair value of amounts recognized for eligible derivative contracts executed with the same counterparty under a master netting agreement, including any cash collateral that may have been received or posted by the Company, is presented on a net basis in accordance with accounting guidance for the offsetting of fair value amounts related to derivative instruments. Insured CDSs and insured swaps are not subject to master netting agreements. VIE derivative assets and liabilities are not presented net of any master netting agreements. Counterparty netting of derivative assets and liabilities offsets balances in "Interest rate swaps" as of June 30, 2014 and December 31, 2013.

As of June 30, 2014, the total fair value of the Company's derivative assets, after counterparty netting of \$62 million, was \$12 million, of which \$4 million was reported within "Other assets" on the Company's consolidated balance sheets. Embedded derivatives of \$8 million were reported within "Medium-term notes" on the Company's consolidated balance sheets.

As of June 30, 2014, the total fair value of the Company's derivative liabilities, after counterparty netting of \$62 million and cash collateral posted by the Company of \$65 million was \$460 million, which was reported within "Derivative liabilities" and "Derivative liabilities" presented under "Liabilities of consolidated variable interest entities" on the Company's consolidated balance sheets. Embedded derivatives of \$26 million were reported within "Medium-term notes" and "Other investments" on the Company's consolidated balance sheets.

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 8: Derivative Instruments (continued)**

The following table presents the total fair value of the Company's derivative assets and liabilities by instrument and balance sheet location, before counterparty netting and posting of cash collateral, as of June 30, 2014:

| In millions                            |                             | Derivative Assets <sup>(1)</sup> |              | Derivative Liabilities <sup>(1)</sup> |                 |
|----------------------------------------|-----------------------------|----------------------------------|--------------|---------------------------------------|-----------------|
| Derivative Instruments                 | Notional Amount Outstanding | Balance Sheet Location           | Fair Value   | Balance Sheet Location                | Fair Value      |
| Not designated as hedging instruments: |                             |                                  |              |                                       |                 |
| Insured credit default swaps           | \$ 15,986                   | Other assets                     | \$ -         | Derivative liabilities                | \$ (332)        |
| Insured swaps                          | 4,096                       | Other assets                     | -            | Derivative liabilities                | (3)             |
| Interest rate swaps                    | 1,485                       | Other assets                     | 66           | Derivative liabilities                | (208)           |
| Interest rate swaps-embedded           | 494                         | Medium-term notes                | 8            | Medium-term notes                     | (25)            |
| Currency swaps-VIE                     | 94                          | Other assets-VIE                 | -            | Derivative liabilities-VIE            | (11)            |
| All other                              | 83                          | Other assets                     | -            | Derivative liabilities                | (33)            |
| All other-VIE                          | 264                         | Other assets-VIE                 | -            | Derivative liabilities-VIE            | -               |
| All other-embedded                     | 11                          | Other investments                | -            | Other investments                     | (1)             |
| Total non-designated derivatives       | <u>\$ 22,513</u>            |                                  | <u>\$ 74</u> |                                       | <u>\$ (613)</u> |

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

As of December 31, 2013, the total fair value of the Company's derivative assets, after counterparty netting of \$42 million, was \$13 million, of which \$4 million was reported within "Other assets" on the Company's consolidated balance sheets. Embedded derivatives of \$9 million were reported within "Medium-term notes" on the Company's consolidated balance sheets.

As of December 31, 2013, the total fair value of the Company's derivative liabilities, after counterparty netting of \$42 million and cash collateral posted by the Company of \$123 million, was \$1.2 billion which was reported within "Derivative liabilities" and "Derivative liabilities" presented under "Liabilities of consolidated variable interest entities" on the Company's consolidated balance sheets. Embedded derivatives of \$19 million were reported within "Medium-term notes" and "Other investments" on the Company's consolidated balance sheets.

The following table presents the total fair value of the Company's derivative assets and liabilities by instrument and balance sheet location, before counterparty netting and posting of cash collateral, as of December 31, 2013:

| In millions                            |                             | Derivative Assets <sup>(1)</sup> |              | Derivative Liabilities <sup>(1)</sup> |                   |
|----------------------------------------|-----------------------------|----------------------------------|--------------|---------------------------------------|-------------------|
| Derivative Instruments                 | Notional Amount Outstanding | Balance Sheet Location           | Fair Value   | Balance Sheet Location                | Fair Value        |
| Not designated as hedging instruments: |                             |                                  |              |                                       |                   |
| Insured credit default swaps           | \$ 23,954                   | Other assets                     | \$ -         | Derivative liabilities                | \$ (1,132)        |
| Insured swaps                          | 4,945                       | Other assets                     | -            | Derivative liabilities                | (5)               |
| Interest rate swaps                    | 1,495                       | Other assets                     | 46           | Derivative liabilities                | (165)             |
| Interest rate swaps-embedded           | 496                         | Medium-term notes                | 9            | Medium-term notes                     | (19)              |
| Currency swaps-VIE                     | 99                          | Other assets-VIE                 | -            | Derivative liabilities-VIE            | (11)              |
| All other                              | 36                          | Other assets                     | -            | Derivative liabilities                | (15)              |
| All other-VIE                          | 280                         | Other assets-VIE                 | -            | Derivative liabilities-VIE            | -                 |
| All other-embedded                     | 11                          | Other investments                | -            | Other investments                     | -                 |
| Total non-designated derivatives       | <u>\$ 31,316</u>            |                                  | <u>\$ 55</u> |                                       | <u>\$ (1,347)</u> |

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

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 8: Derivative Instruments (continued)**

The following table presents the effect of derivative instruments on the consolidated statements of operations for the three months ended June 30, 2014:

| In millions                                       |                                                                                    |                                      |
|---------------------------------------------------|------------------------------------------------------------------------------------|--------------------------------------|
| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivative                         | Net Gain (Loss) Recognized in Income |
| Insured credit default swaps                      | Unrealized gains (losses) on insured derivatives                                   | \$ (23)                              |
| Insured credit default swaps                      | Realized gains (losses) and other settlements on insured derivatives               | (24)                                 |
| Interest rate swaps                               | Net gains (losses) on financial instruments at fair value and foreign exchange     | (22)                                 |
| Currency swaps-VIE                                | Net gains (losses) on financial instruments at fair value and foreign exchange-VIE | (6)                                  |
| All other                                         | Net gains (losses) on financial instruments at fair value and foreign exchange     | (2)                                  |
| Total                                             |                                                                                    | <u>\$ (77)</u>                       |

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

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

The following table presents the effect of derivative instruments on the consolidated statements of operations for the six months ended June 30, 2014:

| In millions                                       |                                                                                |                                      |
|---------------------------------------------------|--------------------------------------------------------------------------------|--------------------------------------|
| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivative                     | Net Gain (Loss) Recognized in Income |
| Insured credit default swaps                      | Unrealized gains (losses) on insured derivatives                               | \$ 800                               |
| Insured credit default swaps                      | Realized gains (losses) and other settlements on insured derivatives           | (363)                                |
| Interest rate swaps                               | Net gains (losses) on financial instruments at fair value and foreign exchange | (45)                                 |
| All other                                         | Unrealized gains (losses) on insured derivatives                               | 15                                   |
| All other                                         | Net gains (losses) on financial instruments at fair value and foreign exchange | (3)                                  |
| All other                                         | Realized gains (losses) and other settlements on insured derivatives           | (30)                                 |
| Total                                             |                                                                                | <u>\$ 374</u>                        |

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 8: Derivative Instruments (continued)**

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

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

**Note 9: Income Taxes**

The Company's income taxes and the related effective tax rates for the three and six months ended June 30, 2014 and 2013 are as follows:

| In millions                          | Three Months Ended June 30, |          | Six Months Ended June 30, |         |
|--------------------------------------|-----------------------------|----------|---------------------------|---------|
|                                      | 2014                        | 2013     | 2014                      | 2013    |
| Income (loss) before income taxes    | \$ 55                       | \$ (264) | \$ 459                    | \$ (49) |
| Provision (benefit) for income taxes | \$ (65)                     | \$ (86)  | \$ 83                     | \$ (35) |
| Effective tax rate                   | -118.2%                     | 32.6%    | 18.1%                     | 71.4%   |

For the six months ended June 30, 2014, the Company's effective tax rate applied to its pre-tax income was lower than the U.S. statutory tax rate primarily as a result of the decrease in the valuation allowance against its deferred tax asset.

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

The Company's provision for income taxes for interim financial periods is not based on an estimated annual effective rate due to the variability in fair value of its credit derivatives, which prevents the Company from projecting a reliable estimated annual effective tax rate and pretax income for the full year of 2014. A discrete calculation of the provision is calculated for each interim period.

**Deferred Tax Asset, Net of Valuation Allowance**

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

As of June 30, 2014, the Company reported a net deferred tax asset of \$950 million, net of a \$7 million valuation allowance. This valuation allowance related to losses from asset impairments. As of December 31, 2013, the valuation allowance against a portion of the deferred tax asset was \$93 million. This decrease in the valuation allowance was primarily due to sales of previously impaired assets.

In accordance with ASU 2013-11, the netting of deferred taxes between different taxpaying jurisdictions is not permitted. As of June 30, 2014, there was a gross deferred tax asset of \$986 million and a gross deferred tax liability of \$36 million, which was included in "Other liabilities" on the Company's consolidated balance sheet.

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 9: Income Taxes (continued)**

###### ***Tax Sharing Agreement***

The Company has a tax sharing agreement among its members effective January 1, 1987. The agreement was amended and restated effective September 8, 2011 to change the method of calculating each domestic insurer's tax liability to the method permitted by paragraph 3(a) of Department Circular Letter #33 (1979). The agreement was submitted to the NYSDFS for review and non-disapproval pursuant to Section 1505 of the New York Insurance Law. Refer to "Note 2: Significant Accounting Policies" in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, for further discussion on the Company's tax sharing agreement.

###### ***Accounting for Uncertainty in Income Taxes***

The Company's policy is to record and disclose any change in UTB and related interest and/or penalties to income tax in the consolidated statements of operations. The Company includes interest as a component of income tax expense. The amounts in the table below do not include accrued interest of \$2 million. All amounts below are reflected before any applicable tax benefit.

| In millions                                                                                |              |
|--------------------------------------------------------------------------------------------|--------------|
| Unrecognized tax benefit as of December 31, 2013                                           | \$ 65        |
| The gross amount of the increase/(decrease) in the UTB as a result of tax positions taken: |              |
| During a prior year                                                                        | -            |
| During the current year                                                                    | 16           |
| The amounts of decreases in the UTB related to settlements with taxing authorities         | -            |
| The reduction in the UTB as a result of the applicable statute of limitations              | -            |
| Unrecognized tax benefit as of June 30, 2014                                               | <u>\$ 81</u> |

The Company does not anticipate any amount to reverse in the next twelve months based on settling certain issues.

In 2013, the Internal Revenue Service ("IRS") contacted the Company to review the 2011 consolidated return of MBIA Inc. and its subsidiaries, for the purpose of determining whether to formally examine the tax return. In July of 2014, the IRS concluded its review of the 2011 consolidated tax return with no changes to taxable income.

The U.K. tax authorities are currently auditing tax years 2005 through 2011. On June 5, 2013, the Company met with the HM Revenue & Customs ("HMRC"). During the third and fourth quarters of 2013 the Company sent HMRC additional information supporting its position. On January 24, 2014, the Company provided an independent report to HMRC. On April 8, 2014, HMRC responded with comments. The Company has responded to HMRC's April letter and anticipates another meeting with HMRC. As of June 30, 2014, there has been no resolution.

During 2013, the Company met with New York State Department of Taxation and Finance to discuss the Company's respective tax positions regarding certain issues related to the 2008 tax year. As of June 30, 2014, there has been no resolution.

As of December 31, 2013, the Company's NOL is approximately \$2.8 billion which will expire between tax years 2029 through 2033. As of December 31, 2013, the Company has an alternative minimum tax credit carryforward of \$22 million, which does not expire. As a result of the commutation of CMBS exposure that occurred during the six months ended June 30, 2014, the Company's NOL is approximately \$3.4 billion as of June 30, 2014.

###### ***Treatment of Undistributed Earnings of Certain Foreign Subsidiaries – "Accounting for Income Taxes – Special Areas"***

U.S. deferred income taxes are provided on the differences in the book and tax basis in the Company's investment in MBIA UK and certain other entities since the Company no longer intends to have these earnings permanently reinvested. The impact is reflected in the Company's current period's provision.

##### **Note 10: Business Segments**

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

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### **MBIA Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements (Unaudited)**

##### **Note 10: Business Segments (continued)**

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

##### *U.S. Public Finance Insurance*

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

##### *Structured Finance and International Insurance*

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

- MBIA Inc.;
- MBIA Global Funding, LLC ("GFL");
- MBIA Investment Management Corp. ("IMC"); and
- LaCrosse Financial Products, LLC, a wholly-owned affiliate, in which MBIA Corp. has written insurance policies guaranteeing the obligations under CDS, including termination payments that may become due upon certain events including the insolvency or payment default of the financial guarantor or the CDS issuer.

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

##### *Advisory Services*

The advisory services segment primarily consists of the operations of Cutwater Investor Services Corp. ("Cutwater-ISC") and Cutwater Asset Management Corp. ("Cutwater-AMC"). Cutwater-ISC and Cutwater-AMC provide advisory services, including cash management, discretionary asset management and structured products on a fee-for-service basis. Cutwater offers these services to public, not-for-profit, corporate and financial services clients, including MBIA Inc. and its subsidiaries, as well as portfolio accounting and reporting services. Cutwater-ISC and Cutwater-AMC are Securities and Exchange Commission registered investment advisers. Cutwater-AMC is also a Financial Industry Regulatory Authority member firm. During the six months ended June 30, 2014, the Company exited the advisory and asset management services business in the European Union.

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**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 10: Business Segments (continued)**
*Corporate*

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

*Wind-down Operations*

The Company's wind-down operations consist of the asset/liability products and conduit segments. The asset/liability products segment principally consists of the activities of MBIA Inc., IMC and GFL. IMC, along with MBIA Inc., provided customized investment agreements. It also provided customized products for funds that are invested as part of asset-backed or structured product transactions. GFL raised funds through the issuance of MTNs with varying maturities, which were, in turn, guaranteed by MBIA Corp. GFL lent the proceeds of these MTN issuances to MBIA Inc.

The Company's conduit segment was operated through Meridian Funding Company, LLC ("Meridian") and administered through MBIA Asset Finance, LLC. Assets financed by Meridian were funded by MTNs. During the six months ended June 30, 2014, the Company retired Meridian's remaining \$129 million of outstanding MTNs, which resulted in a gain on extinguishment of debt of \$4 million, and completed the winding down of the business. Meridian was dissolved during the second quarter of 2014.

**Segments Results**

The following tables provide the Company's segment results for the three months ended June 30, 2014 and 2013:

| In millions                                                                    | Three Months Ended June 30, 2014    |                                                         |                      |           |                         |                           |              |
|--------------------------------------------------------------------------------|-------------------------------------|---------------------------------------------------------|----------------------|-----------|-------------------------|---------------------------|--------------|
|                                                                                | U.S. Public<br>Finance<br>Insurance | Structured<br>Finance and<br>International<br>Insurance | Advisory<br>Services | Corporate | Wind-down<br>Operations | Eliminations              | Consolidated |
| Revenues <sup>(1)</sup>                                                        | \$ 84                               | \$ 43                                                   | \$ 4                 | \$ (2)    | \$ 6                    | \$ -                      | \$ 135       |
| Net change in fair value of insured derivatives                                | -                                   | (47)                                                    | -                    | -         | -                       | -                         | (47)         |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 15                                  | 13                                                      | 1                    | 52        | (20)                    | -                         | 61           |
| Net gains (losses) on extinguishment of debt                                   | -                                   | -                                                       | -                    | -         | 2                       | -                         | 2            |
| Revenues of consolidated VIEs                                                  | -                                   | 31                                                      | -                    | 5         | -                       | -                         | 36           |
| Inter-segment revenues <sup>(2)</sup>                                          | 11                                  | 13                                                      | 6                    | 67        | (2)                     | (95)                      | -            |
| Total revenues                                                                 | 110                                 | 53                                                      | 11                   | 122       | (14)                    | (95)                      | 187          |
| Losses and loss adjustment                                                     | 17                                  | (5)                                                     | -                    | -         | -                       | -                         | 12           |
| Operating                                                                      | 11                                  | 16                                                      | 11                   | 18        | 1                       | -                         | 57           |
| Interest                                                                       | -                                   | 27                                                      | -                    | 11        | 14                      | -                         | 52           |
| Expenses of consolidated VIEs                                                  | -                                   | 11                                                      | -                    | -         | -                       | -                         | 11           |
| Inter-segment expenses <sup>(2)</sup>                                          | 20                                  | 16                                                      | 2                    | 5         | 11                      | (54)                      | -            |
| Total expenses                                                                 | 48                                  | 65                                                      | 13                   | 34        | 26                      | (54)                      | 132          |
| Income (loss) before income taxes                                              | \$ 62                               | \$ (12)                                                 | \$ (2)               | \$ 88     | \$ (40)                 | \$ (41)                   | \$ 55        |
| Identifiable assets                                                            | \$ 6,194                            | \$ 10,787                                               | \$ 38                | \$ 1,173  | \$ 1,498                | \$ (3,666) <sup>(3)</sup> | \$ 16,024    |

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

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

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

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 10: Business Segments (continued)**

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

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

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

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

The following tables provide the Company's segment results for the six months ended June 30, 2014 and 2013:

| In millions                                                                    | Six Months Ended June 30, 2014 |                                                |                   |           |                      |                           |              |
|--------------------------------------------------------------------------------|--------------------------------|------------------------------------------------|-------------------|-----------|----------------------|---------------------------|--------------|
|                                                                                | U.S. Public Finance Insurance  | Structured Finance and International Insurance | Advisory Services | Corporate | Wind-down Operations | Eliminations              | Consolidated |
| Revenues <sup>(1)</sup>                                                        | \$ 172                         | \$ 77                                          | \$ 7              | \$ 6      | \$ 15                | \$ -                      | \$ 277       |
| Net change in fair value of insured derivatives                                | 1                              | 421                                            | -                 | -         | -                    | -                         | 422          |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 19                             | 10                                             | (3)               | 38        | (58)                 | -                         | 6            |
| Net gains (losses) on extinguishment of debt                                   | -                              | -                                              | -                 | -         | 3                    | -                         | 3            |
| Other net realized gains (losses)                                              | -                              | -                                              | -                 | 1         | -                    | -                         | 1            |
| Revenues of consolidated VIEs                                                  | -                              | 51                                             | -                 | -         | 4                    | -                         | 55           |
| Inter-segment revenues <sup>(2)</sup>                                          | 23                             | 25                                             | 12                | 83        | (5)                  | (138)                     | -            |
| Total revenues                                                                 | 215                            | 584                                            | 16                | 128       | (41)                 | (138)                     | 764          |
| Losses and loss adjustment                                                     | 3                              | 59                                             | -                 | -         | -                    | -                         | 62           |
| Operating                                                                      | 20                             | 32                                             | 22                | 38        | 1                    | -                         | 113          |
| Interest                                                                       | -                              | 54                                             | -                 | 20        | 32                   | -                         | 106          |
| Expenses of consolidated VIEs                                                  | -                              | 24                                             | -                 | -         | -                    | -                         | 24           |
| Inter-segment expenses <sup>(2)</sup>                                          | 38                             | 35                                             | 3                 | 10        | 13                   | (99)                      | -            |
| Total expenses                                                                 | 61                             | 204                                            | 25                | 68        | 46                   | (99)                      | 305          |
| Income (loss) before income taxes                                              | \$ 154                         | \$ 380                                         | \$ (9)            | \$ 60     | \$ (87)              | \$ (39)                   | \$ 459       |
| Identifiable assets                                                            | \$ 6,194                       | \$ 10,787                                      | \$ 38             | \$ 1,173  | \$ 1,498             | \$ (3,666) <sup>(3)</sup> | \$ 16,024    |

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

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

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

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 10: Business Segments (continued)**

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

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

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

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

Premiums on financial guarantees and insured derivatives reported within the Company's insurance segments are generated within and outside the U.S. The following table summarizes premiums earned on financial guarantees and insured derivatives by geographic location of risk for the three and six months ended June 30, 2014 and 2013:

| In millions                       | Three Months Ended June 30, |        | Six Months Ended June 30, |        |
|-----------------------------------|-----------------------------|--------|---------------------------|--------|
|                                   | 2014                        | 2013   | 2014                      | 2013   |
| Total premiums earned:            |                             |        |                           |        |
| United States                     | \$ 71                       | \$ 109 | \$ 138                    | \$ 215 |
| United Kingdom                    | 10                          | 9      | 19                        | 17     |
| Europe (excluding United Kingdom) | 1                           | 3      | 4                         | 6      |
| Internationally diversified       | 1                           | 3      | 3                         | 6      |
| Central and South America         | 7                           | 7      | 16                        | 15     |
| Asia                              | 1                           | 1      | 2                         | 2      |
| Other                             | 2                           | 2      | 4                         | 4      |
| Total                             | \$ 93                       | \$ 134 | \$ 186                    | \$ 265 |

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 10: Business Segments (continued)**

The following tables provide the results of the segments within the wind-down operations for the three months ended June 30, 2014 and 2013:

| In millions                                                                    | Three Months Ended June 30, 2014 |             |              | Total Wind-down Operations |
|--------------------------------------------------------------------------------|----------------------------------|-------------|--------------|----------------------------|
|                                                                                | Asset / Liability Products       | Conduits    | Eliminations |                            |
| Revenues <sup>(1)</sup>                                                        | \$ 6                             | \$ -        | \$ -         | \$ 6                       |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (20)                             | -           | -            | (20)                       |
| Net gains (losses) on extinguishment of debt                                   | 2                                | -           | -            | 2                          |
| Inter-segment revenues <sup>(2)</sup>                                          | (2)                              | -           | -            | (2)                        |
| Total revenues                                                                 | (14)                             | -           | -            | (14)                       |
| Operating                                                                      | 1                                | -           | -            | 1                          |
| Interest                                                                       | 14                               | -           | -            | 14                         |
| Inter-segment expenses <sup>(2)</sup>                                          | 2                                | 9           | -            | 11                         |
| Total expenses                                                                 | 17                               | 9           | -            | 26                         |
| Income (loss) before income taxes                                              | \$ (31)                          | \$ (9)      | \$ -         | \$ (40)                    |
| Identifiable assets                                                            | <u>\$1,498</u>                   | <u>\$ -</u> | <u>\$ -</u>  | <u>\$ 1,498</u>            |

(1) - Represents the sum of third-party interest income, investment management services fees and other fees.

(2) - Represents intercompany asset management fees and expenses plus intercompany interest income and expense pertaining to intercompany debt.

| In millions                                                                    | Three Months Ended June 30, 2013 |               |              | Total Wind-down Operations |
|--------------------------------------------------------------------------------|----------------------------------|---------------|--------------|----------------------------|
|                                                                                | Asset / Liability Products       | Conduits      | Eliminations |                            |
| Revenues <sup>(1)</sup>                                                        | \$ 6                             | \$ -          | \$ -         | \$ 6                       |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (12)                             | -             | -            | (12)                       |
| Revenues of consolidated VIEs                                                  | -                                | 5             | -            | 5                          |
| Inter-segment revenues <sup>(2)</sup>                                          | -                                | (7)           | 7            | -                          |
| Total revenues                                                                 | (6)                              | (2)           | 7            | (1)                        |
| Operating                                                                      | 1                                | -             | -            | 1                          |
| Interest                                                                       | 20                               | -             | -            | 20                         |
| Expenses of consolidated VIEs                                                  | -                                | 2             | -            | 2                          |
| Inter-segment expenses <sup>(2)</sup>                                          | 2                                | -             | -            | 2                          |
| Total expenses                                                                 | 23                               | 2             | -            | 25                         |
| Income (loss) before income taxes                                              | <u>\$ (29)</u>                   | <u>\$ (4)</u> | <u>\$ 7</u>  | <u>\$ (26)</u>             |
| Identifiable assets                                                            | <u>\$1,638</u>                   | <u>\$ 359</u> | <u>\$ 12</u> | <u>\$ 2,009</u>            |

(1) - Represents the sum of third-party interest income, investment management services fees and other fees.

(2) - Represents intercompany asset management fees and expenses plus intercompany interest income and expense pertaining to intercompany debt.

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 10: Business Segments (continued)**

The following tables provide the results of the segments within the wind-down operations for the six months ended June 30, 2014 and 2013:

| In millions                                                                    | Six Months Ended June 30, 2014 |          |              | Total Wind-down Operations |
|--------------------------------------------------------------------------------|--------------------------------|----------|--------------|----------------------------|
|                                                                                | Asset / Liability Products     | Conduits | Eliminations |                            |
| Revenues <sup>(1)</sup>                                                        | \$ 15                          | \$ -     | \$ -         | \$ 15                      |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (58)                           | -        | -            | (58)                       |
| Net gains (losses) on extinguishment of debt                                   | 3                              | -        | -            | 3                          |
| Revenues of consolidated VIEs                                                  | -                              | 4        | -            | 4                          |
| Inter-segment revenues <sup>(2)</sup>                                          | (4)                            | (1)      | -            | (5)                        |
| Total revenues                                                                 | (44)                           | 3        | -            | (41)                       |
| Operating                                                                      | 1                              | -        | -            | 1                          |
| Interest                                                                       | 32                             | -        | -            | 32                         |
| Inter-segment expenses <sup>(2)</sup>                                          | 4                              | 9        | -            | 13                         |
| Total expenses                                                                 | 37                             | 9        | -            | 46                         |
| Income (loss) before income taxes                                              | \$ (81)                        | \$ (6)   | \$ -         | \$ (87)                    |
| Identifiable assets                                                            | \$1,498                        | \$ -     | \$ -         | \$ 1,498                   |

(1) - Represents the sum of third-party interest income, investment management services fees and other fees.

(2) - Represents intercompany asset management fees and expenses plus intercompany interest income and expense pertaining to intercompany debt.

| In millions                                                                    | Six Months Ended June 30, 2013 |          |              | Total Wind-down Operations |
|--------------------------------------------------------------------------------|--------------------------------|----------|--------------|----------------------------|
|                                                                                | Asset / Liability Products     | Conduits | Eliminations |                            |
| Revenues <sup>(1)</sup>                                                        | \$ 15                          | \$ -     | \$ -         | \$ 15                      |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (9)                            | -        | -            | (9)                        |
| Net gains (losses) on extinguishment of debt                                   | 4                              | -        | -            | 4                          |
| Revenues of consolidated VIEs                                                  | -                              | 7        | -            | 7                          |
| Inter-segment revenues <sup>(2)</sup>                                          | (2)                            | (7)      | 7            | (2)                        |
| Total revenues                                                                 | 8                              | -        | 7            | 15                         |
| Operating                                                                      | 1                              | -        | -            | 1                          |
| Interest                                                                       | 40                             | -        | -            | 40                         |
| Expenses of consolidated VIEs                                                  | -                              | 4        | -            | 4                          |
| Inter-segment expenses <sup>(2)</sup>                                          | 4                              | 11       | -            | 15                         |
| Total expenses                                                                 | 45                             | 15       | -            | 60                         |
| Income (loss) before income taxes                                              | \$ (37)                        | \$ (15)  | \$ 7         | \$ (45)                    |
| Identifiable assets                                                            | \$1,638                        | \$ 359   | \$ 12        | \$ 2,009                   |

(1) - Represents the sum of third-party interest income, investment management services fees and other fees.

(2) - Represents intercompany asset management fees and expenses plus intercompany interest income and expense pertaining to intercompany debt.

**MBIA Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited)**
**Note 11: Earnings Per Share**

Earnings per share is calculated using the two-class method in which earnings are allocated to common stock and participating securities based on their rights to receive nonforfeitable dividends or dividend equivalents. The Company grants restricted stock and restricted stock units to certain employees and non-employee directors in accordance with the Company's long-term incentive programs, which entitle the participants to receive nonforfeitable dividends or dividend equivalents during the vesting period on the same basis as those dividends are paid to common shareholders. These unvested stock awards represent participating securities. During periods of net income, the calculation of earnings per share exclude the income attributable to participating securities in the numerator and the dilutive impact of these securities from the denominator. During periods of net loss, no effect is given to participating securities in the numerator and the denominator excludes the dilutive impact of these securities since they do not share in the losses of the Company.

Basic earnings per share excludes dilution and is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the dilutive effect of all stock options, warrants and unvested restricted stock outstanding during the period that could potentially result in the issuance of common stock. The dilution from stock options, warrants and unvested restricted stock are calculated by applying the two-class method and using the treasury stock method. The treasury stock method assumes the proceeds from the exercise of stock options and warrants or the unrecognized compensation expense from unvested restricted stock will be used to purchase shares of the Company's common stock at the average market price during the period. For the three months ended June 30, 2014 and 2013, there were 32,475,786 and 43,523,338, respectively, of stock options, warrants and unvested restricted stock outstanding that were antidilutive. For the six months ended June 30, 2014 and 2013, there were 31,495,902 and 45,239,346, respectively, of stock options, warrants and unvested restricted stock outstanding that were antidilutive.

The following table presents the computation of basic and diluted earnings per share for the three and six months ended June 30, 2014 and 2013:

| \$ in millions except share and per share amounts                  | Three Months Ended June 30, |                  | Six Months Ended June 30, |                  |
|--------------------------------------------------------------------|-----------------------------|------------------|---------------------------|------------------|
|                                                                    | 2014                        | 2013             | 2014                      | 2013             |
| <b>Basic earnings per share:</b>                                   |                             |                  |                           |                  |
| Net income (loss)                                                  | \$ 120                      | \$ (178)         | \$ 376                    | \$ (14)          |
| Less: undistributed earnings allocated to participating securities | 4                           | -                | 10                        | -                |
| Net income (loss) available to common shareholders                 | 116                         | (178)            | 366                       | (14)             |
| Basic weighted average shares <sup>(1)</sup>                       | 189,169,042                 | 189,163,527      | 189,101,884               | 189,135,587      |
| Net income (loss) per basic common share                           | <u>\$ 0.61</u>              | <u>\$ (0.94)</u> | <u>\$ 1.93</u>            | <u>\$ (0.07)</u> |
| <b>Diluted earnings per share:</b>                                 |                             |                  |                           |                  |
| Net income (loss)                                                  | 120                         | (178)            | 376                       | (14)             |
| Less: undistributed earnings allocated to participating securities | 3                           | -                | 9                         | -                |
| Less: mark-to-market gain (loss) on warrants                       | 30                          | -                | 14                        | -                |
| Net income (loss) available to common shareholders                 | 87                          | (178)            | 353                       | (14)             |
| Basic weighted average shares <sup>(1)</sup>                       | 189,169,042                 | 189,163,527      | 189,101,884               | 189,135,587      |
| Effect of common stock equivalents:                                |                             |                  |                           |                  |
| Stock options                                                      | 1,111,816                   | -                | 1,170,182                 | -                |
| Warrants                                                           | 2,626,013                   | -                | 2,779,370                 | -                |
| Diluted weighted average shares                                    | 192,906,871                 | 189,163,527      | 193,051,436               | 189,135,587      |
| Net income (loss) per diluted common share                         | <u>\$ 0.45</u>              | <u>\$ (0.94)</u> | <u>\$ 1.83</u>            | <u>\$ (0.07)</u> |

(1) - Includes 270,443 and 549,265 of participating securities that met the service condition and were eligible to receive nonforfeitable dividends or dividend equivalents for the three months ended June 30, 2014 and 2013, respectively. Includes 337,827 and 628,692 of participating securities that met the service condition and were eligible to receive nonforfeitable dividends or dividend equivalents for the six months ended June 30, 2014 and 2013, respectively.

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**MBIA Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 12: Accumulated Other Comprehensive Income**

The following table presents the changes in the components of AOCI for the six months ended June 30, 2014:

| In millions                                                | Unrealized Gains (Losses) on AFS Securities, Net | Foreign Currency Translation, Net | Total   |
|------------------------------------------------------------|--------------------------------------------------|-----------------------------------|---------|
| Balance, December 31, 2013                                 | \$ (96)                                          | \$ 10                             | \$ (86) |
| Other comprehensive income (loss) before reclassifications | 120                                              | 4                                 | 124     |
| Amounts reclassified from AOCI                             | 14                                               | 4                                 | 18      |
| Total other comprehensive income (loss)                    | 134                                              | 8                                 | 142     |
| Balance, June 30, 2014                                     | \$ 38                                            | \$ 18                             | \$ 56   |

The following table presents the details of the reclassifications from AOCI for the three and six months ended June 30, 2014 and 2013:

| In millions                                           | Amounts Reclassified from AOCI |        |                              |       | Affected Line Item on the Consolidated Statements of Operations                |
|-------------------------------------------------------|--------------------------------|--------|------------------------------|-------|--------------------------------------------------------------------------------|
|                                                       | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |       |                                                                                |
| Details about AOCI Components                         | 2014                           | 2013   | 2014                         | 2013  |                                                                                |
| Unrealized gains (losses) on AFS securities:          |                                |        |                              |       |                                                                                |
| Realized gain (loss) on sale of securities            | \$ (19)                        | \$ -   | \$ (20)                      | \$ 26 | Net gains (losses) on financial instruments at fair value and foreign exchange |
| Amortization on securities                            | (1)                            | (2)    | (2)                          | (3)   | Net investment income                                                          |
|                                                       | (20)                           | (2)    | (22)                         | 23    | Income (loss) before income taxes                                              |
|                                                       | (7)                            | (1)    | (8)                          | 8     | Provision (benefit) for income taxes                                           |
|                                                       | (13)                           | (1)    | (14)                         | 15    | Net income (loss)                                                              |
| Foreign currency translation:                         |                                |        |                              |       |                                                                                |
| Realized gain (loss) on liquidation of foreign entity | -                              | -      | (4)                          | -     | Net gains (losses) on financial instruments at fair value and foreign exchange |
| Total reclassifications for the period                | \$ (13)                        | \$ (1) | \$ (18)                      | \$ 15 | Net income (loss)                                                              |

**Note 13: Commitments and Contingencies**

The following commitments and contingencies provide an update of those discussed in "Note 21: Commitments and Contingencies" in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, and should be read in conjunction with the complete descriptions provided in the aforementioned Form 10-K.

**Litigation**

*MBIA Insurance Corp. v. Credit Suisse Securities (USA) LLC, et al.*; Index No. 603751/2009 (N.Y. Sup. Ct., N.Y. County)

On March 21, 2014, the court issued an order scheduling fact discovery to close in August of 2014. On June 24, 2014, the court granted MBIA Corp.'s motion to prove liability and damages through sampling.

*MBIA Insurance Corp. v. J.P. Morgan Securities LLC (f/k/a Bear, Stearns & Co. Inc.)*; Index No. 64676/2012 (N.Y. Sup. Ct., County of Westchester)

On May 6, 2014, the court granted J.P. Morgan's motion for summary judgment and also granted MBIA Corp. leave to file a motion to submit an amended complaint within twenty days of the court's decision. The briefing on MBIA Corp.'s motion for leave to amend its complaint was completed on July 21, 2014.

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**MBIA Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 13: Commitments and Contingencies (continued)**

*CQS ABS Master Fund Ltd., CQS Select ABS Master Fund Ltd., and CQS ABS Alpha Master Fund Ltd. v. MBIA Inc. et al.*; Civil Action No. 12-cv-6840 (R.S.) (S.D.N.Y.)

In May of 2014, the CQS plaintiffs and MBIA filed a Stipulation of Dismissal with prejudice resolving the litigation and the case has been closed on the court's docket. MBIA paid to CQS an immaterial amount to resolve the litigation.

*Ambac Bond Insurance Coverage Cases*, Coordinated Proceeding Case No. JCCP 4555 (Super. Ct. of Cal., County of San Francisco)

On March 26, 2014, the court granted in part the Bond Insurer defendants' motions for reimbursement of legal fees incurred in connection with the defendants' motion to strike pursuant to California's Anti-SLAPP statute, which dismissed the plaintiffs' claims under California's Cartwright Act. On July 7, 2014, the Bond Insurer defendants filed their opening appellate brief with respect to a portion of the plaintiffs' Unfair Competition Law claim.

*National Public Finance Guarantee Corp. et al. v City of Detroit, Michigan et al.*; Adv. Pro. No 13-05309-swr (Bkcy. E.D. MI)

In April of 2014, National reached a settlement with the City of Detroit regarding its enhanced Unlimited Tax General Obligation ("Detroit UTGOs"). Pursuant to the settlement, which remains subject to bankruptcy court approval, the City of Detroit has agreed to "reinstate" \$288 million of Detroit UTGOs, of which approximately \$69 million will be insured by National. At the time of the bankruptcy filing, there were \$369 million of Detroit UTGOs outstanding, of which \$88 million were insured by National. If approved, the reinstated Detroit UTGOs will benefit from a court order confirming their secured status. In addition, the Detroit UTGOs will receive additional security in the form of a fourth lien on Distributable State Aid from the State of Michigan.

*National Public Finance Guarantee Corp. et al. v. Harris County - Houston Sports Authority et al.*; Case No. 2013-05824 (Dist. Ct. of Harris County, 215 Judicial Dist.)

On April 15, 2014, the Texas First District Court of Appeals reversed the decision of the trial court dismissing the case on grounds of governmental immunity. National's claims against the Sports Authority have been remanded back to the trial court.

The Company is defending against the aforementioned actions in which it is a defendant and expects ultimately to prevail on the merits. There is no assurance, however, that the Company will prevail in these actions. Adverse rulings in these actions could have a material adverse effect on the Company's ability to implement its strategy and on its business, results of operations, cash flows and financial condition. At this stage of the litigation, there has not been a determination as to the amount, if any, of damages. Accordingly, the Company is not able to estimate any amount of loss or range of loss.

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.

**Headquarters Lease Agreement**

In March of 2014, the Company entered into a lease agreement for its new headquarters at a property located in Purchase, New York as part of the Company's cost reduction measures that included the plan to sell the Armonk, New York facility classified as held for sale. The initial lease term expires in 2030 with the option to terminate the lease in 2025 upon the payment of a termination amount. At the end of the initial lease term, the Company has the option to extend the term of the lease for two additional terms of five years at a fixed annual rent based on the fair market rent at the time of any extension. The total future minimum lease payments over the initial lease term are \$42 million. The Company will receive a lease incentive amount of \$6 million from the property owner to fund certain leasehold improvements. The total future minimum lease payments include annual rent escalation amounts and a free rent period and exclude the lease incentive amount. The lease agreement has been classified as an operating lease, and operating rent expense is recognized on a straight-line basis beginning in the second quarter of 2014.

**Note 14: Subsequent Events**

Refer to "Note 13: Commitments and Contingencies" for information about legal proceedings that occurred after June 30, 2014.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### INTRODUCTION

MBIA Inc. ("MBIA", the "Company", "we", "us", or "our") operates one of the largest financial guarantee insurance businesses in the industry and is a provider of asset management and advisory services. These activities are managed through three business segments: United States ("U.S.") public finance insurance; structured finance and international insurance; and advisory services. Our U.S. public finance insurance business is primarily operated through National Public Finance Guarantee Corporation (together with its subsidiaries, "National"), our structured finance and international insurance business is primarily operated through MBIA Insurance Corporation and its subsidiaries ("MBIA Corp."), and our asset management and advisory services business is primarily operated through Cutwater Holdings, LLC and its subsidiaries ("Cutwater"). Unless otherwise indicated or the context otherwise requires, references to "MBIA Corp." are to MBIA Insurance Corporation, together with its subsidiaries, MBIA UK Insurance Limited ("MBIA UK") and MBIA Mexico S.A. de C.V. We also manage certain business activities through our corporate, asset/liability products, and conduit segments. Our corporate segment includes revenues and expenses that arise from general corporate activities. Funding programs managed through our asset/liability products and conduit segments have been in wind-down. During the second quarter of 2014, we completed the winding down of our conduit segment with the dissolution of Meridian Funding Company, LLC ("Meridian").

### EXECUTIVE OVERVIEW

#### *National*

National is the largest U.S. municipal-only bond insurer in the financial guarantee industry. Our primary strategy is to insure new issue and secondary market municipal bonds through National while providing ongoing surveillance of National's existing insured portfolio. National's ability to write new business and to compete with other financial guarantors is largely dependent on the financial strength ratings assigned to National by major rating agencies. During the six months ended June 30, 2014, Standard & Poor's Financial Services LLC ("S&P") upgraded National to AA- with a stable outlook, Moody's Investors Service, Inc. ("Moody's") upgraded National to a rating of A3 with a stable outlook, and subsequent to June 30, 2014, Moody's affirmed National's A3 rating and changed the outlook to negative. In addition, Kroll Bond Rating Agency assigned National a AA+ insurer financial strength rating with a stable outlook. With these current ratings, National has begun executing its business plan and seeks to support the credit enhancement needs of municipal debt issuers across the U.S.

National maintains underwriting criteria for most municipal risk types and expects opportunities for new business across the spectrum of municipal sectors. We expect that the majority of its new business will be in the general obligation, tax-backed and revenue bond sectors. In addition to the new issue market, there are attractive opportunities in the secondary market with respect to bonds issued in recent years which were not insured upon issuance and which meet our underwriting criteria.

National seeks to generate shareholder value through appropriate risk adjusted pricing; however, current market conditions and the competitive landscape may limit National's new business opportunities and its ability to price and underwrite risk with attractive returns. Financial guarantee insurance competes in nearly all instances with the issuer's alternative of foregoing insurance and paying a higher interest rate. If the interest savings from insurance are not greater than the cost of the insurance, the issuer will generally choose to issue bonds without insurance.

Prevailing interest rate levels can affect demand for financial guarantee insurance. Higher interest rates and higher levels of issuance of new municipal debt would present new business opportunities for National in the U.S. public finance market. Lower interest rates are typically accompanied by narrower spreads between insured and uninsured obligations. This is, in part, due to the fact that investors may choose to forego insurance to increase the yield on their investment. Therefore, the purchase of insurance during periods of relatively narrower interest rate spreads will generally provide lower cost savings to the issuer than during periods of relatively wider spreads. These lower cost savings could be accompanied by a corresponding decrease in demand for financial guarantee insurance.

Given that National's insurance policies protect policyholders from potential defaults and guarantee payments of scheduled principal and interest, we believe the increase in municipal stress will increase the demand for National's insurance product.

National has begun underwriting and pricing new business opportunities primarily through the daily competitive market calendar. The Company submits bid information for select transactions that are consistent with its risk appetite. National also expects to increase participation in the negotiated market as it re-engages with the public finance market.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**EXECUTIVE OVERVIEW (continued)**

While our U.S. public finance insured portfolio in National continued to perform satisfactorily on the whole, some of the obligations that we insure were issued by state and local governments and territories that are now under financial and budgetary stress. In addition, a few of these local governments have filed for protection under Chapter 9 of the United States Bankruptcy Code or have entered into state statutory proceedings established to assist municipalities in managing through periods of severe fiscal stress. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments on a greater number of our insured transactions. We continue to monitor and analyze these situations and other stressed credits closely, and the overall extent and duration of this stress is uncertain.

One example of an issuer in significant financial distress is the City of Detroit, which filed for Chapter 9 protection in July of 2013. Following the bankruptcy filing, and after months of court-ordered mediation, in April of 2014, National and other financial guarantee insurers reached a settlement with the City of Detroit regarding its insured Unlimited Tax General Obligation bonds ("Detroit UTGOs"). At the time of the bankruptcy filing, there were \$369 million of Detroit UTGOs outstanding, of which \$88 million were insured by National. Pursuant to the settlement, which remains subject to bankruptcy court approval, the City of Detroit has agreed to "reinstate" \$288 million of Detroit UTGOs, of which approximately \$69 million will be insured by National. If approved, the reinstated Detroit UTGOs will benefit from a court order confirming their secured status. In addition, the Detroit UTGOs will receive additional security in the form of a fourth lien on Distributable State Aid from the State of Michigan.

National has also insured \$1.0 billion of Detroit Water Supply System Revenue Bonds and \$1.2 billion of Detroit Sewage Disposal Bonds (together, the "DWSD Bonds") that are also subject to Detroit's Chapter 9 proceeding. Detroit's current plan seeks to impair certain of the DWSD Bonds by eliminating call protection, which would allow an early redemption of the bonds, and, in some cases, resetting interest rates below current levels. If approved by the bankruptcy court, and depending on certain key facts and circumstances, this could result in National incurring a loss on the DWSD Bonds. We do not believe that the City's current treatment of the DWSD bonds is confirmable, and as a result, do not believe a claim is likely to arise in connection with the DWSD Bonds as a result of changed interest rates or early redemption. We do not believe that applicable law permits the City to take actions that would impair "special revenue" bonds, like the DWSD Bonds, which are entitled to additional protections under the bankruptcy code. Accordingly, National has voted with respect to its DWSD claims to "reject" the plan and filed an objection to plan confirmation. A plan confirmation hearing is scheduled to begin at the end of August of 2014.

National also has exposure to the Commonwealth of Puerto Rico and certain of its instrumentalities ("Puerto Rico"). Puerto Rico is experiencing fiscal stress. However it has taken pro-active actions to address its significant economic challenges, including the passage of the first balanced general fund budget in 22 years for the fiscal year ending June 30, 2015, the passage of comprehensive reform of its employee retirement system, and the recent enactment of the Fiscal Sustainability Act, which allows the government to exercise emergency powers to deal with its fiscal crisis. Under this Act, the government could institute a number of steps to lower spending on government operations and labor by renegotiating its public employees' contracts. Given the fiscal and economic challenges that Puerto Rico is facing, we continue to monitor our exposures there closely. Refer to the "U.S. Public Finance Insurance Puerto Rico Exposures" section for additional information on our Puerto Rico exposures by bond type.

***MBIA Inc.***

As of June 30, 2014 and December 31, 2013, the liquidity position of MBIA Inc., which consists of the liquidity positions of its corporate and asset/liability products segments, was \$365 million and \$359 million, respectively. During the six months ended June 30, 2014, \$202 million was released to MBIA Inc. under the MBIA group's tax sharing agreement (the "Tax Escrow Account"). Also, during the six months ended June 30, 2014, we repurchased \$122 million of debt issued by MBIA Inc. through its subsidiary MBIA Global Funding, LLC ("GFL") and retired \$129 million of medium-term notes ("MTNs") issued by our conduit segment. These repurchases or redemptions are part of our strategy to bring our leverage down using cash generated from operations. In addition, during the six months ended June 30, 2014, we repurchased \$9 million of common shares of MBIA Inc. and subsequent to June 30, 2014, repurchased the remaining \$14 million available under the share repurchase program. We expect that MBIA Inc. will generate sufficient cash to satisfy its debt obligations and its general corporate needs over time from expected subsidiary dividends and additional anticipated releases from the Tax Escrow Account however, there can be no assurance that such sources will generate sufficient cash. Refer to the "Liquidity—MBIA Inc. Liquidity" section for additional information on MBIA Inc.'s liquidity position.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**EXECUTIVE OVERVIEW (continued)**

***MBIA Corp.***

MBIA Corp.'s primary strategies are maximizing the value of its insured portfolio through the collection of excess spread and put-back recoveries and mitigating MBIA Corp.'s high risk insurance exposures policies. MBIA Corp. has significant negative earned surplus and does not have the statutory capital to pay dividends. In addition, as of July 15, 2014, there was \$232 million of accrued and unpaid interest on MBIA Corp.'s outstanding surplus notes, which was significantly in excess of the funds available to make payments on the surplus notes. Also, the New York State Department of Financial Services ("NYSDFS") has not permitted MBIA Corp. to pay interest on the surplus notes since July of 2012. As a result, management does not expect MBIA Corp. to pay dividends to MBIA Inc. or make payments to the surplus noteholders for the foreseeable future. MBIA Corp. does provide economic value with its contribution to the Company's net operating loss carryforward. Refer to the "Capital Resources-MBIA Corp." section for additional information on MBIA Corp.'s surplus notes and statutory capital.

During the six months ended June 30, 2014, MBIA Corp. commuted \$3.9 billion of gross par exposure, of which \$3.8 billion was previously disclosed, primarily comprising structured commercial mortgage-backed securities ("CMBS") pools, commercial real estate ("CRE") collateralized debt obligations ("CDOs"), and first-lien residential mortgage-backed securities ("RMBS"). Subsequent to June 30, 2014, we commuted \$238 million of gross par exposure, primarily related to asset-backed securities ("ABS") CDOs. We continue to evaluate opportunities to terminate or commute additional high risk insurance exposures, although our ability to commute is limited by available liquidity.

MBIA Corp.'s liquidity position was adequate during the six months ended June 30, 2014. MBIA Corp. continues to manage liquidity risk and satisfy all payment obligations when due. Our expected liquidity and capital forecasts for MBIA Corp. and projected collections of excess spread and the remaining put-back recoverable reflect more than adequate resources to pay expected claims. However, there are risks to these forecasts. If MBIA Corp. experiences higher than expected claim payments or lower collections of excess spread or put-back recoverables, it may ultimately have insufficient resources to continue to pay claims, which could cause the NYSDFS to put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding.

Management does not believe that a rehabilitation or liquidation proceeding of MBIA Insurance Corporation by the NYSDFS will have any significant long-term liquidity impact on MBIA Inc. or result in a liquidation or similar proceeding of MBIA UK. Refer to the "Liquidity-MBIA Corp. Liquidity" section for additional information on MBIA Corp.'s liquidity position.

***Other***

In March of 2014, we entered into a lease agreement for the Company's new headquarters. Refer to "Note 13: Commitments and Contingencies" in the Notes to Consolidated Financial Statements for further discussion of this lease agreement.

***Economic and Financial Market Trends***

The recovery in the U.S. economy was modest during the first half of 2014 with consumer spending and the housing sector improving from the harsh winter weather. Although the unemployment rate improved in the second quarter of 2014 to its lowest levels in almost six years, the growth in average wages has been slow. In the second quarter of 2014, the Federal Reserve continued reducing its monthly asset purchase program and to keep short-term interest rates low through 2014. Information concerning our interest rate sensitivity appears in Part I, Item 3, "Quantitative and Qualitative Disclosures about Market Risk." We believe consumer confidence and spending should improve throughout the rest of 2014 as wages rise and gains in full-time employment are made. However, to ensure sustained job growth and prosperity, we believe that Washington must exhibit greater long-term fiscal discipline and pursue countercyclical economic policies. Although economic growth and employment have shown signs of improvement throughout much of Europe, debt and budget issues, as well as lower-than-expected inflation, continue to pose risks to achieving sustained growth and a return to a robust economy in this region. In addition, the recent tension spurred on by the Ukraine crisis and the growing violence in the Middle East may further impede global growth.

Economic and financial market trends impact MBIA's business outlook and its financial results. An ongoing low interest rate environment will adversely impact the demand for municipal bond insurance as well as National's ability to price risk at levels that meet its underwriting objectives and return. However, the consistent gradual improvement of economic indicators at the state and local levels will benefit the performance of our insured public finance portfolio and could reduce the amount of National's incurred losses.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**EXECUTIVE OVERVIEW (continued)**

***Financial Highlights***

Our financial results, prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), have been volatile as a result of unrealized gains and losses from our insured credit derivatives, as well as a result of insured losses and recoveries on second-lien RMBS. Our economic performance may also be volatile depending on changes in our loss estimates based on changes in macroeconomic conditions in the U.S. and abroad and deviations in collateral performance from our expectations.

For the three months ended June 30, 2014, we recorded consolidated net income of \$120 million or \$0.45 per diluted share compared with a consolidated net loss of \$178 million, or \$0.94 per diluted share for the same period of 2013.

For the six months ended June 30, 2014, we recorded consolidated net income of \$376 million or \$1.83 per diluted share compared with a consolidated net loss of \$14 million, or \$0.07 per diluted share for the same period of 2013.

We also use adjusted pre-tax income (loss), a non-GAAP measure, to supplement our analysis of our periodic results. We consider adjusted pre-tax income (loss) a fundamental measure of periodic financial performance, which we believe is useful for an understanding of our results. Adjusted pre-tax income (loss) adjusts GAAP pre-tax income (loss) to remove the effects of consolidating insured variable interest entities ("VIEs") and gains and losses related to insured credit derivatives, which we believe will reverse over time, as well as to add in changes in the present value of insurance claims we expect to pay on insured credit derivatives based on our ongoing insurance loss monitoring. Adjusted pre-tax income (loss) is not a substitute for and should not be viewed in isolation of GAAP pre-tax income (loss), and our definition of adjusted pre-tax income (loss) may differ from that used by other companies. Refer to the following "Results of Operations" section for a reconciliation of adjusted pre-tax income (loss) to GAAP pre-tax income (loss).

For the three months ended June 30, 2014, consolidated adjusted pre-tax income was \$39 million compared with an adjusted pre-tax loss of \$160 million for the same period of 2013.

For the six months ended June 30, 2014, consolidated adjusted pre-tax loss was \$60 million compared with an adjusted pre-tax loss of \$180 million for the same period of 2013.

Our consolidated shareholders' equity increased to \$3.8 billion as of June 30, 2014 compared with \$3.3 billion as of December 31, 2013. Our consolidated book value per share as of June 30, 2014 was \$19.48 compared with \$17.05 as of December 31, 2013.

In addition to book value per share, we also analyze adjusted book value ("ABV") per share, a non-GAAP measure. We consider ABV a measure of fundamental value of the Company and the change in ABV an important measure of financial performance. ABV adjusts GAAP book value to remove the impact of certain items which the Company believes will reverse from GAAP book value over time through the GAAP statements of operations and GAAP statements of comprehensive income, as well as to add in the impact of certain items which the Company believes will be realized in GAAP book value in future periods. The Company has limited such adjustments to those items that it deems to be important to fundamental value and performance and which the likelihood and amount can be reasonably estimated. ABV assumes no new business activity. We have presented ABV to allow investors and analysts to evaluate the Company using the same measure that MBIA's management regularly uses to measure financial performance and value. ABV is not a substitute for and should not be viewed in isolation of GAAP book value, and our definition of ABV may differ from that used by other companies. Refer to the following "Results of Operations" section for a further discussion of ABV and a reconciliation of GAAP book value per share to ABV per share.

As of June 30, 2014, ABV per share was \$27.05, down from \$27.78 as of December 31, 2013. This decrease was primarily driven by insurance losses and credit impairments and an increase in common shares outstanding. This decrease was partially offset by a reduction in the valuation allowance against the Company's deferred tax asset from the sale of certain previously impaired assets.

A detailed discussion of our financial results is presented within the "Results of Operations" section included herein. Refer to the "Capital Resources—Insurance Statutory Capital" section for a discussion of National's and MBIA Corp.'s capital positions under statutory accounting principles ("U.S. STAT").

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**CRITICAL ACCOUNTING ESTIMATES**

We prepare our financial statements in accordance with GAAP, which requires the use of estimates and assumptions. Management has discussed and reviewed the development, selection, and disclosure of critical accounting estimates with the Company's Audit Committee. Management believes that the most critical accounting estimates, since these estimates require significant judgment, are loss and loss adjustment expense ("LAE") reserves, valuation of financial instruments, and deferred income taxes. Financial results could be materially different if other methodologies were used or if management modified its assumptions.

For a discussion of the Company's critical accounting estimates, see "Critical Accounting Estimates" in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. In addition, refer to "Note 5: Loss and Loss Adjustment Expense Reserves" in the Notes to Consolidated Financial Statements for a current description of estimates used in our insurance loss reserving process.

**RECENT ACCOUNTING PRONOUNCEMENTS**

Refer to "Note 3: Recent Accounting Pronouncements" in the Notes to Consolidated Financial Statements for a discussion of accounting guidance recently adopted by the Company.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS

#### Summary of Consolidated Results

The following table presents a summary of our consolidated financial results for the three and six months ended June 30, 2014 and 2013:

| In millions except for per share amounts              | Three Months Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                |
|-------------------------------------------------------|--------------------------------|-----------------|------------------------------|----------------|
|                                                       | 2014                           | 2013            | 2014                         | 2013           |
| Total revenues                                        | \$ 187                         | \$ 112          | \$ 764                       | \$ 331         |
| Total expenses                                        | 132                            | 376             | 305                          | 380            |
| Pre-tax income (loss)                                 | 55                             | (264)           | 459                          | (49)           |
| Provision (benefit) for income taxes                  | (65)                           | (86)            | 83                           | (35)           |
| Net income (loss)                                     | <u>\$ 120</u>                  | <u>\$ (178)</u> | <u>\$ 376</u>                | <u>\$ (14)</u> |
| Net income (loss) per common share:                   |                                |                 |                              |                |
| Basic                                                 | \$ 0.61                        | \$ (0.94)       | \$ 1.93                      | \$ (0.07)      |
| Diluted                                               | \$ 0.45                        | \$ (0.94)       | \$ 1.83                      | \$ (0.07)      |
| Weighted average number of common shares outstanding: |                                |                 |                              |                |
| Basic                                                 | 189,169,042                    | 189,163,527     | 189,101,884                  | 189,135,587    |
| Diluted                                               | 192,906,871                    | 189,163,527     | 193,051,436                  | 189,135,587    |

Consolidated total revenues for the three months ended June 30, 2014 included \$47 million of net losses on insured derivatives compared with \$182 million of net losses for the same period of 2013. The net losses on insured derivatives in 2014 were principally the result of claim payments and changes in spreads and pricing of underlying collateral, partially offset by the effects of changes in the weighted average lives on transactions. The net losses on insured derivatives in 2013 were principally the result of favorable changes in the market's perception of MBIA Corp.'s credit risk, partially offset by commuting derivatives at prices below fair value. Consolidated total expenses for the three months ended June 30, 2014 included \$12 million of net insurance loss and LAE compared with \$188 million for the same period of 2013. The decrease in net insurance loss and LAE was principally the result of the lower losses from an international road transaction and high yield corporate CDOs.

Consolidated total revenues for the six months ended June 30, 2014 included \$422 million of net gains on insured derivatives compared with \$243 million of net losses for the same period of 2013. The net gains on insured derivatives in 2014 were principally associated with the reversal of unrealized losses from commutations partially offset by settlement and claim payments. The net losses on insured derivatives in 2013 were principally the result of favorable changes in the market's perception of MBIA Corp.'s credit risk, partially offset by commuting derivatives at prices below fair value and a decline in the weighted average lives on transactions. Consolidated total expenses for the six months ended June 30, 2014 included \$62 million of net insurance loss and LAE compared with a benefit of \$6 million for the same period of 2013. The increase in net insurance loss and LAE in 2014 when compared with 2013 was principally related to decreases in recoveries of actual and expected payments related to second-lien RMBS transactions, partially offset by a decrease in losses for certain U.S. public finance transactions.

#### European Sovereign Debt Exposure

Uncertainties regarding the European sovereign debt crisis have affected the global economy. Outside the U.S., financial guarantee insurance has been used by issuers of sovereign-related and sub-sovereign bonds, structured finance securities, utility debt and financing for public purpose projects, among others. MBIA does not insure any direct European sovereign debt. However, we do insure both structured finance and public finance obligations in select international markets. MBIA's indirect European sovereign insured debt exposure totaled \$8.0 billion as of June 30, 2014 and included obligations of sovereign-related and sub-sovereign issuers, such as regions, departments and sovereign-owned entities that are supported by a sovereign state, region or department. Of the \$8.0 billion of insured gross par outstanding, \$663 million, \$411 million, and \$256 million related to Spain, Portugal, and Ireland, respectively. The remaining \$6.7 billion related to the U.K. We closely monitor our existing insured European portfolios on an ongoing basis. We consider country risk, including economic and political factors, the type and quality of local regulatory oversight, the strength of the legal framework in each country and the stability of the local institutional framework. We also monitor local accounting, regulatory and legal requirements, local financial market developments, the impact of exchange rates and local demand dynamics. A default by one or more sovereign issuers could have an adverse effect on our insured debt exposures. The Company has an immaterial amount of direct and indirect European sovereign debt holdings included in its investment portfolios.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

#### Adjusted Pre-Tax Income

In addition to the above results, we also analyze the operating performance of the Company using adjusted pre-tax income (loss), a non-GAAP measure. We believe adjusted pre-tax income (loss), as used by management, is useful for an understanding of the results of operations of the Company. Adjusted pre-tax income (loss) is not a substitute for pre-tax income (loss) determined in accordance with GAAP, and our definition of adjusted pre-tax income (loss) may differ from that used by other companies.

For the three months ended June 30, 2014, consolidated adjusted pre-tax income (loss) increased compared with the same period of 2013 primarily as a result of decreases in insurance losses and LAE, legal and litigation operating expenses, and impairments on insured credit derivatives.

For the six months ended June 30, 2014, consolidated adjusted pre-tax loss decreased compared with the same period of 2013 primarily as a result of decreases in impairments on insured credit derivatives and legal and litigation operating expenses, partially offset by an increase in insurance losses and LAE and decreases in premiums earned and net gains of financial instruments at fair value and foreign exchange revenues.

The following table presents our consolidated adjusted pre-tax income (loss) (a non-GAAP measure) and provides a reconciliation of adjusted pre-tax income (loss) to GAAP pre-tax income (loss) for the three and six months ended June 30, 2014 and 2013:

| In millions                                                 | Three Months Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                |
|-------------------------------------------------------------|--------------------------------|-----------------|------------------------------|----------------|
|                                                             | 2014                           | 2013            | 2014                         | 2013           |
| Adjusted pre-tax income (loss)                              | \$ 39                          | \$ (160)        | \$ (60)                      | \$ (180)       |
| Additions to adjusted pre-tax income (loss):                |                                |                 |                              |                |
| Impact of consolidating certain VIEs                        | (1)                            | (20)            | 18                           | (2)            |
| Mark-to-market gains (losses) on insured credit derivatives | (24)                           | 1,350           | 814                          | 1,277          |
| Subtractions from adjusted pre-tax income (loss):           |                                |                 |                              |                |
| Impairments on insured credit derivatives                   | (41)                           | 1,434           | 313                          | 1,144          |
| Pre-tax income (loss)                                       | <u>\$ 55</u>                   | <u>\$ (264)</u> | <u>\$ 459</u>                | <u>\$ (49)</u> |

#### Adjusted Book Value

As of June 30, 2014, ABV per share (a non-GAAP measure) was \$27.05, down from \$27.78 as of December 31, 2013. The decrease in ABV per share was primarily driven by insurance losses and credit impairments and an increase in common shares outstanding. This decrease was partially offset by a reduction in the valuation allowance against the Company's deferred tax asset from the sale of certain previously impaired assets.

The following table provides a reconciliation of consolidated book value per share to consolidated ABV per share:

| In millions except share and per share amounts                                           | As of<br>June 30, 2014 | As of<br>December 31, 2013 |
|------------------------------------------------------------------------------------------|------------------------|----------------------------|
| Total shareholders' equity of MBIA Inc.                                                  | \$ 3,787               | \$ 3,278                   |
| Common shares outstanding                                                                | 194,435,138            | 192,249,884                |
| Book value per share                                                                     | \$ 19.48               | \$ 17.05                   |
| Reverse net unrealized (gains) losses included in other comprehensive income (after-tax) | (0.32)                 | 0.37                       |
| Add net unearned premium revenue (after-tax) <sup>(1)(2)</sup>                           | 7.67                   | 8.39                       |
| Add present value of insured derivative installment revenue (after-tax) <sup>(3)</sup>   | 0.15                   | 0.21                       |
| Subtract deferred acquisition costs (after-tax)                                          | (0.83)                 | (0.90)                     |
| Reverse cumulative net loss from consolidating certain VIEs (after-tax) <sup>(4)</sup>   | 0.30                   | 0.38                       |
| Reverse cumulative unrealized loss on insured credit derivatives (after-tax)             | 1.11                   | 3.87                       |
| Subtract cumulative impairments on insured credit derivatives (after-tax) <sup>(3)</sup> | (0.51)                 | (1.59)                     |
| Total adjustments per share                                                              | 7.57                   | 10.73                      |
| Adjusted book value per share                                                            | <u>\$ 27.05</u>        | <u>\$ 27.78</u>            |

(1) - Consists of financial guarantee premiums and fees.

(2) - The discount rate on financial guarantee installment premiums was the risk-free rate as defined by the accounting principles for financial guarantee insurance contracts.

(3) - The discount rate on insured derivative installment revenue and impairments was 5% as of June 30, 2014 and December 31, 2013.

(4) - Represents the impact on book value per share of consolidated VIEs that are not considered business enterprises of the Company.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

Our "Net unearned premium revenue" adjustment to book value per share consists of unearned premium revenue net of prepaid reinsurance premiums related to financial guarantee insurance contracts, the unamortized portion of installment premiums collected on insured derivative contracts, and the unamortized portion of insurance-related deferred fee revenue. Our "Present value of insured derivative installment revenue" adjustment to book value per share consists of the present value of premiums not yet collected from insured derivative contracts, which are not recorded on our balance sheet in accordance with accounting principles for financial guarantee insurance contracts but which are contractually due to the Company.

#### U.S. Public Finance Insurance

Our U.S. public finance insurance business is primarily conducted through National. The financial guarantees issued by National provide unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due or, in the event National has exercised, at its discretion, the right to accelerate the payment under its policies upon the acceleration of the underlying insured obligations due to default or otherwise. National's guarantees insure municipal bonds, including tax-exempt and taxable indebtedness of U.S. political subdivisions, as well as utility districts, airports, healthcare institutions, higher educational facilities, student loan issuers, housing authorities and other similar agencies and obligations issued by private entities that finance projects that serve a substantial public purpose. Municipal bonds and privately issued bonds used for the financing of public purpose projects are generally supported by taxes, assessments, user fees or tariffs related to the use of these projects, lease payments or other similar types of revenue streams.

The following table presents our U.S. public finance insurance segment results for the three and six months ended June 30, 2014 and 2013:

| In millions                                                                    | Three Months Ended June 30, |        | Percent Change | Six Months Ended June 30, |        | Percent Change |
|--------------------------------------------------------------------------------|-----------------------------|--------|----------------|---------------------------|--------|----------------|
|                                                                                | 2014                        | 2013   |                | 2014                      | 2013   |                |
| Net premiums earned                                                            | \$ 67                       | \$ 102 | -34%           | \$ 132                    | \$ 205 | -36%           |
| Net investment income                                                          | 27                          | 35     | -23%           | 60                        | 84     | -29%           |
| Fees and reimbursements                                                        | 1                           | 1      | -%             | 3                         | 3      | -%             |
| Realized gains (losses) and other settlements on insured derivatives           | -                           | -      | -%             | 1                         | -      | n/m            |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 15                          | (2)    | n/m            | 19                        | 30     | -37%           |
| Total revenues                                                                 | 110                         | 136    | -19%           | 215                       | 322    | -33%           |
| Losses and loss adjustment                                                     | 17                          | 66     | -74%           | 3                         | 70     | -96%           |
| Amortization of deferred acquisition costs                                     | 15                          | 21     | -29%           | 29                        | 43     | -33%           |
| Operating                                                                      | 16                          | 35     | -54%           | 29                        | 53     | -45%           |
| Total expenses                                                                 | 48                          | 122    | -61%           | 61                        | 166    | -63%           |
| Pre-tax income                                                                 | \$ 62                       | \$ 14  | n/m            | \$ 154                    | \$ 156 | -1%            |

n/m - Percent change not meaningful.

For the three and six months ended June 30, 2014 and 2013, we did not write any U.S. public finance insurance as we maintained our underwriting and pricing discipline in a market where low interest rates, narrow spreads and competitive pricing levels were inconsistent with meeting our return targets. During the first six months of 2014, S&P upgraded National's rating to AA- with a stable outlook, Moody's upgraded National to a rating of A3 with a stable outlook, and subsequent to June 30, 2014, Moody's affirmed National's A3 rating and changed the outlook to negative. In addition, Kroll Bond Rating Agency assigned National a AA+ insurer financial strength rating with a stable outlook. With these current ratings, National has begun executing its business plan and seeks to support the credit enhancement needs of municipal debt issuers across the U.S. National maintains underwriting criteria for most municipal risk types and expects opportunities for new business across the spectrum of municipal sectors. National's underwriting criteria does not limit it to particular sectors. We expect that the majority of its new business will be in the general obligation, tax-backed and revenue bond sectors.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

**NET PREMIUMS EARNED** Net premiums earned on financial guarantees represent gross premiums earned net of premiums ceded to reinsurers, and include scheduled premium earnings and premium earnings from refunded issues. The decrease in net premiums earned for the three months ended June 30, 2014 compared with the same period of 2013 resulted from a decrease in refunded premiums earned of \$22 million and a decrease in scheduled premiums earned of \$14 million. The decrease in net premiums earned for the six months ended June 30, 2014 compared with the same period of 2013 resulted from a decrease in refunded premiums earned of \$46 million and a decrease in scheduled premiums earned of \$26 million. Scheduled premium earnings declined due to the refunding and maturity of insured issues within our U.S. public finance portfolio with no new insurance writings. Refunding activity over the past several years has accelerated premium earnings in prior periods and reduced the amount of scheduled premiums that would have been earned in the current period. Refundings have experienced a decline when compared to the prior period due to an overall decrease in municipal market issuance.

**NET INVESTMENT INCOME** The decreases in net investment income for the three and six months ended June 30, 2014 compared with the same periods of 2013 were primarily due to a lower yield on investment assets as a result of investing the proceeds from the repayment of the National Secured Loan by MBIA Corp. in May of 2013.

**NET GAINS (LOSSES) ON FINANCIAL INSTRUMENTS AT FAIR VALUE AND FOREIGN EXCHANGE** The increase in net gains (losses) on financial instruments at fair value and foreign exchange for the three months ended June 30, 2014 compared with the same period of 2013 was primarily due to increases in net realized gains from the sales of securities from the ongoing management of our U.S. public finance insurance investment portfolio and mark-to-market gains on financial instruments. The decrease in net gains (losses) on financial instruments at fair value and foreign exchange for the six months ended June 30, 2014 compared with the same period of 2013 was principally due to decreases in net realized gains from the sales of securities from the ongoing management of our U.S. public finance insurance investment portfolio partially offset by mark-to-market gains on financial instruments.

**LOSS AND LOSS ADJUSTMENT EXPENSES** National's portfolio surveillance group is responsible for monitoring our U.S. public finance segment's insured obligations. The level and frequency of monitoring of any insured obligation depends on the type, size, rating and performance of the insured issue.

Refer to "Note 5: Loss and Loss Adjustment Expense Reserves" in the Notes to Consolidated Financial Statements for a description of the Company's loss reserving policy and additional information related to its loss reserves.

The following table presents information about our U.S. public finance insurance loss and LAE expenses for the three and six months ended June 30, 2014 and 2013:

| In millions                                          | Three Months Ended June 30, |              | Percent Change | Six Months Ended June 30, |              | Percent Change |
|------------------------------------------------------|-----------------------------|--------------|----------------|---------------------------|--------------|----------------|
|                                                      | 2014                        | 2013         |                | 2014                      | 2013         |                |
| Loss and LAE related to actual and expected payments | \$ 23                       | \$ 105       | -78%           | \$ (2)                    | \$ 110       | -102%          |
| Recoveries of actual and expected payments           | (6)                         | (38)         | -84%           | 5                         | (39)         | -113%          |
| Gross losses incurred                                | 17                          | 67           | -75%           | 3                         | 71           | -96%           |
| Reinsurance                                          | -                           | (1)          | -100%          | -                         | (1)          | -100%          |
| Losses and loss adjustment expenses                  | <u>\$ 17</u>                | <u>\$ 66</u> | <u>-74%</u>    | <u>\$ 3</u>               | <u>\$ 70</u> | <u>-96%</u>    |

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS (continued)**

The losses and LAE for the three and six months ended June 30, 2014, primarily related to Puerto Rico exposures, partially offset by decreases in reserves for certain general obligation bonds. The losses and LAE for the same periods of 2013 related to increases in reserves for certain general obligation bonds.

The following table presents information about our U.S. public finance insurance loss and LAE reserves and recoverables as of June 30, 2014 and December 31, 2013:

| In millions                                                      | June 30,<br>2014 | December 31,<br>2013 | Percent<br>Change |
|------------------------------------------------------------------|------------------|----------------------|-------------------|
| Gross loss and LAE reserves                                      | \$ 120           | \$ 147               | -18%              |
| Expected recoveries on unpaid losses                             | (50)             | (60)                 | -17%              |
| Loss and LAE reserves                                            | \$ 70            | \$ 87                | -20%              |
| Insurance loss recoverable                                       | \$ 14            | \$ 13                | 8%                |
| Reinsurance recoverable on paid and unpaid losses <sup>(1)</sup> | \$ 1             | \$ 1                 | 0%                |

(1) - Reported within "Other assets" on our consolidated balance sheets.

Loss and LAE reserves as of June 30, 2014 decreased compared with December 31, 2013 primarily as a result of decreases in expected payments on certain general obligation bonds.

Included in our U.S. public finance loss and LAE reserves are both reserves for insured obligations for which a payment default has occurred and National has already paid a claim and also for which a payment default has not yet occurred, but a claim is expected in the future. The following table includes LAE reserves, but excludes par outstanding, as of June 30, 2014 and December 31, 2013 for two issues and one issue, respectively, that had no expected future claim payments, but for which National was obligated to pay LAE incurred in prior periods. As of June 30, 2014 and December 31, 2013, loss and LAE reserves comprised the following:

| \$ in millions             | Number of Issues <sup>(1)</sup> |                      | Loss and LAE Reserve |                      | Par Outstanding  |                      |
|----------------------------|---------------------------------|----------------------|----------------------|----------------------|------------------|----------------------|
|                            | June 30,<br>2014                | December 31,<br>2013 | June 30,<br>2014     | December 31,<br>2013 | June 30,<br>2014 | December 31,<br>2013 |
| Gross of reinsurance:      |                                 |                      |                      |                      |                  |                      |
| Issues with defaults       | 7                               | 7                    | \$ 40                | \$ 74                | \$ 596           | \$ 621               |
| Issues without defaults    | 7                               | 7                    | 30                   | 13                   | 1,612            | 87                   |
| Total gross of reinsurance | 14                              | 14                   | \$ 70                | \$ 87                | \$2,208          | \$ 708               |

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

Par outstanding as of June 30, 2014 increased compared with December 31, 2013 as a result from the addition of a Puerto Rico issue to our classified list.

POLICY ACQUISITION COSTS AND OPERATING EXPENSES U.S. public finance insurance segment expenses for the three and six months ended June 30, 2014 and 2013 are presented in the following table:

| In millions                                | Three Months Ended June 30, |       | Percent<br>Change | Six Months Ended June 30, |       | Percent<br>Change |
|--------------------------------------------|-----------------------------|-------|-------------------|---------------------------|-------|-------------------|
|                                            | 2014                        | 2013  |                   | 2014                      | 2013  |                   |
| Gross expenses                             | \$ 16                       | \$ 35 | -54%              | \$ 29                     | \$ 53 | -45%              |
| Amortization of deferred acquisition costs | \$ 15                       | \$ 21 | -29%              | \$ 29                     | \$ 43 | -33%              |
| Operating                                  | 16                          | 35    | -54%              | 29                        | 53    | -45%              |
| Total insurance operating expenses         | \$ 31                       | \$ 56 | -45%              | \$ 58                     | \$ 96 | -40%              |

Gross expenses represent total insurance expenses before the deferral of any policy acquisition costs. Gross expenses decreased for the three and six months ended June 30, 2014 compared with the same periods of 2013 due to decreases in consulting fees and legal and litigation related costs partially offset by increases in costs associated with support provided by our corporate segment. Amortization of deferred acquisition costs decreased for the three and six months ended June 30, 2014 compared with the same periods of 2013 due to lower refunding activity in 2014. We did not defer a material amount of policy acquisition costs during the first half of 2014 or 2013.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS (continued)**

**INSURED PORTFOLIO EXPOSURE** 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 sources in the analysis of credit quality measures of its insured portfolio. In evaluating credit risk, we obtain, when available, the underlying rating of the insured obligation before the benefit of its insurance policy from nationally recognized rating agencies, Moody's and S&P. Other companies within the financial guarantee industry may report credit quality information based upon internal ratings that would not be comparable to our presentation. We maintain internal ratings on our entire portfolio, and our ratings may be higher or lower than the ratings assigned by Moody's or S&P.

The following table presents the credit quality distribution of MBIA's U.S. public finance outstanding gross par insured as of June 30, 2014 and December 31, 2013. Capital appreciation bonds ("CABs") are reported at the par amount at the time of issuance of the insurance policy. All ratings are as of the period presented and represent S&P ratings. If transactions are not rated by S&P, a Moody's equivalent rating is used. If transactions are not rated by either S&P or Moody's, an internal equivalent rating is used.

| In millions<br>Rating  | Gross Par Outstanding |               |                   |               |
|------------------------|-----------------------|---------------|-------------------|---------------|
|                        | June 30, 2014         |               | December 31, 2013 |               |
|                        | Amount                | %             | Amount            | %             |
| AAA                    | \$ 14,613             | 5.8%          | \$ 16,293         | 5.9%          |
| AA                     | 121,137               | 47.7%         | 133,188           | 48.1%         |
| A                      | 91,844                | 36.1%         | 99,631            | 36.0%         |
| BBB                    | 17,315                | 6.8%          | 23,127            | 8.3%          |
| Below investment grade | 9,104                 | 3.6%          | 4,607             | 1.7%          |
| Total                  | <u>\$254,013</u>      | <u>100.0%</u> | <u>\$276,846</u>  | <u>100.0%</u> |

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS (continued)**

National has exposure to the Commonwealth of Puerto Rico and certain of its instrumentalities ("Puerto Rico"). Puerto Rico is experiencing fiscal stress. However it has taken proactive actions to address its significant economic challenges, including the passage of the first balanced general fund budget in 22 years for the fiscal year ending on June 30, 2015, the passage of comprehensive reform of its employee retirement system, and the recent enactment of the Fiscal Sustainability Act, which allows the government to exercise emergency powers to deal with its fiscal crisis. Under this Act, the government could institute a number of steps to lower spending on government operations and labor by renegotiating its public employees' contracts. Given the fiscal and economic challenges that Puerto Rico is facing, we continue to monitor our exposures there closely. Refer to the following "U.S. Public Finance Insurance Puerto Rico Exposures" section for additional information on our Puerto Rico exposures by bond type.

**U.S. Public Finance Insurance Puerto Rico Exposures**

The following is a summary of exposures within the insured portfolio of our U.S. public finance insurance segment related to Puerto Rico as of June 30, 2014.

| In millions                                                                                    | Gross Par Outstanding | National Internal Rating |
|------------------------------------------------------------------------------------------------|-----------------------|--------------------------|
| Puerto Rico Electric Power Authority (PREPA) <sup>(1)</sup>                                    | \$ 1,531              | d                        |
| Puerto Rico Commonwealth GO <sup>(1)</sup>                                                     | 1,238                 | bbb3                     |
| Puerto Rico Highway and Transportation Authority Transportation Revenue (PRHTA) <sup>(1)</sup> | 801                   | bb3                      |
| Puerto Rico Sales Tax Financing Corporation (COFINA) <sup>(1)</sup>                            | 684                   | a1                       |
| Puerto Rico Government Development Bank GO                                                     | 267                   | bbb3                     |
| Puerto Rico Highway and Transportation Authority Highway Revenue (PRHTA)                       | 173                   | bb2                      |
| University of Puerto Rico System Revenue                                                       | 94                    | bbb3                     |
| Inter American University of Puerto Rico Inc.                                                  | 29                    | a3                       |
| Puerto Rico Industrial Development Company                                                     | 15                    | bbb1                     |
| Total                                                                                          | <u>\$ 4,832</u>       |                          |

(1) - Includes CABs that reflect the gross par amount at the time of issuance of the insurance policy.

In June of 2014, the Governor of Puerto Rico signed into law the Puerto Rico Public Corporations Debt Enforcement and Recovery Act (the "Recovery Act") that establishes a restructuring framework for allowing certain of its public corporations to address their financial difficulties. Many of Puerto Rico's instrumentalities and all of its municipalities are insulated from the Recovery Act as the law principally applies to three public corporations referred to as PRHTA (highway authority), PREPA (power authority) and Puerto Rico Aqueduct and Sewer Authority (water and sewer authority). According to the government, the intent behind implementing this extraordinary action was to stabilize the island's fiscal condition, promote economic growth and protect and reinforce Puerto Rico's credit. Despite its intent, the law was immediately challenged on constitutional grounds in U.S. District Court by two large municipal bond investment funds. Although the Recovery Act is intended to restore the solvency of public corporations over the long term, procedural steps may afford these public corporations to suspend debt payments while proceedings are underway. Largely as a result of the new Recovery Act, the ratings of certain Puerto Rico issuers were downgraded deeper into non-investment grade status by the rating agencies. These rating actions have constrained and continue to constrain traditional market access for Puerto Rico and certain of its instrumentalities, further straining liquidity. While Puerto Rico is experiencing fiscal stress that could lead to defaults on its debt obligations, it continues to take proactive actions to address its significant financial challenges, including the passage of a balanced budget for the fiscal year ending on June 30, 2015 and the recent enactment of the Fiscal Sustainability Act, which allows the government to exercise emergency powers to deal with its fiscal crisis. In addition, although we have downgraded our internal rating of certain Puerto Rico issuers to below investment grade, all of the insured obligations included in the preceding table are presently current on debt service payments.

National's outstanding gross par exposure to Puerto Rico was reduced by \$290 million on July 1, 2014 as a result of debt service payments made by Puerto Rico, including \$109 million of debt service payments on exposure to the Puerto Rico Electric Power Authority ("PREPA"). Following the July 1 debt service payment date, PREPA announced that it did not make a June 25, 2014 deposit to the bond service account and redemption account used to fund debt service payments on its bonds. PREPA also announced that in order to cover the shortfall in the amounts available to make the July 1 debt service payment, the trustee for the bonds withdrew approximately \$41.6 million from the reserve account for the bonds, which amount included approximately \$10.6 million in excess of the amount of interest determined by PREPA to be payable on the bonds within the ensuing twelve months.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS (continued)**

***Structured Finance and International Insurance***

Our structured finance and international insurance business is principally conducted through MBIA Corp. The financial guarantees issued by MBIA Corp. generally provide unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due or, in the event MBIA Corp. has the right, at its discretion, to accelerate insured obligations upon default or otherwise, upon MBIA Corp.'s acceleration. Certain guaranteed investment contracts written by MBIA Inc. or its subsidiaries are insured by MBIA Corp. If MBIA Inc. or such subsidiaries were to have insufficient assets to pay amounts due upon maturity or termination, MBIA Corp. would make such payments under its insurance policies. MBIA Corp. also insured debt obligations of other affiliates, including GFL, and provides reinsurance to its insurance subsidiaries. MBIA Corp. has also written insurance policies guaranteeing the obligations under credit default swap ("CDS") contracts of an affiliate, LaCrosse Financial Products, LLC, including termination payments that may become due in certain circumstances, including the occurrence of certain insolvency or payment defaults under the CDS contracts.

MBIA Corp.'s guarantees insure structured finance and asset-backed obligations, privately issued bonds used for the financing of public purpose projects that are primarily located outside of the U.S. which include toll roads, bridges, airports, public transportation facilities, utilities and other types of infrastructure projects serving a substantial public purpose, and obligations of sovereign-related and sub-sovereign issuers. Structured finance and ABS typically are securities repayable from expected cash flows generated by a specified pool of assets, such as residential and commercial mortgage loans, insurance policies, consumer loans, corporate loans and bonds, trade and export receivables, and leases and loans for equipment, aircraft and real property.

In certain cases, we may be required to consolidate entities established by issuers of insured obligations as part of securitizations when we insure the assets or liabilities of those entities and in connection with remediations under our insurance policies. These entities typically meet the definition of a VIE under accounting principles for the consolidation of VIEs. We do not believe there is any difference in the risks and profitability of financial guarantees provided to VIEs compared with other financial guarantees written by us.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**
**RESULTS OF OPERATIONS (continued)**

The following table presents our structured finance and international insurance segment results for the three and six months ended June 30, 2014 and 2013:

| In millions                                                                    | Three Months Ended June 30, |          | Percent Change | Six Months Ended June 30, |          | Percent Change |
|--------------------------------------------------------------------------------|-----------------------------|----------|----------------|---------------------------|----------|----------------|
|                                                                                | 2014                        | 2013     |                | 2014                      | 2013     |                |
| Net premiums earned                                                            | \$ 31                       | \$ 35    | -11%           | \$ 64                     | \$ 71    | -10%           |
| Net investment income                                                          | 5                           | 4        | 25%            | 10                        | 9        | 11%            |
| Fees and reimbursements                                                        | 16                          | 23       | -30%           | 30                        | 47       | -36%           |
| Change in fair value of insured derivatives:                                   |                             |          |                |                           |          |                |
| Realized gains (losses) and other settlements on insured derivatives           | (24)                        | (1,532)  | -98%           | (394)                     | (1,520)  | -74%           |
| Unrealized gains (losses) on insured derivatives                               | (23)                        | 1,350    | -102%          | 815                       | 1,277    | -36%           |
| Net change in fair value of insured derivatives                                | (47)                        | (182)    | -74%           | 421                       | (243)    | n/m            |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 13                          | 12       | 8%             | 10                        | 34       | -71%           |
| Revenues of consolidated VIEs:                                                 |                             |          |                |                           |          |                |
| Net investment income                                                          | 13                          | 12       | 8%             | 25                        | 25       | -%             |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 22                          | 73       | -70%           | 24                        | 104      | -77%           |
| Other net realized gains (losses)                                              | -                           | 1        | -100%          | -                         | 1        | -100%          |
| Total revenues                                                                 | 53                          | (22)     | n/m            | 584                       | 48       | n/m            |
| Losses and loss adjustment                                                     | (5)                         | 122      | -104%          | 59                        | (76)     | n/m            |
| Amortization of deferred acquisition costs                                     | 16                          | 24       | -33%           | 35                        | 57       | -39%           |
| Operating                                                                      | 15                          | 35       | -57%           | 30                        | 61       | -51%           |
| Interest                                                                       | 27                          | 41       | -34%           | 55                        | 99       | -44%           |
| Expenses of consolidated VIEs:                                                 |                             |          |                |                           |          |                |
| Operating                                                                      | 2                           | 2        | -%             | 5                         | 7        | -29%           |
| Interest                                                                       | 10                          | 10       | -%             | 20                        | 20       | -%             |
| Total expenses                                                                 | 65                          | 234      | -72%           | 204                       | 168      | 21%            |
| Pre-tax income (loss)                                                          | \$ (12)                     | \$ (256) | -95%           | \$ 380                    | \$ (120) | n/m            |

n/m - Percent change not meaningful.

For the three and six months ended June 30, 2014 and 2013, we did not have any new structured finance and international insurance writings. As of June 30, 2014, MBIA Corp.'s total insured gross par outstanding was \$69.0 billion. The lack of insurance writings in our structured finance and international insurance segment reflects the insurance financial strength credit ratings assigned to MBIA Corp. by the major rating agencies. Pre-tax income (loss) in each of the periods included in the preceding table was primarily driven by changes in the fair value of our insured credit derivatives, which reflects changes in the market's perception of MBIA Corp.'s credit risk.

**ADJUSTED PRE-TAX INCOME (LOSS)** In addition to the above results, we also analyze the operating performance of our structured finance and international insurance segment using adjusted pre-tax income (loss), a non-GAAP measure. We believe adjusted pre-tax income (loss), as used by management, is useful for an understanding of the results of operations of our structured finance and international insurance segment. Adjusted pre-tax income (loss) is not a substitute for pre-tax income (loss) determined in accordance with GAAP, and our definition of adjusted pre-tax income (loss) may differ from that used by other companies.

Adjusted pre-tax loss for the three and six months ended June 30, 2014 decreased compared with the same periods of 2013 principally due to decreases in credit impairments on insured credit derivatives, legal and litigation costs and interest expense from the National Secured Loan, which was repaid in full in May of 2013. These decreases were partially offset by a decrease in net gains on financial instruments at fair value and foreign exchange.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**
**RESULTS OF OPERATIONS (continued)**

The following table presents the adjusted pre-tax income (loss) of our structured finance and international insurance segment and a reconciliation of adjusted pre-tax income (loss) to GAAP pre-tax income (loss) for the three and six months ended June 30, 2014 and 2013:

| In millions                                              | Three Months Ended June 30, |                 | Percent Change | Six Months Ended June 30, |                 | Percent Change |
|----------------------------------------------------------|-----------------------------|-----------------|----------------|---------------------------|-----------------|----------------|
|                                                          | 2014                        | 2013            |                | 2014                      | 2013            |                |
| Adjusted pre-tax income (loss)                           | \$ (28)                     | \$ (93)         | -70%           | \$ (138)                  | \$ (190)        | -27%           |
| Additions to adjusted pre-tax income (loss):             |                             |                 |                |                           |                 |                |
| Impact of consolidating certain VIEs                     | (1)                         | (79)            | -99%           | 17                        | (63)            | -127%          |
| Mark-to-market gain (loss) on insured credit derivatives | (24)                        | 1,350           | -102%          | 814                       | 1,277           | -36%           |
| Subtractions from adjusted pre-tax income (loss):        |                             |                 |                |                           |                 |                |
| Impairments on insured credit derivatives                | (41)                        | 1,434           | -103%          | 313                       | 1,144           | -73%           |
| Pre-tax income (loss)                                    | <u>\$ (12)</u>              | <u>\$ (256)</u> | <u>-95%</u>    | <u>\$ 380</u>             | <u>\$ (120)</u> | <u>n/m</u>     |

n/m - Percent change not meaningful.

**NET PREMIUMS EARNED** Our structured finance and international insurance segment generates net premiums from insurance policies accounted for as financial guarantee contracts. Certain premiums may be eliminated in our consolidated financial statements as a result of the Company consolidating VIEs. In addition, the Company generates net premiums from insured credit derivatives that are included in "Realized gains (losses) and other settlements on insured derivatives" on our consolidated statements of operations. The following table provides net premiums earned from our financial guarantee contracts for the three and six months ended June 30, 2014 and 2013:

| In millions                        | Three Months Ended June 30, |              | Percent Change | Six Months Ended June 30, |              | Percent Change |
|------------------------------------|-----------------------------|--------------|----------------|---------------------------|--------------|----------------|
|                                    | 2014                        | 2013         |                | 2014                      | 2013         |                |
| Net premiums earned:               |                             |              |                |                           |              |                |
| U.S.                               | \$ 9                        | \$ 13        | -31%           | \$ 19                     | \$ 26        | -27%           |
| Non-U.S.                           | 22                          | 22           | -%             | 45                        | 45           | -%             |
| Total net premiums earned          | <u>\$ 31</u>                | <u>\$ 35</u> | <u>-11%</u>    | <u>\$ 64</u>              | <u>\$ 71</u> | <u>-10%</u>    |
| VIEs (eliminated in consolidation) | \$ 3                        | \$ 4         | -25%           | \$ 7                      | \$ 7         | -%             |

Net premiums earned represent gross premiums earned net of premiums ceded to reinsurers, and include scheduled premium earnings and premium earnings from refunded issues. Structured finance and international net premiums earned decreased for the three and six months ended June 30, 2014 compared with the same periods of 2013 primarily due to the maturity and early settlement of insured transactions with no material writings of new insurance policies.

**NET CHANGE IN FAIR VALUE OF INSURED DERIVATIVES** The following table presents the net premiums and fees earned related to derivatives and the components of the net change in fair value of insured derivatives for the three and six months ended June 30, 2014 and 2013:

| In millions                                                          | Three Months Ended June 30, |                 | Percent Change | Six Months Ended June 30, |                 | Percent Change |
|----------------------------------------------------------------------|-----------------------------|-----------------|----------------|---------------------------|-----------------|----------------|
|                                                                      | 2014                        | 2013            |                | 2014                      | 2013            |                |
| Net premiums and fees earned on insured derivatives                  | \$ 4                        | \$ 10           | -60%           | \$ 8                      | \$ 23           | -65%           |
| Realized gains (losses) on insured derivatives                       | (28)                        | (1,542)         | -98%           | (402)                     | (1,543)         | -74%           |
| Realized gains (losses) and other settlements on insured derivatives | (24)                        | (1,532)         | -98%           | (394)                     | (1,520)         | -74%           |
| Unrealized gains (losses) on insured derivatives                     | (23)                        | 1,350           | -102%          | 815                       | 1,277           | -36%           |
| Net change in fair value of insured derivatives                      | <u>\$ (47)</u>              | <u>\$ (182)</u> | <u>-74%</u>    | <u>\$ 421</u>             | <u>\$ (243)</u> | <u>n/m</u>     |

n/m - Percent change not meaningful.

The Company no longer insures new credit derivative contracts except in transactions related to the restructuring or reduction of existing derivative exposure. Premiums earned related to insured credit derivatives will decrease over time as a result of settlements prior to maturity and scheduled amortizations. For the three and six months ended June 30, 2014, realized losses on insured derivatives resulted primarily from settlements and claim payments on CMBS transactions.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS (continued)**

For the three months ended June 30, 2014, unrealized losses on insured derivatives were principally associated with unfavorable movements in spreads and pricing on collateral, the effects of MBIA's nonperformance risk on its derivative liabilities and collateral erosion, partially offset by shorter weighted average lives on transactions. For the three months ended June 30, 2013, unrealized gains on insured derivatives were principally associated with the reversal of unrealized losses from commutations, partially offset by the effects of MBIA's nonperformance risk on its derivative liabilities.

For the six months ended June 30, 2014, unrealized gains on insured derivatives were principally associated with the reversal of unrealized losses from commutations. For the six months ended June 30, 2013, unrealized gains on insured derivatives were principally associated with the reversal of unrealized losses from commutations and changes in weighted average lives on transactions, partially offset by the effects of MBIA's nonperformance risk on its derivative liabilities.

As of June 30, 2014, MBIA Corp.'s five year CDS cost was 9.81% upfront plus 5% per annum compared with 8.38% upfront plus 5% per annum as of June 30, 2013. Our mark-to-market on insured credit derivatives uses the most appropriate of the one to ten year CDS cost for each transaction, and those costs ranged from 0.64% upfront plus 5% per annum to 13.16% upfront plus 5% per annum as of June 30, 2014. As of June 30, 2013, those costs ranged from -0.06% upfront plus 5% per annum to 13.50% upfront plus 5% per annum.

As of June 30, 2014, MBIA Corp. had \$16.0 billion of gross par outstanding on insured credit derivatives compared with \$16.7 billion and \$24.0 billion as of March 31, 2014 and December 31, 2013, respectively. The decrease in gross par outstanding was primarily due to commutations, contractual terminations, amortizations and maturities. During the six months ended June 30, 2014, seven insured issues, representing \$7.5 billion in gross par outstanding, either matured or were contractually settled.

Since our insured credit derivatives have similar terms, conditions, risks, and economic profiles as our financial guarantee insurance policies, we evaluate them for impairment periodically in the same way that we estimate loss and LAE for our financial guarantee policies. Credit impairments on insured derivatives represent actual payments plus the present values of our estimates of expected future claim payments, net of expected future recoveries. MBIA Corp.'s expected future claim payments were discounted using a rate of 5.09%, the same rate used to calculate its statutory loss reserves as of June 30, 2014. MBIA UK Insurance Limited used a rate of 2.50% to discount its expected future claim payments and statutory loss reserves. We estimated that additional credit impairments on insured derivatives (excluding LAE) for the six months ended June 30, 2014 were \$82 million across eight insured issues. As of June 30, 2014, statutory loss and LAE reserves and credit impairments were \$178 million. Refer to the following "Loss and Loss Adjustment Expenses" section for additional information about credit impairments on insured derivatives.

Our estimate of credit impairments, a non-GAAP measure, may differ from the fair values recorded in our consolidated financial statements. The Company believes its disclosure of credit impairments on insured derivatives provides additional meaningful information about potential realized losses on these contracts. The fair value of an insured derivative contract will be influenced by a variety of market and transaction-specific factors that may be unrelated to potential future claim payments. In the absence of credit impairments or the termination of derivatives at losses, the cumulative unrealized losses recorded from insured derivatives should reverse before or at the maturity of the contracts. Contracts also may be settled prior to maturity at amounts that may be more or less than their recorded fair values. Those settlements can result in realized gains or losses, and will result in the reversal of unrealized gains or losses. The Company is not required to post collateral to counterparties of these contracts. Refer to "Risk Factors" in Part I, Item 1A of MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013 for information on legislative changes that could require collateral posting by MBIA Corp. notwithstanding the contract terms.

**NET GAINS (LOSSES) ON FINANCIAL INSTRUMENTS AT FAIR VALUE AND FOREIGN EXCHANGE** The decrease in net gains on financial instruments at fair value and foreign exchange for the six months ended June 30, 2014 compared with the same period of 2013 was primarily due to the revaluation of non-functional currency cash and a decrease in net realized gains from the sales of securities.

**REVENUES OF CONSOLIDATED VIEs** For the three months ended June 30, 2014, total revenues of consolidated VIEs were \$35 million compared with \$86 million for the same period of 2013. This decrease was primarily related to decreases in net gains from second-lien RMBS put-back claims on ineligible mortgage loans and lower mark-to-market gains on assets of consolidated VIEs due to fluctuations in collateral pricing. For the six months ended June 30, 2014, total revenues of consolidated VIEs were \$49 million compared with \$130 million for the same period of 2013. This decrease was primarily related to a decrease in net gains from second-lien RMBS put-back claims on ineligible mortgage loans.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

LOSS AND LOSS ADJUSTMENT EXPENSES MBIA's insured portfolio management group within our structured finance and international insurance business is responsible for monitoring structured finance and international insured obligations. The level and frequency of monitoring of any insured obligation depends on the type, size, rating and performance of the insured issue.

Refer to "Note 5: Loss and Loss Adjustment Expense Reserves" in the Notes to Consolidated Financial Statements for a description of the Company's loss reserving policy and additional information related to its loss reserves.

#### Summary of Financial Guarantee Insurance Losses and LAE

The following table presents information about our financial guarantee insurance losses and LAE recorded in accordance with GAAP for the three and six months ended June 30, 2014 and 2013:

| In millions                                 | Three Months Ended June 30, |               | Percent Change | Six Months Ended June 30, |                | Percent Change |
|---------------------------------------------|-----------------------------|---------------|----------------|---------------------------|----------------|----------------|
|                                             | 2014                        | 2013          |                | 2014                      | 2013           |                |
| Losses and LAE related to expected payments | \$ (44)                     | \$ 102        | -143%          | \$ 4                      | \$ 101         | -96%           |
| Recoveries of expected payments             | 38                          | 21            | 81%            | 55                        | (176)          | -131%          |
| Gross losses incurred                       | (6)                         | 123           | -105%          | 59                        | (75)           | n/m            |
| Reinsurance                                 | 1                           | (1)           | n/m            | -                         | (1)            | -100%          |
| Losses and loss adjustment expenses         | <u>\$ (5)</u>               | <u>\$ 122</u> | <u>-104%</u>   | <u>\$ 59</u>              | <u>\$ (76)</u> | <u>n/m</u>     |

n/m - Percent change not meaningful.

For the three months ended June 30, 2014, the benefit in losses and LAE related to expected payments of \$44 million included a benefit of \$61 million, primarily related to an international road transaction and ABS CDOs, partially offset by \$12 million of expense related to insured second-lien RMBS transactions and \$5 million of expense related to insured first-lien RMBS transactions. The recoveries of expected payments of \$38 million of expense primarily related to decreases in projected collections from excess spread within the insured second-lien RMBS securitizations.

Excess spread is generated by performing loans within insured second-lien RMBS securitizations and is the difference between interest inflows on mortgage loan collateral and interest outflows on insured beneficial interests. The amount of excess spread depends on the future loss trends (which include future delinquency trends, average time to charge-off delinquent loans and the availability of pool mortgage insurance), the future spread between prime and LIBOR interest rates; and borrower refinancing behavior which results in voluntary prepayments. Minor deviations in loss trends and voluntary prepayments may substantially impact the amounts we collect from excess spread.

For the three months ended June 30, 2013, losses and LAE related to expected payments of \$102 million included \$100 million of other loss activity, primarily related to an international road transaction, and \$32 million related to insured second-lien RMBS transactions. Partially offsetting these losses was a \$29 million decrease in expected payments related to insured CMBS transactions. The \$21 million decrease in recoveries of expected payments primarily related to a reversal of recoveries related to high yield corporate CDOs, partially offset by an increase in recoveries related to an international road transaction.

For the six months ended June 30, 2014, recoveries of expected payments of \$55 million of expense primarily related to decreases in projected collections from excess spread within the insured second-lien RMBS securitizations. Losses and LAE related to expected payments of \$4 million included \$33 million related to insured first-lien RMBS transactions and \$19 million related to insured second-lien RMBS transactions, partially offset by a benefit of \$48 million of other loss activity, primarily related to an international road transaction and ABS CDOs.

For the six months ended June 30, 2013, recoveries of expected payments of \$176 million included \$308 million of recoveries resulting from ineligible mortgage loans included in insured second-lien RMBS exposures that were subject to contractual obligations by sellers/servicers to repurchase or replace such mortgage loans, partially offset by an \$97 million reduction in excess spread within these securitizations and \$43 million of other activity. The other activity was primarily the result of a reversal of recoveries related to high yield corporate CDOs, partially offset by an increase in recoveries related to an international road transaction. These recoveries were partially offset by losses and LAE related to expected future payments of \$101 million, of which \$99 million related to insured second-lien RMBS transactions.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

For the three and six months ended June 30, 2014, losses and LAE incurred included the elimination of a \$13 million benefit and a \$7 million expense, respectively, as a result of the consolidation of VIEs. The \$13 million benefit included gross losses related to expected payments of \$11 million and recoveries of expected payments of \$2 million. The \$7 million expense included gross losses related to expected payments of \$8 million, partially offset by gross recoveries of expected payments of \$1 million.

For the three and six months ended June 30, 2013, losses and LAE incurred included the elimination of \$100 million and \$95 million in benefits, respectively, as a result of the consolidation of VIEs. The \$100 million elimination included recoveries of expected payments of \$71 million and gross losses related to expected payments of \$29 million. The \$95 million elimination included gross recoveries of expected payments of \$104 million, partially offset by gross losses related to expected payments of \$9 million.

The following table presents information about our insurance reserves and recoverable as of June 30, 2014 and December 31, 2013. The Company's insurance loss recoverable represents expected potential recoveries of paid claims based on probability-weighted net cash inflows discounted at applicable risk-free rates as of the measurement date.

| In millions                                                      | June 30,<br>2014 | December 31,<br>2013 | Percent<br>Change |
|------------------------------------------------------------------|------------------|----------------------|-------------------|
| Gross loss and LAE reserves                                      | \$ 593           | \$ 700               | -15%              |
| Expected recoveries on unpaid losses                             | (109)            | (146)                | -25%              |
| Loss and LAE reserves                                            | \$ 484           | \$ 554               | -13%              |
| Insurance loss recoverable                                       | \$ 610           | \$ 681               | -10%              |
| Insurance loss recoverable—ceded <sup>(1)</sup>                  | \$ 5             | \$ 5                 | -%                |
| Reinsurance recoverable on paid and unpaid losses <sup>(2)</sup> | \$ 6             | \$ 7                 | -14%              |

(1) - Reported within "Other liabilities" on our consolidated balance sheets.

(2) - Reported within "Other assets" on our consolidated balance sheets.

Included in the Company's loss and LAE reserves are both reserves for insured obligations for which a payment default has occurred and MBIA Corp. has already paid a claim and also for which a payment default has not yet occurred but a claim is expected in the future. The following table includes LAE reserves, but excludes par outstanding, as of June 30, 2014 and December 31, 2013 for four issues and one issue, respectively, that had no expected future claim payments or par outstanding, but for which the Company was obligated to pay LAE incurred in prior periods. As of June 30, 2014 and December 31, 2013, loss and LAE reserves comprised the following:

| \$ in millions             | Number of Issues <sup>(1)</sup> |                      | Loss and LAE Reserve |                      | Par Outstanding  |                      |
|----------------------------|---------------------------------|----------------------|----------------------|----------------------|------------------|----------------------|
|                            | June 30,<br>2014                | December 31,<br>2013 | June 30,<br>2014     | December 31,<br>2013 | June 30,<br>2014 | December 31,<br>2013 |
| Gross of reinsurance:      |                                 |                      |                      |                      |                  |                      |
| Issues with defaults       | 108                             | 103                  | \$ 362               | \$ 388               | \$5,570          | \$ 6,124             |
| Issues without defaults    | 15                              | 20                   | 122                  | 166                  | 880              | 1,029                |
| Total gross of reinsurance | 123                             | 123                  | \$ 484               | \$ 554               | \$6,450          | \$ 7,153             |

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

As of June 30, 2014, we had loss and LAE reserves related to our remaining insured second-lien RMBS exposure of \$136 million before eliminating \$18 million of loss and LAE reserves related to our consolidated VIEs. The loss and LAE reserves represent the present value of the difference between cash payments we expect to make on the insured transactions and the excess spread we expect from the performing mortgage loans in the securitizations. As payments are made, a portion of those expected future receipts is recorded within "Insurance loss recoverable" on our consolidated balance sheets. The payments that we make virtually all go to reduce the principal balances of the securitizations.

### Aggregate Losses and LAE

The Company faces significant risks and uncertainties related to potential or actual losses from its first and second-lien RMBS, ABS CDO, CMBS and CRE CDO insured exposures. Continued significant adverse developments and higher than expected payments on these exposures and/or lower than expected recoveries on the RMBS exposures, could result in a decline in the Company's liquidity and statutory capital position.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

The impact of insured exposures on the Company's liquidity position is best understood by assessing the ultimate amount of payments and recoveries with respect to these exposures. In this regard, the Company discloses the discounted expected future net cash flows under all insurance contracts, irrespective of the legal form of the guarantee (i.e., financial guarantee insurance policy or insured derivative contract) or the GAAP accounting basis.

All amounts presented in the following aggregate losses and LAE tables are calculated in accordance with GAAP, with the exception of those related to insured credit derivative impairments. The amounts reported in aggregate losses and LAE and adjusted pre-tax income for insured credit derivative impairments are calculated in accordance with U.S. STAT because GAAP does not contain a comparable measurement basis for these contracts. All losses and recoverables reported in the following tables are measured using discounted probability-weighted cash flows. Losses and recoverables on VIEs that are eliminated in consolidation are included because the consolidation of these VIEs does not impact whether or not we will be required to make payments under our insurance contracts. As a result of the different accounting bases of amounts included in the following tables, the total provided in each table represents a non-GAAP measure.

The following tables present the aggregate change in the discounted values of net payments expected to be made on all insurance contracts for the three and six months ended June 30, 2014 and 2013:

#### Aggregate Losses and LAE (change in discounted values of net payments)

| In millions                              | Three Months Ended June 30, 2014   |                    |                |              |                      |              |
|------------------------------------------|------------------------------------|--------------------|----------------|--------------|----------------------|--------------|
|                                          | Second-lien<br>RMBS <sup>(1)</sup> | First-lien<br>RMBS | ABS CDO        | CMBS         | Other <sup>(2)</sup> | Total        |
| Increase (decrease) in expected payments | \$ 3                               | \$ 6               | \$ (30)        | \$ 62        | \$ (31)              | \$ 10        |
| (Increase) decrease in expected salvage  | 31                                 | (8)                | 6              | (1)          | 6                    | 34           |
| Total aggregate losses and LAE           | <u>\$ 34</u>                       | <u>\$ (2)</u>      | <u>\$ (24)</u> | <u>\$ 61</u> | <u>\$ (25)</u>       | <u>\$ 44</u> |

(1) - Includes HELOC loans and CES.

(2) - Primarily represents an international road transaction.

| In millions                              | Three Months Ended June 30, 2013   |                    |                |              |                      |               |
|------------------------------------------|------------------------------------|--------------------|----------------|--------------|----------------------|---------------|
|                                          | Second-lien<br>RMBS <sup>(1)</sup> | First-lien<br>RMBS | ABS CDO        | CMBS         | Other <sup>(2)</sup> | Total         |
| Increase (decrease) in expected payments | \$ 25                              | \$ 10              | \$ (37)        | \$ 96        | \$ 102               | \$ 196        |
| (Increase) decrease in expected salvage  | (68)                               | (1)                | (3)            | (17)         | 19                   | (70)          |
| Total aggregate losses and LAE           | <u>\$ (43)</u>                     | <u>\$ 9</u>        | <u>\$ (40)</u> | <u>\$ 79</u> | <u>\$ 121</u>        | <u>\$ 126</u> |

(1) - Includes HELOC loans and CES.

(2) - Primarily represents an international road transaction and high yield corporate CDOs.

#### Aggregate Losses and LAE (change in discounted values of net payments)

| In millions                              | Six Months Ended June 30, 2014     |                    |               |              |                      |               |
|------------------------------------------|------------------------------------|--------------------|---------------|--------------|----------------------|---------------|
|                                          | Second-lien<br>RMBS <sup>(1)</sup> | First-lien<br>RMBS | ABS CDO       | CMBS         | Other <sup>(2)</sup> | Total         |
| Increase (decrease) in expected payments | \$ 19                              | \$ 32              | \$ (13)       | \$ 80        | \$ (24)              | \$ 94         |
| (Increase) decrease in expected salvage  | 52                                 | (6)                | 5             | 1            | 2                    | 54            |
| Total aggregate losses and LAE           | <u>\$ 71</u>                       | <u>\$ 26</u>       | <u>\$ (8)</u> | <u>\$ 81</u> | <u>\$ (22)</u>       | <u>\$ 148</u> |

(1) - Includes HELOC loans and CES.

(2) - Primarily represents an international road transaction.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS (continued)**

| In millions                              | Six Months Ended June 30, 2013     |                    |                |               |                      |               |
|------------------------------------------|------------------------------------|--------------------|----------------|---------------|----------------------|---------------|
|                                          | Second-lien<br>RMBS <sup>(1)</sup> | First-lien<br>RMBS | ABS CDO        | CMBS          | Other <sup>(2)</sup> | Total         |
| Increase (decrease) in expected payments | \$ 134                             | \$ (2)             | \$ (80)        | \$ 381        | \$ 92                | \$ 525        |
| (Increase) decrease in expected salvage  | (323)                              | (5)                | 2              | (20)          | 45                   | (301)         |
| <b>Total aggregate losses and LAE</b>    | <b>\$ (189)</b>                    | <b>\$ (7)</b>      | <b>\$ (78)</b> | <b>\$ 361</b> | <b>\$ 137</b>        | <b>\$ 224</b> |

(1) - Includes HELOC loans and CES.

(2) - Primarily represents an international road transaction and high yield corporate CDOs.

The decrease in total aggregate losses and LAE for the three and six months ended June 30, 2014 compared with the same period of 2013 primarily resulted from a decrease in expected payments on an international road transaction and CMBS exposures, partially offset by an increase in recoveries of ineligible mortgage loans included in insured second-lien RMBS exposures in 2013 with no comparable increase in 2014. Furthermore, in 2013 there was a reversal of recoveries related to high yield corporate CDOs.

In addition to the information presented above, the following tables present aggregate losses and LAE for the three and six months ended June 30, 2014 and 2013 by insurance type:

**Aggregate Losses and LAE by Insurance Type (change in discounted values of net payments)**

| In millions                                                                                                | Three Months Ended June 30, 2014   |                    |                |              |                      |              |
|------------------------------------------------------------------------------------------------------------|------------------------------------|--------------------|----------------|--------------|----------------------|--------------|
|                                                                                                            | Second-lien<br>RMBS <sup>(1)</sup> | First-lien<br>RMBS | ABS CDO        | CMBS         | Other <sup>(2)</sup> | Total        |
| Financial guarantee insurance <sup>(3)</sup>                                                               | \$ 47                              | \$ (3)             | \$ (23)        | \$ (1)       | \$ (25)              | \$ (5)       |
| Financial guarantee insurance related to consolidated<br>VIEs (eliminated in consolidation) <sup>(4)</sup> | (13)                               | 1                  | (1)            | -            | -                    | (13)         |
| Insured credit derivatives (statutory basis) <sup>(5)</sup>                                                | -                                  | -                  | -              | 62           | -                    | 62           |
| <b>Total aggregate losses and LAE</b>                                                                      | <b>\$ 34</b>                       | <b>\$ (2)</b>      | <b>\$ (24)</b> | <b>\$ 61</b> | <b>\$ (25)</b>       | <b>\$ 44</b> |

(1) - Includes HELOC loans and CES.

(2) - Primarily represents an international road transaction.

(3) - Included in "Losses and loss adjustment" as reported on the Company's consolidated statements of operations.

(4) - Represents losses eliminated upon the consolidation of insured VIEs.

(5) - Represents statutory losses and LAE for insurance contracts accounted for as derivatives. Realized and unrealized gains and losses on these contracts under GAAP are recorded in "Net change in fair value of insured derivatives" on the Company's consolidated statements of operations.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**
**RESULTS OF OPERATIONS (continued)**

| In millions                                                                                                | Three Months Ended June 30, 2013   |                    |                |              |                      |               |
|------------------------------------------------------------------------------------------------------------|------------------------------------|--------------------|----------------|--------------|----------------------|---------------|
|                                                                                                            | Second-lien<br>RMBS <sup>(1)</sup> | First-lien<br>RMBS | ABS CDO        | CMBS         | Other <sup>(2)</sup> | Total         |
| Financial guarantee insurance <sup>(3)</sup>                                                               | \$ 33                              | \$ 9               | \$ (11)        | \$ (30)      | \$ 121               | \$ 122        |
| Financial guarantee insurance related to consolidated<br>VIEs (eliminated in consolidation) <sup>(4)</sup> | (76)                               | -                  | (24)           | -            | -                    | (100)         |
| Insured credit derivatives (statutory basis) <sup>(5)</sup>                                                | -                                  | -                  | (5)            | 109          | -                    | 104           |
| Total aggregate losses and LAE                                                                             | <u>\$ (43)</u>                     | <u>\$ 9</u>        | <u>\$ (40)</u> | <u>\$ 79</u> | <u>\$ 121</u>        | <u>\$ 126</u> |

(1) - Includes HELOC loans and CES.

(2) - Primarily represents an international road transaction and high yield corporate CDOs.

(3) - Included in "Losses and loss adjustment" as reported on the Company's consolidated statements of operations.

(4) - Represents losses eliminated upon the consolidation of insured VIEs.

(5) - Represents statutory losses and LAE for insurance contracts accounted for as derivatives. Realized and unrealized gains and losses on these contracts under GAAP are recorded in "Net change in fair value of insured derivatives" on the Company's consolidated statements of operations.

**Aggregate Losses and LAE by Insurance Type (change in discounted values of net payments)**

| In millions                                                                                                | Six Months Ended June 30, 2014     |                    |               |              |                      |               |
|------------------------------------------------------------------------------------------------------------|------------------------------------|--------------------|---------------|--------------|----------------------|---------------|
|                                                                                                            | Second-lien<br>RMBS <sup>(1)</sup> | First-lien<br>RMBS | ABS CDO       | CMBS         | Other <sup>(2)</sup> | Total         |
| Financial guarantee insurance <sup>(3)</sup>                                                               | \$ 72                              | \$ 27              | \$ (17)       | \$ (1)       | \$ (22)              | \$ 59         |
| Financial guarantee insurance related to consolidated VIEs (eliminated in<br>consolidation) <sup>(4)</sup> | (1)                                | (1)                | 9             | -            | -                    | 7             |
| Insured credit derivatives (statutory basis) <sup>(5)</sup>                                                | -                                  | -                  | -             | 82           | -                    | 82            |
| Total aggregate losses and LAE                                                                             | <u>\$ 71</u>                       | <u>\$ 26</u>       | <u>\$ (8)</u> | <u>\$ 81</u> | <u>\$ (22)</u>       | <u>\$ 148</u> |

(1) - Includes HELOC loans and CES.

(2) - Primarily represents an international road transaction.

(3) - Included in "Losses and loss adjustment" as reported on the Company's consolidated statements of operations.

(4) - Represents losses eliminated upon the consolidation of insured VIEs.

(5) - Represents statutory losses and LAE for insurance contracts accounted for as derivatives. Realized and unrealized gains and losses on these contracts under GAAP are recorded in "Net change in fair value of insured derivatives" on the Company's consolidated statements of operations.

| In millions                                                                                                | Six Months Ended June 30, 2013     |                    |                |               |                      |               |
|------------------------------------------------------------------------------------------------------------|------------------------------------|--------------------|----------------|---------------|----------------------|---------------|
|                                                                                                            | Second-lien<br>RMBS <sup>(1)</sup> | First-lien<br>RMBS | ABS CDO        | CMBS          | Other <sup>(2)</sup> | Total         |
| Financial guarantee insurance <sup>(3)</sup>                                                               | \$ (120)                           | \$ (7)             | \$ (48)        | \$ (38)       | \$ 137               | \$ (76)       |
| Financial guarantee insurance related to consolidated VIEs (eliminated in<br>consolidation) <sup>(4)</sup> | (69)                               | -                  | (26)           | -             | -                    | (95)          |
| Insured credit derivatives (statutory basis) <sup>(5)</sup>                                                | -                                  | -                  | (4)            | 399           | -                    | 395           |
| Total aggregate losses and LAE                                                                             | <u>\$ (189)</u>                    | <u>\$ (7)</u>      | <u>\$ (78)</u> | <u>\$ 361</u> | <u>\$ 137</u>        | <u>\$ 224</u> |

(1) - Includes HELOC loans and CES.

(2) - Primarily represents an international road transaction and high yield corporate CDOs.

(3) - Included in "Losses and loss adjustment" as reported on the Company's consolidated statements of operations.

(4) - Represents losses eliminated upon the consolidation of insured VIEs.

(5) - Represents statutory losses and LAE for insurance contracts accounted for as derivatives. Realized and unrealized gains and losses on these contracts under GAAP are recorded in "Net change in fair value of insured derivatives" on the Company's consolidated statements of operations.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**
**RESULTS OF OPERATIONS (continued)**

The following table presents the aggregate loss and LAE reserves and insurance loss recoverables as of June 30, 2014 and December 31, 2013:

| In millions                                              | Financial<br>Guarantee<br>Insurance <sup>(1)</sup> | Financial<br>Guarantee<br>Insurance<br>Related to<br>Consolidated<br>VIEs <sup>(2)</sup> | Insured<br>Credit<br>Derivative<br>Impairments<br>and LAE <sup>(3)</sup> | Reinsurance <sup>(4)</sup> | Total<br>Aggregate<br>Loss <sup>(5)</sup> |
|----------------------------------------------------------|----------------------------------------------------|------------------------------------------------------------------------------------------|--------------------------------------------------------------------------|----------------------------|-------------------------------------------|
| Gross loss and LAE reserves as of December 31, 2013      | \$ 554                                             | \$ 271                                                                                   | \$ 476                                                                   | \$ (7)                     | \$ 1,294                                  |
| Gross insurance loss recoverable as of December 31, 2013 | (681)                                              | (540)                                                                                    | (21)                                                                     | 5                          | (1,237)                                   |
| Total reserves (recoverable) as of December 31, 2013     | (127)                                              | (269)                                                                                    | 455                                                                      | (2)                        | 57                                        |
| Ceded reserves                                           | (2)                                                | -                                                                                        | -                                                                        | 2                          | -                                         |
| Net reserves as of December 31, 2013                     | (129)                                              | (269)                                                                                    | 455                                                                      | -                          | 57                                        |
| Total aggregate losses and LAE incurred                  | 59                                                 | 7                                                                                        | 82                                                                       | -                          | 148                                       |
| (Payments) collections and other                         | (57)                                               | (12)                                                                                     | (359)                                                                    | -                          | (428)                                     |
| Net reserves as of June 30, 2014                         | (127)                                              | (274)                                                                                    | 178                                                                      | -                          | (223)                                     |
| Ceded reserves                                           | 1                                                  | -                                                                                        | -                                                                        | (1)                        | -                                         |
| Total reserves (recoverable) as of June 30, 2014         | \$ (126)                                           | \$ (274)                                                                                 | \$ 178                                                                   | \$ (1)                     | \$ (223)                                  |
| Gross loss and LAE reserves as of June 30, 2014          | \$ 484                                             | \$ 253                                                                                   | \$ 187                                                                   | \$ (6)                     | \$ 918                                    |
| Gross insurance loss recoverable as of June 30, 2014     | (610)                                              | (527)                                                                                    | (9)                                                                      | 5                          | (1,141)                                   |
| Total reserves (recoverable) as of June 30, 2014         | \$ (126)                                           | \$ (274)                                                                                 | \$ 178                                                                   | \$ (1)                     | \$ (223)                                  |

(1) - Included in "Losses and loss adjustment," "Loss and loss adjustment expense reserves," and "Insurance loss recoverable" on the Company's consolidated financial statements.

(2) - Represents loss expense, reserves and insurance loss recoverable eliminated upon the consolidation of insured VIEs.

(3) - Represents statutory losses and LAE and recoveries for insurance contracts accounted for as derivatives. Realized and unrealized gains and losses on these contracts under GAAP are recorded in "Net change in fair value of insured derivatives" on the Company's consolidated statements of operations and the fair value of these contracts are recorded in "Derivative liabilities" on the Company's consolidated balance sheets.

(4) - Represents "Losses and loss adjustment," "Loss and loss adjustment expense reserves" and "Insurance loss recoverable" on the Company's consolidated financial statements that are ceded to third-party reinsurers under insurance contracts. As of June 30, 2014 and December 31, 2013, there was a \$1 million and \$2 million receivable, respectively.

(5) - Represents totals after ceding to third-party reinsurers under insurance contracts.

As of June 30, 2014, our estimated recoveries from excess spread within insured second-lien RMBS was \$750 million. Included in the total aggregate insurance loss recoverable was \$737 million, of which \$168 million was included in consolidated VIEs, and included in the total aggregate loss and LAE reserves was \$13 million, of which \$5 million was included in consolidated VIEs.

POLICY ACQUISITION COSTS AND OPERATING EXPENSES Structured finance and international insurance segment expenses for the three and six months ended June 30, 2014 and 2013 are presented in the following table:

| In millions                                | Three Months Ended June 30, |       | Percent<br>Change | Six Months Ended June 30, |        | Percent<br>Change |
|--------------------------------------------|-----------------------------|-------|-------------------|---------------------------|--------|-------------------|
|                                            | 2014                        | 2013  |                   | 2014                      | 2013   |                   |
| Gross expenses                             | \$ 15                       | \$ 37 | -59%              | \$ 31                     | \$ 66  | -53%              |
| Amortization of deferred acquisition costs | \$ 16                       | \$ 24 | -33%              | \$ 35                     | \$ 57  | -39%              |
| Operating                                  | 15                          | 35    | -57%              | 30                        | 61     | -51%              |
| Total insurance operating expenses         | \$ 31                       | \$ 59 | -47%              | \$ 65                     | \$ 118 | -45%              |

Gross expenses represent total insurance expenses before the deferral of any policy acquisition costs. Gross expenses decreased for the three months ended June 30, 2014 compared with the same period of 2013 primarily due to decreases in consulting fees, compensation expense and costs associated with support provided by our corporate segment. Gross expenses decreased for the six months ended June 30, 2014 compared with the same period of 2013 primarily due to decreases in consulting fees, compensation expense, costs associated with support provided by our corporate segment and legal and litigation related costs. The decreases in the amortization of deferred acquisition costs for the three and six months ended June 30, 2014 compared with the same periods of 2013 principally reflect the acceleration of deferred costs into earnings in prior periods as policies were terminated. Operating expenses decreased for the three and six months ended June 30, 2014 compared with the same periods of 2013 due to decreases in gross expenses. We did not defer a material amount of policy acquisition costs during the first half of 2014 or 2013. Policy acquisition costs in these periods were primarily related to ceding commission income and premium taxes on installment policies written in prior periods.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

**INTEREST EXPENSE** Interest expense incurred by our structured finance and international insurance segment decreased for the three and six months ended June 30, 2014 compared with the same periods of 2013 primarily due to the repayment of the National Secured Loan in May of 2013.

**INSURED PORTFOLIO EXPOSURE** The credit quality of our structured finance and international insured portfolio is assessed in the same manner as our U.S. public finance insured portfolio. As of June 30, 2014 and December 31, 2013, 23% of our structured finance and international insured portfolio, was rated below investment grade, before giving effect to MBIA's guarantees, based on MBIA's internal ratings, which are more current than the underlying ratings provided by S&P and Moody's for this subset of our insured portfolio.

#### *Structured Finance and International Insurance Selected Portfolio Exposures*

The following is a summary of selected significant exposures within the insured portfolio of our structured finance and international insurance segment. Many of these sectors are and have been considered volatile over the past several years. As described below, we may experience considerable incurred losses and future expected payments in certain of these sectors. There can be no assurance that the loss reserves described below will be sufficient or that we will not experience losses on transactions on which we currently have no loss reserves, in particular if the economy deteriorates.

#### **Collateralized Debt Obligations and Related Instruments**

As part of our structured finance and international insurance activities, MBIA Corp. typically provided guarantees on senior and, in a limited number of cases, mezzanine tranches of CDOs, as well as protection on structured CMBS pools and corporate securities, and CDS referencing such securities. The following discussion, including reported amounts and percentages, includes insured CDO transactions consolidated by the Company as VIEs.

As of June 30, 2014, MBIA Corp.'s \$20.9 billion CDO portfolio represented 30% of its total insured gross par outstanding of \$69.0 billion. As of December 31, 2013, MBIA Corp.'s \$29.7 billion CDO portfolio represented 37% of its total insured gross par outstanding of \$80.4 billion. The distribution of the Company's insured CDO and related instruments portfolio by collateral type is presented in the following table:

| In billions<br>Collateral Type            | Gross Par Outstanding as of |                   | Percent Change |
|-------------------------------------------|-----------------------------|-------------------|----------------|
|                                           | June 30, 2014               | December 31, 2013 |                |
| Multi-sector CDOs                         | \$ 1.3                      | \$ 1.5            | -13%           |
| Investment grade corporate CDOs           | 11.2                        | 15.6              | -28%           |
| High yield corporate CDOs                 | 4.0                         | 4.3               | -7%            |
| Commercial real estate pools and CRE CDOs | 4.4                         | 8.3               | -47%           |
| <b>Total</b>                              | <b>\$ 20.9</b>              | <b>\$ 29.7</b>    | <b>-30%</b>    |

#### *Multi-Sector CDOs*

The multi-sector CDO portfolio is comprised of 11 transactions insured in the primary market between 2002 and 2006 and 18 transactions insured in the secondary market between 2000 and 2004. The underlying collateral in MBIA Corp.'s insured multi-sector CDO transactions is comprised of RMBS, other multi-sector CDOs, corporate CDOs, collateralized loan obligations, ABS (e.g., securitizations of auto receivables, credit cards, etc.), CRE CDOs, CMBS and corporate credits.

Generally, we are subject to a claim on a multi-sector CDO when the insured tranche incurs an interest or principal shortfall. Such shortfalls result once the underlying collateral supporting the transaction no longer generates enough cash flow to support the insured notes. MBIA Corp.'s payment obligation after a default insures current interest and ultimate principal. Original subordination levels for transactions insured in the primary market ranged from 10% to 31%. Current subordinations range from 0% to 31%.

The significant erosion of subordination in our multi-sector CDO transactions principally resulted from the underperformance of RMBS and CDO collateral. The erosion of subordination in these transactions increases the likelihood that MBIA Corp. will pay claims. As of June 30, 2014, there were credit impairment estimates for 20 classified multi-sector CDO transactions for which MBIA Corp. expects to incur actual net claims in the future, representing 69% of all MBIA Corp.-insured multi-sector CDO transactions (including both CDS and non-CDS contracts). Of the remaining transactions, 14% are on our "Caution List" and 17% continue to perform at or close to our original expectations. In the event of further performance deterioration of the collateral referenced or held in our multi-sector CDO transactions, the amount of credit impairments could increase materially.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

As of June 30, 2014, our gross par exposure to multi-sector CDOs of \$1.3 billion represented 2% of MBIA Corp.'s total gross par insured.

#### *Investment Grade Corporate CDOs*

Our gross par exposure to investment grade CDOs of \$11.2 billion represents 54% of MBIA Corp.'s CDO exposure and 16% of MBIA Corp.'s total gross par insured. The portfolio is comprised of eight investment grade corporate CDO exposures insured in 2006 and 2007 referencing pools of predominantly investment grade corporate credits. Two of these pools include limited exposure to other asset classes, including structured finance securities (such as RMBS and CDOs). Our investment grade corporate CDO policies guarantee coverage of losses on collateral assets once a deductible has been eroded, and are highly customized structures. The Company's insured investment grade corporate CDOs have experienced erosion of subordination due to the default of underlying referenced corporate and structured finance securities, but we currently do not expect losses on MBIA Corp.'s insured tranches. Original subordination levels for six of the investment grade corporate CDO policies referencing only direct corporate credit ranged from 17% to 30%. Current subordination levels for these six policies are between 12% and 28%.

Our gross par exposure to insured investment grade corporate CDOs includes \$4.5 billion across two transactions that were structured to include buckets (35% of the overall CDO) of references to specific tranches of other investment grade corporate CDOs (monotranche). In such transactions, MBIA Corp.'s insured investment grade corporate CDOs include direct corporate or structured credit reference risks, and monotranche or single layer credit risk referencing a diverse pool of corporate assets or obligors with a specific attachment and a specific detachment point. The referenced monotranche in such CDOs were typically rated double-A and sized to 3.5% of the overall reference risk pool. The inner referenced monotranche are not subject to acceleration and do not give control rights to a senior investor. The inner referenced monotranche have also experienced erosion of subordination due to defaults in their referenced corporate assets. These transactions had original subordination of 25% and current subordination ranges from 16% to 18%.

#### *High Yield Corporate CDOs*

Our high yield corporate CDO portfolio, totaling \$4.0 billion of gross par exposure, largely comprises middle-market/special- opportunity corporate loan transactions. Our gross par exposure to high yield corporate CDOs represents 19% of MBIA Corp.'s CDO exposure and 6% of MBIA Corp.'s total gross par insured as of June 30, 2014. Original subordination for our high yield corporate portfolio ranged from 22% to 33%. Current subordination is between 9% and 35%. Declines in subordination levels result from defaults in underlying collateral, as well as sales of underlying collateral at discounted prices. Subordination within CDOs may decline further over time as a result of additional collateral deterioration. We do not expect insured losses on our high yield corporate CDO portfolio. Accordingly, as of June 30, 2014, there is no loss reserve established for this portfolio. However, there can be no assurance that the Company will not incur losses as a result of further deterioration in subordination.

#### *Commercial Real Estate Pools and CRE CDOs*

The following table presents our gross par exposure to the CRE sector through insured structured transactions primarily comprising CRE collateral. In addition to the table, MBIA Corp. insures approximately \$693 million in CRE loan pools, primarily comprising European assets. We do not expect insured losses on our CRE loan pools. These CRE loans are not included in the following "Structured CMBS Pools" and "CRE CDOs" sections.

| In billions<br>Collateral Type | Gross Par Outstanding as of |                   | Percent Change |
|--------------------------------|-----------------------------|-------------------|----------------|
|                                | June 30, 2014               | December 31, 2013 |                |
| Commercial real estate pools   | \$ 3.5                      | \$ 7.1            | -51%           |
| CRE CDOs                       | 0.9                         | 1.2               | -25%           |
| Total                          | \$ 4.4                      | \$ 8.3            | -47%           |

#### Structured CMBS Pools

As of June 30, 2014, our gross par exposure to structured CMBS pools totaled \$3.5 billion and represented approximately 5% of MBIA Corp.'s total gross par insured. Our structured CMBS pool insured transactions are pools of CMBS bonds, Real Estate Investment Trust ("REIT") debt and other CRE CDOs structured with first loss deductibles. The deductible sizing was a function of the underlying collateral ratings and certain structural attributes. MBIA Corp.'s guarantees for most structured CMBS pool transactions cover losses on collateral assets once the deductibles have been eroded. These deductibles provide credit enhancement and subordination to MBIA's insured position.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS (continued)**

MBIA Corp.'s guarantee generally is in the form of a CDS referencing the static pooled transactions. MBIA Corp. would have a payment obligation if the volume of collateral losses exceeds the deductible level in the transaction. Loss payments on these transactions are generally due upon settlement of individual collateral losses as they occur after any deductible or subordination has been exhausted. Each pool comprising CMBS bonds is ultimately backed by the commercial mortgage loans securitized within each CMBS trust. The same CMBS bonds may be referenced in multiple pools. The Company's structured CMBS pools are static, meaning that the collateral pool of securitizations cannot be and has not been changed since the origination of the policy. Most transactions comprised similarly rated underlying tranches at inception. The deductible for each transaction varies.

As of June 30, 2014, we had exposure to two static CMBS pools, having \$572 million of gross par outstanding, that were originally insured in 2007, and in which substantially all of the underlying collateral comprised CMBS tranches originally rated triple-B and lower. We believe this exposure represents our greatest loss potential within our CMBS portfolio. We are currently paying claims on one of these pools with an insured gross par exposure of \$350 million as of June 30, 2014, that is comprised of 2004, 2005 and 2006 vintage collateral. Aside from these original triple-B collateral-backed deals, our \$2.9 billion of remaining insured structured CMBS pools primarily consists of transactions backed by collateral originally rated triple-A and originated in 2004, 2005, 2006 or 2007.

Original deductibles for our structured CMBS pools ranged from 5% to 82%. As of June 30, 2014, the deductibles for these transactions ranged from 0% to 84%. Deductibles are eroded as bonds experience realized losses which are ultimately due to liquidations of underlying loan collateral.

Actual losses will be a function of the proportion of loans in the pools that are foreclosed and liquidated and the loss severities associated with those liquidations. If the deductibles in the Company's insured transactions and underlying referenced CMBS transactions are fully eroded, additional property level losses upon foreclosures and liquidations could result in substantial losses for MBIA. Ultimate loss rates remain uncertain and it is possible that we will experience severe losses or liquidity needs due to increased deterioration in our insured CMBS portfolio or our failure to commute the policies, in particular if macroeconomic stress escalates, there is a new recession, increased delinquencies, higher levels of liquidations of delinquent loans, and/or higher severities of loss upon liquidation. Although we still believe the likelihood of a recession in the near future is low, we do consider the possibility in our estimates for future claims.

**CRE CDOs**

As of June 30, 2014, our gross par exposure to CRE CDOs was approximately \$860 million and represented approximately 1% of MBIA Corp.'s total gross par insured. CRE CDOs are managed pools of CMBS, CRE whole loans, B-Notes, mezzanine loans, REIT debt, and other securities (including, in some instances, buckets for RMBS and CRE CDOs) that allow for reinvestment during a defined time period. These transactions benefit from typical CDO structural features such as cash diversion triggers, collateral quality tests, and manager replacement provisions. MBIA Corp. guarantees timely interest and ultimate principal of these CDOs. As with our other insured CDOs, these transactions were structured with credit protection originally rated triple-A, or a multiple of triple-A, below our guarantee. To the extent losses do occur on these transactions, the principal payments are due at the maturity date, which range from the years 2045 through 2056.

**Residential Mortgage Exposure**

MBIA Corp. insures mortgage-backed securities ("MBS") backed by residential mortgage loans, including second-lien RMBS transactions (revolving HELOC loans and CES). MBIA Corp. also insures MBS backed by first-lien alternative A-paper ("Alt-A") and subprime mortgage loans directly through RMBS securitizations. There has been considerable stress and continued deterioration in the mortgage market since 2008 reflected by increased delinquencies and losses, particularly related to Alt-A and subprime mortgage loans originated during 2005, 2006 and 2007.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

The following tables present the gross par outstanding by vintage year of MBIA Corp.'s total direct RMBS insured exposure as of June 30, 2014 and December 31, 2013. Amounts include the gross par outstanding related to transactions that the Company consolidates under accounting guidance for VIEs.

| In millions            | Gross Par Outstanding as of June 30, 2014 |                               |                             |                      |                    |                |
|------------------------|-------------------------------------------|-------------------------------|-----------------------------|----------------------|--------------------|----------------|
|                        | Prime<br>First-lien                       | Alt-A<br>First-lien           | Subprime<br>First-lien      | HELOC<br>Second-lien | CES<br>Second-lien | Total          |
| 2005 - 2007            | \$ 13                                     | \$1,379                       | \$ 254                      | \$ 2,051             | \$ 2,335           | \$6,032        |
| 2004 and prior         | 142                                       | 609                           | 672                         | 449                  | 42                 | 1,914          |
| <b>Total gross par</b> | <b>\$ 155</b>                             | <b>\$ 1,988<sup>(1)</sup></b> | <b>\$ 926<sup>(2)</sup></b> | <b>\$ 2,500</b>      | <b>\$ 2,377</b>    | <b>\$7,946</b> |

(1) - Includes international exposure of \$573 million.

(2) - Includes international exposure of \$6 million.

| In millions            | Gross Par Outstanding as of December 31, 2013 |                               |                               |                      |                    |                |
|------------------------|-----------------------------------------------|-------------------------------|-------------------------------|----------------------|--------------------|----------------|
|                        | Prime<br>First-lien                           | Alt-A<br>First-lien           | Subprime<br>First-lien        | HELOC<br>Second-lien | CES<br>Second-lien | Total          |
| 2005 - 2007            | \$ 14                                         | \$1,564                       | \$ 358                        | \$ 2,186             | \$ 2,560           | \$6,682        |
| 2004 and prior         | 167                                           | 648                           | 742                           | 500                  | 49                 | 2,106          |
| <b>Total gross par</b> | <b>\$ 181</b>                                 | <b>\$ 2,212<sup>(1)</sup></b> | <b>\$ 1,100<sup>(2)</sup></b> | <b>\$ 2,686</b>      | <b>\$ 2,609</b>    | <b>\$8,788</b> |

(1) - Includes international exposure of \$589 million.

(2) - Includes international exposure of \$8 million.

During the six months ended June 30, 2014, we paid approximately \$13 million of claim payments and LAE, net of reinsurance and collections, on insured second-lien RMBS transactions, or \$2 million after eliminating \$11 million of net payments made on behalf of consolidated VIEs. Through June 30, 2014, we made claim and LAE payments for 37 out of 43 insured second-lien RMBS policies.

### Loss Remediation Transactions

We may seek to purchase, from time to time, directly or indirectly, obligations guaranteed by MBIA or seek to commute policies. The amount of insurance exposure reduced, if any, and the nature of any such actions will depend on market conditions, pricing levels from time to time, and other considerations. In some cases, these activities may result in a reduction of expected loss reserves, but in all cases they are intended to limit our ultimate losses and reduce the future volatility in loss development on the related policies. Our ability to purchase guaranteed obligations and to commute policies will depend on management's assessment of available liquidity.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS (continued)**

***U.S. Public Finance and Structured Finance and International Reinsurance***

Reinsurance enables the Company to cede exposure for purposes of syndicating risk and increasing its capacity to write new business while complying with its single risk and credit guidelines. When a reinsurer is downgraded by one or more of the rating agencies, less capital credit is given to MBIA under rating agency models and the overall value of the reinsurance to MBIA is reduced. The Company generally retains the right to reassume the business ceded to reinsurers under certain circumstances, including a reinsurer's rating downgrade below specified thresholds. The following table presents information about our reinsurance agreements as of June 30, 2014 for our U.S. public finance and structured finance and international insurance operations:

| In millions                             | Standard & Poor's Rating (Status) | Moody's Rating (Status)    | Ceded Par Outstanding | Letters of Credit/Trust Accounts | Reinsurance Recoverable <sup>(1)</sup> |
|-----------------------------------------|-----------------------------------|----------------------------|-----------------------|----------------------------------|----------------------------------------|
| Reinsurers                              |                                   |                            |                       |                                  |                                        |
| Assured Guaranty Re Ltd.                | AA<br>(Stable Outlook)            | Baa1<br>(Negative Outlook) | \$ 3,844              | \$ 30                            | \$ -                                   |
| Assured Guaranty Corp.                  | AA<br>(Stable Outlook)            | A3<br>(Stable Outlook)     | 2,443                 | -                                | 7                                      |
| Overseas Private Investment Corporation | AA+<br>(Stable Outlook)           | Aaa<br>(Stable Outlook)    | 315                   | -                                | -                                      |
| Others                                  | A- or above                       | A2 or above                | 104                   | 3                                | -                                      |
| <b>Total</b>                            |                                   |                            | <b>\$ 6,706</b>       | <b>\$ 33</b>                     | <b>\$ 7</b>                            |

(1) - Total reinsurance recoverable is primarily recoverables on unpaid losses.

MBIA requires certain unauthorized reinsurers to maintain bank letters of credit or establish trust accounts to cover liabilities ceded to such reinsurers under reinsurance contracts. The Company 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 June 30, 2014, the aggregate amount of insured par outstanding ceded by MBIA to reinsurers under reinsurance agreements was \$6.7 billion compared with \$7.1 billion as of December 31, 2013. As of June 30, 2014, \$5.4 billion of the ceded par outstanding was ceded from our U.S. public finance insurance segment and \$1.3 billion was ceded from our structured finance and international insurance segment. Under National's reinsurance agreement with MBIA Corp., if a reinsurer of MBIA Corp. is unable to pay claims ceded by MBIA Corp. on U.S. public finance exposure, National will assume liability for such ceded claim payments.

***Advisory Services***

Our asset management and advisory business is primarily conducted through Cutwater. Cutwater provides advisory services, including cash management, discretionary asset management and structured products on a fee-for-service basis. Cutwater offers these services to public, not-for-profit, corporate and financial services clients, including MBIA Inc. and its other subsidiaries.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**
**RESULTS OF OPERATIONS (continued)**

The following table summarizes the results and assets under management of our advisory services segment for the three and six months ended June 30, 2014 and 2013. These results include revenues and expenses from transactions with the Company's insurance, corporate, and wind-down operations.

| In millions                                                                    | Three Months Ended June 30, |           | Percent Change | Six Months Ended June 30, |           | Percent Change |
|--------------------------------------------------------------------------------|-----------------------------|-----------|----------------|---------------------------|-----------|----------------|
|                                                                                | 2014                        | 2013      |                | 2014                      | 2013      |                |
| Fees                                                                           | \$ 10                       | \$ 11     | -9%            | \$ 19                     | \$ 22     | -14%           |
| Net gains (losses) of financial instruments at fair value and foreign exchange | 1                           | -         | n/m            | (3)                       | -         | n/m            |
| Total revenues                                                                 | 11                          | 11        | -%             | 16                        | 22        | -27%           |
| Operating expenses                                                             | 13                          | 17        | -24%           | 25                        | 29        | -14%           |
| Pre-tax income (loss)                                                          | \$ (2)                      | \$ (6)    | -67%           | \$ (9)                    | \$ (7)    | 29%            |
| Ending assets under management:                                                |                             |           |                |                           |           |                |
| Third-party                                                                    | \$ 12,457                   | \$ 16,943 | -26%           | \$ 12,457                 | \$ 16,943 | -26%           |
| Insurance and corporate                                                        | 7,061                       | 6,749     | 5%             | 7,061                     | 6,749     | 5%             |
| Asset/liability products and conduits                                          | 3,401                       | 4,230     | -20%           | 3,401                     | 4,230     | -20%           |
| Total ending assets under management                                           | \$ 22,919                   | \$ 27,922 | -18%           | \$ 22,919                 | \$ 27,922 | -18%           |

n/m - Percent change not meaningful.

For the three months ended June 30, 2014, the favorable change in pre-tax income (loss) compared with the same period of 2013 was primarily due to decreases in compensation, legal and consulting expenses. For the six months ended June 30, 2014, the unfavorable change in pre-tax income (loss) compared with the same period of 2013 was primarily driven by a \$3 million loss in foreign exchange from the liquidation of a foreign subsidiary. In addition, during the three and six months ended June 30, 2014, there were decreases in fee revenues due to declines in asset balances managed for third parties and our other segments.

Average third-party assets under management for the six months ended June 30, 2014 and 2013 were \$12.6 billion and \$17.4 billion, respectively. This decrease was principally due to declines in our pool products and CDO management business.

**Corporate**

General corporate activities are conducted through our corporate segment. Our corporate operations primarily consist of holding company activities, including our service company, Optinuity Alliance Resources Corporation ("Optinuity"). Revenues and expenses for Optinuity are included in the results of our corporate segment. Optinuity provides support services such as management, legal, accounting, treasury, information technology, and insurance portfolio surveillance, among others, to our corporate segment and other operating businesses on a fee-for-service basis.

The following table summarizes the consolidated results of our corporate segment for the three and six months ended June 30, 2014 and 2013. The results include revenues and expenses that arise from general corporate activities and from providing support to our other segments.

| In millions                                                                    | Three Months Ended June 30, |         | Percent Change | Six Months Ended June 30, |          | Percent Change |
|--------------------------------------------------------------------------------|-----------------------------|---------|----------------|---------------------------|----------|----------------|
|                                                                                | 2014                        | 2013    |                | 2014                      | 2013     |                |
| Net investment income                                                          | \$ 5                        | \$ 8    | -38%           | \$ 11                     | \$ 9     | 22%            |
| Fees                                                                           | 24                          | 17      | 41%            | 42                        | 44       | -5%            |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 93                          | (29)    | n/m            | 79                        | (24)     | n/m            |
| Other net realized gains (losses)                                              | -                           | -       | -%             | 1                         | -        | n/m            |
| Revenues of consolidated VIEs:                                                 |                             |         |                |                           |          |                |
| Other net realized gains (losses)                                              | -                           | (10)    | -100%          | (5)                       | (10)     | -50%           |
| Total revenues                                                                 | 122                         | (14)    | n/m            | 128                       | 19       | n/m            |
| Operating                                                                      | 23                          | 34      | -32%           | 45                        | 101      | -55%           |
| Interest                                                                       | 11                          | 11      | -%             | 23                        | 23       | -%             |
| Total expenses                                                                 | 34                          | 45      | -24%           | 68                        | 124      | -45%           |
| Pre-tax income (loss)                                                          | \$ 88                       | \$ (59) | n/m            | \$ 60                     | \$ (105) | n/m            |

n/m - Percent change not meaningful.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### RESULTS OF OPERATIONS (continued)

**FEES** Fees are generated from support services provided to business units within the Company on a fee-for-service basis. Fees for the three months ended June 30, 2014 increased compared with the same period of 2013 primarily due to a fee paid by our conduit segment for administrative and other services. Fees for the six months ended June 30, 2014 decreased compared with the same period of 2013 due to decreases in fees paid by our conduit segment for administrative and other services. Such fees may vary significantly from period to period.

**NET GAINS (LOSSES) ON FINANCIAL INSTRUMENTS AT FAIR VALUE AND FOREIGN EXCHANGE** The changes in net gains (losses) on financial instruments at fair value and foreign exchange for the three and six months ended June 30, 2014 compared with the same periods of 2013 were primarily due to changes in the fair value of outstanding warrants issued on MBIA Inc. common stock and increases in net gains on the sales of investments. The changes in the fair value of outstanding warrants were primarily attributable to fluctuations in MBIA Inc.'s stock price and volatility, which are used in the valuation of the warrants.

**REVENUES OF CONSOLIDATED VIEs** For the three months ended June 30, 2013 and the six months ended June 30, 2014 and 2013, total revenues of consolidated VIEs related to net losses as a result of the deconsolidation of VIEs.

**OPERATING EXPENSES** Operating expenses for the three and six months ended June 30, 2014 decreased compared with the same periods of 2013 due to decreases in expenses related to the Bank of America Settlement and compensation expense.

### Wind-down Operations

We operate an asset/liability products business in which we historically issued debt and investment agreements insured by MBIA Corp. to capital markets and municipal investors. The proceeds of the debt and investment agreements were used initially to purchase assets that largely matched the duration of those liabilities. We also operated a conduit business in which we funded transactions by issuing debt insured by MBIA Corp. The rating downgrades of MBIA Corp. resulted in the termination and collateralization of certain derivatives and investment agreements and, together with the rising cost and declining availability of funding and liquidity within many of the asset classes in which proceeds were invested, caused the Company to begin winding down its asset/liability products and conduit businesses in 2008. Since the downgrades of MBIA Corp., we have not issued debt in connection with either business and, as a result, the outstanding liability balances and corresponding asset balances will continue to decline over time as liabilities mature, terminate or are retired by us. In the second quarter of 2014, we completed the winding down of our conduit segment with the dissolution of Meridian.

### Asset/Liability Products

The following table presents the results of our asset/liability products segment for the three and six months ended June 30, 2014 and 2013. These results include revenues and expenses from transactions with the Company's other segments.

| In millions                                                                    | Three Months Ended June 30, |                | Percent Change | Six Months Ended June 30, |                | Percent Change |
|--------------------------------------------------------------------------------|-----------------------------|----------------|----------------|---------------------------|----------------|----------------|
|                                                                                | 2014                        | 2013           |                | 2014                      | 2013           |                |
| Net investment income                                                          | \$ 5                        | \$ 6           | -17%           | \$ 11                     | \$ 13          | -15%           |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (21)                        | (12)           | 75%            | (58)                      | (9)            | n/m            |
| Net gains (losses) on extinguishment of debt                                   | 2                           | -              | n/m            | 3                         | 4              | -25%           |
| Total revenues                                                                 | (14)                        | (6)            | 133%           | (44)                      | 8              | n/m            |
| Operating                                                                      | 2                           | 2              | -%             | 4                         | 4              | -%             |
| Interest                                                                       | 15                          | 21             | -29%           | 33                        | 41             | -20%           |
| Total expenses                                                                 | 17                          | 23             | -26%           | 37                        | 45             | -18%           |
| Pre-tax income (loss)                                                          | <u>\$ (31)</u>              | <u>\$ (29)</u> | <u>7%</u>      | <u>\$ (81)</u>            | <u>\$ (37)</u> | <u>119%</u>    |

n/m - Percent change not meaningful.

**NET GAINS (LOSSES) ON FINANCIAL INSTRUMENTS AT FAIR VALUE AND FOREIGN EXCHANGE** The unfavorable changes in net gains (losses) on financial instruments at fair value and foreign exchange for the three and six months ended June 30, 2014 compared with the same periods of 2013 were primarily the result of derivative losses in 2014 compared with gains in 2013 partially offset by declines in losses related to the sales of investments.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

#### RESULTS OF OPERATIONS (continued)

**INTEREST EXPENSE** The decreases in interest expense for the three and six months ended June 30, 2014 compared with the same periods of 2013 were primarily due to the continued maturity and repurchases of liabilities by the Company.

#### *Conduit*

Our conduit segment was operated through Meridian. During the six months ended June 30, 2014, we retired the remaining \$129 million of outstanding MTNs issued by Meridian and completed the winding down of this business. Meridian was dissolved during the second quarter of 2014. Certain of MBIA's consolidated subsidiaries had received fees for services provided to Meridian.

For the three months ended June 30, 2014 and 2013, total pre-tax loss was \$9 million and \$4 million, respectively. The increase in pre-tax loss was primarily due to a \$9 million fee paid to our corporate segment for administrative and other services. For the six months ended June 30, 2014 and 2013, total pre-tax loss was \$6 million and \$15 million, respectively. The decrease in pre-tax loss was primarily due to a \$4 million gain on extinguishment of debt and a decrease in interest expense due to the continued repurchases of MTNs by the Company.

#### **Taxes**

##### *Provision for Income Taxes*

The Company's income taxes and the related effective tax rates for the three and six months ended June 30, 2014 and 2013 are presented in the following table:

| In millions                          | Three Months Ended June 30, |          | Six Months Ended June 30, |         |
|--------------------------------------|-----------------------------|----------|---------------------------|---------|
|                                      | 2014                        | 2013     | 2014                      | 2013    |
| Pre-tax income (loss)                | \$ 55                       | \$ (264) | \$ 459                    | \$ (49) |
| Provision (benefit) for income taxes | \$ (65)                     | \$ (86)  | \$ 83                     | \$ (35) |
| Effective tax rate                   | -118.2%                     | 32.6%    | 18.1%                     | 71.4%   |

For the six months ended June 30, 2014, our effective tax rate applied to our pre-tax income was lower than the U.S. statutory tax rate of 35% primarily due to a decrease in our valuation allowance against our deferred tax asset from asset sales of previously impaired assets, partially offset by an increase in our reserve for uncertain tax positions. Effective in 2014, the consolidated tax provision is based on actual results and not on an estimated annual effective tax rate.

For the six months ended June 30, 2013, our effective tax rate applied to our pre-tax loss was higher than the U.S. statutory tax rate of 35% primarily due to a reduction in our valuation allowance against our deferred tax asset, net of certain nondeductible expenses.

The Company is party to a tax allocation agreement with members of its holding company system effective January 1, 1987. The agreement was amended and restated effective September 8, 2011 to change the method of calculating each domestic insurer's tax liability to the method permitted by paragraph 3(a) of Department Circular Letter #33 (1979). The agreement was submitted to the NYSDFS for review and non-disapproval pursuant to Section 1505 of the New York Insurance Law ("NYIL").

Refer to "Note 9: Income Taxes" in the Notes to Consolidated Financial Statements for a further discussion of income taxes, including the Company's valuation allowance against deferred tax assets and its accounting for tax uncertainties.

#### **CAPITAL RESOURCES**

The Company manages its capital resources to minimize its cost of capital while maintaining appropriate claims-paying resources ("CPR") for National and MBIA Corp. The Company's capital resources consist of total shareholders' equity, total debt issued by MBIA Inc. for general corporate purposes, and surplus notes issued by MBIA Corp. Total capital resources was \$5.3 billion and \$4.8 billion as of June 30, 2014 and December 31, 2013, respectively. MBIA Inc. uses its capital resources to support the business activities of its subsidiaries. As of June 30, 2014, MBIA Inc.'s investments in subsidiaries totaled \$4.2 billion.

In addition, MBIA Inc. also supports the MTN and investment agreement obligations originally issued by our asset/liability products segment. MBIA Inc. seeks to maintain sufficient liquidity and capital resources to meet its general corporate needs, including those of its asset/liability products segment, which are in wind-down. As of June 30, 2014 and December 31, 2013, the combined net debt of MBIA Inc.'s corporate segment and asset/liability products segment, which primarily comprised long-term debt, MTNs, investment agreements and derivative liabilities net of cash and investments at amortized cost and a tax receivable from subsidiaries, totaled \$1.0 billion and \$1.1 billion, respectively. The Company expects that MBIA Inc. will generate sufficient cash to satisfy its net debt and its general corporate needs over time from distributions from its operating subsidiaries. In addition, the Company may also consider raising third-party capital. There can be no assurance that the aforementioned factors will generate sufficient cash to satisfy its net debt. Refer to the following "Liquidity—MBIA Inc. Liquidity" section for additional information about MBIA Inc.'s liquidity.

As of June 30, 2014 and December 31, 2013, total GFL MTNs outstanding were \$1.3 billion and \$1.4 billion, respectively.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**CAPITAL RESOURCES**

***Securities Repurchases***

Repurchases of debt and common stock may be made from time to time in the open market or in private transactions as permitted by securities laws and other legal requirements. We may also choose to redeem debt obligations where permitted by the relevant agreements. We believe that debt and share repurchases and redemptions can be an appropriate deployment of capital in excess of amounts needed to support our liquidity while maintaining the CPR of MBIA Corp. and National as well as other business needs.

***Equity securities***

During the six months ended June 30, 2014, we repurchased 842,072 common shares of MBIA Inc. under our share repurchase program at a cost of \$9 million and an average share price of \$11.07 per share. As of June 30, 2014, \$14 million was available for future repurchases under the program. In July of 2014, the remaining \$14 million available for future repurchases was used to repurchase 1,244,665 common shares of MBIA Inc. at an average share price of \$11.03.

***Debt securities***

In addition to equity repurchases, MBIA Inc. or its subsidiaries may repurchase or redeem their outstanding debt at prices that we deem to be economically advantageous. During the six months ended June 30, 2014, we retired \$129 million par value outstanding of MTNs issued by our conduit segment at a cost of approximately 97% of par value. In addition, we repurchased approximately \$122 million par value outstanding of GFL MTNs issued by our asset/liability segment at a weighted average cost of approximately 98% of par value.

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

***Insurance Statutory Capital***

National and MBIA Corp. are incorporated and licensed in, and are subject to primary insurance regulation and supervision by, the State of New York. MBIA UK Insurance Limited is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority in the United Kingdom. National and MBIA Corp. each are required to file detailed annual financial statements, as well as interim financial statements, with the NYSDFS and similar supervisory agencies in each of the other jurisdictions in which it is licensed. These financial statements are prepared in accordance with New York State and the National Association of Insurance Commissioners' statements of U.S. STAT and assist our regulators in evaluating minimum standards of solvency, including minimum capital requirements, and business conduct. U.S. STAT differs from GAAP in a number of ways. Refer to the statutory accounting practices note to consolidated financial statements of National and MBIA Corp. within exhibits 99.1 and 99.2, respectively, of MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013 for an explanation of the differences between U.S. STAT and GAAP.

***National***

***Capital and Surplus***

National reported total statutory capital of \$3.4 billion as of June 30, 2014 compared with \$3.3 billion as of December 31, 2013. As of June 30, 2014, statutory capital comprised \$1.1 billion of contingency reserves and \$2.3 billion of policyholders' surplus. National had statutory net income of \$93 million for the six months ended June 30, 2014. Consistent with our plan to transform our insurance business, the Company received approval from the NYSDFS to reset National's unassigned surplus to zero, which was effective January 1, 2010. As of June 30, 2014, National's unassigned surplus was \$1.6 billion.

In order to maintain its New York State financial guarantee insurance license, National is required to maintain a minimum of \$65 million of policyholders' surplus. National is also required to maintain contingency reserves to provide protection to policyholders in the event of extreme losses in adverse economic events. Refer to the following "MBIA Corp.—Capital and Surplus" section for additional information about contingency reserves under the NYIL. National's policyholders' surplus would grow over time from the recognition of unearned premiums and investment income and the expected release of the contingency reserves. Conversely, dividends and incurred losses would reduce policyholders' surplus. As of June 30, 2014 and December 31, 2013, National was not in compliance with certain of its single risk limits but was in compliance with its aggregate risk limits.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**CAPITAL RESOURCES (continued)**

NYIL regulates the payment of dividends by financial guarantee insurance companies and provides that such companies may not declare or distribute dividends except out of statutory earned surplus. Under NYIL, the sum of (i) the amount of dividends declared or distributed during the preceding 12-month period and (ii) the dividend to be declared may not exceed the lesser of (a) 10% of policyholders' surplus, as reported in the latest statutory financial statements or (b) 100% of adjusted net investment income for such 12-month period (the net investment income for such 12-month period plus the excess, if any, of net investment income over dividends declared or distributed during the two-year period preceding such 12-month period), unless the Superintendent of the NYSDFS approves a greater dividend distribution based upon a finding that the insurer will retain sufficient surplus to support its obligations.

National had a positive earned surplus as of June 30, 2014, which provides National with dividend capacity. As a condition to the NYSDFS' approval of the simultaneous repurchase and reverse repurchase agreements ("Asset Swap") between MBIA Inc. and National, the NYSDFS requested that, until the notional amount of the Asset Swap has been reduced to 5% or less of National's admitted assets, each of MBIA Inc., MBIA Corp. and National provide the NYSDFS with three months prior notice, or such shorter period as the NYSDFS may permit, of its intent to initiate cash dividends on shares of its common stock. During the second quarter of 2014, National provided the NYSDFS with notice of its intention to pay a dividend during the fourth quarter of 2014. In October of 2013, National declared and paid a dividend of \$214 million to its ultimate parent, MBIA Inc.

National's statutory policyholders' surplus was lower than its GAAP shareholder's equity by \$1.7 billion as of June 30, 2014. U.S. STAT differs from GAAP in certain respects. Refer to "Note 11: Statutory Accounting Practices" in the Notes to Consolidated Financial Statements of National within exhibit 99.1 of MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013 for an explanation of the differences between U.S. STAT and GAAP.

**Claims-Paying Resources (Statutory Basis)**

CPR is a key measure of the resources available to National to pay claims under its insurance policies. CPR consists of total financial resources and reserves calculated on a statutory basis. CPR has been a common measure used by financial guarantee insurance companies to report and compare resources and continues to be used by MBIA's management to evaluate changes in such resources. We have provided CPR to allow investors and analysts to evaluate National using the same measure that MBIA's management uses to evaluate National's resources to pay claims under its insurance policies. There is no directly comparable GAAP measure. Our calculation of CPR may differ from the calculation of CPR reported by other companies.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**CAPITAL RESOURCES (continued)**

National's CPR and components thereto, as of June 30, 2014 and December 31, 2013 are presented in the following table:

| In millions                                          | As of June 30,<br>2014 | As of December 31,<br>2013 |
|------------------------------------------------------|------------------------|----------------------------|
| Policyholders' surplus                               | \$ 2,207               | \$ 2,086                   |
| Contingency reserves                                 | 1,148                  | 1,172                      |
| Statutory capital                                    | 3,355                  | 3,258                      |
| Unearned premium reserve                             | 1,548                  | 1,678                      |
| Present value of installment premiums <sup>(1)</sup> | 221                    | 226                        |
| Premium resources <sup>(2)</sup>                     | 1,769                  | 1,904                      |
| Net loss and LAE reserves <sup>(1)</sup>             | (24)                   | (87)                       |
| Salvage reserves                                     | 140                    | 177                        |
| Gross loss and LAE reserve                           | 116                    | 90                         |
| Total claims-paying resources                        | \$ 5,240               | \$ 5,252                   |

(1) - Calculated using a discount rate of 3.14% as of June 30, 2014 and December 31, 2013.

(2) - Includes financial guarantee and insured credit derivative related premiums.

*MBIA Corp.*

Capital and Surplus

MBIA Corp. reported total statutory capital of \$758 million as of June 30, 2014 compared with \$825 million as of December 31, 2013. As of June 30, 2014, statutory capital comprised \$387 million of contingency reserves and \$371 million of policyholders' surplus. For the six months ended June 30, 2014, MBIA Corp. had a statutory net loss of \$74 million, primarily due to losses and LAE incurred partially offset by net premiums earned. MBIA Corp.'s policyholders' surplus as of June 30, 2014 included a negative unassigned surplus of \$1.7 billion. As of June 30, 2014, MBIA Corp.'s policyholders' surplus was negatively impacted by \$166 million because under NYIL it was not permitted to treat as an admitted asset the portion of its investment in subsidiaries in excess of 60% of surplus. This overage was caused by a decrease in MBIA Corp.'s policyholders' surplus due to additional insured losses during the first six months of 2014. MBIA Corp.'s policyholders' surplus may be further negatively impacted if future additional insured losses are incurred and the percentage of its assets invested in subsidiaries continues to increase.

As of June 30, 2014, MBIA Corp. recognized estimated recoveries of \$232 million, net of reinsurance and income taxes at a rate of 35%, on a statutory basis related to put-backs of ineligible mortgage loans in its insured transactions and \$430 million related to excess spread recoveries on second-lien RMBS, net of reinsurance and income taxes at a rate of 35%. These excess spread recoveries represented 57% of MBIA Corp.'s statutory capital as of June 30, 2014. There can be no assurance that we will be successful or that we will not be delayed in realizing these recoveries. Refer to "Note 5: Loss and Loss Adjustment Expense Reserves" in the Notes to Consolidated Financial Statements for additional information about these recoveries.

In order to maintain its New York State financial guarantee insurance license, MBIA Corp. is required to maintain a minimum of \$65 million of policyholders' surplus. MBIA Corp.'s policyholders' surplus would grow over time from the recognition of unearned premiums and investment income and the expected release of the contingency reserves. In addition, MBIA Corp.'s policyholders' surplus could be enhanced by the settlement, commutation or repurchase of insured obligations at prices less than its statutory loss reserves for such transactions. Conversely, dividends or incurred losses or an inability to collect on our excess spread recoveries or ineligible mortgage loan put-back claims would reduce policyholders' surplus.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**CAPITAL RESOURCES (continued)**

Under NYIL, MBIA Corp. is also required to establish a contingency reserve to provide protection to policyholders in the event of extreme losses in adverse economic events. The amount of the reserve is based on the percentage of principal insured or premiums earned, depending on the type of obligation (net of collateral, reinsurance, refunding, refinancings and certain insured securities). Under NYIL, MBIA Corp. is required to invest its minimum surplus and contingency reserves, and 50% of its loss reserves and unearned premium reserves, in certain qualifying assets. Reductions in the contingency reserve may be recognized based on excessive reserves and under certain stipulated conditions, subject to the approval of the Superintendent of the NYSDFS. As of June 30, 2014, MBIA Corp. had a deficit of qualifying assets required to support its contingency reserves. The deficit was caused by the failure of certain mortgage originators to honor contractual obligations to repurchase ineligible mortgage loans from securitizations we insured thus requiring MBIA Corp. to sell liquid assets in order to make claim payments. The deficit may grow due to additional commutation and claim payments until such time as MBIA Corp. collects additional put-back recoveries. For risks associated with MBIA Corp.'s failure to meet its contingency reserve requirement, see Part I, Item 1A, "Risk Factors-Capital, Liquidity and Market Related Risk Factors- If our insurance companies fail to meet regulatory capital requirements they may become subject to regulatory action" in MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013.

In connection with MBIA Corp. obtaining approval from the NYSDFS to release excessive contingency reserves in previous periods, MBIA Corp. agreed that it would not pay any dividends without prior approval from the NYSDFS. Due to its significant negative earned surplus, MBIA Corp. has not had the statutory capacity to pay dividends since December 31, 2009 and is not expected to have any statutory capacity to pay any dividends in the near term.

As of June 30, 2014, MBIA Corp. exceeded its aggregate risk limits under the NYIL by \$128 million. The overage was caused by the decrease in statutory capital described above. MBIA Corp. previously notified the NYSDFS of the overage and submitted a plan to achieve compliance with the limits in accordance with the NYIL. If MBIA Corp. is not in compliance with its aggregate risk limits, the NYSDFS may prevent MBIA Corp. from transacting any new financial guarantee insurance business until it no longer exceeds the limitations. In 2014 and 2013, MBIA Corp. reported additional overages to the NYSDFS with respect to its single risk limits due to changes in its statutory capital.

As of June 30, 2014, the par amount outstanding of MBIA Corp.'s 14% Fixed-to-Floating Rate Surplus Notes due January 15, 2033 (the "Surplus Notes") was \$953 million. Section 1307 of the Insurance Law and the Fiscal Agency Agreement governing the surplus notes (the "Fiscal Agency Agreement"), which was approved as it relates to Section 1307 by the NYSDFS in connection with the issuance of the Surplus Notes, each impose restrictions on the payments of principal and interest (or the redemption price or any make-whole premium) on the Surplus Notes ("Surplus Note Payments"). Section 1307 of the Insurance Law provides that any payments on surplus notes issued by an insurer "shall be repaid only out of free and divisible surplus of such insurer with the approval of the superintendent whenever, in his judgment, the financial condition of such insurer warrants." The Superintendent has broad discretion in determining whether to allow us to make Surplus Note Payments. We are not aware of any guidelines or interpretations that govern the exercise of the Superintendent's discretion under Section 1307 in determining whether the financial condition of an insurer warrants the making of such payments. The Fiscal Agency Agreement provides that (a) Surplus Note Payments may be made only with the prior approval of the Superintendent, whenever, in his judgment, the financial condition of MBIA Corp. warrants, and (b) any such Surplus Note Payments may only be made to the extent MBIA Corp. has sufficient "Eligible Surplus" to make such payment. The Fiscal Agency Agreement defines "Eligible Surplus" as MBIA Corp. "surplus as regards policyholders," less the sum of its "common capital stock" and "preferred capital stock", as shown on its annual and quarterly statements filed with state insurance regulatory authorities. While the insurance law does not explicitly set forth the calculation of "free and divisible surplus", MBIA believes that the calculation of Eligible Surplus, as set forth in the Fiscal Agency Agreement is the appropriate calculation of "free and divisible surplus" and is the commonly accepted calculation of "free and divisible surplus" used in connection with other surplus notes issued by New York domiciled insurance companies. MBIA Corp.'s "free and divisible" surplus, determined as set forth above, was \$80 million as of June 30, 2014. MBIA Corp. is required to seek the Superintendent's approval to make payments of accrued interest and principal when scheduled on the Surplus Notes. There is no assurance the Superintendent will approve Surplus Note Payments. Notwithstanding the sufficiency of MBIA Corp.'s Eligible Surplus available for the payment of Surplus Note Payments, the NYSDFS may deny approval of any Surplus Note Payments if the Superintendent concludes that MBIA Corp.'s financial condition does not warrant such approval.

The NYSDFS has not approved MBIA Corp.'s requests to make interest payments on the Surplus Notes since, and including, the January 15, 2013 interest payment. The NYSDFS has cited both MBIA Corp.'s liquidity and financial condition as well as the availability of "free and divisible surplus" as the basis for such non-approvals. As of July 15, 2014, the scheduled interest payment date, there was \$232 million of accrued and unpaid interest on the Surplus Notes. The accrued and unpaid interest on the Surplus Notes will become due on the first business day on or after which MBIA Corp. obtains approval to pay some or all of such accrued and unpaid interest. No interest has been accrued or will accrue on the deferred interest.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

#### CAPITAL RESOURCES (continued)

MBIA Corp.'s statutory policyholders' surplus is lower than its GAAP shareholders' equity by \$595 million as of June 30, 2014. U.S. STAT differs from GAAP in certain respects. Refer to "Note 14: Statutory Accounting Practices" in the Notes to Consolidated Financial Statements of MBIA Corp. within exhibit 99.2 of MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013 for an explanation of the differences between U.S. STAT and GAAP.

#### Claims-Paying Resources (Statutory Basis)

CPR is a key measure of the resources available to MBIA Corp. to pay claims under its insurance policies. CPR consists of total financial resources and reserves calculated on a statutory basis. CPR has been a common measure used by financial guarantee insurance companies to report and compare resources, and continues to be used by MBIA's management to evaluate changes in such resources. We have provided CPR to allow investors and analysts to evaluate MBIA Corp., using the same measure that MBIA's management uses to evaluate MBIA Corp.'s resources to pay claims under its insurance policies. There is no directly comparable GAAP measure. Our calculation of CPR may differ from the calculation of CPR reported by other companies.

MBIA Corp.'s CPR and components thereto, as of June 30, 2014 and December 31, 2013 are presented in the following table:

| In millions                                          | As of June 30,<br>2014 | As of December 31,<br>2013 |
|------------------------------------------------------|------------------------|----------------------------|
| Policyholders' surplus                               | \$ 371                 | \$ 403                     |
| Contingency reserves                                 | 387                    | 422                        |
| Statutory capital                                    | 758                    | 825                        |
| Unearned premium reserve                             | 526                    | 535                        |
| Present value of installment premiums <sup>(1)</sup> | 771                    | 850                        |
| Premium resources <sup>(2)</sup>                     | 1,297                  | 1,385                      |
| Net loss and LAE reserves <sup>(1)</sup>             | (235)                  | 103                        |
| Salvage reserves <sup>(3)</sup>                      | 1,051                  | 1,148                      |
| Gross loss and LAE reserve                           | 816                    | 1,251                      |
| Total claims-paying resources                        | <u>\$ 2,871</u>        | <u>\$ 3,461</u>            |

(1) - Calculated using a discount rate of 5.09% as of June 30, 2014 and December 31, 2013.

(2) - Includes financial guarantee and insured credit derivative related premiums.

(3) - This amount primarily consists of expected recoveries related to the Company's excess spread.

#### LIQUIDITY

We evaluate and manage liquidity on a legal-entity basis to take into account the legal, regulatory and other limitations on available liquidity resources within the enterprise. We monitor our cash and liquid asset resources using stress-scenario testing. Members of MBIA's senior management meet regularly to review liquidity metrics, discuss contingency plans and establish target liquidity cushions on an enterprise-wide basis. Below is a discussion of our liquidity resources and requirements for our holding company and our insurance subsidiaries.

#### **MBIA Inc. Liquidity**

MBIA Inc.'s liquidity resources support our corporate and asset/liability products segments. The activities of MBIA Inc. consist of:

- holding and managing investments including investments in subsidiaries;
- servicing outstanding corporate debt instruments, investment agreements and the intercompany loans that support MTNs issued by GFL;
- posting collateral under hedging arrangements, investment agreements and the Asset Swap;
- making payments related to interest rate swaps; and
- payments of operating expenses.

The primary sources of cash within MBIA Inc. used to meet its liquidity needs include:

- available cash and liquid assets not subject to collateral posting requirements;
- payments under tax sharing agreements from subsidiaries;
- dividends from subsidiaries;
- scheduled principal and interest on assets held in its investment portfolio; and
- access to capital markets.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**LIQUIDITY (continued)**

We expect that for the foreseeable future National will be the predominant source of dividends and tax sharing agreement payments. There can be no assurance as to the amount and timing of any such dividends or payments under the tax sharing agreements. Refer to the "Capital Resources – Insurance Statutory Capital" section for additional information on payments of dividends. We do not expect that liquidity stress at MBIA Corp. would have any direct impact on MBIA Inc. given that we do not expect MBIA Inc. to receive distributions from MBIA Corp. for the foreseeable future.

During the first six months of 2014, MBIA Inc. received \$202 million under the MBIA group tax sharing agreement and related escrow agreement. Included in this amount was \$160 million that represents National's liability under the tax sharing agreement for the 2011 tax year, and was released from escrow pursuant to the terms of the tax sharing agreement following the expiration of National's two-year net operating loss carry-back period under U.S. tax rules. During the first six months of 2014, National paid to MBIA Inc. estimated 2014 taxes of \$51 million. As of June 30, 2014, \$417 million remained in escrow for the 2012 through the 2014 tax years. We expect to release up to \$228 million of this escrow related to the 2012 tax year in 2015 which will further increase MBIA Inc.'s liquidity position. There can be no assurance that payments under the Tax Escrow Account from subsidiaries will be released to MBIA Inc.

MBIA Inc.'s corporate debt, investment agreements, derivatives and loans from GFL, and the GFL MTNs may be accelerated by the holders of such instruments upon the occurrence of certain events, such as a breach of covenant or representation or certain instances of bankruptcy or insolvency. In the event of any acceleration of our obligations, including under our corporate debt, investment agreements, GFL MTNs, or derivatives, we likely would have insufficient resources to pay amounts due. Refer to "Liquidity—MBIA Inc. Liquidity" in Part II Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for information on these acceleration events.

MBIA Inc. has a net debt, which comprised long-term debt, GFL loans that support the GFL MTNs, investment agreements and derivative liabilities net of cash and investments at amortized cost (excluding investments in subsidiaries) and a tax receivable from subsidiaries, of \$1.0 billion as of June 30, 2014. The Company expects that MBIA Inc. will generate sufficient cash to satisfy its net debt and its general corporate needs over time from distributions from its operating subsidiaries, although there can be no assurance that these distributions will generate sufficient cash to satisfy its net debt.

Currently, the majority of the cash and securities of MBIA Inc. is pledged against investment agreement liabilities, derivatives and the Asset Swap, which limit its ability to raise liquidity through asset sales. A significant portion of MBIA Inc.'s assets that are pledged against Asset Swap liabilities are structured finance securities which have been particularly susceptible to price fluctuations during periods of market volatility. In addition, if the market value or rating eligibility of the assets which are pledged against MBIA Inc.'s obligations were to decline, we would be required to pledge additional eligible assets in order to meet minimum required collateral amounts against these liabilities. To mitigate these risks, we seek to maintain cash and liquidity resources that we believe will be sufficient to make all payments due on our obligations and to meet other financial requirements, such as posting collateral. Contingent liquidity resources include: (1) accessing the capital markets; (2) sales of invested assets exposed to credit spread stress risk, which may occur at losses and increase MBIA Inc.'s net debt; (3) termination and settlement of interest rate swap agreements; and (4) advances from subsidiaries. These actions, if taken, are expected to result in either additional liquidity or reduced exposure to adverse credit spread movements. There can be no assurance that these actions will be sufficient to fully mitigate this risk.

Because some of MBIA Inc.'s assets are pledged against the obligations described above, the widening of credit spreads would have an adverse impact on the market value of these pledged assets and increase collateralization requirements for the portfolio. The following table presents the estimated pre-tax change in the aggregate fair value of MBIA Inc.'s pledged assets as of June 30, 2014 from instantaneous shifts in credit spread curves. This table assumes that all credit spreads move by the same amount; however, it is more likely that the actual changes in credit spreads will vary by investment sector and individual security. The table presents hypothetical increases and decreases in credit spreads of 50 and 200 basis points. Because downward movements of these amounts in some cases would result in negative spreads, a floor of zero was assumed for minimum spreads.

| In millions                    | Change in Credit Spreads<br>(MBIA Inc.) |                            |                            |                             |
|--------------------------------|-----------------------------------------|----------------------------|----------------------------|-----------------------------|
|                                | 200 Basis Point<br>Decrease             | 50 Basis Point<br>Decrease | 50 Basis Point<br>Increase | 200 Basis Point<br>Increase |
| Estimated change in fair value | \$ 85                                   | \$ 32                      | \$ (30)                    | \$ (106)                    |

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### LIQUIDITY (continued)

As of June 30, 2014, the liquidity position of MBIA Inc., which consists of the liquidity positions of its corporate and asset/liability products activities, was \$365 million and comprised cash and liquid assets of \$317 million available for general corporate liquidity purposes, excluding the amounts held in escrow under its tax sharing agreement, and \$48 million not pledged directly as collateral for its asset/liability products activities. As of December 31, 2013, MBIA Inc. had \$359 million of cash and liquid assets comprising \$307 million available for general corporate liquidity purposes, excluding the amounts held in escrow under its tax sharing agreement, and \$52 million not pledged directly as collateral for its asset/liability products activities.

#### ***MBIA Corp. Liquidity***

Liquidity available in the structured finance and international insurance segment is affected by:

- the payment of claims on insured exposures;
- the persistence of installment premiums;
- our ability to collect on recoveries associated with loss payments;
- payments made to commute insured exposures;
- the repayment of surplus notes;
- expenses;
- investment results; or
- the impairment or a significant decline in the fair value of invested assets.

We may also experience liquidity constraints as a result of NYIL requirements that we maintain specified, high quality assets to back our reserves and surplus.

MBIA Corp. has recorded expected excess spread recoveries of \$750 million as of June 30, 2014, associated with insured second-lien RMBS issues, including recoveries related to consolidated VIEs. MBIA Corp. has also recorded expected recoveries related to its claims against Credit Suisse related to ineligible loans included in an MBIA Corp. insured RMBS transaction. There can be no assurance that we will be successful or that we will not be delayed in realizing these recoveries. During the first six months of 2014, MBIA Corp. collected \$64 million of excess spread and mortgage insurance before reinsurance related to insured second-lien RMBS issues. During the second quarter of 2014, recoveries on second-lien RMBS issues exceeded paid claims and LAE.

Liquidity needs within MBIA Corp. are primarily a result of the following:

- loss payments on insured transactions;
- operating expenses; and
- principal and interest related to its surplus notes, to the extent approved by the NYSDFS. Refer to "Capital Resources—Insurance Statutory Capital" for a discussion on the denied requests from the NYSDFS to pay interest on its surplus notes.

Loss payment requirements for the structured finance and international financial guarantee contracts fall into three categories:

- timely interest and ultimate principal;
- ultimate principal only at final maturity; and
- payments upon settlement of individual collateral losses as they occur after any deductible or subordination has been exhausted, which payments are unscheduled and therefore more difficult to predict, and which category applies to most of the transactions on which we have recorded loss reserves.

Insured transactions that require payment in full of the principal insured at maturity could present liquidity risks for MBIA Corp. since payment of the principal is due at maturity but any salvage could be recovered over time after payment of the principal amount. MBIA Corp. has insured transactions with substantial principal amounts due at maturity that are scheduled to mature in the near term. MBIA Corp. expects the transactions to be repaid on or prior to the maturity date. MBIA Corp. is generally required to satisfy claims within one to three business days, and as a result seeks to identify potential claims in advance through our monitoring process. While our financial guarantee policies generally cannot be accelerated, thereby helping to mitigate liquidity risk, the insurance of CDS contracts may, in certain circumstances, including the occurrence of certain insolvency or payment defaults under the CDS contracts, be subject to termination by the counterparty, triggering a claim for the fair value of the contract. In order to monitor liquidity risk and maintain appropriate liquidity resources, we use the same methodology as we use to monitor credit quality and losses within our insured portfolio, including stress scenarios. Refer to "Note 5: Loss and Loss Adjustment Expense Reserves" in the Notes to Consolidated Financial Statements for a discussion of our loss process.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**LIQUIDITY (continued)**

We believe that MBIA Corp.'s liquidity resources, including expected cash inflows, will adequately provide for anticipated cash outflows, including expected future claim payments. The liquidity position of MBIA Corp. has been stressed due to ongoing payments on second-lien RMBS exposures, payments on its remaining CMBS exposures and payments to counterparties in consideration for the commutation of insured transactions, which have resulted in a substantial reduction of exposure and potential loss volatility. Depending on the amount of actual future claims, including claims on insured exposures that in some cases may require large bullet payments, and the amount of future cash inflows, in particular in excess spread and put-back recoverables, MBIA Corp. may not have sufficient liquid assets to pay its claims. Also, future commutation payments on insured transactions to counterparties will depend on management's assessment of available liquidity or ability to secure other sources of financing. In the event that we experience other unexpected liquidity requirements, we may have insufficient resources to meet our obligations or insufficient qualifying assets to support our surplus and reserves, and may seek to increase liquidity through financing transactions. There can be no assurance that we will be successful in generating sufficient cash to meet our obligations.

As of June 30, 2014, MBIA Corp. held cash and available-for-sale ("AFS") investments of \$1.3 billion, of which \$427 million comprised cash and highly liquid assets that were immediately available to MBIA Insurance Corporation. Included in the \$1.3 billion was \$953 million of cash and AFS investments held by MBIA Corp.'s subsidiaries. As of December 31, 2013, MBIA Corp. held cash and AFS investments of \$1.6 billion, of which \$827 million comprised cash and highly liquid assets that were immediately available to MBIA Insurance Corporation. Included in the \$1.6 billion was \$693 million of cash and AFS investments held by MBIA Corp.'s subsidiaries.

***National Liquidity***

We believe that the liquidity position of our U.S. public finance insurance segment is sufficient to meet cash requirements in the ordinary course of business.

Liquidity needs within our U.S. public finance insurance segment are primarily a result of the following:

- loss payments on insured transactions;
- operating expenses; and
- posting collateral under the Asset Swap.

The insurance policies issued or reinsured by National provide unconditional and irrevocable guarantees of payments of the principal of, and interest or other amounts owing on, insured obligations when due. In the event of a default in payment of principal, interest or other insured amounts by an issuer, National generally promises to make funds available in the insured amount within one to three business days following notification. In some cases, the amount due can be substantial, particularly if the default occurs on a transaction to which National has a large notional exposure or on a transaction structured with large, bullet-type principal maturities. The fact that the U.S. public finance insurance segment's financial guarantee contracts generally cannot be accelerated by a party other than the insurer helps to mitigate liquidity risk in this segment.

National maintains the Asset Swap with MBIA Inc. which was amended in 2009 to replace MBIA Corp. with National. The Asset Swap provides MBIA Inc. with eligible assets to pledge under investment agreements and derivative contracts in the asset/liability products business. As of June 30, 2014, the notional amount used under each of these agreements was \$472 million and the fair value of collateral pledged by National and MBIA Inc. under these agreements was \$488 million and \$505 million, respectively. The net average interest rate on these transactions was 0.23% and 0.22% for the six months ended June 30, 2014 and 2013, respectively.

As of June 30, 2014, National held cash and short-term investments of \$662 million, of which \$573 million was highly liquid and comprised highly rated commercial paper, money market funds and municipal, U.S. agency and corporate bonds. As of December 31, 2013, National held cash and short-term investments of \$665 million, of which \$627 million was highly liquid and comprised commercial paper, money market funds, and highly rated municipal, U.S. agency and corporate bonds.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**LIQUIDITY (continued)**

**Consolidated Cash Flows**

Information about our consolidated cash flows by category is presented on our consolidated statements of cash flows. The following table presents a summary of our consolidated cash flows for the six months ended June 30, 2014 and 2013:

| In millions                                                  | Six Months Ended June 30, |          | Percent Change |
|--------------------------------------------------------------|---------------------------|----------|----------------|
|                                                              | 2014                      | 2013     |                |
| Statement of cash flow data:                                 |                           |          |                |
| Net cash provided (used) by:                                 |                           |          |                |
| Operating activities                                         | \$ (396)                  | \$ 1,171 | -134%          |
| Investing activities                                         | 324                       | (253)    | n/m            |
| Financing activities                                         | (589)                     | (902)    | -35%           |
| Effect of exchange rate changes on cash and cash equivalents | 3                         | -        | n/m            |
| Cash and cash equivalents—beginning of period                | 1,258                     | 990      | 27%            |
| Cash and cash equivalents—end of period                      | \$ 600                    | \$ 1,006 | -40%           |

n/m - Percent change not meaningful.

*Operating activities*

Net cash used by operating activities increased for the six months ended June 30, 2014 compared with the same period of 2013 primarily due to a decrease in proceeds from recoveries and reinsurance of \$1.7 billion.

*Investing activities*

Net cash provided by investing activities increased for the six months ended June 30, 2014 compared with the same period of 2013 primarily due to a net increase in proceeds from net sales and redemptions of investments of \$537 million and an increase in cash from derivative settlements and cash pledged as collateral of \$42 million, partially offset by a decrease in the paydowns and maturities of loans of \$25 million.

*Financing activities*

Net cash used by financing activities decreased for the six months ended June 30, 2014 compared with the same period of 2013 primarily due to a decrease in principal paydowns of debt related to financial guarantee VIEs and investment agreements of \$441 million, partially offset by an increase in principal paydowns of MTNs of \$126 million.

**Investments**

The following discussion of investments, including references to consolidated investments, excludes investments reported under "Assets of consolidated variable interest entities" on our consolidated balance sheets. Investments of VIEs support the repayment of VIE obligations and are not available to settle obligations of MBIA. Our AFS investments comprise high-quality fixed-income securities and short-term investments. The following table presents our investment portfolio as of June 30, 2014 and December 31, 2013:

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

LIQUIDITY (continued)

| In millions                                        | As of June 30,<br>2014 | As of December 31,<br>2013 | Percent Change |
|----------------------------------------------------|------------------------|----------------------------|----------------|
| Available-for-sale investments:                    |                        |                            |                |
| U.S. public finance insurance                      |                        |                            |                |
| Amortized cost                                     | \$ 4,510               | \$ 4,640                   | -3%            |
| Unrealized net gain (loss)                         | 28                     | (105)                      | -127%          |
| Fair value                                         | 4,538                  | 4,535                      | -%             |
| Structured finance and international insurance     |                        |                            |                |
| Amortized cost                                     | 966                    | 686                        | 41%            |
| Unrealized net gain (loss)                         | 16                     | 10                         | 60%            |
| Fair value                                         | 982                    | 696                        | 41%            |
| Corporate                                          |                        |                            |                |
| Amortized cost                                     | 534                    | 577                        | -7%            |
| Unrealized net gain (loss)                         | (30)                   | (56)                       | -46%           |
| Fair value                                         | 504                    | 521                        | -3%            |
| Advisory services                                  |                        |                            |                |
| Amortized cost                                     | 2                      | 2                          | -%             |
| Unrealized net gain (loss)                         | -                      | -                          | -%             |
| Fair value                                         | 2                      | 2                          | -%             |
| Wind-down operations                               |                        |                            |                |
| Amortized cost                                     | 771                    | 783                        | -2%            |
| Unrealized net gain (loss)                         | 63                     | 19                         | n/m            |
| Fair value                                         | 834                    | 802                        | 4%             |
| Total available-for-sale investments:              |                        |                            |                |
| Amortized cost                                     | 6,783                  | 6,688                      | 1%             |
| Unrealized net gain (loss)                         | 77                     | (132)                      | n/m            |
| Total available-for-sale investments at fair value | 6,860                  | 6,556                      | 5%             |

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**
**LIQUIDITY (continued)**

| In millions                                      | As of June 30,<br>2014 | As of December 31,<br>2013 | Percent Change |
|--------------------------------------------------|------------------------|----------------------------|----------------|
| Investments carried at fair value:               |                        |                            |                |
| U.S. public finance insurance                    |                        |                            |                |
| Amortized cost                                   | 139                    | 136                        | 2%             |
| Unrealized net gain (loss)                       | -                      | (7)                        | -100%          |
| Fair value                                       | 139                    | 129                        | 8%             |
| Structured finance and international insurance   |                        |                            |                |
| Amortized cost                                   | 49                     | 27                         | 81%            |
| Unrealized net gain (loss)                       | 6                      | 2                          | n/m            |
| Fair value                                       | 55                     | 29                         | 90%            |
| Corporate                                        |                        |                            |                |
| Amortized cost                                   | 95                     | 112                        | -15%           |
| Unrealized net gain (loss)                       | 3                      | (1)                        | n/m            |
| Fair value                                       | 98                     | 111                        | -12%           |
| Advisory services                                |                        |                            |                |
| Amortized cost                                   | 5                      | 5                          | -%             |
| Unrealized net gain (loss)                       | -                      | -                          | n/m            |
| Fair value                                       | 5                      | 5                          | -%             |
| Total investments carried at fair value:         |                        |                            |                |
| Amortized cost                                   | 288                    | 280                        | 3%             |
| Unrealized net gain (loss)                       | 9                      | (6)                        | n/m            |
| Total investments carried at fair value          | 297                    | 274                        | 8%             |
| Other investments at amortized cost:             |                        |                            |                |
| U.S. public finance insurance operations segment | 4                      | 4                          | -%             |
| Structured finance and international insurance   | -                      | 1                          | -100%          |
| Total other investments at amortized cost        | 4                      | 5                          | -20%           |
| Consolidated investments at carrying value       | <u>\$ 7,161</u>        | <u>\$ 6,835</u>            | <u>5%</u>      |

n/m - Percent change not meaningful.

The fair value of the Company's investments is based on prices which include quoted prices in active markets and prices based on market-based inputs that are either directly or indirectly observable, as well as prices from dealers in relevant markets. Differences between fair value and amortized cost arise primarily as a result of changes in interest rates and general market credit spreads occurring after a fixed-income security is purchased, although other factors may also influence fair value, including specific credit-related changes, supply and demand forces and other market factors. When the Company holds an AFS investment to maturity, any unrealized gain or loss currently recorded in accumulated other comprehensive income (loss) in the shareholders' equity section of the balance sheet is reversed. As a result, the Company would realize a value substantially equal to amortized cost. However, when investments are sold prior to maturity, the Company will realize any difference between amortized cost and the sale price of an investment as a realized gain or loss within its consolidated statements of operations.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**
**LIQUIDITY (continued)**
*Credit Quality*

The credit quality distribution of the Company's AFS fixed-maturity investment portfolios, excluding short-term investments, based on ratings from Moody's as of June 30, 2014 is presented in the following table. Alternate ratings sources, such as S&P or the best estimate of the ratings assigned by the Company, have been used for a small percentage of securities that are not rated by Moody's.

| In millions                                | U.S. Public Finance Insurance |                               | Structured Finance and International Insurance |                               | Advisory Services |                               | Corporate  |                               | Wind-down Operations |                               | 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 | Fair Value           | % of Fixed-Income Investments | Fair Value | % of Fixed-Income Investments |
| Available-for-sale:                        |                               |                               |                                                |                               |                   |                               |            |                               |                      |                               |            |                               |
| Aaa                                        | \$ 1,762                      | 44%                           | \$ 175                                         | 31%                           | \$ 1              | 50%                           | \$ -       | 0%                            | \$ 188               | 24%                           | \$2,126    | 39%                           |
| Aa                                         | 1,312                         | 33%                           | 266                                            | 47%                           | -                 | 0%                            | -          | 0%                            | 119                  | 15%                           | 1,697      | 31%                           |
| A                                          | 641                           | 16%                           | 90                                             | 16%                           | -                 | 0%                            | -          | 0%                            | 358                  | 47%                           | 1,089      | 20%                           |
| Baa                                        | 144                           | 3%                            | 27                                             | 5%                            | 1                 | 50%                           | -          | 0%                            | 92                   | 12%                           | 264        | 5%                            |
| Below investment grade                     | 28                            | 1%                            | 6                                              | 1%                            | -                 | 0%                            | 90         | 77%                           | 1                    | 0%                            | 125        | 2%                            |
| Not rated                                  | 115                           | 3%                            | -                                              | 0%                            | -                 | 0%                            | 27         | 23%                           | 15                   | 2%                            | 157        | 3%                            |
| Total                                      | \$ 4,002                      | 100%                          | \$ 564                                         | 100%                          | \$ 2              | 100%                          | \$ 117     | 100%                          | \$ 773               | 100%                          | \$5,458    | 100%                          |
| Short-term investments                     | 529                           |                               | 416                                            |                               | -                 |                               | 387        |                               | 58                   |                               | 1,390      |                               |
| Investments carried at fair value          | 139                           |                               | 55                                             |                               | 5                 |                               | 98         |                               | -                    |                               | 297        |                               |
| Other investments                          | 11                            |                               | 2                                              |                               | -                 |                               | -          |                               | 3                    |                               | 16         |                               |
| Consolidated investments at carrying value | \$ 4,681                      |                               | \$1,037                                        |                               | \$ 7              |                               | \$ 602     |                               | \$ 834               |                               | \$7,161    |                               |

As of June 30, 2014, the weighted average credit quality of the Company's AFS investment portfolios, excluding short-term and other investments, as presented in the preceding table are as follows:

|                                         | U.S. Public Finance Insurance | Structured Finance and International Insurance | Advisory Services | Corporate              | Wind-down Operations |
|-----------------------------------------|-------------------------------|------------------------------------------------|-------------------|------------------------|----------------------|
| Weighted average credit quality ratings | Aa                            | Aa                                             | Aa                | Below investment grade | A                    |

*Insured Investments*

MBIA's consolidated investment portfolio includes investments that are insured by various financial guarantee insurers ("Insured Investments"), including investments insured by MBIA Corp. and National ("Company-Insured Investments"). As of June 30, 2014, Insured Investments at fair value represented \$530 million or 7% of consolidated investments, of which \$337 million or 5% of consolidated investments were Company-Insured Investments.

As of June 30, 2014, based on the actual or estimated underlying ratings of our consolidated investment portfolio, without giving effect to financial guarantees, the weighted average rating of the consolidated investment portfolio would be in the Aa range, the weighted average rating of only the Insured Investments in the investment portfolio would be in the A range, and 2% of the total investment portfolio would be rated below investment grade in the Insured Investments.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**LIQUIDITY (continued)**

The distribution of our Insured Investments by financial guarantee insurer as of June 30, 2014 is presented in the following table:

| In millions                          | U.S. Public Finance Insurance |                        | Structured Finance and International Insurance |                        | Corporate    |                        | Wind-down Operations |                        | Total         |                        |
|--------------------------------------|-------------------------------|------------------------|------------------------------------------------|------------------------|--------------|------------------------|----------------------|------------------------|---------------|------------------------|
|                                      | Fair Value                    | % of Total Investments | Fair Value                                     | % of Total Investments | Fair Value   | % of Total Investments | Fair Value           | % of Total Investments | Fair Value    | % of Total Investments |
| MBIA Corp.                           | \$ -                          | 0%                     | \$ -                                           | 0%                     | \$ 81        | 1%                     | \$ 57                | 1%                     | \$ 138        | 2%                     |
| National                             | 21                            | 0%                     | -                                              | 0%                     | -            | 0%                     | 178                  | 3%                     | 199           | 3%                     |
| Assured Guaranty Municipal Corp.     | 24                            | 0%                     | 7                                              | 0%                     | -            | 0%                     | 130                  | 2%                     | 161           | 2%                     |
| Ambac Financial Group, Inc.          | 1                             | 0%                     | -                                              | 0%                     | 8            | 0%                     | 13                   | 0%                     | 22            | 0%                     |
| Financial Guaranty Insurance Company | 4                             | 0%                     | -                                              | 0%                     | -            | 0%                     | 6                    | 0%                     | 10            | 0%                     |
| Other                                | -                             | 0%                     | -                                              | 0%                     | -            | 0%                     | -                    | 0%                     | -             | 0%                     |
| <b>Total</b>                         | <b>\$ 50</b>                  | <b>0%</b>              | <b>\$ 7</b>                                    | <b>0%</b>              | <b>\$ 89</b> | <b>1%</b>              | <b>\$ 384</b>        | <b>6%</b>              | <b>\$ 530</b> | <b>7%</b>              |

In purchasing Insured Investments, the Company independently assesses the underlying credit quality, structure and liquidity of each investment, in addition to the creditworthiness of the insurer. Insured Investments are diverse by sector, issuer and size of holding. The Company assigns underlying ratings to its Insured Investments without giving effect to financial guarantees based on underlying ratings assigned by Moody's, or another external agency when a rating is not published by Moody's. 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. A downgrade of a financial guarantee insurer will likely have an adverse effect on the fair value of investments insured by the downgraded financial guarantee insurer. If MBIA determines that declines in the fair values of Insured Investments are other-than-temporary, the Company will record a realized loss through earnings.

The underlying ratings of the Company-Insured Investments as of June 30, 2014 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 following table are based on ratings from Moody's. Alternate ratings sources, such as S&P, have been used for a small percentage of securities that are not rated by Moody's.

| In millions                           | U.S. Public Finance Insurance | Corporate    | Wind-down Operations | Total         |
|---------------------------------------|-------------------------------|--------------|----------------------|---------------|
| <b>Underlying Ratings Scale</b>       |                               |              |                      |               |
| <b>National:</b>                      |                               |              |                      |               |
| Aa                                    | \$ -                          | \$ -         | \$ 24                | \$ 24         |
| A                                     | 21                            | -            | 154                  | 175           |
| Baa                                   | -                             | -            | -                    | -             |
| <b>Total National</b>                 | <b>\$ 21</b>                  | <b>\$ -</b>  | <b>\$ 178</b>        | <b>\$ 199</b> |
| <b>MBIA Corp.:</b>                    |                               |              |                      |               |
| Aa                                    | \$ -                          | \$ -         | \$ 57                | \$ 57         |
| A                                     | -                             | -            | -                    | -             |
| Baa                                   | -                             | -            | -                    | -             |
| Below investment grade                | -                             | 81           | -                    | 81            |
| <b>Total MBIA Corp.</b>               | <b>\$ -</b>                   | <b>\$ 81</b> | <b>\$ 57</b>         | <b>\$ 138</b> |
| <b>Total MBIA-Insured Investments</b> | <b>\$ 21</b>                  | <b>\$ 81</b> | <b>\$ 235</b>        | <b>\$ 337</b> |

Without giving effect to the MBIA guarantee of the Company-Insured Investments in the consolidated investment portfolio, as of June 30, 2014, based on actual or estimated underlying ratings, the weighted average rating of the consolidated investment portfolio was in the Aa range, the weighted average rating of only the Company-Insured Investments was in the Baa range, and investments rated as below investment grade in the Company-Insured Investments were 2% of the total consolidated investment portfolio.

*Impaired Investments*

As of June 30, 2014 and December 31, 2013, we held impaired AFS investments (investments for which fair value was less than amortized cost) with a fair value of \$2.2 billion and \$3.5 billion, respectively.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### LIQUIDITY (continued)

We analyze impaired investments within our investment portfolio for other-than-temporary impairments ("OTTI") on a quarterly basis. Key factors considered when assessing OTTI include but are not limited to: (a) structural and economic factors among security types that represent our largest exposure to credit impairment losses; (b) the duration and severity of the unrealized losses (i.e., a decline in the market value of a security by 20% or more at the time of the review, or 5% impaired at the time of review with a fair value below amortized cost for a consecutive 12-month period); and (c) the results of various cash flow modeling techniques. Our cash flow analysis considers all sources of cash, including credit enhancement, that support the payment of amounts owed by an issuer of a security. This includes the consideration of cash expected to be provided by financial guarantors, including MBIA Corp., resulting from an actual or potential insurance policy claim.

Refer to "Note 7: Investments" in the Notes to Consolidated Financial Statements for a detailed discussion about impaired investments.

### Debt Obligations

Principal payments due under our debt obligations for the six months ending December 31, 2014 and each of the subsequent four years ending December 31 and thereafter are presented in the following table. The repayment of principal on our surplus notes is reflected in 2018, which is the next call date. Principal payments under investment agreements are based on expected withdrawal dates. All other principal payments are based on contractual maturity dates. Foreign currency denominated liabilities are presented in U.S. dollars using applicable exchange rates as of June 30, 2014, and liabilities issued at a discount reflect principal amounts due at maturity.

| In millions                                             | As of June 30, 2014                          |               |               |               |                |                 |                |
|---------------------------------------------------------|----------------------------------------------|---------------|---------------|---------------|----------------|-----------------|----------------|
|                                                         | Six Months<br>Ending<br>December 31,<br>2014 | 2015          | 2016          | 2017          | 2018           | Thereafter      | Total          |
| Structured finance and international insurance segment: |                                              |               |               |               |                |                 |                |
| Variable interest entity notes                          | \$ 215                                       | \$ 449        | \$ 323        | \$ 356        | \$ 352         | \$ 3,607        | \$5,302        |
| Surplus notes                                           | -                                            | -             | -             | -             | 940            | -               | 940            |
| Corporate segment:                                      |                                              |               |               |               |                |                 |                |
| Long-term debt                                          | -                                            | -             | -             | -             | -              | 583             | 583            |
| Asset/liability products segment:                       |                                              |               |               |               |                |                 |                |
| Investment agreements                                   | 96                                           | 42            | 42            | 57            | 18             | 479             | 734            |
| Medium-term notes                                       | -                                            | 106           | 132           | 53            | 59             | 1,295           | 1,645          |
| <b>Total</b>                                            | <b>\$ 311</b>                                | <b>\$ 597</b> | <b>\$ 497</b> | <b>\$ 466</b> | <b>\$1,369</b> | <b>\$ 5,964</b> | <b>\$9,204</b> |

### Other Commitments

#### Headquarters Lease Agreement

In March of 2014, the Company entered into a lease agreement for its new headquarters as part of the Company's cost reduction measures. The initial lease term expires in 2030 with the option to terminate the lease in 2025 upon the payment of a termination amount. The total future minimum lease payments over the initial lease term are \$42 million inclusive of the annual rent escalation amounts and free rent period. Refer to "Note 13: Commitments and Contingencies" in the Notes to the Consolidated Financial Statements for further information about this lease commitment.

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

In general, MBIA's market risk relates to changes in the value of financial instruments that arise from adverse movements in factors such as interest rates, foreign exchange rates and credit spreads. MBIA is exposed to changes in interest rates, foreign exchange rates and credit spreads that affect the fair value of its financial instruments, namely investment securities, investment agreement liabilities, MTNs, debentures and certain derivative transactions. The Company's investment portfolio holdings are primarily U.S. dollar-denominated fixed-income securities including municipal bonds, U.S. government bonds, MBS, collateralized mortgage obligations, corporate bonds and ABS. In periods of rising and/or volatile interest rates, foreign exchange rates and credit spreads, profitability could be adversely affected should the Company have to liquidate these securities.

MBIA minimizes its exposure to interest rate risk, foreign exchange risk and credit spread movement through active portfolio management to ensure a proper mix of the types of securities held and to stagger the maturities of its fixed-income securities. In addition, the Company enters into various swap agreements that hedge the risk of loss due to interest rate and foreign currency volatility.

**Interest Rate Sensitivity**

Interest rate sensitivity can be estimated by projecting a hypothetical instantaneous increase or decrease in interest rates. The following table presents the estimated pre-tax change in fair value of the Company's financial instruments as of June 30, 2014 from instantaneous shifts in interest rates:

| In millions                    | Change in Interest Rates |                          |                          |                          |                          |                          |
|--------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
|                                | 300 Basis Point Decrease | 200 Basis Point Decrease | 100 Basis Point Decrease | 100 Basis Point Increase | 200 Basis Point Increase | 300 Basis Point Increase |
| Estimated change in fair value | \$ 245                   | \$ 182                   | \$ 101                   | \$ (120)                 | \$ (235)                 | \$ (346)                 |

**Foreign Exchange Sensitivity**

Foreign exchange rate sensitivity can be estimated by projecting a hypothetical instantaneous increase or decrease in foreign exchange rates. The following table presents the estimated pre-tax change in fair value of the Company's financial instruments as of June 30, 2014 from instantaneous shifts in foreign exchange rates:

| In millions                    | Change in Foreign Exchange Rates |        |                    |       |
|--------------------------------|----------------------------------|--------|--------------------|-------|
|                                | Dollar Weakens                   |        | Dollar Strengthens |       |
|                                | 20%                              | 10%    | 10%                | 20%   |
| Estimated change in fair value | \$ (12)                          | \$ (6) | \$ 6               | \$ 12 |

**Credit Spread Sensitivity**

Credit spread sensitivity can be estimated by projecting a hypothetical instantaneous increase or decrease in credit spreads. The following table presents the estimated pre-tax change in fair value of the Company's financial instruments as of June 30, 2014 from instantaneous shifts in credit spread curves. For this table it was assumed that all credit spreads move by the same amount. It is more likely that the actual changes in credit spreads will vary by security. National's investment portfolio would generally be expected to experience lower credit spread volatility than the investment portfolio of the asset/liability products segment because of higher credit quality and portfolio composition in sectors that have been less volatile historically. The following table shows hypothetical increases and decreases in credit spreads of 50 and 200 basis points. Because downward movements of these amounts in some cases would result in negative spreads, a floor was assumed for minimum spreads. The changes in fair value reflect partially offsetting effects as the value of the investment portfolios generally changes in an opposite direction from the liability portfolio.

| In millions                    | Change in Credit Spreads |                         |                         |                          |
|--------------------------------|--------------------------|-------------------------|-------------------------|--------------------------|
|                                | 200 Basis Point Decrease | 50 Basis Point Decrease | 50 Basis Point Increase | 200 Basis Point Increase |
| Estimated change in fair value | \$ (1)                   | \$ 75                   | \$ (78)                 | \$ (324)                 |

**Credit Derivatives Sensitivity**

MBIA Corp. issued insurance policies insuring payments due on structured credit derivative contracts which are marked-to-market through earnings under the accounting principles for derivatives and hedging activities. The majority of these structured CDSs related to structured finance transactions with underlying reference obligations of cash securities and CDSs referencing liabilities of corporations or of other structured finance securitizations. The asset classes of the underlying reference obligations included corporate, ABS, RMBS and CMBS. These transactions were usually underwritten at or above a triple-A credit rating level. As of June 30, 2014, approximately 43% of the tranches insured by the Company were rated triple-A.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk (continued)

In the first six months of 2014, MBIA Corp. has observed a tightening of its own credit spreads. As changes in fair value can be caused by factors unrelated to the performance of MBIA Corp.'s business and credit portfolio, including general market conditions and perceptions of credit risk, as well as market use of credit derivatives for hedging purposes unrelated to the specific referenced credits in addition to events that affect particular credit derivative exposures, the application of fair value accounting will cause the Company's earnings to be more volatile than would be suggested by the underlying performance of MBIA's business operations and credit portfolio.

The following tables reflect sensitivities to changes in credit spreads, rating migrations, recovery rates and MBIA Corp.'s own credit spreads. Each table stands on its own and should be read independently of each other. Refer to "Note 6: Fair Value of Financial Instruments" in the Notes to Consolidated Financial Statements for further information about the Company's financial assets and liabilities that are accounted for at fair value, including valuation techniques and disclosures required by GAAP.

Sensitivity to changes in credit spreads can be estimated by projecting a hypothetical instantaneous shift in credit spread curves. The following table presents the estimated pre-tax change in fair value and the cumulative estimated net fair value of MBIA Corp.'s credit derivatives portfolio of instantaneous shifts in credit spreads as of June 30, 2014. In scenarios where credit spreads decreased, a floor of zero was used.

| In millions                          | Change in Credit Spreads<br>(Structured Finance and International Insurance) |                                |                               |                            |                               |                                |
|--------------------------------------|------------------------------------------------------------------------------|--------------------------------|-------------------------------|----------------------------|-------------------------------|--------------------------------|
|                                      | 600 Basis<br>Point<br>Decrease                                               | 200 Basis<br>Point<br>Decrease | 50 Basis<br>Point<br>Decrease | 0 Basis<br>Point<br>Change | 50 Basis<br>Point<br>Increase | 200 Basis<br>Point<br>Increase |
|                                      |                                                                              |                                |                               |                            |                               | 600 Basis<br>Point<br>Increase |
| Estimated pre-tax net gains (losses) | \$ 97                                                                        | \$ 58                          | \$ 20                         | \$ -                       | \$ (27)                       | \$ (134)                       |
| Estimated net fair value             | \$ (235)                                                                     | \$ (274)                       | \$ (312)                      | \$ (332)                   | \$ (359)                      | \$ (466)                       |
|                                      |                                                                              |                                |                               |                            |                               | \$ (813)                       |

Actual shifts in credit spread curves will vary based on the credit quality of the underlying reference obligations. In general, within any asset class, higher credit rated reference obligations will exhibit less credit spread movement than lower credit rated reference obligations. Additionally, the degree of credit spread movement can vary significantly for different asset classes. The basis point change presented in the preceding table, however, represents a fixed basis point change in referenced obligation credit spreads across all credit quality rating categories and asset classes and, therefore, the actual impact of spread changes would vary from this presentation depending on the credit rating and distribution across asset classes, both of which will adjust over time depending on new business written and runoff of the existing portfolio.

Sensitivity to changes in the collateral portfolio credit quality can be estimated by projecting a hypothetical change in rating migrations. The following table presents the estimated pre-tax change in fair value and the cumulative estimated net fair value of MBIA Corp.'s insured credit derivatives portfolio of a one and three notch rating change in the credit quality as of June 30, 2014. A notch represents a one step movement up or down in the credit rating.

| In millions                          | Change in Credit Ratings<br>(Structured Finance and International Insurance) |                       |           |                       |                         |
|--------------------------------------|------------------------------------------------------------------------------|-----------------------|-----------|-----------------------|-------------------------|
|                                      | Three Notch<br>Increase                                                      | One Notch<br>Increase | No Change | One Notch<br>Decrease | Three Notch<br>Decrease |
| Estimated pre-tax net gains (losses) | \$ 113                                                                       | \$ 62                 | \$ -      | \$ (92)               | \$ (321)                |
| Estimated net fair value             | \$ (219)                                                                     | \$ (270)              | \$ (332)  | \$ (424)              | \$ (653)                |

Recovery rates on defaulted collateral are an input into MBIA Corp.'s valuation model. Sensitivity to changes in the recovery rate assumptions used by MBIA Corp. can be estimated by projecting a hypothetical change in these assumptions. The following table presents the estimated pre-tax change in fair value and the cumulative estimated net fair value of MBIA Corp.'s insured credit derivatives portfolio of a 10% and 20% change in the recovery rate assumptions as of June 30, 2014.

| In millions                          | Change in Recovery Rates<br>(Structured Finance and International Insurance) |              |           |              |              |
|--------------------------------------|------------------------------------------------------------------------------|--------------|-----------|--------------|--------------|
|                                      | 20% Increase                                                                 | 10% Increase | No Change | 10% Decrease | 20% Decrease |
| Estimated pre-tax net gains (losses) | \$ 44                                                                        | \$ 29        | \$ -      | \$ (37)      | \$ (69)      |
| Estimated net fair value             | \$ (288)                                                                     | \$ (303)     | \$ (332)  | \$ (369)     | \$ (401)     |

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### Item 3. Quantitative and Qualitative Disclosures About Market Risk (continued)

Accounting principles for fair value measurements require MBIA Corp. to incorporate its own nonperformance risk in its valuation methodology. Sensitivity to changes in MBIA Corp.'s credit spreads can be estimated by projecting a hypothetical change in this assumption. The following table presents the estimated pre-tax change in fair value and the cumulative estimated net fair value of MBIA Corp.'s insured credit derivative portfolio using upfront credit spreads of 0%, an increase of 7 percentage points, and an increase of 15 percentage points. The actual upfront spread used in the valuation as of June 30, 2014 ranged from 0.64% to 13.16% based on the tenor of each transaction. The below amounts include an additional annual running credit spread of 5%.

| In millions                          | MBIA Corp.'s Upfront Credit Spread<br>(Structured Finance and International Insurance) |                                    |           |                                    |
|--------------------------------------|----------------------------------------------------------------------------------------|------------------------------------|-----------|------------------------------------|
|                                      | Increase by 15<br>Percentage Points                                                    | Increase by 7<br>Percentage Points | No Change | Decrease to 0<br>Percentage Points |
| Estimated pre-tax net gains (losses) | \$ 57                                                                                  | \$ 27                              | \$ -      | \$ (18)                            |
| Estimated net fair value             | \$ (275)                                                                               | \$ (305)                           | \$ (332)  | \$ (350)                           |

MBIA Corp.'s insurance of structured credit derivatives typically remain in place until the maturity of the derivative. With respect to MBIA Corp.'s insured structured credit derivatives, in the absence of credit impairments or the termination of derivatives at losses, the cumulative unrealized losses should reverse before or at maturity of the contracts. Additionally, in the event of the termination and settlement of a contract prior to maturity, any resulting gain or loss upon settlement will be recorded in our consolidated financial statements. In February of 2008, the Company announced its intention not to insure credit derivatives in the future, except in transactions that are intended to reduce its overall exposure to insured derivatives.

#### Warrants Sensitivity

Warrants issued by the Company to purchase shares of MBIA Inc. common stock are recorded at fair value in the Company's balance sheet and changes in fair value are recorded through earnings. The Company values these warrants using the Black-Scholes model. Refer to "Note 6: Fair Value of Financial Instruments" in the Notes to Consolidated Financial Statements for further information about the valuation of warrants issued by the Company.

While several factors influence the value of the Company's warrants, including stock price, stock volatility, interest rates and dividends, changes in the value of the Company's warrants during the first six months of 2014 were primarily driven by changes in the Company's stock price. The following table presents the estimated pre-tax change in fair value and the estimated aggregate fair value of the Company's warrants assuming a hypothetical stock price change of 10% and 25% as of June 30, 2014.

| In millions                          | Change in Stock Price |              |           |              |              |
|--------------------------------------|-----------------------|--------------|-----------|--------------|--------------|
|                                      | 25% Increase          | 10% Increase | No Change | 10% Decrease | 25% Decrease |
| Estimated pre-tax net gains (losses) | \$ (28)               | \$ (11)      | \$ -      | \$ 9         | \$ 21        |
| Estimated net fair value             | \$ (70)               | \$ (53)      | \$ (42)   | \$ (33)      | \$ (21)      |

### Item 4. Controls and Procedures

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

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

For a discussion of the Company's litigation and related matters, see "Note 13: Commitments and Contingencies" in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries in Part I, Item 1. In the normal course of operating its businesses, MBIA Inc. may be involved in various legal proceedings. As a courtesy, the Company posts on its website under the section "Legal Proceedings," selected information and documents in reference to selected legal proceedings in which the Company is the plaintiff or the defendant. The Company will not necessarily post all documents for each proceeding and undertakes no obligation to revise or update them to reflect changes in events or expectations. The complete official court docket can be publicly accessed by contacting the clerk's office of the respective court where each litigation is pending.

### Item 1A. Risk Factors

The following should be read in conjunction with and supplements the risk factors described under Part I, Item 1A, "Risk Factors" of the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

#### Insured Portfolio Loss Related Risk Factors

***MBIA Corp. insures certain transactions that continue to perform poorly, in particular RMBS transactions that include a substantial number of ineligible mortgage loans, and increased losses or a delay or failure in collecting expected recoveries may materially and adversely affect its financial condition and results of operations.***

MBIA Corp. insures certain structured finance transactions that remain volatile and could result in additional losses, which could be substantial, including residential mortgage-backed securities ("RMBS"), asset-backed securities ("ABS") within collateralized debt obligation ("CDOs"), commercial mortgage-backed securities ("CMBS") pools and commercial real estate ("CRE") transactions. Furthermore, MBIA Corp. has recorded expected recoveries on second-lien RMBS, and the timing and amount of those recoveries could change. Increased losses or a delay or failure in collecting expected recoveries may materially and adversely affect MBIA Corp.'s financial condition and results of operations.

With respect to RMBS transactions, MBIA Corp. continues to be exposed to risk of losses as a result of poor performance of ineligible loans included in its insured second-lien RMBS transactions, including transactions where it has reached settlements with the sellers/servicers but continues to insure the transactions. Losses in these transactions and in other transactions due to the inclusion of ineligible loans could continue. MBIA Corp. has also recorded significant loss reserves on its first-lien RMBS and ABS CDO exposures, and there can be no assurance that these reserves will be sufficient, in particular if the economy deteriorates.

With respect to insured credit default swap ("CDS") contracts that are backed by structured CMBS pools and CRE CDOs, MBIA Corp. has experienced ratings erosion in the total CMBS collateral underlying its insured static pools. Since 2013, MBIA Corp. paid claims on a CMBS pool transaction which experienced deterioration such that all of the deductible was eliminated, and we expect to experience additional claims on this transaction in the future. Ultimate loss rates on these transactions remain uncertain. It is possible that MBIA Corp. will experience severe losses and/or near-term liquidity needs on its insured commercial real estate transactions. Such losses and/or liquidity needs are highly sensitive to the trajectory of the U.S. economy, the trends in delinquencies and liquidations, and the severity of loss upon liquidation.

MBIA Corp. has also recorded significant recoveries related to its second-lien RMBS losses, and there can be no assurance as to the timing or amount of collections. As of June 30, 2014, we recorded estimated recoveries of \$577 million for the reimbursement of past and future expected claims through excess spread in our insured second-lien RMBS transactions. Of this amount, \$569 million is included in "Insurance loss recoverable" and \$8 million is included in "Loss and loss adjustment expense reserves" on the Company's consolidated balance sheets. Excess spread is generated by performing loans within insured second-lien RMBS securitizations. It is the difference between interest inflows on mortgage loan collateral and interest outflows on insured beneficial interests. The amount of excess spread depends on the future loss trends (which include future delinquency trends, average time it takes to charge-off delinquent loans, and the availability of pool mortgage insurance), the future trends in PRIME and LIBOR interest rates and borrower refinancing behavior, which results in voluntary prepayments. Minor deviations in loss trends and voluntary prepayments can have significant effect on excess spread. In addition, some of the second-lien RMBS are backed by HELOCs originated between 2004 and 2006. Some of these HELOCs complete their 10 year interest-only period between 2014 and 2016, at which time borrowers will be subject to increased monthly payments, possibly leading to increased voluntary prepayments or defaults.

In addition, the Company is also pursuing claims related to ineligible loans securitized by Credit Suisse and included in a home equity mortgage trust securitization. The Company's assessment of the ineligibility of individual mortgage loans has been challenged by Credit Suisse in litigation and there is no assurance that the Company's determinations will prevail, or that the Company will be successful in collecting its estimated recoveries. The litigation may take several years to resolve, during which time we will be required to pay losses on the subject transaction.

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

The table below presents repurchases made by the Company in each month during the second quarter of 2014:

| Month | Total Number of<br>Shares Purchased <sup>(1)</sup> | Average Price<br>Paid Per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plan | Maximum Amount<br>That May Be Purchased<br>Under the Plan<br>(in millions) <sup>(2)</sup> |
|-------|----------------------------------------------------|---------------------------------|------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|
| April | 463                                                | \$ 12.61                        | -                                                                            | \$ 23                                                                                     |
| May   | 318                                                | 12.08                           | -                                                                            | 23                                                                                        |
| June  | 842,449                                            | 11.07                           | 842,072                                                                      | 14                                                                                        |
|       | 843,230                                            | \$ 11.07                        | 842,072                                                                      | \$ 14                                                                                     |

(1) - Includes 1,158 shares purchased in open market transactions as investments in the Company's non-qualified deferred compensation plan.

(2) - On February 1, 2007, the Company's Board of Directors authorized the repurchase of common stock up to \$1 billion under a new share repurchase program, which superseded the previously authorized program. In July of 2014, the remaining \$14 million available for future repurchases was used to repurchase 1,244,665 common shares of MBIA Inc. at an average share price of \$11.03.

### Item 5. Other Information

#### Disclosure pursuant to Section 13(r) of the Securities Exchange Act of 1934

Pursuant to Section 13(r) of the Securities Exchange Act of 1934, we may be required to disclose in our annual and quarterly reports to the Securities and Exchange Commission (the "SEC"), whether we or any of our "affiliates" knowingly engaged in certain activities, transactions or dealings relating to Iran or with certain individuals or entities targeted by US economic sanctions. Disclosure is generally required even where the activities, transactions or dealings were conducted in compliance with applicable law. Because the SEC defines the term "affiliate" broadly, it includes any entity under common "control" with us (and the term "control" is also construed broadly by the SEC).

The description of the activities below has been provided to the Company by Warburg Pincus LLC ("WP"), affiliates of which: (i) beneficially own more than 10% of MBIA Inc.'s outstanding common stock and are members of our board of directors and (ii) beneficially own more than 10% of the equity interests of, and have the right to designate members of the board of directors of Santander Asset Management Investment Holdings Limited ("SAMIH"). SAMIH may therefore be deemed to be under common "control" with MBIA Inc.; however, this statement is not meant to be an admission that common control exists.

The disclosure below relates solely to activities conducted by SAMIH and its non-U.S. affiliates that may be deemed to be under common "control" with MBIA Inc. The disclosure does not relate to any activities conducted by the Company or by WP and does not involve our or WP's management. Neither the Company nor WP has had any involvement in or control over the disclosed activities of SAMIH, nor has neither the Company nor WP has independently verified or participated in the preparation of the disclosure. Neither the Company nor WP is representing to the accuracy or completeness of the disclosure nor do we or WP undertake any obligation to correct or update it.

The Company understands that SAMIH's affiliates intend to disclose in their next annual or quarterly SEC report that an Iranian national, resident in the U.K., who is currently designated by the U.S. under the Iranian Financial Sanctions Regulations and the NPWMD designation, holds two investment accounts with Santander Asset Management UK Limited. The accounts have remained frozen throughout 2013 and the first half of 2014. The investment returns are being automatically reinvested, and no disbursements have been made to the customer. In the first half of 2014, the total revenue for the Santander Group in connection with the investment accounts was £23,200 whilst net profits were negligible relative to the overall profits of Banco Santander, S.A.

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**Item 6. Exhibits**

- +31.1. Chief Executive Officer—Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- +31.2. Chief Financial Officer—Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*32.1. Chief Executive Officer—Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- \*32.2. Chief Financial Officer—Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- +99.1. Additional Exhibits—MBIA Insurance Corporation and Subsidiaries GAAP Consolidated Financial Statements.
- +101. Additional Exhibits—MBIA Inc. and Subsidiaries Consolidated Financial Statements and Notes to Consolidated Financial Statements from the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2014, formatted in XBRL.

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+ Filed Herewith

\* Furnished Herewith

## 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.

|                      |                                                                                                    |
|----------------------|----------------------------------------------------------------------------------------------------|
| Date: August 6, 2014 | MBIA Inc.<br>Registrant                                                                            |
|                      | <u>/s/ C. Edward Chaplin</u><br>C. Edward Chaplin<br>Chief Financial Officer                       |
| Date: August 6, 2014 | <u>/s/ Douglas C. Hamilton</u><br>Douglas C. Hamilton<br>Controller (Principal Accounting Officer) |

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## Section 2: EX-31.1 (EX-31.1)

**Exhibit 31.1**

### CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Joseph W. Brown, certify that:

1. I have reviewed the Quarterly Report of MBIA Inc. (the "Company") on Form 10-Q for the period ending June 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report");
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this Report;
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
  - (d) disclosed in this Report that there were no changes in the Company's internal control over financial reporting that occurred during the Company's second quarter of 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and to the audit committee of the board of directors:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

/s/ Joseph W. Brown  
Joseph W. Brown  
Chief Executive Officer  
August 6, 2014  
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## Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

### CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, C. Edward Chaplin, certify that:

1. I have reviewed the Quarterly Report of MBIA Inc. (the "Company") on Form 10-Q for the period ending June 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report");
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this Report;
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
  - (d) disclosed in this Report that there were no changes in the Company's internal control over financial reporting that occurred during the Company's second quarter of 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and to the audit committee of the board of directors:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

/s/ C. Edward Chaplin

C. Edward Chaplin  
Chief Financial Officer  
August 6, 2014  
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## Section 4: EX-32.1 (EX-32.1)

Exhibit 32.1

### CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of MBIA Inc. (the "Company") on Form 10-Q for the period ending June 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joseph W. Brown, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Joseph W. Brown

Joseph W. Brown  
Chief Executive Officer  
August 6, 2014  
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## Section 5: EX-32.2 (EX-32.2)

Exhibit 32.2

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of MBIA Inc. (the "Company") on Form 10-Q for the period ending June 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, C. Edward Chaplin, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ C. Edward Chaplin

C. Edward Chaplin  
Chief Financial Officer

August 6, 2014

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## Section 6: EX-99.1 (EX-99.1)

Exhibit 99.1

**MBIA INSURANCE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS**

**As of June 30, 2014 and December 31, 2013  
and for the periods ended June 30, 2014 and 2013**

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**MBIA INSURANCE CORPORATION AND SUBSIDIARIES**  
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**MBIA INSURANCE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS (Unaudited)**  
(In millions except share and per share amounts)

|                                                                                                                                                                         | <u>June 30, 2014</u>    | <u>December 31, 2013</u> |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------|--------------------------|
| <b>Assets</b>                                                                                                                                                           |                         |                          |
| Investments:                                                                                                                                                            |                         |                          |
| Fixed-maturity securities held as available-for-sale, at fair value (amortized cost \$512 and \$321)                                                                    | \$ 528                  | \$ 328                   |
| Investments carried at fair value                                                                                                                                       | 32                      | 5                        |
| Short-term investments held as available-for-sale, at fair value (amortized cost \$411 and \$348)                                                                       | 411                     | 349                      |
| Other investments (includes investments at fair value of \$2 and \$1)                                                                                                   | <u>2</u>                | <u>29</u>                |
| Total investments                                                                                                                                                       | 973                     | 711                      |
| Cash and cash equivalents                                                                                                                                               | 310                     | 930                      |
| Premiums receivable                                                                                                                                                     | 975                     | 1,051                    |
| Deferred acquisition costs                                                                                                                                              | 380                     | 416                      |
| Prepaid reinsurance premiums                                                                                                                                            | 1,041                   | 1,131                    |
| Insurance loss recoverable                                                                                                                                              | 624                     | 694                      |
| Deferred income taxes, net                                                                                                                                              | 1,038                   | 1,139                    |
| Other assets                                                                                                                                                            | 96                      | 121                      |
| Assets of consolidated variable interest entities:                                                                                                                      |                         |                          |
| Cash                                                                                                                                                                    | 66                      | 97                       |
| Investments held-to-maturity, at amortized cost (fair value of \$2,780 and \$2,651)                                                                                     | 2,787                   | 2,801                    |
| Fixed-maturity securities at fair value                                                                                                                                 | 474                     | 587                      |
| Loans receivable at fair value                                                                                                                                          | 1,539                   | 1,612                    |
| Loan repurchase commitments                                                                                                                                             | <u>363</u>              | <u>359</u>               |
| <b>Total assets</b>                                                                                                                                                     | <b><u>\$ 10,666</u></b> | <b><u>\$ 11,649</u></b>  |
| <b>Liabilities and Equity</b>                                                                                                                                           |                         |                          |
| Liabilities:                                                                                                                                                            |                         |                          |
| Unearned premium revenue                                                                                                                                                | \$ 1,949                | \$ 2,105                 |
| Loss and loss adjustment expense reserves                                                                                                                               | 538                     | 629                      |
| Reinsurance premiums payable                                                                                                                                            | 265                     | 280                      |
| Long-term debt                                                                                                                                                          | 1,180                   | 1,125                    |
| Deferred fee revenue                                                                                                                                                    | 305                     | 334                      |
| Derivative liabilities                                                                                                                                                  | 368                     | 1,151                    |
| Other liabilities                                                                                                                                                       | 96                      | 60                       |
| Liabilities of consolidated variable interest entities:                                                                                                                 |                         |                          |
| Variable interest entity notes (includes financial instruments carried at fair value of \$2,202 and \$2,430)                                                            | 4,989                   | 5,231                    |
| Derivative liabilities                                                                                                                                                  | <u>11</u>               | <u>11</u>                |
| <b>Total liabilities</b>                                                                                                                                                | <b><u>9,701</u></b>     | <b><u>10,926</u></b>     |
| Commitments and contingencies (See Note 10)                                                                                                                             |                         |                          |
| Equity:                                                                                                                                                                 |                         |                          |
| Series A non-cumulative perpetual preferred stock, par value \$1,000 per share, liquidation value \$100,000 per share, authorized - 4,000, issued and outstanding—2,759 | 28                      | 28                       |
| Common stock, par value \$220.80 per share; authorized, issued and outstanding - 67,936 shares                                                                          | 15                      | 15                       |
| Additional paid-in capital                                                                                                                                              | 977                     | 980                      |
| Retained earnings (deficit)                                                                                                                                             | (82)                    | (319)                    |
| Accumulated other comprehensive income (loss), net of tax of \$3 and \$2                                                                                                | <u>27</u>               | <u>19</u>                |
| <b>Total equity</b>                                                                                                                                                     | <b><u>965</u></b>       | <b><u>723</u></b>        |
| <b>Total liabilities and equity</b>                                                                                                                                     | <b><u>\$ 10,666</u></b> | <b><u>\$ 11,649</u></b>  |

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

**MBIA INSURANCE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**  
(In millions)

|                                                                                | <u>Three Months Ended June 30,</u> |                 | <u>Six Months Ended June 30,</u> |                |
|--------------------------------------------------------------------------------|------------------------------------|-----------------|----------------------------------|----------------|
|                                                                                | <u>2014</u>                        | <u>2013</u>     | <u>2014</u>                      | <u>2013</u>    |
| <b>Revenues:</b>                                                               |                                    |                 |                                  |                |
| Premiums earned:                                                               |                                    |                 |                                  |                |
| Scheduled premiums earned                                                      | \$ 31                              | \$ 35           | \$ 64                            | \$ 72          |
| Refunding premiums earned                                                      | 4                                  | 1               | 4                                | 2              |
| Premiums earned (net of ceded premiums of \$37, \$56, \$81 and \$118)          | 35                                 | 36              | 68                               | 74             |
| Net investment income                                                          | 4                                  | 2               | 7                                | 6              |
| Fees and reimbursements                                                        | 16                                 | 23              | 30                               | 45             |
| Change in fair value of insured derivatives:                                   |                                    |                 |                                  |                |
| Realized gains (losses) and other settlements on insured derivatives           | (24)                               | (1,532)         | (394)                            | (1,520)        |
| Unrealized gains (losses) on insured derivatives                               | (24)                               | 1,350           | 814                              | 1,277          |
| Net change in fair value of insured derivatives                                | (48)                               | (182)           | 420                              | (243)          |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 1                                  | 12              | (2)                              | 34             |
| Other net realized gains (losses)                                              | (1)                                | -               | (1)                              | -              |
| Revenues of consolidated variable interest entities:                           |                                    |                 |                                  |                |
| Net investment income                                                          | 13                                 | 12              | 25                               | 25             |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 23                                 | 73              | 24                               | 104            |
| Other net realized gains (losses)                                              | -                                  | 1               | -                                | 1              |
| Total revenues                                                                 | 43                                 | (23)            | 571                              | 46             |
| <b>Expenses:</b>                                                               |                                    |                 |                                  |                |
| Losses and loss adjustment                                                     | (5)                                | 122             | 59                               | (76)           |
| Amortization of deferred acquisition costs                                     | 17                                 | 24              | 36                               | 57             |
| Operating                                                                      | 15                                 | 35              | 31                               | 61             |
| Interest                                                                       | 27                                 | 41              | 55                               | 99             |
| Expenses of consolidated variable interest entities:                           |                                    |                 |                                  |                |
| Operating                                                                      | 2                                  | 2               | 5                                | 7              |
| Interest                                                                       | 9                                  | 10              | 19                               | 20             |
| Total expenses                                                                 | 65                                 | 234             | 205                              | 168            |
| Income (loss) before income taxes                                              | (22)                               | (257)           | 366                              | (122)          |
| Provision (benefit) for income taxes                                           | (7)                                | (124)           | 129                              | (95)           |
| <b>Net income (loss)</b>                                                       | <b>\$ (15)</b>                     | <b>\$ (133)</b> | <b>\$ 237</b>                    | <b>\$ (27)</b> |

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

**MBIA INSURANCE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)**  
(In millions)

|                                                                               | <u>Three Months Ended June 30,</u> |                 | <u>Six Months Ended June 30,</u> |                |
|-------------------------------------------------------------------------------|------------------------------------|-----------------|----------------------------------|----------------|
|                                                                               | <u>2014</u>                        | <u>2013</u>     | <u>2014</u>                      | <u>2013</u>    |
| Net income (loss)                                                             | \$ (15)                            | \$ (133)        | \$ 237                           | \$ (27)        |
| Other comprehensive income (loss):                                            |                                    |                 |                                  |                |
| Unrealized gains (losses) on available-for-sale securities:                   |                                    |                 |                                  |                |
| Unrealized gains (losses) arising during the period                           | -                                  | (5)             | 5                                | -              |
| Provision (benefit) for income taxes                                          | (2)                                | (1)             | -                                | -              |
| Total                                                                         | 2                                  | (4)             | 5                                | -              |
| Reclassification adjustments for (gains) losses included in net income (loss) | (3)                                | (3)             | (3)                              | (3)            |
| Provision (benefit) for income taxes                                          | -                                  | (1)             | -                                | (1)            |
| Total                                                                         | (3)                                | (2)             | (3)                              | (2)            |
| Foreign currency translation gains (losses)                                   | 9                                  | 3               | 9                                | (39)           |
| Provision (benefit) for income taxes                                          | 3                                  | -               | 3                                | -              |
| Total                                                                         | 6                                  | 3               | 6                                | (39)           |
| Total other comprehensive income (loss)                                       | 5                                  | (3)             | 8                                | (41)           |
| <b>Comprehensive income (loss)</b>                                            | <u>\$ (10)</u>                     | <u>\$ (136)</u> | <u>\$ 245</u>                    | <u>\$ (68)</u> |

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

**MBIA INSURANCE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)**  
**For The Six Months Ended June 30, 2014**  
(In millions except share amounts)

|                                             | <u>Preferred Stock</u> |               | <u>Common Stock</u> |               | <u>Additional<br/>Paid-in<br/>Capital</u> | <u>Retained<br/>Earnings<br/>(Deficit)</u> | <u>Accumulated<br/>Other<br/>Comprehensive<br/>Income (Loss)</u> | <u>Total<br/>Shareholders'<br/>Equity</u> |
|---------------------------------------------|------------------------|---------------|---------------------|---------------|-------------------------------------------|--------------------------------------------|------------------------------------------------------------------|-------------------------------------------|
|                                             | <u>Shares</u>          | <u>Amount</u> | <u>Shares</u>       | <u>Amount</u> |                                           |                                            |                                                                  |                                           |
| <b>Balance, December 31, 2013</b>           | <b>2,759</b>           | <b>\$ 28</b>  | <b>67,936</b>       | <b>\$ 15</b>  | <b>\$ 980</b>                             | <b>\$ (319)</b>                            | <b>\$ 19</b>                                                     | <b>\$ 723</b>                             |
| Net income (loss)                           | -                      | -             | -                   | -             | -                                         | 237                                        | -                                                                | 237                                       |
| Other comprehensive income (loss)           | -                      | -             | -                   | -             | -                                         | -                                          | 8                                                                | 8                                         |
| Share-based compensation, net of tax of \$3 | -                      | -             | -                   | -             | (3)                                       | -                                          | -                                                                | (3)                                       |
| <b>Balance, June 30, 2014</b>               | <b>2,759</b>           | <b>\$ 28</b>  | <b>67,936</b>       | <b>\$ 15</b>  | <b>\$ 977</b>                             | <b>\$ (82)</b>                             | <b>\$ 27</b>                                                     | <b>\$ 965</b>                             |

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

**MBIA INSURANCE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**  
(In millions)

|                                                                                                 | <u>Six Months Ended June 30,</u> |                 |
|-------------------------------------------------------------------------------------------------|----------------------------------|-----------------|
|                                                                                                 | <u>2014</u>                      | <u>2013</u>     |
| Cash flows from operating activities:                                                           |                                  |                 |
| Premiums, fees and reimbursements received                                                      | \$ 69                            | \$ 89           |
| Investment income received                                                                      | 107                              | 136             |
| Insured derivative commutations and losses paid                                                 | (371)                            | (418)           |
| Financial guarantee losses and loss adjustment expenses paid                                    | (155)                            | (310)           |
| Proceeds from recoveries and reinsurance                                                        | 83                               | 1,792           |
| Operating and employee related expenses paid                                                    | (32)                             | (87)            |
| Interest paid                                                                                   | (57)                             | (87)            |
| Income taxes (paid) received                                                                    | 5                                | -               |
| Net cash provided (used) by operating activities                                                | <u>(351)</u>                     | <u>1,115</u>    |
| Cash flows from investing activities:                                                           |                                  |                 |
| Purchases of available-for-sale investments                                                     | (275)                            | (15)            |
| Sales of available-for-sale investments                                                         | 39                               | 329             |
| Paydowns and maturities of available-for-sale investments                                       | 2                                | 1               |
| Sales, paydowns and maturities of investments at fair value                                     | 95                               | 113             |
| Sales, paydowns and maturities (purchases) of short-term investments, net                       | (13)                             | 18              |
| Sales, paydowns and maturities of held-to-maturity investments                                  | 14                               | 12              |
| Paydowns and maturities of loans                                                                | 112                              | 137             |
| Purchase of an affiliate                                                                        | (4)                              | -               |
| Consolidation (deconsolidation) of variable interest entities, net                              | (1)                              | (26)            |
| (Payments) proceeds for derivative settlements                                                  | -                                | (23)            |
| Capital expenditures                                                                            | (1)                              | -               |
| Net cash provided (used) by investing activities                                                | <u>(32)</u>                      | <u>546</u>      |
| Cash flows from financing activities:                                                           |                                  |                 |
| Principal paydowns of variable interest entity notes                                            | (270)                            | (357)           |
| Issuance of variable interest entity notes                                                      | -                                | 93              |
| (Repayment of) proceeds from secured loan with an affiliate                                     | -                                | (1,596)         |
| Net cash provided (used) by financing activities                                                | <u>(270)</u>                     | <u>(1,860)</u>  |
| Effect of exchange rate changes on cash and cash equivalents                                    | 2                                | -               |
| Net increase (decrease) in cash and cash equivalents                                            | (651)                            | (199)           |
| Cash and cash equivalents - beginning of period                                                 | 1,027                            | 573             |
| Cash and cash equivalents - end of period                                                       | <u>\$ 376</u>                    | <u>\$ 374</u>   |
| Reconciliation of net income (loss) to net cash provided (used) by operating activities:        |                                  |                 |
| Net income (loss)                                                                               | \$ 237                           | \$ (27)         |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: |                                  |                 |
| Change in:                                                                                      |                                  |                 |
| Premiums receivable                                                                             | 83                               | 90              |
| Deferred acquisition costs                                                                      | 36                               | 54              |
| Unearned premium revenue                                                                        | (170)                            | (205)           |
| Prepaid reinsurance premiums                                                                    | 90                               | 122             |
| Loss and loss adjustment expense reserves                                                       | (90)                             | (89)            |
| Insurance loss recoverable                                                                      | 69                               | 2,754           |
| Accrued interest payable                                                                        | 55                               | 85              |
| Realized (gains) losses and other settlements on insured derivatives                            | 30                               | -               |
| Unrealized (gains) losses on insured derivatives                                                | (814)                            | (1,277)         |
| Net (gains) losses on financial instruments at fair value and foreign exchange                  | (22)                             | (138)           |
| Deferred income tax provision (benefit)                                                         | 122                              | (97)            |
| Interest on variable interest entities, net                                                     | 35                               | 49              |
| Other operating                                                                                 | (12)                             | (206)           |
| Total adjustments to net income (loss)                                                          | <u>(588)</u>                     | <u>1,142</u>    |
| Net cash provided (used) by operating activities                                                | <u>\$ (351)</u>                  | <u>\$ 1,115</u> |

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

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 1: Business Developments and Risks and Uncertainties**

**Summary**

MBIA Insurance Corporation is a wholly-owned subsidiary of MBIA Inc. ("MBIA"). The guarantees of MBIA Insurance Corporation and its subsidiaries, ("MBIA Corp.") generally provide unconditional and irrevocable guarantees of the payments of the principal of, and interest or other amounts owing on, insured obligations when due or, in the event MBIA Corp. has the right at its discretion to accelerate insured obligations upon default or otherwise, upon MBIA Corp.'s acceleration. MBIA Corp. owns MBIA UK Insurance Limited ("MBIA UK"), a financial guarantee insurance company licensed in the United Kingdom ("U.K.") that issued financial guarantee insurance in the member countries of the European Economic Area and other regions outside the U.S. MBIA Corp. issued financial guarantee insurance in Mexico through MBIA México, S.A. de C.V. ("MBIA Mexico"). Unless otherwise indicated or the context otherwise requires, references to "MBIA Corp." are to MBIA Insurance Corporation, together with its subsidiaries, MBIA UK and MBIA Mexico. MBIA Corp.'s guarantees insure structured finance and asset-backed obligations, privately issued bonds used for the financing of public purpose projects, which are primarily located outside of the United States ("U.S.") and that include toll roads, bridges, airports, public transportation facilities, utilities and other types of infrastructure projects serving a substantial public purpose, and obligations of sovereign-related and sub-sovereign issuers. Structured finance and asset-backed securities ("ABS") typically are securities repayable from expected cash flows generated by a specified pool of assets, such as residential and commercial mortgages, insurance policies, consumer loans, corporate loans and bonds, trade and export receivables, leases for equipment, aircraft and real property. MBIA Corp. is no longer insuring new credit derivative contracts except in transactions related to the reduction of existing derivative exposure.

Certain investment agreement contracts written by MBIA Inc. are insured by MBIA Corp. If MBIA Inc. were to have insufficient assets to pay amounts due, MBIA Corp. would be called upon to make such payments under its insurance policies. MBIA Corp. also insures debt obligations of the following affiliates:

- MBIA Inc.;
- MBIA Global Funding, LLC ("GFL");
- LaCrosse Financial Products, LLC, a wholly-owned affiliate, in which MBIA Corp. has written insurance policies guaranteeing the obligations under credit default swaps ("CDS"), including termination payments that may become due in certain circumstances including the occurrence of certain insolvency or payment defaults under the CDS contracts.

The structured finance market continues to recover from the global credit crisis with new issuance volume, though increasing, still well below historical averages. It is unclear how or when MBIA Corp. may be able to re-engage this market.

***Liquidity and Strategic Initiatives***

As of June 30, 2014 and December 31, 2013, MBIA Corp.'s cash and short-term investments that were immediately available totaled \$427 million and \$827 million, respectively. Management's expected liquidity and capital forecasts for MBIA Corp., which include expected excess spread recoveries and put back recoveries, reflect adequate resources to pay claims when due. During the six months ended June 30, 2014, MBIA Corp. continued to focus on its strategic initiatives, which are the collection of excess spread and put-back recoveries and the mitigation of MBIA Corp.'s high risk insurance exposure, primarily through terminations of insurance policies. During the six months ended June 30, 2014, MBIA Corp. commuted \$3.9 billion of gross par exposure, primarily comprising structured commercial mortgage-backed securities ("CMBS") pools, commercial real estate ("CRE") collateralized debt obligations ("CDOs"), and first-lien residential mortgage-backed securities ("RMBS"). The difference between the fair values of MBIA Corp.'s derivative liabilities for the commuted policies and the aggregate cost of the commutation was reflected in earnings for the six months ended June 30, 2014.

***Risks and Uncertainties***

MBIA Corp.'s consolidated financial statements include estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The outcome of certain significant risks and uncertainties could cause MBIA Corp. to revise its estimates and assumptions or could cause actual results to differ from MBIA Corp.'s estimates. While MBIA Corp. believes that it continues to have sufficient capital and liquidity to meet all of its expected obligations, if one or more possible adverse outcomes were to be realized, its statutory capital, financial position, results of operations and cash flows could be materially and adversely affected. The discussion below highlights the significant risks and uncertainties that could have a material effect on MBIA Corp.'s financial statements in future periods.

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

- The amount and timing of projected collections from excess spread and put-back recoverable from Credit Suisse Securities (USA) LLC, DLJ Mortgage Capital, Inc., and Select Portfolio Servicing, Inc. (collectively, "Credit Suisse") and the potential of claims from MBIA Corp.'s remaining insured CMBS pools and second-lien RMBS are uncertain. Further, the remaining insured portfolio, aside from these exposures, could deteriorate and result in additional significant loss reserves and claim payments. MBIA Corp.'s expected liquidity and capital forecasts, which include expected excess spread recoveries and put-back recoveries from Credit Suisse, reflect adequate resources to pay claims, when due. However, if MBIA Corp. experiences higher than expected claim payments or is unable to terminate the remaining exposures that represent substantial risk to MBIA Corp., MBIA Corp. may ultimately have insufficient resources to continue to pay claims, which could cause the New York State Department of Financial Services ("NYSDFS") to put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding (an "MBIA Insurance Corporation Proceeding"), as per Article 74 of the New York Insurance Law ("NYIL").

Refer to "Note 5: Loss and Loss Adjustment Expense Reserves" for information about MBIA Corp.'s loss reserves and recoveries.

- Management believes that MBIA Corp. has sufficient liquidity resources to meet all of its obligations for the foreseeable future. In order to meet its liquidity requirements, MBIA Corp. may use its ability to access external sources of financing, although there can be no assurance that this strategy will be available or adequate. A failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp.
- As of June 30, 2014, MBIA Corp., was not in compliance with a requirement under the NYIL to hold qualifying assets in an amount necessary to satisfy its contingency reserves. In addition, as of June 30, 2014, MBIA Corp. exceeded its aggregate risk limits under the NYIL. MBIA Corp. previously notified the NYSDFS of the overage and submitted a plan to achieve compliance with the limits in accordance with the NYIL. If MBIA Corp. is not in compliance with its aggregate risk and single risk limits, the NYSDFS may prevent MBIA Corp. from transacting any new financial guarantee insurance business until it no longer exceeds these limitations.

While MBIA Corp. believes it will have adequate resources to pay expected claims, in the event it does not have adequate resources in the future and the NYSDFS were to commence an MBIA Insurance Corporation Proceeding, MBIA Insurance Corporation may be subject to the below conditions.

- CDS counterparties may seek to terminate CDS contracts insured by MBIA Corp. and make market-based damage claims (irrespective of whether actual credit-related losses are expected under the underlying exposure). MBIA Corp. believes that such acceleration would likely terminate any residual value.
- Medium-term notes ("MTNs") issued by MBIA's subsidiary, GFL, which are insured by MBIA Corp., would accelerate. To the extent GFL fails to pay the accelerated amounts under the GFL MTNs, the MTN holders would have policy claims against MBIA Corp. for scheduled payments of interest and principal.
- An MBIA Insurance Corporation Proceeding may accelerate certain investment agreements issued by MBIA Inc. including, in some cases, with make-whole payments. To the extent MBIA fails to pay the accelerated amounts under these investment agreements or the collateral securing these investment agreements is deemed insufficient to pay the accelerated amounts due, the holders of the investment agreements would have policy claims against MBIA Corp.
- Payments under MBIA Insurance Corporation insurance policies could be suspended, delayed or reduced, in whole or in part.
- An acceleration of the surplus notes issued by MBIA Corp. and a possible reduction or further delay or suspension of the amounts due could occur.
- MBIA Corp.'s ability to carry out its tax planning strategies could be impacted. This may cause it to record additional allowances against a portion or all of its deferred tax assets. Refer to "Note 9: Income Taxes" for information about MBIA Corp.'s deferred tax assets. In addition, MBIA Corp. is currently included in the consolidated tax return of MBIA Inc. An MBIA Insurance Corporation Proceeding could result in challenges to the tax sharing arrangement among the MBIA affiliates that might adversely affect management's ability to manage taxes efficiently.
- Approval of the rehabilitator and the rehabilitation court (or liquidator and liquidation court, as the case may be) may be required for a variety of actions of importance to MBIA Corp. and its policyholders, including, without limitation, settlement of MBIA Corp.'s put-back litigation and commutation of MBIA Corp.-insured exposures.
- The rehabilitator or liquidator would replace the Board of Directors of MBIA Corp. and take control of the operations and assets of MBIA Insurance Corporation, which would result in changes to its strategies and management.
- MBIA Corp. would be subject to significant additional expenses arising from the appointment of the rehabilitator or liquidator, as receiver, and payment of the fees and expenses of the advisors to such rehabilitator or liquidator.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 2: Significant Accounting Policies**

MBIA Corp. has disclosed its significant accounting policies in "Note 2: Significant Accounting Policies" in the Notes to Consolidated Financial Statements included in Exhibit 99.2 to MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013. The following significant accounting policies provide an update to those included under the same captions in Exhibit 99.2 to MBIA Inc.'s Annual Report on Form 10-K.

***Basis of Presentation***

The accompanying unaudited consolidated financial statements do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America ("GAAP") for annual periods. These statements should be read in conjunction with MBIA Corp.'s consolidated financial statements and notes thereto included in Exhibit 99.2 to MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of MBIA Corp.'s consolidated financial position and results of operations. All material intercompany balances and transactions have been eliminated.

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

The results of operations for the three and six months ended June 30, 2014 may not be indicative of the results that may be expected for the year ending December 31, 2014. The December 31, 2013 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP for annual periods. Certain amounts have been reclassified in the prior year's financial statements to conform to the current presentation. Such reclassifications had no impact on total revenues, expenses, assets, liabilities, shareholders' equity, operating cash flows, investing cash flows, or financing cash flows for all periods presented.

***Subsequent Events***

MBIA Corp. has evaluated all subsequent events as of August 6, 2014, the date of issuance of the consolidated financial statements, for inclusion in MBIA Corp.'s consolidated financial statements and/or accompanying notes.

**Note 3: Recent Accounting Pronouncements**

***Recently Adopted Accounting Standards***

For the six months ended June 30, 2014, MBIA Corp. has not adopted any new accounting pronouncements that had a material impact on its consolidated financial statements.

***Recent Accounting Developments***

***Revenue from Contracts with Customers (Topic 606) (ASU 2014-09)***

In May of 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 amends the accounting guidance for recognizing revenue for the transfer of goods or services from contracts with customers unless those contracts are within the scope of other accounting standards. ASU 2014-09 is effective for interim and annual periods beginning January 1, 2017, and is applied on a retrospective or modified retrospective basis. MBIA Corp. is evaluating the impact of adopting ASU 2014-09.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 3: Recent Accounting Pronouncements (continued)**

*Transfers and Servicing (Topic 860)-Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures (ASU 2014-11)*

In June of 2014, the FASB issued ASU 2014-11, "Transfers and Servicing (Topic 860)-Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." The repurchase agreements and similar transactions guidance is amended by ASU 2014-11 to change the accounting for i.) repurchase-to-maturity transactions to secured borrowing accounting and ii.) linked repurchase financing transactions to secured borrowing accounting. ASU 2014-11 amends disclosure requirements for transfers accounted for as sales, and for repurchase transactions accounted for as secured borrowings. ASU 2014-11 is effective for interim and annual periods beginning January 1, 2015, and is applied on a prospective basis. The adoption of ASU 2014-11 is not expected to materially impact MBIA Corp.'s consolidated financial statements.

*Compensation-Stock Compensation (Topic 718)-Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (A Consensus of the FASB Emerging Issues Task Force) (ASU 2014-12)*

In June of 2014, the FASB issued ASU 2014-12, "Compensation-Stock Compensation (Topic 718)-Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." ASU 2014-12 requires that a performance target that affects vesting of share-based payment awards and that could be achieved after an employee's requisite service period be accounted for as a performance condition. ASU 2014-12 is effective for interim and annual periods beginning January 1, 2016 with early adoption permitted, and is applied on a prospective basis or retrospective basis. The adoption of ASU 2014-12 is not expected to materially impact MBIA Corp.'s consolidated financial statements.

**Note 4: Variable Interest Entities**

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

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

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 4: Variable Interest Entities (continued)**

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

**Nonconsolidated VIEs**

The following tables present the total assets of nonconsolidated VIEs in which MBIA Corp. holds a variable interest as of June 30, 2014 and December 31, 2013. The following tables also present MBIA Corp.'s maximum exposure to loss for nonconsolidated VIEs and carrying values of the assets and liabilities for its interests in these VIEs as of June 30, 2014 and December 31, 2013. MBIA Corp. has aggregated nonconsolidated VIEs based on the underlying credit exposure of the insured obligation. The nature of MBIA Corp.'s variable interests in nonconsolidated VIEs is related to financial guarantees and insured CDS contracts.

|                                 | June 30, 2014            |                                |                                       |                                                 |                                               |                                                                   |                                          |
|---------------------------------|--------------------------|--------------------------------|---------------------------------------|-------------------------------------------------|-----------------------------------------------|-------------------------------------------------------------------|------------------------------------------|
|                                 | Carrying Value of Assets |                                |                                       |                                                 | Carrying Value of Liabilities                 |                                                                   |                                          |
|                                 | VIE<br>Assets            | Maximum<br>Exposure<br>to Loss | Premiums<br>Receivable <sup>(1)</sup> | Insurance<br>Loss<br>Recoverable <sup>(2)</sup> | Unearned<br>Premium<br>Revenue <sup>(3)</sup> | Loss and Loss<br>Adjustment<br>Expense<br>Reserves <sup>(4)</sup> | Derivative<br>Liabilities <sup>(5)</sup> |
| In millions                     |                          |                                |                                       |                                                 |                                               |                                                                   |                                          |
| Insurance:                      |                          |                                |                                       |                                                 |                                               |                                                                   |                                          |
| Global structured finance:      |                          |                                |                                       |                                                 |                                               |                                                                   |                                          |
| Collateralized debt obligations | \$ 8,399                 | \$ 6,267                       | \$ 30                                 | \$ -                                            | \$ 25                                         | \$ 8                                                              | \$ 96                                    |
| Mortgage-backed residential     | 15,622                   | 8,274                          | 48                                    | 587                                             | 46                                            | 322                                                               | 5                                        |
| Mortgage-backed commercial      | 617                      | 322                            | 1                                     | -                                               | 1                                             | -                                                                 | -                                        |
| Consumer asset-backed           | 6,372                    | 2,450                          | 18                                    | -                                               | 16                                            | 10                                                                | -                                        |
| Corporate asset-backed          | 10,414                   | 6,414                          | 62                                    | 18                                              | 75                                            | -                                                                 | -                                        |
| Total global structured finance | 41,424                   | 23,727                         | 159                                   | 605                                             | 163                                           | 340                                                               | 101                                      |
| Global public finance           | 56,176                   | 20,609                         | 203                                   | -                                               | 243                                           | 5                                                                 | -                                        |
| Total insurance                 | \$97,600                 | \$44,336                       | \$ 362                                | \$ 605                                          | \$ 406                                        | \$ 345                                                            | \$ 101                                   |

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

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

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

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

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

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 4: Variable Interest Entities (continued)**

| In millions                     | December 31, 2013        |                          |                                    |                                           |                                         |                                                          |                                       |
|---------------------------------|--------------------------|--------------------------|------------------------------------|-------------------------------------------|-----------------------------------------|----------------------------------------------------------|---------------------------------------|
|                                 | Carrying Value of Assets |                          |                                    |                                           | Carrying Value of Liabilities           |                                                          |                                       |
|                                 | VIE Assets               | Maximum Exposure to Loss | Premiums Receivable <sup>(1)</sup> | Insurance Loss Recoverable <sup>(2)</sup> | Unearned Premium Revenue <sup>(3)</sup> | Loss and Loss Adjustment Expense Reserves <sup>(4)</sup> | Derivative Liabilities <sup>(5)</sup> |
| <b>Insurance:</b>               |                          |                          |                                    |                                           |                                         |                                                          |                                       |
| Global structured finance:      |                          |                          |                                    |                                           |                                         |                                                          |                                       |
| Collateralized debt obligations | \$ 12,565                | \$ 7,693                 | \$ 43                              | \$ -                                      | \$ 37                                   | \$ 21                                                    | \$ 108                                |
| Mortgage-backed residential     | 21,738                   | 9,251                    | 53                                 | 658                                       | 51                                      | 327                                                      | 5                                     |
| Mortgage-backed commercial      | 1,367                    | 447                      | 1                                  | -                                         | 1                                       | -                                                        | -                                     |
| Consumer asset-backed           | 7,830                    | 2,740                    | 19                                 | -                                         | 19                                      | 13                                                       | -                                     |
| Corporate asset-backed          | 13,028                   | 7,248                    | 80                                 | 18                                        | 96                                      | -                                                        | -                                     |
| Total global structured finance | 56,528                   | 27,379                   | 196                                | 676                                       | 204                                     | 361                                                      | 113                                   |
| Global public finance           | 52,317                   | 20,162                   | 206                                | -                                         | 248                                     | 5                                                        | -                                     |
| Total insurance                 | <u>\$108,845</u>         | <u>\$47,541</u>          | <u>\$ 402</u>                      | <u>\$ 676</u>                             | <u>\$ 452</u>                           | <u>\$ 366</u>                                            | <u>\$ 113</u>                         |

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

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

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

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

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

The maximum exposure to loss as a result of MBIA Corp.'s variable interests in VIEs is represented by insurance in force. Insurance in force is the maximum future payments of principal and interest which may be required under commitments to make payments on insured obligations issued by nonconsolidated VIEs.

**Consolidated VIEs**

The carrying amounts of assets and liabilities of consolidated VIEs were \$5.2 billion and \$5.0 billion, respectively, as of June 30, 2014, and \$5.5 billion and \$5.3 billion, respectively, as of December 31, 2013. The carrying amounts of assets and liabilities are presented separately in "Assets of consolidated variable interest entities" and "Liabilities of consolidated variable interest entities" on MBIA Corp.'s consolidated balance sheets. Additional VIEs are consolidated or deconsolidated based on an ongoing reassessment of controlling financial interest, when events occur or circumstances arise, and whether the ability to exercise rights that constitute power to direct activities of any VIEs are present according to the design and characteristics of these entities. No additional VIEs were consolidated during the three and six months ended June 30, 2014, and 2013. There were no net realized gains or losses recorded for the three and six months ended June 30, 2014, and net realized gains related to the deconsolidation of VIEs were \$1 million for the three and six months ended June 30, 2013.

Holders of insured obligations of issuer-sponsored VIEs related to MBIA Corp. do not have recourse to the general assets of MBIA Corp. In the event of nonpayment of an insured obligation issued by a consolidated VIE, MBIA Corp. is obligated to pay principal and interest, when due, on the respective insured obligation only. MBIA Corp.'s exposure to consolidated VIEs is limited to the credit protection provided on insured obligations and any additional variable interests held by MBIA Corp.

**Note 5: Loss and Loss Adjustment Expense Reserves**

**Loss and Loss Adjustment Expense Process**

As of June 30, 2014, the majority of MBIA Corp.'s case basis reserves and insurance loss recoveries recorded in accordance with GAAP were related to insured second and first-lien RMBS transactions. These reserves and recoveries do not include estimates for policies insuring credit derivatives or losses and recoveries on financial guarantee VIEs that are eliminated in consolidation. Policies insuring credit derivative contracts are accounted for as derivatives and carried at fair value under GAAP. The fair values of insured derivative contracts are influenced by a variety of market and transaction-specific factors that may be unrelated to potential future claim payments under MBIA Corp.'s insurance policies. In the absence of credit impairments on insured derivative contracts or the early termination of such contracts at a loss, the cumulative unrealized losses recorded from these contracts should reverse before or at the maturity of the contracts.

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

Notwithstanding the difference in accounting under GAAP for financial guarantee policies and MBIA Corp.'s insured derivatives, insured derivatives have similar terms, conditions, risks, and economic profiles to financial guarantee insurance policies, and therefore, are evaluated by MBIA Corp. for loss (referred to as credit impairment herein) and loss adjustment expense ("LAE") periodically in a manner similar to the way that loss and LAE reserves are estimated for financial guarantee insurance policies. Credit impairments represent actual payments and collections plus the present value of estimated expected future claim payments, net of recoveries. MBIA Insurance Corporation's expected future claim payments for insured derivatives were discounted using a rate of 5.09%, the same rate it used to calculate its statutory loss reserves as of June 30, 2014. MBIA UK used a rate of 2.50% to discount its expected future claim payments and statutory loss reserves. These credit impairments, calculated in accordance with statutory accounting principles ("U.S. STAT") differ from the fair values recorded in MBIA Corp.'s consolidated financial statements. MBIA Corp. considers its credit impairment estimates as critical information for investors as it provides information about loss payments MBIA Corp. expects to make on insured derivative contracts. As a result, the following loss and LAE process discussion includes information about loss and LAE activity recorded in accordance with GAAP for financial guarantee insurance policies and credit impairments estimated in accordance with U.S. STAT for insured derivative contracts. Refer to "Note 6: Fair Value of Financial Instruments" included herein for additional information about MBIA Corp.'s insured credit derivative contracts.

*RMBS Case Basis Reserves and Recoveries (Financial Guarantees)*

MBIA Corp.'s RMBS reserves and recoveries relate to financial guarantee insurance policies. MBIA Corp. calculated RMBS case basis reserves as of June 30, 2014 for both second and first-lien RMBS transactions using a process called the "Roll Rate Methodology." The Roll Rate Methodology is a multi-step process using a database of loan level information, a proprietary internal cash flow model, and a commercially available model to estimate losses on insured bonds. "Roll Rate" is defined as the probability that current loans become delinquent and that loans in the delinquent pipeline are charged-off or liquidated. Generally, Roll Rates are calculated for the previous three months and averaged. The loss reserve estimates are based on a probability-weighted average of three scenarios of loan losses (base case, stress case, and an additional stress case).

In calculating ultimate cumulative losses for RMBS, MBIA Corp. estimates the amount of loans that are expected to be charged-off (deemed uncollectible by servicers of the transactions) or liquidated in the future.

Second-lien RMBS Reserves

MBIA Corp.'s second-lien RMBS case basis reserves as of June 30, 2014 relate to RMBS backed by home equity lines of credit ("HELOC") and closed-end second mortgages ("CES").

The Roll Rates for 30-59 day delinquent loans and 60-89 day delinquent loans are calculated on a transaction-specific basis. MBIA Corp. assumes that the Roll Rate for 90+ day delinquent loans, excluding foreclosures and Real Estate Owned ("REO") is 95%. The Roll Rates are applied to the amounts in the respective delinquency buckets based on delinquencies as of May 31, 2014 to estimate future losses from loans that are delinquent as of the current reporting period.

Roll Rates for loans that are current as of May 31, 2014 ("Current Roll to Loss") are also calculated on a transaction-specific basis. A proportion of loans reported current as of May 31, 2014 is assumed to become delinquent every month, at a Current Roll to Loss rate that persists at a high level for a time and subsequently starts to decline. A key assumption in the model is the period of time in which MBIA Corp. projects high levels of Current Roll to Loss to persist. MBIA Corp. runs multiple scenarios, each with varying periods of time, for which the high levels of Current Roll to Loss rates persist. Loss reserves are calculated by using a weighted average of these scenarios, with the majority of the probability assigned to stressful scenarios where the high levels of Current Roll to Loss rates persist for six or twenty four months before reverting to historic levels. For example, in the base case scenario, MBIA Corp. assumes that the Current Roll to Loss begins to decline immediately and continues to decline over the next six months to 25% of their levels as of May 31, 2014. If the amount of current loans which become 30-59 days delinquent is 10%, and recent performance suggests that 30% of those loans will be charged-off, the Current Roll to Loss for the transaction is 3%. In the base case, the Current Roll to Loss will then reduce linearly to 25% of its original value over the next six months (i.e., 3% will linearly reduce to 0.75% over the six months from June 2014 to November 2014). After that six-month period, MBIA Corp. further reduces the Current Roll to Loss to 0% by early 2015 with the expectation that the performing seasoned loans will eventually result in loan performance reverting to lower levels of default consistent with history. In developing multiple loss scenarios, stress is applied by elongating the Current Roll to Loss rate for various periods, simulating a slower improvement in the transaction performance.

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

In addition, in MBIA Corp.'s loss reserve models for transactions secured by HELOCs, MBIA Corp. considers borrower draw and prepayment rates and factors that could affect the excess spread generated by current loans, which offsets losses and reduces payments. For HELOCs, the current three-month average draw rate is generally used to project future draws on the line. For HELOCs and transactions secured by fixed-rate CES, MBIA Corp. uses historical average voluntary prepayment rates to model its loss reserves. For HELOCs, projected cash flows are also based on an assumed constant basis spread between floating rate assets and floating rate insured debt obligations (the difference between prime and London Interbank Offered Rate ("LIBOR") interest rates, minus any applicable fees). For all transactions, cash flow models consider allocations and other structural aspects, including managed amortization periods, rapid amortization periods and claims against MBIA Corp.'s insurance policy consistent with such policy's terms and conditions. The estimated net claims from the procedure above are then discounted using a risk-free rate to a net present value reflecting MBIA Corp.'s general obligation to pay claims over time and not on an accelerated basis. The above assumptions represent MBIA Corp.'s probability-weighted estimates of how transactions will perform over time.

As of June 30, 2014 and December 31, 2013, MBIA Corp. established loss and LAE reserves totaling \$118 million and \$126 million, respectively, related to second-lien RMBS issues after the elimination of \$18 million and \$43 million, respectively, as a result of consolidating VIEs. For the six months ended June 30, 2014, MBIA Corp. incurred \$72 million of losses and LAE recorded in earnings related to second-lien RMBS issues after the elimination of a \$1 million benefit as a result of consolidating VIEs.

MBIA Corp. monitors portfolio performance on a monthly basis against projected performance, reviewing delinquencies, Roll Rates, and prepayment rates (including voluntary and involuntary). However, loan performance remains difficult to predict and losses may exceed expectations. In the event of a material deviation in actual performance from projected performance, MBIA Corp. would increase or decrease the case basis reserves accordingly. If actual performance were to remain at the peak levels for six additional months compared to the probability-weighted outcome currently used by MBIA Corp., the addition to the case basis reserves would be approximately \$60 million.

**Second-lien RMBS Recoveries**

MBIA Corp. primarily records two types of recoveries related to insured second-lien RMBS exposures: "put-back" claims related to those mortgage loans whose inclusion in insured securitizations failed to comply with representations and warranties ("ineligible loans") and excess spread that is generated from performing loans in the insured transactions.

*Excess Spread*

As of June 30, 2014 and December 31, 2013, MBIA Corp. recorded estimated recoveries of \$577 million and \$681 million, respectively, for the reimbursement of past and future expected claims through excess spread in insured second-lien RMBS transactions after the elimination of \$173 million and \$190 million, respectively, as a result of consolidating VIEs. As of June 30, 2014, \$569 million and \$8 million were included in "Insurance loss recoverable" and "Loss and loss adjustment expense reserves" on MBIA Corp.'s consolidated balance sheets, respectively, after the elimination of \$168 million and \$5 million, respectively, as a result of consolidating VIEs. As of December 31, 2013, \$647 million and \$34 million were included in "Insurance loss recoverable" and "Loss and loss adjustment expense reserves" on MBIA Corp.'s consolidated balance sheets, respectively, after the elimination of \$183 million and \$7 million, respectively, as a result of consolidating VIEs.

Excess spread is generated by performing loans within insured second-lien RMBS securitizations and is the difference between interest inflows on mortgage loan collateral and interest outflows on insured beneficial interests. The amount of excess spread depends on the future loss trends (which include future delinquency trends, average time to charge-off delinquent loans, and the availability of pool mortgage insurance), the future spread between prime and LIBOR interest rates; and borrower refinancing behavior which results in voluntary prepayments. Minor deviations in loss trends and voluntary prepayments may substantially impact the amounts collected from excess spread and caused the reduction in estimated recoveries during the first six months of 2014.

*Ineligible Mortgage Loans*

To date, MBIA Corp. has settled the majority of its put-back claims, with its claims against only Credit Suisse remaining as outstanding. The settlement amounts have been consistent with the put-back recoveries previously included in MBIA Corp.'s financial statements. Additional information on the status of the litigation against Credit Suisse can be found within "Note 11: Commitments and Contingencies."

The contract claim remaining with Credit Suisse is related to the inclusion of ineligible mortgage loans in the 2007-2 Home Equity Mortgage Trust ("HEMT") securitization. Credit Suisse has challenged MBIA Corp.'s assessment of the ineligibility of individual mortgage loans and the dispute is the subject of litigation for which there is no assurance that MBIA Corp. will prevail.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

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

As of June 30, 2014 and December 31, 2013, MBIA Corp. recorded estimated recoveries of \$363 million and \$359 million, respectively, related to second-lien RMBS put-back claims on ineligible mortgage loans, reflected in "Loan repurchase commitments" presented under the heading "Assets of consolidated variable interest entities" on MBIA Corp.'s consolidated balance sheets.

MBIA Corp. believes that it will prevail in enforcing its contractual put-back rights against Credit Suisse. Based on MBIA Corp.'s assessment of the strength of these claims, MBIA Corp. believes it is entitled to collect the full amount of its incurred losses, which totaled \$424 million through June 30, 2014. MBIA Corp. is entitled to collect interest on amounts paid. However, uncertainty remains with respect to the ultimate outcome of the litigation with Credit Suisse, which is contemplated in the scenario based-modeling MBIA Corp. uses. The Credit Suisse recovery scenarios are based on the amount of incurred losses measured against certain probabilities of ultimate resolution of the dispute with Credit Suisse over the inclusion of ineligible mortgage loans in the HEMT securitization. Most of the probability weight is assigned to partial recovery scenarios and are discounted using the current risk-free discount rates associated with the underlying transaction's cash flows.

MBIA Corp. frequently reviews the approach and assumptions it applies to calculate put-back recoveries. Refer to "Note 6: Loss and Loss Adjustment Expense Reserves" in the Notes to Consolidated Financial Statements included in Exhibit 99.2 to MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013, for MBIA Corp.'s assessment of the remaining unsettled recoveries related to insured Credit Suisse second-lien RMBS.

**First-lien RMBS Reserves**

MBIA Corp.'s first-lien RMBS case basis reserves as of June 30, 2014, which primarily relate to RMBS backed by Alternative A-paper and subprime mortgage loans, were determined using the Roll Rate Methodology. MBIA Corp. assumes that the Roll Rate for loans in foreclosure, REO and bankruptcy are 90%, 90% and 75%, respectively. Roll Rates for current, 30-59 day delinquent loans, 60-89 day delinquent loans and 90+ day delinquent loans are calculated on a transaction-specific basis. The Current Roll to Loss rates stay at the May 31, 2014 level for one month before declining to 25% of this level over a 24-month period.

MBIA Corp. estimates future losses by using three different probability-weighted scenarios: base; stress; and additional stress. The three scenarios differ in the Roll Rates to loss of 90+ day delinquent loans. In the base scenario, MBIA Corp. uses deal-specific Roll Rates obtained from historic loan level Roll Rate data for 90+ day delinquent loans. In the stress scenario, MBIA Corp. assumes a 90% Roll Rate for all 90+ day delinquent loans. In the additional stress scenario, the Roll Rates for each deal are an average of the deal-specific Roll Rate used in the base scenario and the 90% rate. The Roll Rates are applied to the amounts in each deal's respective 90+ delinquency bucket based on delinquencies as of May 31, 2014 in order to estimate future losses from loans that are delinquent as of June 30, 2014.

In calculating ultimate cumulative losses for first-lien RMBS, MBIA Corp. estimates the amount of loans that are expected to be liquidated through foreclosure or short sale. The time to liquidation for a defaulted loan is specific to the loan's delinquency bucket, with the latest three-month average loss severities generally used to start the projection for trends in loss severities at loan liquidation. The loss severities are reduced over time to account for reduction in the amount of foreclosure inventory, anticipated future increases in home prices, principal amortization of the loan and government foreclosure moratoriums.

As of June 30, 2014, MBIA Corp. established loss and LAE reserves totaling \$237 million related to first-lien RMBS issues. As of December 31, 2013, MBIA Corp. established loss and LAE reserves totaling \$241 million related to first-lien RMBS issues after the elimination of \$2 million as a result of consolidating VIEs. For the six months ended June 30, 2014, MBIA Corp. incurred \$27 million of losses and LAE recorded in earnings related to first-lien RMBS issues after the elimination of a \$1 million benefit as a result of consolidating VIEs.

**ABS CDOs (Financial Guarantees and Insured Derivatives)**

MBIA Corp.'s insured ABS CDOs are transactions that include a variety of collateral ranging from corporate bonds to structured finance assets (which includes but are not limited to RMBS related collateral, ABS CDOs, corporate CDOs and collateralized loan obligations). These transactions were insured as either financial guarantee insurance policies or credit derivatives with the majority currently insured in the form of financial guarantees. Since the fourth quarter of 2007, MBIA Corp.'s insured par exposure within the ABS CDO portfolio has been substantially reduced through a combination of terminations and commutations. Accordingly, as of June 30, 2014, the insured par exposure of the ABS CDO financial guarantee insurance policies and credit derivatives portfolio has declined by approximately 97% of the insured amount as of December 31, 2007.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

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

The primary factor in estimating reserves on insured ABS CDO policies written as financial guarantee insurance policies and in estimating impairments on insured ABS CDO credit derivatives is the losses associated with the underlying collateral in the transactions. MBIA Corp.'s approach to establishing reserves or impairments in this portfolio employs a methodology which is similar to other structured finance asset classes insured by MBIA Corp. MBIA Corp. uses up to a total of five probability-weighted scenarios in order to estimate its reserves or impairments for ABS CDOs. MBIA Corp.'s payment obligations after a default are timely interest and ultimate principal.

As of June 30, 2014 and December 31, 2013, MBIA Corp. established loss and LAE reserves totaling \$92 million and \$115 million, respectively, related to ABS CDO financial guarantee insurance policies after the elimination of \$235 million and \$226 million, respectively, as a result of consolidating VIEs. For the six months ended June 30, 2014, MBIA Corp. had a benefit of \$17 million of losses and LAE recorded in earnings related to ABS CDO financial guarantee insurance policies after the elimination of a \$9 million expense as a result of consolidating VIEs. In the event of further deteriorating performance of the collateral referenced or held in ABS CDO transactions, the amount of losses estimated by MBIA Corp. could increase substantially.

*Credit Impairments Related to Structured CMBS Pools, CRE CDOs and CRE Loan Pools (Financial Guarantees and Insured Derivatives)*

MBIA Corp.'s insured CRE transactions comprise structured CMBS pools, CRE CDOs and CRE loan pools. The majority of this portfolio is accounted for as insured credit derivatives and carried at fair value in MBIA Corp.'s consolidated financial statements. Refer to "Note 8: Derivative Instruments" for a further discussion of MBIA Corp.'s use of derivatives and their impact on MBIA Corp.'s consolidated financial statements. Since MBIA Corp.'s insured credit derivatives have similar terms, conditions, risks, and economic profiles to its financial guarantee insurance policies, MBIA Corp. evaluates them for impairment in the same way that it estimates loss and LAE for its financial guarantee policies. The following discussion provides information about MBIA Corp.'s process for estimating credit impairments on these contracts using its statutory loss reserve methodology, determined as the present value of the probability-weighted potential future losses, net of estimated recoveries, across multiple scenarios, plus actual payments and collections.

MBIA Corp. considers several factors when developing the range of potential outcomes in the CRE market and their impact on MBIA Corp. The following approaches require substantial judgments about the future performance of the underlying loans:

1. Each transaction is evaluated for its commutation potential, which is customized by counterparty and considers historical commutation prices, the level of dialogue with the counterparty and the credit quality and payment profile of the underlying exposure.
2. Delinquency rates, net operating income ("NOI") and capitalization rates ("Cap Rates") are used to project losses under two scenarios. These scenarios assume that property performance remains flat for the near term and then improves gradually. Additionally, certain large loans are reviewed individually so that performance and loss severity can be more accurately determined, while other loans are also reviewed for factors that may impact potential performance.
3. A proprietary model was developed by reviewing performance data on over 80,000 securitized CRE loans originated between 1992 and 2011. MBIA Corp. found property type and the debt service coverage ratio to be the most significant determinants of a loan's average annual default probability, and developed a model based on these factors. MBIA Corp. then ran Monte Carlo simulations to estimate the timing of defaults and losses at the property level by applying property type-based Cap Rates to estimate the property's NOI.

The loss severities projected by these approaches vary widely. Actual losses will be a function of the proportion of loans in the pools that are foreclosed and liquidated and the loss severities associated with those liquidations.

For the six months ended June 30, 2014, additional credit impairments and LAE for insured derivatives on structured CMBS pools, CRE CDOs and CRE loan pools were estimated to be \$82 million as a result of additional delinquencies and loan level liquidations, as well as MBIA Corp.'s continued assessment of various commutation possibilities. Since 2013, MBIA Corp. has been paying claims on a CMBS pool transaction that had experienced deterioration such that all remaining deductible was eliminated.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

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

**Loss and LAE Activity**

Financial Guarantee Insurance Losses (Non-Derivative and Non-Consolidated VIEs)

MBIA Corp.'s financial guarantee insurance losses and LAE for the six months ended June 30, 2014 are presented in the following table:

| In millions                                 | Six Months Ended June 30, 2014 |                    |                              |              |
|---------------------------------------------|--------------------------------|--------------------|------------------------------|--------------|
|                                             | Second-lien<br>RMBS            | First-lien<br>RMBS | Other                        | Total        |
| Losses and LAE related to expected payments | \$ 19                          | \$ 33              | \$ (57)                      | \$ (5)       |
| Recoveries of expected payments             | 53                             | (6)                | 15                           | 62           |
| Gross losses incurred                       | 72                             | 27                 | (42)                         | 57           |
| Reinsurance                                 | -                              | -                  | 2                            | 2            |
| Losses and LAE                              | <u>\$ 72</u>                   | <u>\$ 27</u>       | <u>\$ (40)<sup>(1)</sup></u> | <u>\$ 59</u> |

(1) - Includes ABS CDOs, CMBS and other issues.

The losses and LAE related to expected payments in the preceding table primarily related to increases in previously established reserves on insured first and second-lien RMBS transactions, partially offset by a decrease in previously established reserves on an international road transaction and ABS CDOs. The recoveries of expected payments primarily related to decreases in projected collections from excess spread within the insured second-lien RMBS securitizations.

The following table provides information about the financial guarantees and related claim liability included in each of MBIA Corp.'s surveillance categories as of June 30, 2014:

| \$ in millions                                                 | Surveillance Categories |                        |                      |                    |                 |
|----------------------------------------------------------------|-------------------------|------------------------|----------------------|--------------------|-----------------|
|                                                                | Caution List<br>Low     | Caution List<br>Medium | Caution List<br>High | Classified<br>List | Total           |
| Number of policies                                             | 57                      | 110                    | 4                    | 195                | 366             |
| Number of issues <sup>(1)</sup>                                | 22                      | 12                     | 3                    | 129                | 166             |
| Remaining weighted average contract period (in years)          | 10.2                    | 10.9                   | 5.4                  | 8.4                | 9.2             |
| Gross insured contractual payments outstanding: <sup>(2)</sup> |                         |                        |                      |                    |                 |
| Principal                                                      | \$ 3,860                | \$ 1,869               | \$ 22                | \$ 8,044           | \$13,795        |
| Interest                                                       | 2,883                   | 1,018                  | 7                    | 4,156              | 8,064           |
| Total                                                          | <u>\$ 6,743</u>         | <u>\$ 2,887</u>        | <u>\$ 29</u>         | <u>\$12,200</u>    | <u>\$21,859</u> |
| Gross Claim Liability                                          | \$ -                    | \$ -                   | \$ -                 | \$ 946             | \$ 946          |
| Less:                                                          |                         |                        |                      |                    |                 |
| Gross Potential Recoveries                                     | -                       | -                      | -                    | 884                | 884             |
| Discount, net <sup>(3)</sup>                                   | -                       | -                      | -                    | 163                | 163             |
| Net claim liability (recoverable)                              | <u>\$ -</u>             | <u>\$ -</u>            | <u>\$ -</u>          | <u>\$ (101)</u>    | <u>\$ (101)</u> |
| Unearned premium revenue                                       | \$ 94                   | \$ 35                  | \$ -                 | \$ 96              | \$ 225          |

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

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

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

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

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

The following table provides information about the financial guarantees and related claim liability included in each of MBIA Corp.'s surveillance categories as of December 31, 2013:

| \$ in millions                                                 | Surveillance Categories |                        |                      |                    | Total           |
|----------------------------------------------------------------|-------------------------|------------------------|----------------------|--------------------|-----------------|
|                                                                | Caution List<br>Low     | Caution List<br>Medium | Caution List<br>High | Classified<br>List |                 |
| Number of policies                                             | 59                      | 19                     | 4                    | 189                | 271             |
| Number of issues <sup>(1)</sup>                                | 23                      | 14                     | 3                    | 134                | 174             |
| Remaining weighted average contract period (in years)          | 10.1                    | 4.9                    | 11.1                 | 9.4                | 9.3             |
| Gross insured contractual payments outstanding: <sup>(2)</sup> |                         |                        |                      |                    |                 |
| Principal                                                      | \$ 4,132                | \$ 1,073               | \$ 19                | \$ 7,771           | \$12,995        |
| Interest                                                       | 3,044                   | 253                    | 10                   | 4,462              | 7,769           |
| Total                                                          | <u>\$ 7,176</u>         | <u>\$ 1,326</u>        | <u>\$ 29</u>         | <u>\$12,233</u>    | <u>\$20,764</u> |
| Gross Claim Liability                                          | \$ -                    | \$ -                   | \$ -                 | \$ 1,196           | \$ 1,196        |
| Less:                                                          |                         |                        |                      |                    |                 |
| Gross Potential Recoveries                                     | -                       | -                      | -                    | 1,052              | 1,052           |
| Discount, net <sup>(3)</sup>                                   | -                       | -                      | -                    | 211                | 211             |
| Net claim liability (recoverable)                              | <u>\$ -</u>             | <u>\$ -</u>            | <u>\$ -</u>          | <u>\$ (67)</u>     | <u>\$ (67)</u>  |
| Unearned premium revenue                                       | \$ 107                  | \$ 19                  | \$ -                 | \$ 95              | \$ 221          |

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

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

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

The gross claim liability in the preceding tables represents MBIA Corp.'s estimate of undiscounted probability-weighted future claim payments. As of June 30, 2014 and December 31, 2013, the gross claim liability primarily related to insured first and second-lien RMBS issues, ABS CDOs and an international road transaction.

The gross potential recoveries represent MBIA Corp.'s estimate of undiscounted probability-weighted recoveries of actual claim payments and recoveries of estimated future claim payments. As of June 30, 2014 and December 31, 2013, the gross potential recoveries principally related to insured second-lien RMBS issues. MBIA Corp. recoveries have been, and remain based on either salvage rights, the rights conferred to MBIA Corp. through the transactional documents (inclusive of the insurance agreement), or subrogation rights embedded within financial guarantee insurance policies. Expected salvage and subrogation recoveries, as well as recoveries from other remediation efforts, reduce MBIA Corp.'s claim liability. Once a claim payment has been made, the claim liability has been satisfied and MBIA Corp.'s right to recovery is no longer considered an offset to future expected claim payments, it is recorded as a salvage asset. The amount of recoveries recorded by MBIA Corp. is limited to paid claims plus the present value of projected future claim payments. As claim payments are made, the recorded amount of potential recoveries may exceed the remaining amount of the claim liability for a given policy. The gross claim liability and gross potential recoveries reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by MBIA Corp.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

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

The following table presents the components of MBIA Corp.'s loss and LAE reserves and insurance loss recoverable as reported on MBIA Corp.'s consolidated balance sheets as of June 30, 2014 and December 31, 2013 for insured obligations within MBIA Corp.'s "Classified List." The loss reserves (claim liability) and insurance claim loss recoverable included in the following table represent the present value of the probability-weighted future claim payments and recoveries reported in the preceding tables.

| In millions                                       | As of June 30,<br>2014 | As of December 31,<br>2013 |
|---------------------------------------------------|------------------------|----------------------------|
| Loss reserves (claim liability)                   | \$ 472                 | \$ 570                     |
| LAE reserves                                      | 66                     | 59                         |
| Loss and LAE reserves                             | <u>\$ 538</u>          | <u>\$ 629</u>              |
| Insurance claim loss recoverable                  | \$ (619)               | \$ (694)                   |
| LAE insurance loss recoverable                    | (5)                    | -                          |
| Insurance loss recoverable                        | <u>\$ (624)</u>        | <u>\$ (694)</u>            |
| Reinsurance recoverable on unpaid losses          | \$ 27                  | \$ 57                      |
| Reinsurance recoverable on unpaid LAE reserves    | 34                     | 24                         |
| Reinsurance recoverable on paid and unpaid losses | <u>\$ 61</u>           | <u>\$ 81</u>               |

As of June 30, 2014, loss and LAE reserves include \$679 million of reserves for expected future payments offset by expected recoveries of such future payments of \$141 million. As of December 31, 2013, loss and LAE reserves included \$820 million of reserves for expected future payments offset by expected recoveries of such future payments of \$191 million. As of June 30, 2014 and December 31, 2013, the insurance loss recoverable primarily related to expected future recoveries on second-lien RMBS transactions resulting from excess spread generated by performing loans in such transactions.

The decrease in insurance loss recoverable was primarily due to decreases in projected collections from excess spread within insured second-lien RMBS securitizations.

The following table presents the amounts of MBIA Corp.'s second-lien RMBS exposure, gross undiscounted claim liability and potential recoveries related to non-consolidated VIEs and consolidated VIEs, included in MBIA Corp.'s "Classified List," as of June 30, 2014:

**Second-lien RMBS Exposure**

| \$ in billions        | Issues | Outstanding     |                | Gross Undiscounted |                      |
|-----------------------|--------|-----------------|----------------|--------------------|----------------------|
|                       |        | Gross Principal | Gross Interest | Claim Liability    | Potential Recoveries |
| Non-consolidated VIEs | 24     | \$ 3.2          | \$ 1.1         | \$ 0.1             | \$ 0.6               |
| Consolidated VIEs     | 11     | \$ 1.6          | \$ 0.6         | \$ -               | \$ 0.6               |

The following table presents changes in MBIA Corp.'s loss and LAE reserves for the six months ended June 30, 2014. Changes in the loss and LAE reserves attributable to the accretion of the claim liability discount, changes in discount rates, changes in amount and timing of estimated payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in "Losses and loss adjustment" expenses on MBIA Corp.'s consolidated statements of operations. As of June 30, 2014, the weighted average risk-free rate used to discount MBIA Corp.'s loss reserves (claim liability) was 1.96%. LAE reserves are expected to be settled within a one-year period and are not discounted.

| In millions                                         | Changes in Loss and LAE Reserves for the Six Months Ended June 30, 2014 |                                       |                           |                        |                                     |                         |                      | Gross Loss and LAE Reserves as of June 30, 2014 |
|-----------------------------------------------------|-------------------------------------------------------------------------|---------------------------------------|---------------------------|------------------------|-------------------------------------|-------------------------|----------------------|-------------------------------------------------|
| Gross Loss and LAE Reserves as of December 31, 2013 | Loss Payments for Cases with Reserves                                   | Accretion of Claim Liability Discount | Changes in Discount Rates | Changes in Assumptions | Changes in Unearned Premium Revenue | Changes in LAE Reserves | Other <sup>(1)</sup> |                                                 |
| \$ 629                                              | \$ (107)                                                                | \$ 7                                  | \$ 37                     | \$ (39)                | \$ 12                               | \$ 7                    | \$ (8)               | \$ 538                                          |

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

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

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

The decrease in MBIA Corp.'s gross loss and LAE reserves reflected in the preceding table was primarily related to loss payments, partially offset by increases in reserves due to changes in discount rate on ABS CDOs and insured first and second-lien RMBS issues outstanding as of December 31, 2013.

Current period changes in MBIA Corp.'s estimate of potential recoveries may be recorded as an insurance loss recoverable asset, netted against the gross loss and LAE reserve liability, or both. The following tables present changes in MBIA Corp.'s insurance loss recoverable and changes in recoveries on unpaid losses reported within MBIA Corp.'s claim liability for the six months ended June 30, 2014. Changes in insurance loss recoverable attributable to the accretion of the discount on the recoverable, changes in discount rates, changes in amount and timing of estimated collections, changes in assumptions and changes in LAE recoveries are recorded in "Losses and loss adjustment" expenses in MBIA Corp.'s consolidated statements of operations.

| Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses for the<br>Six Months Ended June 30, 2014 |                               |                                                |                               |                                 |                           |                                 |                      |                           |
|-----------------------------------------------------------------------------------------------------------------|-------------------------------|------------------------------------------------|-------------------------------|---------------------------------|---------------------------|---------------------------------|----------------------|---------------------------|
| In millions                                                                                                     | As of<br>December<br>31, 2013 | Collections<br>for Cases<br>with<br>Recoveries | Accretion<br>of<br>Recoveries | Changes in<br>Discount<br>Rates | Changes in<br>Assumptions | Changes in<br>LAE<br>Recoveries | Other <sup>(1)</sup> | As of<br>June 30,<br>2014 |
| Insurance loss recoverable                                                                                      | \$ 694                        | \$ (55)                                        | \$ 7                          | \$ 10                           | \$ (45)                   | \$ 5                            | \$ 8                 | \$ 624                    |
| Recoveries on unpaid losses                                                                                     | 191                           | -                                              | 2                             | 9                               | (61)                      | -                               | -                    | 141                       |
| Total                                                                                                           | \$ 885                        | \$ (55)                                        | \$ 9                          | \$ 19                           | \$ (106)                  | \$ 5                            | \$ 8                 | \$ 765                    |

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

The decrease in MBIA Corp.'s insurance loss recoverable and recoveries on unpaid losses during 2014 was primarily due to changes in assumptions associated with insured first and second-lien RMBS and collections associated with issues outstanding as of December 31, 2013.

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

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

| In millions                             | Six Months Ended June 30, |       |
|-----------------------------------------|---------------------------|-------|
|                                         | 2014                      | 2013  |
| Loss adjustment expense incurred, gross | \$ 29                     | \$ 33 |

**Note 6: Fair Value of Financial Instruments (continued)**

***Fair Value Measurement***

Fair value is a market-based measure considered from the perspective of a market participant. Therefore, even when market assumptions are not readily available, MBIA Corp.'s own assumptions are set to reflect those which it believes market participants would use in pricing an asset or liability at the measurement date. The fair value measurements of financial instruments held or issued by MBIA Corp. are determined through the use of observable market data when available. Market data is obtained from a variety of third-party sources, including dealer quotes. If dealer quotes are not available for an instrument that is infrequently traded, MBIA Corp. uses alternate valuation methods, including either dealer quotes for similar instruments or modeling using market data inputs. The use of alternate valuation methods generally requires considerable judgment in the application of estimates and assumptions, and changes to such estimates and assumptions may produce materially different fair values.

The accounting guidance for fair value measurement establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available and reliable. Observable inputs are those MBIA Corp. believes that market participants would use in pricing an asset or liability based on available market data. Unobservable inputs are those that reflect MBIA Corp.'s beliefs about the assumptions market participants would use in pricing an asset or liability based on the best information available. The fair value hierarchy is broken down into three levels based on the observability and reliability of inputs, as follows:

- Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities that MBIA Corp. can access. Valuations are based on quoted prices that are readily and regularly available in an active market with significant trading volumes.
- Level 2—Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. Level 2 assets include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, securities which are priced using observable inputs and derivative contracts whose values are determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3—Valuations based on inputs that are unobservable and supported by little or no market activity and that are significant to the overall fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques where significant inputs are unobservable, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The availability of observable inputs can vary from product to product and period to period and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, and other characteristics particular to the product. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, MBIA Corp. assigns the level in the fair value hierarchy for which the fair value measurement in its entirety falls, based on the least observable input that is significant to the fair value measurement.

***Financial Assets (excluding derivative assets)***

Financial assets, excluding derivative assets, held by MBIA Corp. primarily consist of investments in debt securities. Substantially all of MBIA Corp.'s investments are priced by independent third parties, including pricing services and brokers. Typically, MBIA Corp. receives one pricing service value or broker quote for each instrument, which represents a non-binding indication of value. MBIA Corp. reviews the assumptions, inputs and methodologies used by pricing services and brokers to obtain reasonable assurance that the prices used in its valuations reflect fair value. When MBIA Corp. believes a third-party quotation differs significantly from its internally developed expectation of fair value, whether higher or lower, MBIA Corp. reviews its data or assumptions with the provider. This review includes comparing significant assumptions such as prepayment speeds, default ratios, forward yield curves, credit spreads and other significant quantitative inputs to internal assumptions, and working with the price provider to reconcile the differences. The price provider may subsequently provide an updated price. In the event that the price provider does not update its price, and MBIA Corp. still does not agree with the price provided, MBIA Corp. will obtain a price from another third-party provider, such as a broker, or use an internally developed price which it believes represents the fair value of the investment. The fair values of investments for which internal prices were used were not significant to the aggregate fair value of MBIA Corp.'s investment portfolio as of June 30, 2014 or December 31, 2013. All challenges to third-party prices are reviewed by staff of MBIA Corp. with relevant expertise to ensure reasonableness of assumptions.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

*Derivative Liabilities*

MBIA Corp.'s derivative liabilities are primarily insured credit derivatives that reference structured pools of cash securities and CDSs. MBIA Corp. generally insured the most senior liabilities of such transactions, and at the inception of transactions its exposure generally had more subordination than needed to achieve triple-A ratings from credit rating agencies. The types of collateral underlying its insured derivatives consist of cash securities and CDSs referencing primarily corporate obligations, ABS, RMBS, CMBS, CRE loans, and CDOs.

MBIA Corp.'s insured credit derivative contracts are non-traded structured credit derivative transactions. Since insured derivatives are highly customized and there is generally no observable market for these derivatives, MBIA Corp. estimates their fair values in a hypothetical market based on internal and third-party models simulating what a similar company would charge to assume MBIA Corp.'s position in the transaction at the measurement date. This pricing would be based on the expected loss of the exposure. MBIA Corp. reviews its valuation model results on a quarterly basis to assess the appropriateness of the assumptions and results in light of current market activity and conditions. This review is performed by internal staff with relevant expertise. If live market spreads or securities prices are observable for similar transactions, those spreads are an integral part of the analysis. New insured transactions that resemble existing (previously insured) transactions, if any, would be considered, as well as negotiated settlements of existing transactions.

MBIA Corp. may from time to time make changes in its valuation techniques if the change results in a measurement that it believes is equally or more representative of fair value under current circumstances.

*Internal Review Process*

All significant financial assets and liabilities, including derivative assets and liabilities, are reviewed by committees created by MBIA Corp. to ensure compliance with MBIA Corp. policies and risk procedures in the development of fair values of financial assets and liabilities. These valuation committees review, among other things, key assumptions used for internally developed prices, significant changes in sources and uses of inputs, including changes in model approaches, and any adjustments from third-party inputs or prices to internally developed inputs or prices. The committees also review any significant impairment or improvements in fair values of the financial instruments from prior periods. From time to time, these committees will consult with MBIA Corp. valuation experts to better understand key methods and assumptions used for the determination of fair value, including understanding significant changes in fair values. These committees are comprised of senior finance team members with the relevant experience in the financial instruments their committee is responsible for. Each quarter, these committees document their agreement with the fair values developed by management of MBIA Corp. as reported in the quarterly and annual financial statements.

**Valuation Techniques**

Valuation techniques for financial instruments measured at fair value or disclosed at fair value are described below:

*Fixed-Maturity Securities (including short-term investments) Held as Available-For-Sale, Investments (including fixed-maturity securities) Carried at Fair Value, Other Investments, and Investments Held-to-Maturity, at Amortized Cost*

Fixed-maturity securities (including short-term investments) held as available-for-sale ("AFS"), investments carried at fair value, other investments, and held-to-maturity ("HTM") investments, at amortized cost include investments in U.S. Treasury and government agencies, foreign governments, corporate obligations, mortgage-backed securities ("MBS") and ABS, state and municipal bonds, perpetual debt and equity securities (including money market mutual funds), and loans receivable with an affiliate.

These investments are generally valued based on recently executed transaction prices or quoted market prices. When quoted market prices are not available, fair value is generally determined using quoted prices of similar investments or a valuation model based on observable and unobservable inputs. Inputs vary depending on the type of investment. Observable inputs include contractual cash flows, interest rate yield curves, CDS spreads, prepayment and volatility scores, diversity scores, cross-currency basis index spreads, and credit spreads for structures similar to the financial instrument in terms of issuer, maturity and seniority. Unobservable inputs include cash flow projections and the value of any credit enhancement.

The fair value of the HTM investments is determined using discounted cash flow models. Key inputs include unobservable cash flows projected over the expected term of the investment discounted using observable interest rate yield curves of similar securities.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

Investments based on quoted market prices of identical investments in active markets are classified as Level 1 of the fair value hierarchy. Level 1 investments generally consist of U.S. Treasury and government agency, foreign government and money market investments. Quoted market prices of investments in less active markets, as well as investments which are valued based on other than quoted prices for which the inputs are observable, such as interest rate yield curves, are categorized in Level 2 of the fair value hierarchy. Investments that contain significant inputs that are not observable are categorized as Level 3.

*Cash and Cash Equivalents, Accrued Investment Income, Receivable for Investments Sold and Payable for Investments Purchased*

The carrying amounts of cash and cash equivalents, accrued investment income, receivable for investments sold and payable for investments purchased approximate fair values due to the short-term nature and credit worthiness of these instruments. These items are categorized in Level 1 or Level 2 of the fair value hierarchy.

*Loans Receivable at Fair Value*

Loans receivable at fair value are comprised of loans held by consolidated VIEs consisting of residential mortgage loans. Fair values of residential mortgage loans are determined using quoted prices for MBS issued by the respective VIE and adjustments for the fair values of the financial guarantees provided by MBIA Corp. on the related MBS. Loans receivable at fair value are categorized in Level 3 of the fair value hierarchy.

*Loan Repurchase Commitments*

Loan repurchase commitments are obligations owed by the sellers/servicers of mortgage loans to either MBIA Corp. as reimbursement of paid claims or to the RMBS trusts as defined in the transaction documents. Loan repurchase commitments are assets of the consolidated VIEs. This asset represents the rights of MBIA Corp. against the sellers/servicers for breaches of representations and warranties that the securitized residential mortgage loans sold to the trust to comply with stated underwriting guidelines and for the sellers/servicers to cure, replace, or repurchase mortgage loans. Fair value measurements of loan repurchase commitments represent the amounts owed by the sellers/servicers to MBIA Corp. as reimbursement of paid claims. Loan repurchase commitments are not securities and no quoted prices or comparable market transaction information are observable or available. Loan repurchase commitments at fair value are categorized in Level 3 of the fair value hierarchy. Fair values of loan repurchase commitments are determined using discounted cash flow techniques based on inputs including:

- breach rates representing the rate at which the sellers/servicers failed to comply with stated representations and warranties;
- recovery rates representing the estimates of future cash flows for the asset, including estimates about possible variations in the amount of cash flows expected to be collected;
- expectations about possible variations in the timing of collections of the cash flows; and
- time value of money, represented by the rate on risk-free monetary assets.

*Variable Interest Entity Notes*

The fair values of VIE notes are determined based on recently executed transaction prices or quoted prices where observable. When position-specific quoted prices are not observable, fair values are based on quoted prices of similar securities. Fair values based on quoted prices of similar securities may be adjusted for factors unique to the securities, including any credit enhancement. When observable quoted prices are not available, fair value is determined based on discounted cash flow techniques of the underlying collateral using observable and unobservable inputs. Observable inputs include interest rate yield curves and bond spreads of similar securities. Unobservable inputs include the value of any credit enhancement. VIE notes are categorized in Level 2 or Level 3 of the fair value hierarchy based on the lowest level input that is significant to the fair value measurement in its entirety.

*Variable Interest Entity Derivatives*

The VIEs have entered into derivative transactions consisting of cross currency swaps and interest rate caps. Fair values of over-the-counter derivatives are determined using valuation models based on observable and/or unobservable inputs. These observable and market-based inputs include interest rates and volatilities. These derivatives are categorized in Level 2 or Level 3 of the fair value hierarchy based on the input that is significant to the fair value measurement in its entirety.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

*Long-term Debt*

Long-term debt consists of surplus notes and related accrued interest. The fair value of the surplus notes is estimated based on quoted prices for identical or similar securities. The fair value of the accrued interest expense on the surplus notes due 2033 is determined based on the scheduled interest payments discounted by the market's perception of the credit risk related to the repayment of the surplus notes. The credit risk related to the repayment of the surplus notes is based on recent trades of the surplus notes. The deferred interest payment will be due on the first business day on or after which MBIA Corp. obtains approval to make such payment.

Long-term debt is categorized as Level 2 of the fair value hierarchy.

*Derivatives*

MBIA Corp. derivative contracts primarily consist of insured credit derivatives which cannot be legally traded and generally do not have observable market prices. MBIA Corp. determines the fair values of insured credit derivatives using valuation models. The valuation models are consistently applied from period to period, with refinements to the fair value estimation approach being applied as and when the information becomes available. Negotiated settlements are also considered when determining fair value to provide the best estimate of how another market participant would evaluate fair value.

Approximately 93% of the balance sheet fair value of insured credit derivatives as of June 30, 2014 was valued based on the Binomial Expansion Technique ("BET") Model. Approximately 7% of the balance sheet fair value of insured credit derivatives as of June 30, 2014 was valued based on the internally developed Direct Price Model and the Dual Default model. The valuation of insured derivatives includes the impact of its credit standing. All of these derivatives are categorized as Level 3 of the fair value hierarchy as their fair value is derived using significant unobservable inputs.

MBIA Corp. has also entered into a derivative contract as a result of a commutation. The fair value of the derivative is determined using a discounted cash flow model. Key inputs include unobservable cash flows projected over the expected term of the derivative, discounted using observable discount rates and CDS spreads.

Description of the BET Model

1. Valuation Model Overview

The BET Model estimates what a bond insurer would charge to guarantee a transaction at the measurement date, based on the market-implied default risk of the underlying collateral and the remaining structural protection in a deductible or subordination.

Inputs to the process of determining fair value for structured transactions using the BET Model include estimates of collateral loss, allocation of loss to separate tranches of the capital structure and calculation of the change in value.

- Estimates of aggregated collateral losses are calculated by reference to the following (described in further detail under "BET Model Inputs" below):
  - credit spreads of underlying collateral based on actual spreads or spreads on similar collateral with similar ratings, or in some cases, are benchmarked; for collateral pools where the spread distribution is characterized by extremes, MBIA Corp. models each segment of the pool separately instead of using an overall pool average;
  - diversity score of the collateral pool as an indication of correlation of collateral defaults; and
  - recovery rate for all defaulted collateral.
- Allocation of losses to separate tranches of the capital structure according to priority of payments in a transaction.
- The inception-to-date unrealized gain or loss on a transaction is the difference between the original price of the risk (the original market-implied expected loss) and the current price of the risk based on the assumed market-implied expected losses derived from the model.

Additional structural assumptions of the BET Model are:

- Default probabilities are determined by three factors: credit spread, recovery rate after default and the time period under risk;
- Frequencies of defaults are modeled evenly over time;
- Collateral assets are generally considered on an average basis rather than being modeled on an individual basis; and
- Collateral asset correlation is modeled using a diversity score, which is calculated based on industry or sector concentrations. Recovery rates are based on historical averages and updated based on market evidence.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

**2. BET Model Inputs**

**a. Credit spreads**

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

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

**Spread Hierarchy:**

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

There were some transactions where MBIA Corp. incorporated multiple levels within the hierarchy, including using actual collateral-specific credit spreads in combination with a calculated spread based on an assumed relationship. In those cases, MBIA Corp. classified the transaction as being benchmarked from the most relevant spread source even though the majority of the average spread was from actual collateral-specific spreads. As of June 30, 2014, sector-specific spreads were used in 6% of the transactions valued using the BET Model. Corporate spreads were used in 50% of the transactions and spreads benchmarked from the most relevant spread source were used for 44% of the transactions. The spread source can also be identified by whether or not it is based on collateral weighted average rating factor ("WARF"). No collateral-specific spreads are based on WARF. Sector-specific spreads, corporate spreads and some benchmarked spreads are based on WARF. WARF-sourced and/or ratings-sourced credit spreads were used for 72% of the transactions.

Over time, the data inputs change as new sources become available, existing sources are discontinued or are no longer considered to be reliable or the most appropriate. It is always MBIA Corp.'s objective to use more observable spread inputs defined above. However, MBIA Corp. may on occasion move to less observable spread inputs due to the discontinuation of data sources or due to MBIA Corp. considering certain spread inputs no longer representative of market spreads.

**b. Diversity Scores**

Diversity scores are a means of estimating the diversification in a portfolio. The diversity score estimates the number of uncorrelated assets that are assumed to have the same loss distribution as the actual portfolio of correlated assets. While diversity score is a required input into the BET model, due to current high levels of default within the collateral of the structures, diversity score does not have a significant impact on valuation.

**c. Recovery Rate**

The recovery rate represents the percentage of par expected to be recovered after an asset defaults, indicating the severity of a potential loss. MBIA Corp. generally uses rating agency recovery assumptions which may be adjusted to account for differences between the characteristics and performance of the collateral used by the rating agencies and the actual collateral in MBIA Corp.-insured transactions. MBIA Corp. may also adjust rating agency assumptions based on the performance of the collateral manager and on empirical market data.

#### d. Nonperformance Risk

MBIA Corp.'s valuation methodology for insured credit derivative liabilities incorporates MBIA Corp.'s own nonperformance risk. MBIA Corp. calculates the fair value by discounting the market value loss estimated through the BET Model at discount rates which include MBIA Corp.'s CDS spreads as of June 30, 2014. The CDS spreads assigned to each deal are based on the weighted average life of the deal. MBIA Corp. limits the nonperformance impact so that the derivative liability could not be lower than MBIA Corp.'s recovery derivative price multiplied by the unadjusted derivative liability.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

**Overall Model Results**

As of June 30, 2014 and December 31, 2013, MBIA Corp.'s net insured CDS derivative liability was \$332 million and \$1.2 billion, respectively, based on the results of the aforementioned models. A significant driver of changes in fair value is nonperformance risk. In aggregate, the nonperformance calculation resulted in a pre-tax net insured derivative liability that was \$84 million and \$393 million lower than the net liability that would have been estimated if MBIA Corp. excluded nonperformance risk in its valuation as of June 30, 2014 and December 31, 2013, respectively. Nonperformance risk is a fair value concept and does not contradict MBIA Corp.'s internal view, based on fundamental credit analysis of MBIA Corp.'s economic condition, that MBIA Corp. will be able to pay all claims when due.

*Financial Guarantees*

Gross Financial Guarantees—The fair value of gross financial guarantees is determined using discounted cash flow techniques based on inputs that include (i) assumptions of expected losses on financial guarantee policies where loss reserves have not been recognized, (ii) amount of losses expected on financial guarantee policies where loss reserves have been established, net of expected recoveries, (iii) the cost of capital reserves required to support the financial guarantee liability, (iv) operating expenses, and (v) discount rates. MBIA Corp.'s CDS spread and recovery rate are used as its discount rate.

The carrying value of MBIA Corp.'s gross financial guarantees consists of unearned premium revenue and loss and LAE reserves, net of the insurance loss recoverable as reported on MBIA Corp.'s consolidated balance sheets.

Ceded Financial Guarantees—The fair value of ceded financial guarantees is determined by applying the percentage ceded to reinsurers to the related fair value of the gross financial guarantees. The carrying value of ceded financial guarantees consists of prepaid reinsurance premiums and reinsurance recoverable on paid and unpaid losses as reported within "Other assets" on MBIA Corp.'s consolidated balance sheets.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

**Significant Unobservable Inputs**

The following tables provide quantitative information regarding the significant unobservable inputs used by MBIA Corp. for assets and liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013. These tables exclude inputs used to measure fair value that are not developed by MBIA Corp., such as broker prices and other third-party pricing service valuations.

| In millions                                | Fair Value as of<br>June 30, 2014 | Valuation Techniques                                                        | Unobservable Input                                           | Range<br>(Weighted Average)      |
|--------------------------------------------|-----------------------------------|-----------------------------------------------------------------------------|--------------------------------------------------------------|----------------------------------|
| <b>Assets of consolidated VIEs:</b>        |                                   |                                                                             |                                                              |                                  |
| Loans receivable at fair value             | \$ 1,539                          | Market prices adjusted for financial guarantees provided to VIE obligations | Impact of financial guarantee                                | 0% - 9% (2%)                     |
| Loan repurchase commitments                | 363                               | Discounted cash flow                                                        | Recovery rates <sup>(1)</sup><br>Breach rates <sup>(1)</sup> |                                  |
| <b>Liabilities of consolidated VIEs:</b>   |                                   |                                                                             |                                                              |                                  |
| Variable interest entity notes             | 802                               | Market prices of VIE assets adjusted for financial guarantees provided      | Impact of financial guarantee                                | 0% - 32% (14%)                   |
| <b>Credit derivative liabilities, net:</b> |                                   |                                                                             |                                                              |                                  |
| CMBS                                       | 277                               | BET Model                                                                   | Recovery rates                                               | 25% - 90% (74%)                  |
|                                            |                                   |                                                                             | Nonperformance risk                                          | 4% - 19% (17%)                   |
|                                            |                                   |                                                                             | Weighted average life (in years)                             | 0.7 - 3.1 (2.7)                  |
|                                            |                                   |                                                                             | CMBS spreads                                                 | 0% - 35% (10%)                   |
| Multi-sector CDO                           | 12                                | Direct Price Model                                                          | Nonperformance risk                                          | 54% - 54% (54%)                  |
| Other                                      | 43                                | BET Model and Dual Default                                                  | Recovery rates                                               | 42% - 45% (45%)                  |
|                                            |                                   |                                                                             | Nonperformance risk                                          | 7% - 46% (22%)                   |
|                                            |                                   |                                                                             | Weighted average life (in years)                             | 0.7 - 8.3 (2.0)                  |
| Other derivative liabilities               | 33                                | Discounted cash flow                                                        | Cash flows                                                   | \$0 - \$83 (\$42) <sup>(2)</sup> |

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

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

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

| In millions                                | Fair Value as of<br>December 31, 2013 | Valuation Techniques                                                        | Unobservable Input                                           | Range<br>(Weighted Average) |
|--------------------------------------------|---------------------------------------|-----------------------------------------------------------------------------|--------------------------------------------------------------|-----------------------------|
| <b>Assets of consolidated VIEs:</b>        |                                       |                                                                             |                                                              |                             |
| Loans receivable at fair value             | \$ 1,612                              | Market prices adjusted for financial guarantees provided to VIE obligations | Impact of financial guarantee                                | 0% - 17% (3%)               |
| Loan repurchase commitments                | 359                                   | Discounted cash flow                                                        | Recovery rates <sup>(1)</sup><br>Breach rates <sup>(1)</sup> |                             |
| <b>Liabilities of consolidated VIEs:</b>   |                                       |                                                                             |                                                              |                             |
| Variable interest entity notes             | 948                                   | Market prices of VIE assets adjusted for financial guarantees provided      | Impact of financial guarantee                                | 0% - 25% (12%)              |
| <b>Credit derivative liabilities, net:</b> |                                       |                                                                             |                                                              |                             |
| CMBS                                       | 1,050                                 | BET Model                                                                   | Recovery rates                                               | 25% - 90% (60%)             |
|                                            |                                       |                                                                             | Nonperformance risk                                          | 8% - 57% (25%)              |
|                                            |                                       |                                                                             | Weighted average life (in years)                             | 1.1 - 28.0 (3.3)            |
|                                            |                                       |                                                                             | CMBS spreads                                                 | 1% - 29% (13%)              |
| Multi-sector CDO                           | 12                                    | Direct Price Model                                                          | Nonperformance risk                                          | 57% - 57% (57%)             |
| Other                                      | 85                                    | BET Model and Dual Default                                                  | Recovery rates                                               | 42% - 90% (45%)             |
|                                            |                                       |                                                                             | Nonperformance risk                                          | 13% - 54% (25%)             |
|                                            |                                       |                                                                             | Weighted average life (in years)                             | 0.2 - 8.7 (2.3)             |

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

**Sensitivity of Significant Unobservable Inputs**

The significant unobservable input used in the fair value measurement of MBIA Corp.'s loans receivable at fair value of consolidated VIEs is the impact of the financial guarantee. The fair value of loans receivable is calculated by subtracting the value of the financial guarantee from the market value of VIE liabilities. The value of a financial guarantee is estimated by MBIA Corp. as the present value of expected cash payments under the policy. As expected cash payments provided by MBIA Corp. under the insurance policy increase, there is a lower expected cash flow on the underlying loans receivable of the VIE. This results in a lower fair value of the loans receivable in relation to the obligations of the VIE.

The significant unobservable inputs used in the fair value measurement of MBIA Corp.'s loan repurchase commitments of consolidated VIEs are the recovery rates and breach rates. Recovery rates reflect the estimates of future cash flows reduced for litigation delays and risks and/or potential financial distress of the sellers/servicers. The estimated recoveries of the loan repurchase commitments may differ from the actual recoveries that may be received in the future. Breach rates represent the rate at which mortgages fail to comply with stated representations and warranties of the sellers/servicers. Significant increases or decreases in the recovery rates and the breach rates would result in significantly higher or lower fair values of the loan repurchase commitments, respectively. Additionally, changes in the legal environment and the ability of the counterparties to pay would impact the recovery rate assumptions, which could significantly impact the fair value measurement. Any significant challenges by the counterparties to MBIA Corp.'s determination of breaches of representations and warranties could significantly adversely impact the fair value measurement. Recovery rates and breach rates are determined independently. Changes in one input will not necessarily have any impact on the other input.

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

The significant unobservable input used in the fair value measurement of MBIA Corp.'s variable interest entity notes of consolidated VIEs is the impact of the financial guarantee. The fair value of VIE notes is calculated by adding the value of the financial guarantee to the market value of VIE assets. The value of a financial guarantee is estimated by MBIA Corp. as the present value of expected cash payments under the policy. As the value of the guarantee provided by MBIA Corp. to the obligations issued by the VIE increases, the credit support adds value to the liabilities of the VIE. This results in an increase in the fair value of the liabilities of the VIE.

The significant unobservable inputs used in the fair value measurement of MBIA Corp.'s CMBS credit derivatives, which are valued using the BET Model, are CMBS spreads, recovery rates, nonperformance risk and weighted average life. The CMBS spread is an indicator of credit risk of the collateral securities. The recovery rate represents the percentage of notional expected to be recovered after an asset defaults, indicating the severity of a potential loss. The nonperformance risk is an assumption of MBIA Corp.'s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Weighted average life is based on MBIA Corp.'s estimate of when the principal of the underlying collateral of the CMBS structure will be repaid. A significant increase or decrease in CMBS spreads would result in an increase or decrease in the fair value of the derivative liability, respectively. A significant increase in weighted average life can result in an increase or decrease in the fair value of the derivative liability, depending on the discount rate and the timing of significant losses. Any significant increase or decrease in recovery rates or MBIA Corp.'s nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively. CMBS spreads, recovery rates, nonperformance risk and weighted average lives are determined independently. Changes in one input will not necessarily have any impact on the other inputs.

The significant unobservable input used in the fair value measurement of MBIA Corp.'s multi-sector CDO credit derivatives, which are valued using the Direct Price Model, is nonperformance risk. The nonperformance risk is an assumption of MBIA Corp.'s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Any significant increase or decrease in MBIA Corp.'s nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively.

The significant unobservable inputs used in the fair value measurement of MBIA Corp.'s other credit derivatives, which are valued using the BET Model and Dual Default, are recovery rates, nonperformance risk and weighted average life. The recovery rate represents the percentage of notional expected to be recovered after an asset defaults, indicating the severity of a potential loss. The nonperformance risk is an assumption of MBIA Corp.'s own ability to pay and whether MBIA Corp. will have the necessary resources to pay the obligations as they come due. Weighted average life is based on MBIA Corp.'s estimate of when the principal of the underlying collateral will be repaid. A significant increase in weighted average life can result in an increase or decrease in the fair value of the derivative liability, depending on the discount rate and the timing of significant losses. Any significant increase or decrease in recovery rates or MBIA Corp.'s nonperformance risk would result in a decrease or increase in the fair value of the derivative liabilities, respectively. Recovery rates, nonperformance risk and weighted average lives are determined independently. Changes in one input will not necessarily have any impact on the other inputs.

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

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

**Fair Value Measurements**

The following tables present the fair value of MBIA Corp.'s assets (including short-term investments) and liabilities measured and reported at fair value on a recurring basis as of June 30, 2014 and December 31, 2013:

| In millions                            | Fair Value Measurements at Reporting Date Using                            |                                                           |                                                    | Balance as of<br>June 30,<br>2014 |
|----------------------------------------|----------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-----------------------------------|
|                                        | Quoted Prices in<br>Active Markets<br>for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                                   |
| Assets:                                |                                                                            |                                                           |                                                    |                                   |
| Fixed-maturity investments:            |                                                                            |                                                           |                                                    |                                   |
| U.S. Treasury and government agency    | \$ 11                                                                      | \$ -                                                      | \$ -                                               | \$ 11                             |
| State and municipal bonds              | -                                                                          | 90                                                        | -                                                  | 90                                |
| Foreign governments                    | 225                                                                        | 61                                                        | 5 <sup>(1)</sup>                                   | 291                               |
| Corporate obligations                  | -                                                                          | 516                                                       | 20 <sup>(1)</sup>                                  | 536                               |
| Mortgage-backed securities:            |                                                                            |                                                           |                                                    |                                   |
| Residential mortgage-backed agency     | -                                                                          | 3                                                         | -                                                  | 3                                 |
| Residential mortgage-backed non-agency | -                                                                          | 16                                                        | -                                                  | 16                                |
| Commercial mortgage-backed             | -                                                                          | 6                                                         | -                                                  | 6                                 |
| Asset-backed securities:               |                                                                            |                                                           |                                                    |                                   |
| Other asset-backed                     | -                                                                          | -                                                         | 4 <sup>(1)</sup>                                   | 4                                 |
| Total fixed-maturity investments       | 236                                                                        | 692                                                       | 29                                                 | 957                               |
| Money market securities                | 1                                                                          | -                                                         | -                                                  | 1                                 |
| Perpetual debt and equity securities   | -                                                                          | 2                                                         | 13 <sup>(1)</sup>                                  | 15                                |
| Cash and cash equivalents              | 310                                                                        | -                                                         | -                                                  | 310                               |
| Derivative assets:                     |                                                                            |                                                           |                                                    |                                   |
| Credit derivatives                     | -                                                                          | 3                                                         | -                                                  | 3                                 |
| Assets of consolidated VIEs:           |                                                                            |                                                           |                                                    |                                   |
| Cash                                   | 66                                                                         | -                                                         | -                                                  | 66                                |
| Corporate obligations                  | -                                                                          | 24                                                        | 62 <sup>(1)</sup>                                  | 86                                |
| Mortgage-backed securities:            |                                                                            |                                                           |                                                    |                                   |
| Residential mortgage-backed non-agency | -                                                                          | 205                                                       | 4 <sup>(1)</sup>                                   | 209                               |
| Commercial mortgage-backed             | -                                                                          | 91                                                        | -                                                  | 91                                |
| Asset-backed securities:               |                                                                            |                                                           |                                                    |                                   |
| Collateralized debt obligations        | -                                                                          | 10                                                        | 6 <sup>(1)</sup>                                   | 16                                |
| Other asset-backed                     | -                                                                          | 46                                                        | 26 <sup>(1)</sup>                                  | 72                                |
| Loans receivable                       | -                                                                          | -                                                         | 1,539                                              | 1,539                             |
| Loan repurchase commitments            | -                                                                          | -                                                         | 363                                                | 363                               |
| Total assets                           | <u>\$ 613</u>                                                              | <u>\$ 1,073</u>                                           | <u>\$ 2,042</u>                                    | <u>\$ 3,728</u>                   |
| Liabilities:                           |                                                                            |                                                           |                                                    |                                   |
| Derivative liabilities:                |                                                                            |                                                           |                                                    |                                   |
| Credit derivatives                     | \$ -                                                                       | \$ 3                                                      | \$ 332                                             | \$ 335                            |
| Other derivatives                      | -                                                                          | -                                                         | 33                                                 | 33                                |
| Total derivative liabilities           | -                                                                          | 3                                                         | 365                                                | 368                               |
| Liabilities of consolidated VIEs:      |                                                                            |                                                           |                                                    |                                   |
| Variable interest entity notes         | -                                                                          | 1,400                                                     | 802                                                | 2,202                             |
| Derivative liabilities:                |                                                                            |                                                           |                                                    |                                   |
| Currency rate derivatives              | -                                                                          | -                                                         | 11 <sup>(1)</sup>                                  | 11                                |
| Total liabilities                      | <u>\$ -</u>                                                                | <u>\$ 1,403</u>                                           | <u>\$ 1,178</u>                                    | <u>\$ 2,581</u>                   |

(1) - Unobservable inputs are either not developed by MBIA Corp. or do not significantly impact the overall fair values of the aggregate financial assets and liabilities.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

| In millions                            | Fair Value Measurements at Reporting Date Using                            |                                                           |                                                    | Balance as of<br>December 31,<br>2013 |
|----------------------------------------|----------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|---------------------------------------|
|                                        | Quoted Prices in<br>Active Markets<br>for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                                       |
| Assets:                                |                                                                            |                                                           |                                                    |                                       |
| Fixed-maturity investments:            |                                                                            |                                                           |                                                    |                                       |
| U.S. Treasury and government agency    | \$ 11                                                                      | \$ -                                                      | \$ -                                               | \$ 11                                 |
| State and municipal bonds              | -                                                                          | 82                                                        | -                                                  | 82                                    |
| Foreign governments                    | 112                                                                        | 47                                                        | 12 <sup>(1)</sup>                                  | 171                                   |
| Corporate obligations                  | -                                                                          | 195                                                       | -                                                  | 195                                   |
| Mortgage-backed securities:            |                                                                            |                                                           |                                                    |                                       |
| Residential mortgage-backed agency     | -                                                                          | 3                                                         | -                                                  | 3                                     |
| Residential mortgage-backed non-agency | -                                                                          | 23                                                        | -                                                  | 23                                    |
| Total fixed-maturity investments       | 123                                                                        | 350                                                       | 12                                                 | 485                                   |
| Money market securities                | 191                                                                        | -                                                         | -                                                  | 191                                   |
| Perpetual debt and equity securities   | -                                                                          | 1                                                         | 6 <sup>(1)</sup>                                   | 7                                     |
| Cash and cash equivalents              | 930                                                                        | -                                                         | -                                                  | 930                                   |
| Derivative assets:                     |                                                                            |                                                           |                                                    |                                       |
| Credit derivatives                     | -                                                                          | 4                                                         | -                                                  | 4                                     |
| Assets of consolidated VIEs:           |                                                                            |                                                           |                                                    |                                       |
| Cash                                   | 97                                                                         | -                                                         | -                                                  | 97                                    |
| Corporate obligations                  | -                                                                          | 41                                                        | 48 <sup>(1)</sup>                                  | 89                                    |
| Mortgage-backed securities:            |                                                                            |                                                           |                                                    |                                       |
| Residential mortgage-backed non-agency | -                                                                          | 255                                                       | 4 <sup>(1)</sup>                                   | 259                                   |
| Commercial mortgage-backed             | -                                                                          | 102                                                       | 3 <sup>(1)</sup>                                   | 105                                   |
| Asset-backed securities:               |                                                                            |                                                           |                                                    |                                       |
| Collateralized debt obligations        | -                                                                          | 14                                                        | 22 <sup>(1)</sup>                                  | 36                                    |
| Other asset-backed                     | -                                                                          | 44                                                        | 54 <sup>(1)</sup>                                  | 98                                    |
| Loans receivable                       | -                                                                          | -                                                         | 1,612                                              | 1,612                                 |
| Loan repurchase commitments            | -                                                                          | -                                                         | 359                                                | 359                                   |
| Total assets                           | \$ 1,341                                                                   | \$ 811                                                    | \$ 2,120                                           | \$ 4,272                              |
| Liabilities:                           |                                                                            |                                                           |                                                    |                                       |
| Derivative liabilities:                |                                                                            |                                                           |                                                    |                                       |
| Credit derivatives                     | \$ -                                                                       | \$ 4                                                      | \$ 1,147                                           | \$ 1,151                              |
| Liabilities of consolidated VIEs:      |                                                                            |                                                           |                                                    |                                       |
| Variable interest entity notes         | -                                                                          | 1,482                                                     | 948                                                | 2,430                                 |
| Derivative liabilities:                |                                                                            |                                                           |                                                    |                                       |
| Currency rate derivatives              | -                                                                          | -                                                         | 11 <sup>(1)</sup>                                  | 11                                    |
| Total liabilities                      | \$ -                                                                       | \$ 1,486                                                  | \$ 2,106                                           | \$ 3,592                              |

(1) - Unobservable inputs are either not developed by MBIA Corp. or do not significantly impact the overall fair values of the aggregate financial assets and liabilities.

Level 3 assets at fair value, as of June 30, 2014 and December 31, 2013 represented approximately 55% and 50%, respectively, of total assets measured at fair value. Level 3 liabilities at fair value, as of June 30, 2014 and December 31, 2013, represented approximately 46% and 59%, respectively, of total liabilities measured at fair value.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

The following tables present the fair values and carrying values of MBIA Corp.'s assets and liabilities that are disclosed at fair value but not reported at fair value on MBIA Corp.'s consolidated balance sheets as of June 30, 2014 and December 31, 2013:

| In millions                                      | Fair Value Measurements at Reporting Date Using                         |                                                     |                                                 | Fair Value<br>Balance as of<br>June 30, 2014 | Carry Value<br>Balance as of<br>June 30, 2014 |
|--------------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------|-------------------------------------------------|----------------------------------------------|-----------------------------------------------|
|                                                  | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |                                              |                                               |
| Assets:                                          |                                                                         |                                                     |                                                 |                                              |                                               |
| Accrued investment income <sup>(1)</sup>         | \$ -                                                                    | \$ 10                                               | \$ -                                            | \$ 10                                        | \$ 10                                         |
| Receivable for investments sold <sup>(1)</sup>   | -                                                                       | 1                                                   | -                                               | 1                                            | 1                                             |
| Assets of consolidated VIEs:                     |                                                                         |                                                     |                                                 |                                              |                                               |
| Investments held-to-maturity                     | -                                                                       | -                                                   | 2,780                                           | 2,780                                        | 2,787                                         |
| Total assets                                     | <u>\$ -</u>                                                             | <u>\$ 11</u>                                        | <u>\$ 2,780</u>                                 | <u>\$ 2,791</u>                              | <u>\$ 2,798</u>                               |
| Liabilities:                                     |                                                                         |                                                     |                                                 |                                              |                                               |
| Long-term debt                                   | \$ -                                                                    | \$ 920                                              | \$ -                                            | \$ 920                                       | \$ 1,180                                      |
| Payable for investments purchased <sup>(2)</sup> | -                                                                       | 1                                                   | -                                               | 1                                            | 1                                             |
| Liabilities of consolidated VIEs:                |                                                                         |                                                     |                                                 |                                              |                                               |
| VIE notes                                        | -                                                                       | -                                                   | 2,780                                           | 2,780                                        | 2,787                                         |
| Total liabilities                                | <u>\$ -</u>                                                             | <u>\$ 921</u>                                       | <u>\$ 2,780</u>                                 | <u>\$ 3,701</u>                              | <u>\$ 3,968</u>                               |
| Financial Guarantees:                            |                                                                         |                                                     |                                                 |                                              |                                               |
| Gross                                            | \$ -                                                                    | \$ -                                                | \$ 3,650                                        | \$ 3,650                                     | \$ 1,863                                      |
| Ceded                                            | -                                                                       | -                                                   | 2,323                                           | 2,323                                        | 1,102                                         |

(1) - Reported within "Other assets" on MBIA Corp.'s consolidated balance sheets.

(2) - Reported within "Other liabilities" on MBIA Corp.'s consolidated balance sheets.

| In millions                              | Fair Value Measurements at Reporting Date Using                         |                                                     |                                                 | Fair Value<br>Balance as of<br>December 31, 2013 | Carry Value<br>Balance as of<br>December 31, 2013 |
|------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------|-------------------------------------------------|--------------------------------------------------|---------------------------------------------------|
|                                          | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |                                                  |                                                   |
| Assets:                                  |                                                                         |                                                     |                                                 |                                                  |                                                   |
| Other investments                        | \$ -                                                                    | \$ -                                                | \$ 28                                           | \$ 28                                            | \$ 28                                             |
| Accrued investment income <sup>(1)</sup> | -                                                                       | 8                                                   | -                                               | 8                                                | 8                                                 |
| Assets of consolidated VIEs:             |                                                                         |                                                     |                                                 |                                                  |                                                   |
| Investments held-to-maturity             | -                                                                       | -                                                   | 2,651                                           | 2,651                                            | 2,801                                             |
| Total assets                             | <u>\$ -</u>                                                             | <u>\$ 8</u>                                         | <u>\$ 2,679</u>                                 | <u>\$ 2,687</u>                                  | <u>\$ 2,837</u>                                   |
| Liabilities:                             |                                                                         |                                                     |                                                 |                                                  |                                                   |
| Long-term debt                           | \$ -                                                                    | \$ 849                                              | \$ -                                            | \$ 849                                           | \$ 1,125                                          |
| Liabilities of consolidated VIEs:        |                                                                         |                                                     |                                                 |                                                  |                                                   |
| VIE notes                                | -                                                                       | -                                                   | 2,651                                           | 2,651                                            | 2,801                                             |
| Total liabilities                        | <u>\$ -</u>                                                             | <u>\$ 849</u>                                       | <u>\$ 2,651</u>                                 | <u>\$ 3,500</u>                                  | <u>\$ 3,926</u>                                   |
| Financial Guarantees:                    |                                                                         |                                                     |                                                 |                                                  |                                                   |
| Gross                                    | \$ -                                                                    | \$ -                                                | \$ 2,390                                        | \$ 2,390                                         | \$ 2,040                                          |
| Ceded                                    | -                                                                       | -                                                   | 1,214                                           | 1,214                                            | 1,212                                             |

(1) - Reported within "Other assets" on MBIA Corp.'s consolidated balance sheets.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the three months ended June 30, 2014 and 2013:

**Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended June 30, 2014**

| In millions                            | Balance,<br>Beginning<br>of Period | Realized<br>Gains /<br>(Losses) | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in<br>Earnings | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases   | Issuances   | Settlements    | Sales       | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance | Change in<br>Unrealized<br>Gains<br>(Losses) for<br>the Period<br>Included in<br>Earnings<br>for Assets<br>Still Held<br>as of<br>June 30,<br>2014 |
|----------------------------------------|------------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-------------|-------------|----------------|-------------|---------------------------------------------|-----------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assets:</b>                         |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                |             |                                             |                                               |                   |                                                                                                                                                    |
| <b>Foreign</b>                         |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                |             |                                             |                                               |                   |                                                                                                                                                    |
| governments                            | \$ 7                               | \$ -                            | \$ -                                                            | \$ -                                                    | \$ -                                                       | \$ -        | \$ -        | \$ -           | \$ (4)      | \$ -                                        | \$ 2                                          | \$ 5              | \$ -                                                                                                                                               |
| Corporate obligations                  | 18                                 | -                               | 2                                                               | -                                                       | -                                                          | -           | -           | -              | -           | -                                           | -                                             | 20                | 2                                                                                                                                                  |
| Other asset-backed                     | -                                  | -                               | -                                                               | -                                                       | -                                                          | -           | -           | -              | -           | -                                           | 4                                             | 4                 | -                                                                                                                                                  |
| Perpetual debt and equity securities   | 11                                 | -                               | 2                                                               | -                                                       | -                                                          | -           | -           | -              | -           | -                                           | -                                             | 13                | 2                                                                                                                                                  |
| <b>Assets of consolidated VIEs:</b>    |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                |             |                                             |                                               |                   |                                                                                                                                                    |
| Corporate obligations                  | 64                                 | -                               | -                                                               | -                                                       | -                                                          | -           | -           | (2)            | -           | -                                           | -                                             | 62                | -                                                                                                                                                  |
| Residential mortgage-backed non-agency | 5                                  | -                               | (1)                                                             | -                                                       | -                                                          | -           | -           | (1)            | -           | 1                                           | -                                             | 4                 | -                                                                                                                                                  |
| Commercial mortgage-backed             | 3                                  | -                               | (3)                                                             | -                                                       | -                                                          | -           | -           | -              | -           | -                                           | -                                             | -                 | -                                                                                                                                                  |
| <b>Collateralized debt</b>             |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                |             |                                             |                                               |                   |                                                                                                                                                    |
| obligations                            | 14                                 | -                               | (7)                                                             | -                                                       | -                                                          | -           | -           | (2)            | -           | 1                                           | -                                             | 6                 | -                                                                                                                                                  |
| Other asset-backed                     | 42                                 | -                               | (4)                                                             | -                                                       | -                                                          | -           | -           | (2)            | -           | -                                           | (10)                                          | 26                | -                                                                                                                                                  |
| Loans receivable                       | 1,557                              | -                               | 37                                                              | -                                                       | -                                                          | -           | -           | (55)           | -           | -                                           | -                                             | 1,539             | 37                                                                                                                                                 |
| Loan repurchase commitments            | 364                                | -                               | (1)                                                             | -                                                       | -                                                          | -           | -           | -              | -           | -                                           | -                                             | 363               | (1)                                                                                                                                                |
| <b>Total assets</b>                    | <b>\$ 2,085</b>                    | <b>\$ -</b>                     | <b>\$ 25</b>                                                    | <b>\$ -</b>                                             | <b>\$ -</b>                                                | <b>\$ -</b> | <b>\$ -</b> | <b>\$ (66)</b> | <b>\$ -</b> | <b>\$ 8</b>                                 | <b>\$ (10)</b>                                | <b>\$ 2,042</b>   | <b>\$ 40</b>                                                                                                                                       |

| In millions                       | Balance,<br>Beginning<br>of Period | Realized<br>(Gains) /<br>Losses | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in<br>Earnings | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases   | Issuances   | Settlements    | Sales       | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance | Change in<br>Unrealized<br>(Gains)<br>Losses for<br>the Period<br>Included in<br>Earnings<br>for Assets<br>Still Held<br>as of<br>June 30,<br>2014 |
|-----------------------------------|------------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-------------|-------------|----------------|-------------|---------------------------------------------|-----------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Liabilities:</b>               |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                |             |                                             |                                               |                   |                                                                                                                                                    |
| Credit derivative, net            | \$ 309                             | \$ 24                           | \$ 23                                                           | \$ -                                                    | \$ -                                                       | \$ -        | \$ -        | \$ (24)        | \$ -        | \$ -                                        | \$ -                                          | \$ 332            | \$ 24                                                                                                                                              |
| Other derivatives                 | 31                                 | -                               | 2                                                               | -                                                       | -                                                          | -           | -           | -              | -           | -                                           | -                                             | 33                | 2                                                                                                                                                  |
| Liabilities of consolidated VIEs: |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                |             |                                             |                                               |                   |                                                                                                                                                    |
| VIE notes                         | 815                                | -                               | 18                                                              | -                                                       | -                                                          | -           | -           | (31)           | -           | -                                           | -                                             | 802               | 18                                                                                                                                                 |
| Currency derivative, net          | 5                                  | -                               | 6                                                               | -                                                       | -                                                          | -           | -           | -              | -           | -                                           | -                                             | 11                | 6                                                                                                                                                  |
| <b>Total liabilities</b>          | <b>\$ 1,160</b>                    | <b>\$ 24</b>                    | <b>\$ 49</b>                                                    | <b>\$ -</b>                                             | <b>\$ -</b>                                                | <b>\$ -</b> | <b>\$ -</b> | <b>\$ (55)</b> | <b>\$ -</b> | <b>\$ -</b>                                 | <b>\$ -</b>                                   | <b>\$ 1,178</b>   | <b>\$ 50</b>                                                                                                                                       |

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

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

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

| In millions                            | Balance,<br>Beginning<br>of Period | Realized<br>Gains /<br>(Losses) | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in<br>Earnings | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases   | Issuances   | Settlements     | Sales           | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance | Change in<br>Unrealized<br>Gains<br>(Losses) for<br>the Period<br>Included in<br>Earnings<br>for Assets<br>Still Held<br>as of<br>June 30,<br>2013 |
|----------------------------------------|------------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-------------|-------------|-----------------|-----------------|---------------------------------------------|-----------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assets:</b>                         |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                 |                 |                                             |                                               |                   |                                                                                                                                                    |
| <b>Foreign</b>                         |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                 |                 |                                             |                                               |                   |                                                                                                                                                    |
| governments                            | \$ 8                               | \$ -                            | \$ -                                                            | \$ -                                                    | \$ -                                                       | \$ -        | \$ -        | \$ -            | \$ (8)          | \$ 3                                        | \$ -                                          | \$ 3              | \$ -                                                                                                                                               |
| Other asset-backed                     | 5                                  | -                               | -                                                               | -                                                       | -                                                          | -           | -           | -               | (5)             | -                                           | -                                             | -                 | -                                                                                                                                                  |
| Perpetual debt and equity securities   | 4                                  | -                               | 4                                                               | -                                                       | -                                                          | -           | -           | (1)             | -               | -                                           | -                                             | 7                 | -                                                                                                                                                  |
| <b>Assets of consolidated VIEs:</b>    |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                 |                 |                                             |                                               |                   |                                                                                                                                                    |
| Corporate obligations                  | 56                                 | -                               | (6)                                                             | -                                                       | -                                                          | -           | -           | (2)             | -               | -                                           | -                                             | 48                | (1)                                                                                                                                                |
| Residential mortgage-backed non-agency | 6                                  | -                               | (1)                                                             | -                                                       | -                                                          | -           | -           | -               | -               | -                                           | (3)                                           | 2                 | -                                                                                                                                                  |
| Commercial mortgage-backed             | 28                                 | -                               | -                                                               | -                                                       | -                                                          | -           | -           | -               | (24)            | -                                           | -                                             | 4                 | -                                                                                                                                                  |
| Collateralized debt obligations        | 57                                 | -                               | -                                                               | -                                                       | -                                                          | -           | -           | -               | (22)            | -                                           | -                                             | 35                | 3                                                                                                                                                  |
| Other asset-backed                     | 46                                 | -                               | 14                                                              | -                                                       | -                                                          | -           | -           | (7)             | -               | 10                                          | -                                             | 63                | 11                                                                                                                                                 |
| Loans receivable                       | 1,819                              | -                               | 212                                                             | -                                                       | -                                                          | -           | -           | (68)            | (173)           | -                                           | -                                             | 1,790             | 212                                                                                                                                                |
| Loan repurchase commitments            | 1,176                              | -                               | 49                                                              | -                                                       | -                                                          | -           | -           | (110)           | -               | -                                           | -                                             | 1,115             | 49                                                                                                                                                 |
| <b>Total assets</b>                    | <b>\$ 3,205</b>                    | <b>\$ -</b>                     | <b>\$ 272</b>                                                   | <b>\$ -</b>                                             | <b>\$ -</b>                                                | <b>\$ -</b> | <b>\$ -</b> | <b>\$ (196)</b> | <b>\$ (224)</b> | <b>\$ 13</b>                                | <b>\$ (3)</b>                                 | <b>\$ 3,067</b>   | <b>\$ 274</b>                                                                                                                                      |

| In millions                              | Balance,<br>Beginning<br>of Period | Realized<br>(Gains) /<br>Losses | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in<br>Earnings | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases   | Issuances   | Settlements       | Sales             | Transfers<br>into<br>Level 3<br>(1) | Transfers<br>out of<br>Level 3<br>(1) | Ending<br>Balance | Change in<br>Unrealized<br>(Gains)<br>Losses for<br>the Period<br>Included in<br>Earnings<br>for Assets<br>Still Held<br>as of<br>June 30,<br>2013 |
|------------------------------------------|------------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-------------|-------------|-------------------|-------------------|-------------------------------------|---------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Liabilities:</b>                      |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                   |                   |                                     |                                       |                   |                                                                                                                                                    |
| Credit derivative,<br>net                | \$ 2,994                           | \$ 1,532                        | \$ (1,350)                                                      | \$ -                                                    | \$ -                                                       | \$ -        | \$ -        | \$ (1,532)        | \$ -              | \$ 4                                | \$ -                                  | \$ 1,648          | \$ 162                                                                                                                                             |
| <b>Liabilities of consolidated VIEs:</b> |                                    |                                 |                                                                 |                                                         |                                                            |             |             |                   |                   |                                     |                                       |                   |                                                                                                                                                    |
| VIE notes                                | 1,918                              | -                               | 24                                                              | -                                                       | -                                                          | -           | -           | (26)              | (1,084)           | -                                   | -                                     | 832               | 24                                                                                                                                                 |
| Currency<br>derivative, net              | 23                                 | -                               | (4)                                                             | -                                                       | (3)                                                        | -           | -           | -                 | -                 | -                                   | -                                     | 16                | (7)                                                                                                                                                |
| Total liabilities                        | <u>\$ 4,935</u>                    | <u>\$ 1,532</u>                 | <u>\$ (1,330)</u>                                               | <u>\$ -</u>                                             | <u>\$ (3)</u>                                              | <u>\$ -</u> | <u>\$ -</u> | <u>\$ (1,558)</u> | <u>\$ (1,084)</u> | <u>\$ 4</u>                         | <u>\$ -</u>                           | <u>\$ 2,496</u>   | <u>\$ 179</u>                                                                                                                                      |

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

Transfers into and out of Level 3 were \$8 million and \$10 million, respectively, for the three months ended June 30, 2014. Transfers into and out of Level 2 were \$10 million and \$8 million, respectively, for the three months ended June 30, 2014. Transfers into Level 3 were principally related to other ABS and foreign government securities where inputs, which are significant to their valuation, became unobservable during the quarter. Transfers out of Level 3 were related to other ABS securities where inputs, which are significant to their valuation, became observable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

Transfers into and out of Level 3 were \$17 million and \$3 million, respectively, for the three months ended June 30, 2013. Transfers into and out of Level 2 were \$3 million and \$17 million, respectively, for the three months ended June 30, 2013. Transfers into Level 3 were principally for other ABS, credit derivatives and foreign government securities where inputs, which are significant to their valuation, became unobservable during the quarter. Transfers out of Level 3 were principally RMBS non-agency securities where inputs, which are significant to their valuation, became observable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

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

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the six months ended June 30, 2014 and 2013:

**Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Six Months Ended June 30, 2014**

| In millions                            | Balance,<br>Beginning<br>of Year | Realized<br>Gains /<br>(Losses) | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in<br>Earnings | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases    | Issuances   | Settlements     | Sales <sup>(2)</sup> | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance | Change in<br>Unrealized<br>Gains<br>(Losses) for<br>the Period<br>Included in<br>Earnings<br>for Assets<br>Still Held<br>as of<br>June 30,<br>2014 |
|----------------------------------------|----------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|--------------|-------------|-----------------|----------------------|---------------------------------------------|-----------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assets:</b>                         |                                  |                                 |                                                                 |                                                         |                                                            |              |             |                 |                      |                                             |                                               |                   |                                                                                                                                                    |
| <b>Foreign</b>                         |                                  |                                 |                                                                 |                                                         |                                                            |              |             |                 |                      |                                             |                                               |                   |                                                                                                                                                    |
| governments                            | \$ 12                            | \$ -                            | \$ -                                                            | \$ -                                                    | \$ -                                                       | \$ -         | \$ -        | \$ -            | \$ (9)               | \$ -                                        | \$ 2                                          | \$ -              | \$ -                                                                                                                                               |
| Corporate obligations                  | -                                | -                               | 2                                                               | -                                                       | -                                                          | 17           | -           | -               | -                    | 1                                           | -                                             | 20                | 2                                                                                                                                                  |
| Other asset-backed                     | -                                | -                               | -                                                               | -                                                       | -                                                          | -            | -           | -               | -                    | 4                                           | -                                             | 4                 | -                                                                                                                                                  |
| Perpetual debt and equity securities   | 6                                | -                               | 2                                                               | -                                                       | -                                                          | 11           | -           | -               | (6)                  | -                                           | -                                             | 13                | 2                                                                                                                                                  |
| <b>Assets of consolidated VIEs:</b>    |                                  |                                 |                                                                 |                                                         |                                                            |              |             |                 |                      |                                             |                                               |                   |                                                                                                                                                    |
| Corporate obligations                  | 48                               | -                               | -                                                               | -                                                       | -                                                          | -            | -           | (3)             | -                    | 17                                          | -                                             | 62                | 1                                                                                                                                                  |
| Residential mortgage-backed non-agency | 4                                | -                               | (1)                                                             | -                                                       | -                                                          | -            | -           | (1)             | -                    | 2                                           | -                                             | 4                 | -                                                                                                                                                  |
| Commercial mortgage-backed             | 3                                | -                               | (3)                                                             | -                                                       | -                                                          | -            | -           | -               | -                    | -                                           | -                                             | -                 | -                                                                                                                                                  |
| Collateralized debt obligations        | 22                               | -                               | (10)                                                            | -                                                       | -                                                          | -            | -           | (4)             | -                    | 1                                           | (3)                                           | 6                 | 1                                                                                                                                                  |
| Other asset-backed                     | 54                               | -                               | (16)                                                            | -                                                       | -                                                          | -            | -           | (6)             | -                    | 4                                           | (10)                                          | 26                | -                                                                                                                                                  |
| Loans receivable                       | 1,612                            | -                               | 36                                                              | -                                                       | -                                                          | -            | -           | (109)           | -                    | -                                           | -                                             | 1,539             | 36                                                                                                                                                 |
| Loan repurchase commitment             | 359                              | -                               | 4                                                               | -                                                       | -                                                          | -            | -           | -               | -                    | -                                           | -                                             | 363               | 4                                                                                                                                                  |
| <b>Total assets</b>                    | <b>\$ 2,120</b>                  | <b>\$ -</b>                     | <b>\$ 14</b>                                                    | <b>\$ -</b>                                             | <b>\$ -</b>                                                | <b>\$ 28</b> | <b>\$ -</b> | <b>\$ (132)</b> | <b>\$ (6)</b>        | <b>\$ 31</b>                                | <b>\$ (13)</b>                                | <b>\$ 2,042</b>   | <b>\$ 46</b>                                                                                                                                       |

| In millions                       | Balance,<br>Beginning<br>of Year | Realized<br>(Gains) /<br>Losses | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in<br>Earnings | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases   | Issuances   | Settlements     | Sales <sup>(2)</sup> | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance | Change in<br>Unrealized<br>(Gains)<br>Losses for<br>the Period<br>Included in<br>Earnings<br>for Assets<br>Still Held<br>as of<br>June 30,<br>2014 |
|-----------------------------------|----------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-------------|-------------|-----------------|----------------------|---------------------------------------------|-----------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Liabilities:</b>               |                                  |                                 |                                                                 |                                                         |                                                            |             |             |                 |                      |                                             |                                               |                   |                                                                                                                                                    |
| Credit                            |                                  |                                 |                                                                 |                                                         |                                                            |             |             |                 |                      |                                             |                                               |                   |                                                                                                                                                    |
| derivatives,<br>net               | \$ 1,147                         | \$ 363                          | \$ (815)                                                        | \$ -                                                    | \$ -                                                       | \$ -        | \$ -        | \$ (363)        | \$ -                 | \$ -                                        | \$ -                                          | \$ 332            | \$ (6)                                                                                                                                             |
| Other derivative,<br>net          | -                                | 30                              | 3                                                               | -                                                       | -                                                          | -           | -           | -               | -                    | -                                           | -                                             | 33                | 3                                                                                                                                                  |
| Liabilities of consolidated VIEs: |                                  |                                 |                                                                 |                                                         |                                                            |             |             |                 |                      |                                             |                                               |                   |                                                                                                                                                    |
| VIE notes                         | 948                              | -                               | 35                                                              | -                                                       | -                                                          | -           | -           | (136)           | (45)                 | -                                           | -                                             | 802               | 33                                                                                                                                                 |
| Currency derivatives,<br>net      | 11                               | -                               | -                                                               | -                                                       | -                                                          | -           | -           | -               | -                    | -                                           | -                                             | 11                | -                                                                                                                                                  |
| <b>Total liabilities</b>          | <b>\$ 2,106</b>                  | <b>\$ 393</b>                   | <b>\$ (777)</b>                                                 | <b>\$ -</b>                                             | <b>\$ -</b>                                                | <b>\$ -</b> | <b>\$ -</b> | <b>\$ (499)</b> | <b>\$ (45)</b>       | <b>\$ -</b>                                 | <b>\$ -</b>                                   | <b>\$ 1,178</b>   | <b>\$ 30</b>                                                                                                                                       |

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

(2) - Primarily relates to the deconsolidation of VIEs.

**Note 6: Fair Value of Financial Instruments (continued)**

|                                        |                                  |                                 |                                                                 |                                                         |                                                            |           |           |             |                      |                                             |                                               |                   |        |  |  |  |  |  | Change in<br>Unrealized<br>Gains<br>(Losses) for<br>the Period<br>Included in<br>Earnings for Assets<br>Still Held<br>as of<br>June 30,<br>2013 |
|----------------------------------------|----------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-----------|-----------|-------------|----------------------|---------------------------------------------|-----------------------------------------------|-------------------|--------|--|--|--|--|--|-------------------------------------------------------------------------------------------------------------------------------------------------|
| In millions                            | Balance,<br>Beginning<br>of Year | Realized<br>Gains /<br>(Losses) | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in<br>Earnings | Unrealized<br>Gains /<br>(Losses)<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases | Issuances | Settlements | Sales <sup>(2)</sup> | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance |        |  |  |  |  |  |                                                                                                                                                 |
| Assets:                                |                                  |                                 |                                                                 |                                                         |                                                            |           |           |             |                      |                                             |                                               |                   |        |  |  |  |  |  |                                                                                                                                                 |
| Foreign governments                    | \$ 3                             | \$ -                            | \$ -                                                            | \$ -                                                    | \$ -                                                       | \$ -      | \$ -      | \$ (8)      | \$ -                 | \$ 11                                       | \$ (3)                                        | \$ 3              | \$ -   |  |  |  |  |  |                                                                                                                                                 |
| Residential mortgage-backed non-agency | 3                                | -                               | -                                                               | -                                                       | -                                                          | -         | -         | (3)         | -                    | -                                           | -                                             | -                 | -      |  |  |  |  |  |                                                                                                                                                 |
| Other asset-backed                     | 5                                | -                               | -                                                               | -                                                       | -                                                          | -         | -         | -           | (5)                  | -                                           | -                                             | -                 | -      |  |  |  |  |  |                                                                                                                                                 |
| Perpetual debt and equity securities   | 4                                | -                               | 4                                                               | -                                                       | -                                                          | -         | -         | (1)         | -                    | -                                           | -                                             | 7                 | -      |  |  |  |  |  |                                                                                                                                                 |
| Assets of consolidated VIEs:           |                                  |                                 |                                                                 |                                                         |                                                            |           |           |             |                      |                                             |                                               |                   |        |  |  |  |  |  |                                                                                                                                                 |
| Corporate obligations                  | 56                               | -                               | (8)                                                             | -                                                       | -                                                          | -         | -         | (3)         | -                    | 3                                           | -                                             | 48                | (1)    |  |  |  |  |  |                                                                                                                                                 |
| Residential mortgage-backed non-agency | 6                                | -                               | 6                                                               | -                                                       | -                                                          | -         | -         | (7)         | -                    | 1                                           | (4)                                           | 2                 | -      |  |  |  |  |  |                                                                                                                                                 |
| Commercial mortgage-backed             | 7                                | -                               | 1                                                               | -                                                       | -                                                          | -         | -         | -           | (24)                 | 20                                          | -                                             | 4                 | 1      |  |  |  |  |  |                                                                                                                                                 |
| Collateralized debt obligations        | 66                               | -                               | (9)                                                             | -                                                       | -                                                          | -         | -         | -           | (22)                 | 1                                           | (1)                                           | 35                | 4      |  |  |  |  |  |                                                                                                                                                 |
| Other asset-backed                     | 62                               | -                               | -                                                               | -                                                       | -                                                          | -         | -         | (9)         | -                    | 10                                          | -                                             | 63                | 4      |  |  |  |  |  |                                                                                                                                                 |
| Loans receivable                       | 1,881                            | -                               | 221                                                             | -                                                       | -                                                          | -         | -         | (138)       | (174)                | -                                           | -                                             | 1,790             | 207    |  |  |  |  |  |                                                                                                                                                 |
| Loan repurchase commitment             | 1,086                            | -                               | 139                                                             | -                                                       | -                                                          | -         | -         | (110)       | -                    | -                                           | -                                             | 1,115             | 139    |  |  |  |  |  |                                                                                                                                                 |
| Total assets                           | \$ 3,179                         | \$ -                            | \$ 354                                                          | \$ -                                                    | \$ -                                                       | \$ -      | \$ -      | \$ (279)    | \$ (225)             | \$ 46                                       | \$ (8)                                        | \$ 3,067          | \$ 354 |  |  |  |  |  |                                                                                                                                                 |

| In millions                              | Balance,<br>Beginning<br>of Year | Realized<br>(Gains) /<br>Losses | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in<br>Earnings | Unrealized<br>(Gains) /<br>Losses<br>Included<br>in OCI | Foreign<br>Exchange<br>Recognized<br>in OCI or<br>Earnings | Purchases   | Issuances   | Settlements       | Sales <sup>(2)</sup> | Transfers<br>into<br>Level 3 <sup>(1)</sup> | Transfers<br>out of<br>Level 3 <sup>(1)</sup> | Ending<br>Balance | Change in<br>Unrealized<br>(Gains)<br>Losses for<br>the Period<br>Included in<br>Earnings<br>for Assets<br>Still Held<br>as of<br>June 30,<br>2013 |
|------------------------------------------|----------------------------------|---------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------|-------------|-------------|-------------------|----------------------|---------------------------------------------|-----------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Liabilities:</b>                      |                                  |                                 |                                                                 |                                                         |                                                            |             |             |                   |                      |                                             |                                               |                   |                                                                                                                                                    |
| Credit                                   |                                  |                                 |                                                                 |                                                         |                                                            |             |             |                   |                      |                                             |                                               |                   |                                                                                                                                                    |
| derivatives,<br>net                      | \$ 2,921                         | \$ 1,521                        | \$ (1,277)                                                      | \$ -                                                    | \$ -                                                       | \$ -        | \$ -        | \$ (1,521)        | \$ -                 | \$ 4                                        | \$ -                                          | \$ 1,648          | \$ 218                                                                                                                                             |
| <b>Liabilities of consolidated VIEs:</b> |                                  |                                 |                                                                 |                                                         |                                                            |             |             |                   |                      |                                             |                                               |                   |                                                                                                                                                    |
| VIE notes                                | 1,948                            | -                               | 147                                                             | -                                                       | -                                                          | -           | -           | (178)             | (1,085)              | -                                           | -                                             | 832               | 60                                                                                                                                                 |
| Currency derivatives,<br>net             | 21                               | -                               | (5)                                                             | -                                                       | -                                                          | -           | -           | -                 | -                    | -                                           | -                                             | 16                | (5)                                                                                                                                                |
| <b>Total liabilities</b>                 | <b>\$ 4,890</b>                  | <b>\$ 1,521</b>                 | <b>\$ (1,135)</b>                                               | <b>\$ -</b>                                             | <b>\$ -</b>                                                | <b>\$ -</b> | <b>\$ -</b> | <b>\$ (1,699)</b> | <b>\$ (1,085)</b>    | <b>\$ 4</b>                                 | <b>\$ -</b>                                   | <b>\$ 2,496</b>   | <b>\$ 273</b>                                                                                                                                      |

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

(2) - Primarily relates to the deconsolidation of VIEs.

Transfers into and out of Level 3 were \$31 million and \$13 million, respectively, for the six months ended June 30, 2014. Transfers into and out of Level 2 were \$13 million and \$31 million, respectively, for the six months ended June 30, 2014. Transfers into Level 3 were principally related to corporate obligations and other ABS where inputs, which are significant to their valuation, became unobservable during the period. Transfers out of Level 3 were principally for other ABS and CDO securities, where inputs, which are significant to their valuation, became observable during the period. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

Transfers into and out of Level 3 were \$50 million and \$8 million, respectively, for the six months ended June 30, 2013. Transfers into and out of Level 2 were \$8 million and \$50 million, respectively, for the six months ended June 30, 2013. Transfers into Level 3 were principally related to CMBS, foreign governments, and ABS where inputs, which are significant to their valuation, became unobservable during the period. Transfers out of Level 3 were principally for RMBS non-agency and foreign government securities where inputs, which are significant to their valuation, became observable during the period. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1.

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

Gains and losses (realized and unrealized) included in earnings related to Level 3 assets and liabilities for the three and six months ended June 30, 2014 and 2013 are reported on MBIA Corp.'s consolidated statements of operations as follows:

| In millions                                                                    | Three Months Ended June 30, 2014          |                                                                                                                                   | Three Months Ended June 30, 2013          |                                                                                                                                   |
|--------------------------------------------------------------------------------|-------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|
|                                                                                | Total Gains (Losses) Included in Earnings | Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets and Liabilities still held as of June 30, 2014 | Total Gains (Losses) Included in Earnings | Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets and Liabilities still held as of June 30, 2013 |
| <b>Revenues:</b>                                                               |                                           |                                                                                                                                   |                                           |                                                                                                                                   |
| Unrealized gains (losses) on insured derivatives                               | \$ (23)                                   | \$ (24)                                                                                                                           | \$ 1,350                                  | \$ (162)                                                                                                                          |
| Realized gains (losses) and other settlements on insured derivatives           | (24)                                      | -                                                                                                                                 | (1,532)                                   | -                                                                                                                                 |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 2                                         | 2                                                                                                                                 | 4                                         | -                                                                                                                                 |
| <b>Revenues of consolidated VIEs:</b>                                          |                                           |                                                                                                                                   |                                           |                                                                                                                                   |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (3)                                       | 12                                                                                                                                | 248                                       | 257                                                                                                                               |
| <b>Total</b>                                                                   | <b>\$ (48)</b>                            | <b>\$ (10)</b>                                                                                                                    | <b>\$ 70</b>                              | <b>\$ 95</b>                                                                                                                      |

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

| In millions                                                                    | Six Months Ended June 30, 2014            |                                                                                                                                   | Six Months Ended June 30, 2013            |                                                                                                                                   |
|--------------------------------------------------------------------------------|-------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|
|                                                                                | Total Gains (Losses) included in earnings | Change in unrealized gains (losses) for the period included in earnings for assets and liabilities still held as of June 30, 2014 | Total Gains (Losses) included in earnings | Change in unrealized gains (losses) for the period included in earnings for assets and liabilities still held as of June 30, 2013 |
| <b>Revenues:</b>                                                               |                                           |                                                                                                                                   |                                           |                                                                                                                                   |
| Unrealized gains (losses) on insured derivatives                               | 815                                       | 6                                                                                                                                 | 1,277                                     | (218)                                                                                                                             |
| Realized gains (losses) and other settlements on insured derivatives           | (393)                                     | -                                                                                                                                 | (1,521)                                   | -                                                                                                                                 |
| Net gains (losses) on financial instruments at fair value and foreign exchange | 1                                         | 1                                                                                                                                 | 4                                         | -                                                                                                                                 |
| <b>Revenues of consolidated VIEs:</b>                                          |                                           |                                                                                                                                   |                                           |                                                                                                                                   |
| Net gains (losses) on financial instruments at fair value and foreign exchange | (25)                                      | 9                                                                                                                                 | 208                                       | 299                                                                                                                               |
| <b>Total</b>                                                                   | <b>\$ 398</b>                             | <b>\$ 16</b>                                                                                                                      | <b>\$ (32)</b>                            | <b>\$ 81</b>                                                                                                                      |

**Fair Value Option**

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

The following table presents the changes in fair value included in MBIA Corp.'s consolidated statements of operations for the three and six months ended June 30, 2014 and 2013, for all VIE financial instruments for which the fair value option was elected:

| In millions                                  | Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange |         |                           |      |
|----------------------------------------------|--------------------------------------------------------------------------------|---------|---------------------------|------|
|                                              | Three Months Ended June 30,                                                    |         | Six Months Ended June 30, |      |
|                                              | 2014                                                                           | 2013    | 2014                      | 2013 |
| Fixed-maturity securities held at fair value | \$ (30)                                                                        | \$ (16) | \$ (68)                   | \$ 2 |
| Loans receivable at fair value:              |                                                                                |         |                           |      |
| Residential mortgage loans                   | (17)                                                                           | 145     | (73)                      | 71   |
| Other loans                                  | -                                                                              | -       | -                         | 13   |
| Loan repurchase commitments                  | -                                                                              | 50      | 5                         | 139  |
| Variable interest entity notes               | 50                                                                             | (160)   | 178                       | (79) |

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding as of June 30, 2014 and December 31, 2013, for VIE loans and notes for which the fair value option was elected:

| In millions                                           | As of June 30, 2014               |            |            | As of December 31, 2013           |            |            |
|-------------------------------------------------------|-----------------------------------|------------|------------|-----------------------------------|------------|------------|
|                                                       | Contractual Outstanding Principal | Fair Value | Difference | Contractual Outstanding Principal | Fair Value | Difference |
| <b>Loans receivable at fair value:</b>                |                                   |            |            |                                   |            |            |
| Residential mortgage loans                            | \$ 1,729                          | \$ 1,510   | \$ 219     | \$ 1,846                          | \$ 1,562   | \$ 284     |
| Residential mortgage loans (90 days or more past due) | 243                               | 29         | 214        | 231                               | 50         | 181        |
| Total loans receivable at fair value                  | \$ 1,972                          | \$ 1,539   | \$ 433     | \$ 2,077                          | \$ 1,612   | \$ 465     |
| Variable interest entity notes                        | \$ 3,480                          | \$ 2,202   | \$ 1,278   | \$ 3,866                          | \$ 2,430   | \$ 1,436   |

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 6: Fair Value of Financial Instruments (continued)**

Substantially all gains and losses included in earnings during the periods ended June 30, 2014 and December 31, 2013 on loans receivable and VIE notes reported in the preceding table are attributable to credit risk. This is primarily due to the high rate of defaults on loans and the collateral supporting the VIE notes, resulting in depressed pricing of the financial instruments.

**Note 7: Investments**

MBIA Corp.'s investments, excluding those elected under the fair value option, include debt and equity securities classified as either AFS or HTM. Other invested assets designated as AFS are primarily comprised of money market funds.

The following tables present the amortized cost, fair value and corresponding gross unrealized gains and losses for AFS and HTM investments in MBIA Corp.'s investment portfolios as of June 30, 2014 and December 31, 2013:

| In millions                            | June 30, 2014   |                        |                         |                |
|----------------------------------------|-----------------|------------------------|-------------------------|----------------|
|                                        | Amortized Cost  | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value     |
| <b>AFS Investments</b>                 |                 |                        |                         |                |
| Fixed-maturity investments:            |                 |                        |                         |                |
| U.S. Treasury and government agency    | \$ 11           | \$ -                   | \$ -                    | \$ 11          |
| State and municipal bonds              | 84              | 6                      | -                       | 90             |
| Foreign governments                    | 287             | 5                      | (1)                     | 291            |
| Corporate obligations                  | 512             | 6                      | -                       | 518            |
| Mortgage-backed securities:            |                 |                        |                         |                |
| Residential mortgage-backed agency     | 3               | -                      | -                       | 3              |
| Residential mortgage-backed non-agency | 16              | -                      | -                       | 16             |
| Commercial mortgage-backed             | 6               | -                      | -                       | 6              |
| Asset-backed securities:               |                 |                        |                         |                |
| Other asset-backed                     | 4               | -                      | -                       | 4              |
| Total fixed-maturity investments       | 923             | 17                     | (1)                     | 939            |
| Money market securities                | 1               | -                      | -                       | 1              |
| Perpetual debt and equity securities   | 1               | -                      | -                       | 1              |
| Total AFS investments                  | <u>\$ 925</u>   | <u>\$ 17</u>           | <u>\$ (1)</u>           | <u>\$ 941</u>  |
| <b>HTM Investments</b>                 |                 |                        |                         |                |
| Assets of consolidated VIEs:           |                 |                        |                         |                |
| Corporate obligations                  | \$ 2,787        | \$ 123                 | \$ (130)                | \$2,780        |
| Total HTM investments                  | <u>\$ 2,787</u> | <u>\$ 123</u>          | <u>\$ (130)</u>         | <u>\$2,780</u> |

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 7: Investments (continued)**

| In millions                            | December 31, 2013 |                              |                               |                |
|----------------------------------------|-------------------|------------------------------|-------------------------------|----------------|
|                                        | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value  |
| <b>AFS Investments</b>                 |                   |                              |                               |                |
| Fixed-maturity investments:            |                   |                              |                               |                |
| U.S. Treasury and government agency    | \$ 11             | \$ -                         | \$ -                          | \$ 11          |
| State and municipal bonds              | 84                | -                            | (2)                           | 82             |
| Foreign governments                    | 166               | 5                            | -                             | 171            |
| Corporate obligations                  | 192               | 4                            | -                             | 196            |
| Mortgage-backed securities:            |                   |                              |                               |                |
| Residential mortgage-backed agency     | 3                 | -                            | -                             | 3              |
| Residential mortgage-backed non-agency | 23                | -                            | -                             | 23             |
| Total fixed-maturity investments       | 479               | 9                            | (2)                           | 486            |
| Money market securities                | 191               | -                            | -                             | 191            |
| Perpetual debt and equity securities   | 1                 | -                            | -                             | 1              |
| Total AFS investments                  | <u>\$ 671</u>     | <u>\$ 9</u>                  | <u>\$ (2)</u>                 | <u>\$ 678</u>  |
| <b>HTM Investments</b>                 |                   |                              |                               |                |
| Assets of consolidated VIEs:           |                   |                              |                               |                |
| Corporate obligations                  | \$ 2,801          | \$ 31                        | \$ (181)                      | \$2,651        |
| Total HTM investments                  | <u>\$ 2,801</u>   | <u>\$ 31</u>                 | <u>\$ (181)</u>               | <u>\$2,651</u> |

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 7: Investments (continued)**

The following table presents the distribution by contractual maturity of AFS and HTM fixed-maturity securities at amortized cost and fair value as of June 30, 2014. Contractual maturity may differ from expected maturity as borrowers may have the right to call or prepay obligations.

| In millions                            | AFS Securities |               | HTM Securities<br>Consolidated VIEs |                 |
|----------------------------------------|----------------|---------------|-------------------------------------|-----------------|
|                                        | Amortized Cost | Fair Value    | Amortized Cost                      | Fair Value      |
| Due in one year or less                | \$ 397         | \$ 397        | \$ -                                | \$ -            |
| Due after one year through five years  | 344            | 349           | -                                   | -               |
| Due after five years through ten years | 63             | 66            | -                                   | -               |
| Due after ten years                    | 90             | 98            | 2,787                               | 2,780           |
| Mortgage-backed and asset-backed       | 29             | 29            | -                                   | -               |
| Total fixed-maturity investments       | <u>\$ 923</u>  | <u>\$ 939</u> | <u>\$ 2,787</u>                     | <u>\$ 2,780</u> |

**Deposited Securities**

The fair value of securities on deposit with various regulatory authorities was \$4 million as of June 30, 2014 and December 31, 2013. These deposits are required to comply with state insurance laws.

**Impaired Investments**

The following tables present the gross unrealized losses related to AFS and HTM investments as of June 30, 2014 and December 31, 2013:

| In millions                  | June 30, 2014       |                   |                     |                   |               |                   |
|------------------------------|---------------------|-------------------|---------------------|-------------------|---------------|-------------------|
|                              | Less than 12 Months |                   | 12 Months or Longer |                   | Total         |                   |
|                              | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value    | Unrealized Losses |
| <b>AFS Investments</b>       |                     |                   |                     |                   |               |                   |
| Foreign governments          | \$ 148              | \$ (1)            | \$ -                | \$ -              | \$ 148        | \$ (1)            |
| Total AFS investments        | <u>\$ 148</u>       | <u>\$ (1)</u>     | <u>\$ -</u>         | <u>\$ -</u>       | <u>\$ 148</u> | <u>\$ (1)</u>     |
| <b>HTM Investments</b>       |                     |                   |                     |                   |               |                   |
| Assets of consolidated VIEs: |                     |                   |                     |                   |               |                   |
| Corporate obligations        | \$ -                | \$ -              | \$ 445              | \$ (130)          | \$ 445        | \$ (130)          |
| Total HTM investments        | <u>\$ -</u>         | <u>\$ -</u>       | <u>\$ 445</u>       | <u>\$ (130)</u>   | <u>\$ 445</u> | <u>\$ (130)</u>   |

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 7: Investments (continued)**

| In millions                            | Less than 12 Months |                   | December 31, 2013<br>12 Months or Longer |                   | Total          |                   |
|----------------------------------------|---------------------|-------------------|------------------------------------------|-------------------|----------------|-------------------|
|                                        | Fair Value          | Unrealized Losses | Fair Value                               | Unrealized Losses | Fair Value     | Unrealized Losses |
| <b>AFS Investments</b>                 |                     |                   |                                          |                   |                |                   |
| Fixed-maturity investments:            |                     |                   |                                          |                   |                |                   |
| U.S. Treasury and government agency    | \$ 6                | \$ -              | \$ -                                     | \$ -              | \$ 6           | \$ -              |
| State and municipal bonds              | 74                  | (2)               | -                                        | -                 | 74             | (2)               |
| Foreign governments                    | 37                  | -                 | -                                        | -                 | 37             | -                 |
| Corporate obligations                  | 65                  | -                 | -                                        | -                 | 65             | -                 |
| Mortgage-backed securities:            |                     |                   |                                          |                   |                |                   |
| Residential mortgage-backed agency     | 3                   | -                 | -                                        | -                 | 3              | -                 |
| Residential mortgage-backed non-agency | 14                  | -                 | -                                        | -                 | 14             | -                 |
| Total fixed-maturity investments       | 199                 | (2)               | -                                        | -                 | 199            | (2)               |
| Perpetual debt and equity securities   | 1                   | -                 | -                                        | -                 | 1              | -                 |
| Total AFS investments                  | <u>\$ 200</u>       | <u>\$ (2)</u>     | <u>\$ -</u>                              | <u>\$ -</u>       | <u>\$ 200</u>  | <u>\$ (2)</u>     |
| <b>HTM Investments</b>                 |                     |                   |                                          |                   |                |                   |
| Assets of consolidated VIEs:           |                     |                   |                                          |                   |                |                   |
| Corporate obligations                  | \$ -                | \$ -              | \$ 1,244                                 | \$ (181)          | \$1,244        | \$ (181)          |
| Total HTM investments                  | <u>\$ -</u>         | <u>\$ -</u>       | <u>\$ 1,244</u>                          | <u>\$ (181)</u>   | <u>\$1,244</u> | <u>\$ (181)</u>   |

With the weighting applied on the fair value of each security relative to the total fair value, the weighted average contractual maturity of securities in an unrealized loss position as of June 30, 2014 and December 31, 2013 was 26 and 25 years, respectively. As of June 30, 2014 and December 31, 2013, there were 9 and 3 securities, respectively, that were in an unrealized loss position for a continuous twelve-month period or longer, of which the fair values of 1 and 2 securities, respectively, were below book value by more than 5%.

**Other-Than-Temporary Impairments**

MBIA Corp. has evaluated on a security-by-security basis whether the unrealized losses in its investment portfolios were other-than-temporary considering duration and severity of unrealized losses, the circumstances that gave rise to the unrealized losses, and whether MBIA Corp. has the intent to sell the securities or more likely than not will be required to sell the securities before their anticipated recovery. Based on its evaluation, MBIA Corp. determined that the unrealized losses on the remaining securities were temporary in nature because its impairment analysis, including projected future cash flows, indicated that MBIA Corp. would be able to recover the amortized cost of impaired assets. MBIA Corp. also concluded that it does not have the intent to sell securities in an unrealized loss position and it is more likely than not that it would not have to sell these securities before recovery of their cost basis. In making this conclusion, MBIA Corp. examined the cash flow projections for its investment portfolios, the potential sources and uses of cash in its business, and the cash resources available to its business other than sales of securities. It also considered the existence of any risk management or other plans as of June 30, 2014 that would require the sale of impaired securities. On a quarterly basis, MBIA Corp. re-evaluates the unrealized losses in its investment portfolios to determine whether an impairment loss should be realized in current earnings. Impaired securities that MBIA Corp. intends to sell before the expected recovery of such securities' fair values have been written down to fair value.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 7: Investments (continued)**

**Sales of Available-for-Sale Investments**

Gross realized gains and losses are recorded within "Net gains (losses) on financial instruments at fair value and foreign exchange" on MBIA Corp.'s consolidated statements of operations. There were no material amounts of gross realized gains and losses from sales for the six months ended June 30, 2014 and 2013. The proceeds from sales of fixed-maturity securities held as AFS for the six months ended June 30, 2014 and 2013 is as follows:

| In millions           | Three Months Ended June 30, |        | Six Months Ended June 30, |        |
|-----------------------|-----------------------------|--------|---------------------------|--------|
|                       | 2014                        | 2013   | 2014                      | 2013   |
| Proceeds from sales   | \$ 38                       | \$ 213 | \$ 39                     | \$ 329 |
| Gross realized gains  | \$ 2                        | \$ 22  | \$ 2                      | \$ 22  |
| Gross realized losses | \$ -                        | \$ (1) | \$ -                      | \$ (1) |

**Note 8: Derivative Instruments**

**Overview**

MBIA Corp. has entered into derivative instruments through its financial guarantee of CDS and accounts for these derivative instruments in accordance with the accounting principles for derivative and hedging activities, which requires that all such instruments be recorded on MBIA Corp.'s consolidated balance sheets at fair value. Refer to "Note 6: Fair Value of Financial Instruments" for the method of determining the fair value of derivative instruments.

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

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

In certain instances, MBIA Corp. purchased or issued securities that contain embedded derivatives. In accordance with the accounting guidance for derivative instruments and hedging activities, the balance sheet location of MBIA Corp.'s embedded derivative instruments is determined by the location of the related security.

MBIA Corp. has also entered into a derivative contract as a result of a commutation occurring during the six months ended June 30, 2014. Changes in the fair value of MBIA Corp.'s non-insured derivative are included in "Net gains (losses) on financial instruments at fair value and foreign exchange" on MBIA Corp.'s consolidated statements of operations.

**Variable Interest Entities**

VIEs consolidated by MBIA Corp. have entered into derivative instruments consisting of interest rate caps and cross currency swaps. Interest rate caps are entered into to mitigate the risks associated with fluctuations in interest rates or fair values of certain contracts. Cross currency swaps are entered into to hedge the variability in cash flows resulting from fluctuations in foreign currency rates.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 8: Derivative Instruments (continued)**

**Credit Derivatives Sold**

The following tables present information about credit derivatives sold by MBIA Corp. that were outstanding as of June 30, 2014 and December 31, 2013. Credit ratings represent the lower of underlying ratings assigned to the collateral by Moody's Investors Service, Inc., Standard & Poor's Financial Services LLC or MBIA.

| \$ in millions               | As of June 30, 2014                                      |                |               |                |                |                              |                   |                                    |
|------------------------------|----------------------------------------------------------|----------------|---------------|----------------|----------------|------------------------------|-------------------|------------------------------------|
|                              | Weighted<br>Average<br>Remaining<br>Expected<br>Maturity | Notional Value |               |                |                |                              |                   | Fair Value<br>Asset<br>(Liability) |
|                              |                                                          | AAA            | AA            | A              | BBB            | Below<br>Investment<br>Grade | Total<br>Notional |                                    |
| Credit Derivatives Sold      |                                                          |                |               |                |                |                              |                   |                                    |
| Insured credit default swaps | 2.3 Years                                                | \$6,938        | \$ 560        | \$ 968         | \$4,704        | \$ 2,816                     | \$15,986          | \$ (332)                           |
| Insured swaps                | 18.0 Years                                               | -              | 75            | 2,098          | 674            | -                            | 2,847             | (3)                                |
| Total notional               |                                                          | <u>\$6,938</u> | <u>\$ 635</u> | <u>\$3,066</u> | <u>\$5,378</u> | <u>\$ 2,816</u>              | <u>\$18,833</u>   |                                    |
| Total fair value             |                                                          | \$ (2)         | \$ -          | \$ (2)         | \$ (31)        | \$ (300)                     |                   | \$ (335)                           |

| \$ in millions               | As of December 31, 2013                                  |                |         |         |         |                              |                   |                                    |
|------------------------------|----------------------------------------------------------|----------------|---------|---------|---------|------------------------------|-------------------|------------------------------------|
|                              | Weighted<br>Average<br>Remaining<br>Expected<br>Maturity | Notional Value |         |         |         |                              |                   | Fair Value<br>Asset<br>(Liability) |
|                              |                                                          | AAA            | AA      | A       | BBB     | Below<br>Investment<br>Grade | Total<br>Notional |                                    |
| Credit Derivatives Sold      |                                                          |                |         |         |         |                              |                   |                                    |
| Insured credit default swaps | 2.6 Years                                                | \$7,406        | \$1,972 | \$1,068 | \$7,552 | \$ 5,956                     | \$23,954          | \$ (1,132)                         |
| Insured swaps                | 20.1 Years                                               | -              | 77      | 2,214   | 1,296   | -                            | 3,587             | (4)                                |
| All others                   | 28.0 Years                                               | -              | -       | -       | -       | 36                           | 36                | (15)                               |
| Total notional               |                                                          | \$7,406        | \$2,049 | \$3,282 | \$8,848 | \$ 5,992                     | \$27,577          |                                    |
| Total fair value             |                                                          | \$ (2)         | \$ -    | \$ (3)  | \$ (77) | \$ (1,069)                   |                   | \$ (1,151)                         |

Internal credit ratings assigned by MBIA on the underlying collateral are derived by MBIA Corp.'s surveillance group. In assigning an internal rating, current status reports from issuers and trustees, as well as publicly available transaction-specific information, are reviewed. Also, where appropriate, cash flow analyses and collateral valuations are considered. The maximum potential amount of future payments (undiscounted) on CDS contracts are estimated as the notional value plus any additional debt service costs, such as interest or other amounts owing on CDS contracts. The maximum amount of future payments that MBIA Corp. may be required to make under these guarantees as of June 30, 2014 is \$16.4 billion. This amount is net of \$36 million of insured derivatives ceded under reinsurance agreements in which MBIA Corp. economically hedges a portion of the credit and market risk associated with its insured derivatives and offsetting agreements with a counterparty. The maximum potential amount of future payments (undiscounted) on insured swaps are estimated as the notional value of such contracts.

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

**Financial Statement Presentation**

Insured CDSs and insured swaps are not subject to master netting agreements. VIE derivative assets and liabilities are not presented net of any master netting agreements. The following table presents the total fair value of MBIA Corp.'s derivative assets and liabilities by instrument and balance sheet location as of June 30, 2014:

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 8: Derivative Instruments (continued)**

| In millions                            |                             | Derivative Assets      |             | Derivative Liabilities     |                 |
|----------------------------------------|-----------------------------|------------------------|-------------|----------------------------|-----------------|
| Derivative Instruments                 | Notional Amount Outstanding | Balance Sheet Location | Fair Value  | Balance Sheet Location     | Fair Value      |
| Not designated as hedging instruments: |                             |                        |             |                            |                 |
| Insured credit default swaps           | \$ 15,986                   | Other assets           | \$ -        | Derivative liabilities     | \$ (332)        |
| Insured swaps                          | 5,003                       | Other assets           | 3           | Derivative liabilities     | (3)             |
| Cross currency swaps -VIE              | 94                          | Other assets-VIE       | -           | Derivative liabilities-VIE | (11)            |
| All other                              | 83                          | Other assets           | -           | Derivative liabilities     | (33)            |
| All other-VIE                          | 263                         | Other assets-VIE       | -           | Derivative liabilities-VIE | -               |
| All other-embedded                     | 1                           | Other investments      | -           | Derivative liabilities     | -               |
| Total derivatives                      | <u>\$ 21,430</u>            |                        | <u>\$ 3</u> |                            | <u>\$ (379)</u> |

The following table presents the total fair value of MBIA Corp.'s derivative assets and liabilities by instrument and balance sheet location as of December 31, 2013:

| In millions                            |                             | Derivative Assets      |             | Derivative Liabilities     |                   |
|----------------------------------------|-----------------------------|------------------------|-------------|----------------------------|-------------------|
| Derivative Instruments                 | Notional Amount Outstanding | Balance Sheet Location | Fair Value  | Balance Sheet Location     | Fair Value        |
| Not designated as hedging instruments: |                             |                        |             |                            |                   |
| Insured credit default swaps           | \$ 23,954                   | Other assets           | \$ -        | Derivative liabilities     | \$ (1,132)        |
| Insured swaps                          | 6,480                       | Other assets           | 4           | Derivative liabilities     | (4)               |
| Cross currency swaps -VIE              | 99                          | Other assets-VIE       | -           | Derivative liabilities-VIE | (11)              |
| All other                              | 36                          | Other assets           | -           | Derivative liabilities     | (15)              |
| All other-VIE                          | 280                         | Other assets-VIE       | -           | Derivative liabilities-VIE | -                 |
| All other-Embedded                     | 1                           | Other investments      | -           | Other investments          | -                 |
| Total derivatives                      | <u>\$ 30,850</u>            |                        | <u>\$ 4</u> |                            | <u>\$ (1,162)</u> |

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 8: Derivative Instruments (continued)**

The following table presents the effect of derivative instruments on the consolidated statements of operations for the three months ended June 30, 2014:

| <u>In millions</u>                                           |                                                                                    | <u>Net Gain (Loss)<br/>Recognized in<br/>Income</u> |
|--------------------------------------------------------------|------------------------------------------------------------------------------------|-----------------------------------------------------|
| <u>Derivatives Not Designated as<br/>Hedging Instruments</u> | <u>Location of Gain (Loss) Recognized in Income on Derivative</u>                  |                                                     |
| Insured credit default swaps                                 | Unrealized gains (losses) on insured derivatives                                   | \$ (24)                                             |
| Insured credit default swaps                                 | Realized gains (losses) and other settlements on insured derivatives               | (24)                                                |
| Currency swaps-VIE                                           | Net gains (losses) on financial instruments at fair value and foreign exchange-VIE | (6)                                                 |
| All other                                                    | Net gains (losses) on financial instruments at fair value and foreign exchange     | (2)                                                 |
| <b>Total</b>                                                 |                                                                                    | <b>\$ (56)</b>                                      |

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

| <u>In millions</u>                                           |                                                                                    | <u>Net Gain (Loss)<br/>Recognized in<br/>Income</u> |
|--------------------------------------------------------------|------------------------------------------------------------------------------------|-----------------------------------------------------|
| <u>Derivatives Not Designated as<br/>Hedging Instruments</u> | <u>Location of Gain (Loss) Recognized in Income on Derivative</u>                  |                                                     |
| Insured credit default swaps                                 | Unrealized gains (losses) on insured derivatives                                   | \$ 1,318                                            |
| Insured credit default swaps                                 | Realized gains (losses) and other settlements on insured derivatives               | (1,532)                                             |
| Currency swaps-VIE                                           | Net gains (losses) on financial instruments at fair value and foreign exchange-VIE | 7                                                   |
| All other                                                    | Unrealized gains (losses) on insured derivatives                                   | 32                                                  |
| <b>Total</b>                                                 |                                                                                    | <b>\$ (175)</b>                                     |

The following table presents the effect of derivative instruments on the consolidated statements of operations for the six months ended June 30, 2014:

| <u>In millions</u>                                           |                                                                                | <u>Net Gain (Loss)<br/>Recognized in<br/>Income</u> |
|--------------------------------------------------------------|--------------------------------------------------------------------------------|-----------------------------------------------------|
| <u>Derivatives Not Designated as<br/>Hedging Instruments</u> | <u>Location of Gain (Loss) Recognized in Income on Derivative</u>              |                                                     |
| Insured credit default swaps                                 | Unrealized gains (losses) on insured derivatives                               | \$ 799                                              |
| Insured credit default swaps                                 | Realized gains (losses) and other settlements on insured derivatives           | (364)                                               |
| All other                                                    | Unrealized gains (losses) on insured derivatives                               | 15                                                  |
| All other                                                    | Net gains (losses) on financial instruments at fair value and foreign exchange | (3)                                                 |
| All other                                                    | Realized gains (losses) and other settlements on insured derivatives           | (30)                                                |
| <b>Total</b>                                                 |                                                                                | <b>\$ 417</b>                                       |

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

| In millions                   |                                                                                    | Net Gain (Loss) |
|-------------------------------|------------------------------------------------------------------------------------|-----------------|
| Derivatives Not Designated as | Location of Gain (Loss) Recognized in Income on Derivative                         | Recognized in   |
| Hedging Instruments           |                                                                                    | Income          |
| Insured credit default swaps  | Unrealized gains (losses) on insured derivatives                                   | \$ 1,216        |
| Insured credit default swaps  | Realized gains (losses) and other settlements on insured derivatives               | (1,521)         |
| Interest rate swaps-VIE       | Net gains (losses) on financial instruments at fair value and foreign exchange-VIE | 14              |
| Currency swaps-VIE            | Net gains (losses) on financial instruments at fair value and foreign exchange-VIE | 6               |
| All other                     | Unrealized gains (losses) on insured derivatives                                   | 61              |
| Total                         |                                                                                    | <u>\$ (224)</u> |

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 9: Income Taxes**

MBIA Corp.'s income taxes and the related effective tax rates for the three and six months ended June 30, 2014 and 2013 are as follows:

| In millions                          | Three Months Ended June 30, |                | Six Months Ended June 30, |                |
|--------------------------------------|-----------------------------|----------------|---------------------------|----------------|
|                                      | 2014                        | 2013           | 2014                      | 2013           |
| Income (loss) before income taxes    | \$ (22)                     | \$(257)        | \$ 366                    | \$(122)        |
| Provision (benefit) for income taxes | \$ (7) 31.8 %               | \$(124) 48.2 % | \$ 129 35.2 %             | \$ (95) 77.9 % |

For the six months ended June 30, 2014, MBIA Corp.'s effective tax rate applied to its pre-tax income approximated the U.S. statutory tax rate as MBIA Corp. is no longer deferring tax on undistributed earnings with respect to its major U.K. subsidiaries.

For the six months ended June 30, 2013, MBIA Corp.'s effective tax rate applied to its pre-tax loss was greater than the U.S. statutory tax rate primarily as a result of non-U.S. earnings taxed at a lower rate.

MBIA Corp.'s provision for income taxes for interim financial periods is not based on an estimated annual effective rate due to the variability in fair value of its credit derivatives, which prevents MBIA Corp. from projecting a reliable estimated annual effective tax rate and pretax income for the full year of 2014. A discrete calculation of the provision is calculated for each interim period.

**Deferred Tax Asset, Net of Valuation Allowance**

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

As of June 30, 2014, MBIA Corp. reported a net deferred tax asset of \$1.0 billion which is net of a \$3 million valuation allowance. As of June 30, 2014, MBIA Corp. had a valuation allowance against a portion of the deferred tax asset related to losses from asset impairments. The June 30, 2014 valuation allowance reflects no change from the December 31, 2013 valuation allowance of \$3 million.

The netting of deferred taxes between different taxpaying jurisdictions is not permitted. As of June 30, 2014, there was a gross deferred tax asset of \$1.0 billion and a gross deferred tax liability of \$36 million, which was included in "Other liabilities" on MBIA Corp.'s consolidated balance sheet.

**Tax Sharing Agreement**

MBIA Corp. files its U.S. Corporation Income Tax Return as a member of the MBIA Inc. consolidated group and participates in a tax sharing agreement between MBIA Inc. and its subsidiaries under which MBIA Corp. is allocated its share of consolidated tax liability or benefit on a separate, stand-alone basis under the agreement.

As of June 30, 2014, MBIA Corp. has not made tax payments under this tax sharing agreement for 2014 and 2013. If tax payments had been made, all funds would have been placed in escrow by MBIA Inc. and would remain in escrow until the expiration of a two-year carryback period which would allow MBIA Corp. to carryback a separate company tax loss and recover all or a portion of the escrowed funds.

As of June 30, 2014, MBIA Corp. has not received any payment with respect to tax losses contributed to the consolidated group. In accordance with the tax sharing agreement between MBIA Inc. and MBIA Corp., MBIA Corp. will receive benefits of its losses and credits as it is able to earn them out in the future. In addition, MBIA Inc. has advised MBIA Corp. that based on current facts and circumstances, its intention is not to allow any net operating loss ("NOL"), capital loss or tax credit carryforward generated by MBIA Corp. to expire without compensation, and to the extent such carryforward is used in consolidation. Such intention is independent of the tax sharing agreement which does not require such compensation.

**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 9: Income Taxes (continued)**

***Accounting for Uncertainty in Income Taxes***

MBIA Corp.'s policy is to record and disclose any change in unrecognized tax benefit and related interest and/or penalties to income tax in the consolidated statements of operations. As of June 30, 2014 and 2013, MBIA Corp. did not have any uncertain tax positions and corresponding interest or penalties.

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

In 2013, the Internal Revenue Service ("IRS") contacted MBIA to review the 2011 consolidated return of MBIA Inc. and its subsidiaries, for the purpose of determining whether to formally examine the tax return. On July 10, 2014, the IRS concluded its review of 2011 consolidated return with no changes to taxable income.

The U.K. tax authorities are currently auditing tax years 2005 through 2011. On June 5, 2013, MBIA Corp. met with the HM Revenue and Customs ("HMRC"). During the third and fourth quarters of 2013, MBIA Corp. sent HMRC additional information supporting its position. On January 24, 2014, MBIA UK provided an independent report to HMRC. On April 8, 2014, HMRC responded with comments. MBIA Corp. has responded to HMRC's April letter and anticipates another meeting with HMRC. As of the June 30, 2014, there has been no resolution.

As of December 31, 2013, MBIA Corp.'s NOL is approximately \$2.1 billion which will expire between tax years 2031-2032. As of December 31, 2013, MBIA Corp.'s capital loss carryforward is approximately \$113 million which will expire in tax year 2018. As a result of the commutation of CMBS exposure that occurred during the six months ended June 30, 2014, MBIA Corp.'s NOL is approximately \$2.6 billion as of June 30, 2014.

***Treatment of Undistributed Earnings of Certain Foreign Subsidiaries—"Accounting for Income Taxes—Special Areas"***

U.S. deferred income taxes are provided on the differences in the book and tax basis in MBIA Corp.'s investment in MBIA UK and certain other entities since MBIA Corp. no longer intends to have these earnings permanently reinvested. The impact is reflected in MBIA Corp.'s current period's provision.

**Note 10: Accumulated Other Comprehensive Income**

The following table presents the changes in the components of accumulated other comprehensive income ("AOCI") for the six months ended June 30, 2014.

| In millions                                                   | Unrealized<br>Gains (Losses)<br>on AFS<br>Securities, Net | Foreign<br>Currency Translation,<br>Net | Total |
|---------------------------------------------------------------|-----------------------------------------------------------|-----------------------------------------|-------|
| Balance, December 31, 2013                                    | \$ 8                                                      | \$ 11                                   | \$ 19 |
| Other comprehensive income (loss) before<br>reclassifications | 5                                                         | 6                                       | 11    |
| Amounts reclassified from AOCI                                | (3)                                                       | -                                       | (3)   |
| Total other comprehensive income (loss)                       | 2                                                         | 6                                       | 8     |
| Balance, June 30, 2014                                        | \$ 10                                                     | \$ 17                                   | \$ 27 |

The following table presents the details of the reclassifications from AOCI for the three and six months ended June 30, 2014 and 2013:

| In millions                                       | Amounts Reclassified from AOCI |      |                           |      | Affected Line Item on the Consolidated Statements of Operations                |
|---------------------------------------------------|--------------------------------|------|---------------------------|------|--------------------------------------------------------------------------------|
|                                                   | Three Months Ended June 30,    |      | Six Months Ended June 30, |      |                                                                                |
|                                                   | 2014                           | 2013 | 2014                      | 2013 |                                                                                |
| Details about AOCI Components                     |                                |      |                           |      |                                                                                |
| Reclassification adjustment on sale of securities | \$ 3                           | \$ 3 | \$ 3                      | \$ 3 | Net gains (losses) on financial instruments at fair value and foreign exchange |
|                                                   | 3                              | 3    | 3                         | 3    | Income (loss) before income taxes                                              |
|                                                   | -                              | 1    | -                         | 1    | Provision (benefit) for income taxes                                           |
| Total reclassifications for the period            | \$ 3                           | \$ 2 | \$ 3                      | \$ 2 | Net income (loss)                                                              |

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**MBIA Insurance Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Note 11: Commitments and Contingencies**

The following commitments and contingencies provide an update of those discussed in “Note 19: Commitments and Contingencies” in the Notes to Consolidated Financial Statements included in Exhibit 99.2 of MBIA Inc.’s Annual Report on Form 10-K for the year ended December 31, 2013, and should be read in conjunction with the complete descriptions provided in the aforementioned note included in Exhibit 99.2 of Form 10-K. In the normal course of operating its business, MBIA Corp. may be involved in various legal proceedings. Additionally, MBIA may be involved in various legal proceedings that directly or indirectly impact MBIA Corp.

*MBIA Insurance Corp. v. Credit Suisse Securities (USA) LLC, et al.*; Index No. 603751/2009 (N.Y. Sup. Ct., N.Y. County)

On March 21, 2014, the court issued an order scheduling fact discovery to close in August of 2014. On June 24, 2014, the court granted MBIA Corp.’s motion to prove liability and damages through sampling.

*MBIA Insurance Corp. v. J.P. Morgan Securities LLC (f/k/a Bear, Stearns & Co. Inc.)*; Index No. 64676/2012 (N.Y. Sup. Ct., County of Westchester)

On May 6, 2014, the court granted J.P. Morgan’s motion for summary judgment and also granted MBIA Corp. leave to file a motion to submit an amended complaint within twenty days of the court’s decision. The briefing on MBIA Corp.’s motion for leave to amend its complaint was completed on July 21, 2014.

*CQS ABS Master Fund Ltd., CQS Select ABS Master Fund Ltd., and CQS ABS Alpha Master Fund Ltd. v. MBIA Inc. et al.*; Civil Action No. 12-cv-6840 (R.S.) (S.D.N.Y.)

In May of 2014, the CQS plaintiffs and MBIA filed a Stipulation of Dismissal with prejudice resolving the litigation and the case has been closed on the court’s docket. MBIA paid to CQS an immaterial amount to resolve the litigation.

*Ambac Bond Insurance Coverage Cases*, Coordinated Proceeding Case No. JCCP 4555 (Super. Ct. of Cal., County of San Francisco)

On March 26, 2014, the court granted in part the Bond Insurer defendants’ motions for reimbursement of legal fees incurred in connection with the defendants’ motion to strike pursuant to California’s Anti-SLAPP statute, which dismissed the plaintiffs’ claims under California’s Cartwright Act. On July 7, 2014, the Bond Insurer defendants filed their opening appellate brief with respect to a portion of the plaintiffs’ Unfair Competition Law claim.

MBIA and MBIA Corp. are defending against the aforementioned actions in which they are defendants and expect ultimately to prevail on the merits. There is no assurance, however, that they will prevail in these actions. Adverse rulings in these actions could have a material adverse effect on MBIA Corp.’s ability to implement its strategy and on its business, results of operations, cash flows and financial condition. At this stage of the litigation, there has not been a determination as to the amount, if any, of damages. Accordingly, MBIA Corp. is not able to estimate any amount of loss or range of loss.

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

**Note 12: Subsequent Events**

Refer to “Note 11: Commitments and Contingencies” for information about legal proceedings that developed after June 30, 2014.