MBIA INC
Form 10-Q
November 08, 2016
Table of Contents

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from to

Commission File Number 1-9583

MBIA INC.

(Exact name of registrant as specified in its charter)

Connecticut **(State of incorporation)**	**06-1185706** **(I.R.S. Employer** **Identification No.)**
1 Manhattanville Road, Suite 301, Purchase, New York **(Address of principal executive offices)**	**10577** **(Zip Code)**

(914) 273-4545

(Registrant s telephone number, including area code)

Not applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.   Yes þ   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 þ   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 þ	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company ¨

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

As of November 2, 2016, 135,741,783 shares of Common Stock, par value $1 per share, were outstanding.

Table of Contents

Table of Contents

FORWARD-LOOKING AND CAUTIONARY STATEMENTS

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

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

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

The above factors provide a summary of and are qualified in their entirety by the risk factors discussed under Risk Factors in Part I, Item 1A of MBIA Inc. s Annual Report on Form 10-K for the year ended December 31, 2015. In addition, refer to Risk Factors in Part II, Item 1A and Note 1: Business Developments and Risks and Uncertainties in the Notes to Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for a discussion of certain risks and uncertainties related to our financial statements.

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

Table of Contents

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions except share and per share amounts)

	September 30, 2016	December 31, 2015
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $5,131 and $5,155)	$ 5,295	$ 5,145
Investments carried at fair value	73	177
Investments pledged as collateral, at fair value (amortized cost $231 and $322)	227	291
Short-term investments held as available-for-sale, at fair value (amortized cost $756 and $720)	756	721
Other investments (includes investments at fair value of $6 and $13)	9	16
Total investments	6,360	6,350
Cash and cash equivalents	191	464
Premiums receivable	707	792
Deferred acquisition costs	137	168
Insurance loss recoverable	528	577
Deferred income taxes, net	963	951
Other assets	143	156
Assets of consolidated variable interest entities:		
Cash	25	58
Investments held-to-maturity, at amortized cost (fair value $573 and $2,401)	890	2,689
Fixed-maturity securities at fair value	270	932
Loans receivable at fair value	1,142	1,292
Loan repurchase commitments	404	396
Other assets	27	11
Total assets	**$ 11,787**	**$ 14,836**
Liabilities and Equity		
Liabilities:		
Unearned premium revenue	$ 1,344	$ 1,591
Loss and loss adjustment expense reserves	513	516
Long-term debt	1,975	1,889
Medium-term notes (includes financial instruments carried at fair value of $106 and $161)	932	1,016
Investment agreements	418	462
Derivative liabilities	383	314
Other liabilities	229	211
Liabilities of consolidated variable interest entities:		
Variable interest entity notes (includes financial instruments carried at fair value of $1,433 and $2,362)	2,323	5,051
Derivative liabilities	-	45

Total liabilities		**8,117**		**11,095**
Commitments and contingencies (Refer to 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 283,529,999 and 281,833,618		284		282
Additional paid-in capital		3,153		3,138
Retained earnings		2,965		3,038
Accumulated other comprehensive income (loss), net of tax of $2 and $51		35		(61)
Treasury stock, at cost 147,806,592 and 130,303,241 shares		(2,779)		(2,668)
Total shareholders equity of MBIA Inc.		3,658		3,729
Preferred stock of subsidiary		12		12
Total equity		**3,670**		**3,741**
Total liabilities and equity	**$**	**11,787**	**$**	**14,836**

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

1

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In millions except share and per share amounts)

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Revenues:				
Premiums earned:				
Scheduled premiums earned	$ 42	$ 47	$ 131	$ 153
Refunding premiums earned	35	37	94	123
Premiums earned (net of ceded premiums of $2, $2, $5 and $7)	77	84	225	276
Net investment income	39	38	115	112
Fees and reimbursements	22	1	24	4
Change in fair value of insured derivatives:				
Realized gains (losses) and other settlements on insured derivatives	(4)	(18)	(20)	(30)
Unrealized gains (losses) on insured derivatives	20	21	-	121
Net change in fair value of insured derivatives	16	3	(20)	91
Net gains (losses) on financial instruments at fair value and foreign exchange	38	(55)	(17)	20
Net investment losses related to other-than-temporary impairments:				
Investment losses related to other-than-temporary impairments	-	(1)	(1)	(10)
Other-than-temporary impairments recognized in accumulated other comprehensive income (loss)	-	(2)	-	-
Net investment losses related to other-than-temporary impairments	-	(3)	(1)	(10)
Net gains (losses) on extinguishment of debt	-	-	5	(1)
Other net realized gains (losses)	(2)	(1)	(3)	18
Revenues of consolidated variable interest entities:				
Net investment income	5	12	25	37
Net gains (losses) on financial instruments at fair value and foreign exchange	8	13	-	9
Total revenues	203	92	353	556
Expenses:				
Losses and loss adjustment	50	39	149	79
Amortization of deferred acquisition costs	10	11	30	37
Operating	32	35	97	102
Interest	49	49	148	149
Expenses of consolidated variable interest entities:				
Operating	3	3	10	10
Interest	4	10	20	29
Total expenses	148	147	454	406
Income (loss) before income taxes	55	(55)	(101)	150
Provision (benefit) for income taxes	24	(20)	(28)	52

Net income (loss)	**$**	**31**	**$**	**(35)**	**$**	**(73)**	**$**	**98**
Net income (loss) per common share:								
Basic	$	0.23	$	(0.23)	$	(0.55)	$	0.56
Diluted	$	0.23	$	(0.23)	$	(0.55)	$	0.55
Weighted average number of common shares outstanding:								
Basic		131,633,411		155,239,723		133,368,752		169,610,370
Diluted		132,042,067		155,239,723		133,368,752		170,566,386

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

2

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

(In millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income (loss)	$ 31	$ (35)	$ (73)	$ 98
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses) arising during the period	(20)	51	204	(35)
Provision (benefit) for income taxes	(7)	19	72	(11)
Total	(13)	32	132	(24)
Reclassification adjustments for (gains) losses included in net income (loss)	(1)	6	7	10
Provision (benefit) for income taxes	(1)	1	2	3
Total	-	5	5	7
Available-for-sale securities with other-than-temporary impairments:				
Other-than-temporary impairments and unrealized gains (losses) arising during the period	-	(1)	7	(5)
Provision (benefit) for income taxes	-	(1)	2	(2)
Total	-	-	5	(3)
Reclassification adjustments for (gains) losses included in net income (loss)	-	3	-	3
Provision (benefit) for income taxes	-	1	-	1
Total	-	2	-	2
Foreign currency translation:				
Foreign currency translation gains (losses)	(15)	(18)	(70)	(19)
Provision (benefit) for income taxes	(5)	(5)	(24)	(6)
Total	(10)	(13)	(46)	(13)
Total other comprehensive income (loss)	(23)	26	96	(31)
Comprehensive income (loss)	**$ 8**	**$ (9)**	**$ 23**	**$ 67**

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

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

For The Nine Months Ended September 30, 2016

(In millions except share amounts)

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Treasury Stock		Total Shareholders Equity of	Preferred Stock of Subsidiary		Total
	Shares	Amount	Capital	Earnings	Income (Loss)	Shares	Amount	MBIA Inc.	Shares	Amount	Equity
Balance, December 31, 2015	**281,833,618**	**$ 282**	**$ 3,138**	**$ 3,038**	**$ (61)**	**(130,303,241)**	**$ (2,668)**	**$ 3,729**	**1,315**	**$ 12**	**$ 3,741**
Net income (loss)	-	-	-	(73)	-	-	-	(73)	-	-	(73)
Other comprehensive income (loss)	-	-	-	-	96	-	-	96	-	-	96
Share-based compensation	1,696,381	2	15	-	-	(943,414)	(6)	11	-	-	11
Treasury shares acquired under share repurchase program	-	-	-	-	-	(16,559,937)	(105)	(105)	-	-	(105)
Balance, September 30, 2016	**283,529,999**	**$ 284**	**$ 3,153**	**$ 2,965**	**$ 35**	**(147,806,592)**	**$ (2,779)**	**$ 3,658**	**1,315**	**$ 12**	**$ 3,670**

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

4

Table of Contents

MBIA INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In millions)

	Nine Months Ended September 30, 2016	2015
Cash flows from operating activities:		
Premiums, fees and reimbursements received	$ 87	$ 66
Investment income received	249	263
Insured derivative commutations and losses paid	(24)	(42)
Financial guarantee losses and loss adjustment expenses paid	(324)	(68)
Proceeds from recoveries and reinsurance	88	61
Operating and employee related expenses paid	(99)	(99)
Interest paid, net of interest converted to principal	(102)	(130)
Income taxes (paid) received	(4)	(9)
Net cash provided (used) by operating activities	(129)	42
Cash flows from investing activities:		
Purchases of available-for-sale investments	(2,112)	(1,497)
Sales of available-for-sale investments	1,785	630
Paydowns and maturities of available-for-sale investments	410	463
Purchases of investments at fair value	(88)	(324)
Sales, paydowns and maturities of investments at fair value	197	447
Sales, paydowns and maturities (purchases) of short-term investments, net	90	582
Sales, paydowns and maturities of held-to-maturity investments	1,799	50
Sales, paydowns and maturities of other investments	1	-
Paydowns and maturities of loans receivable	188	172
Consolidation of variable interest entities	1	7
(Payments) proceeds for derivative settlements	(36)	33
Collateral (to) from swap counterparty	10	(64)
Capital expenditures	(1)	(3)
Other investing	(8)	47
Net cash provided (used) by investing activities	2,236	543
Cash flows from financing activities:		
Proceeds from investment agreements	17	21
Principal paydowns of investment agreements	(63)	(88)
Principal paydowns of medium-term notes	(122)	(116)
Principal paydowns of variable interest entity notes	(2,136)	(392)
Principal paydowns of long-term debt	-	(11)
Purchases of treasury stock	(108)	(300)
Net cash provided (used) by financing activities	(2,412)	(886)
Effect of exchange rate changes on cash and cash equivalents	(1)	11
Net increase (decrease) in cash and cash equivalents	(306)	(290)
Cash and cash equivalents beginning of period	522	782
Cash and cash equivalents end of period	$ 216	$ 492

Reconciliation of net income (loss) to net cash provided (used) by operating activities:				
Net income (loss)	$	(73)	$	98
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:				
Change in:				
Premiums receivable		61		63
Deferred acquisition costs		31		35
Unearned premium revenue		(197)		(274)
Loss and loss adjustment expense reserves		(1)		(24)
Insurance loss recoverable		(98)		96
Accrued interest payable		82		78
Accrued expenses		4		-
Unrealized (gains) losses on insured derivatives		-		(121)
Net (gains) losses on financial instruments at fair value and foreign exchange		17		(29)
Other net realized (gains) losses		3		(18)
Deferred income tax provision (benefit)		(33)		50
Interest on variable interest entities, net		45		51
Other operating		30		37
Total adjustments to net income (loss)		(56)		(56)
Net cash provided (used) by operating activities	$	(129)	$	42

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

Table of Contents

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. MBIA manages three operating segments: 1) United States (U.S.) public finance insurance; 2) corporate; and 3) international and structured finance insurance. The Company s U.S. public finance insurance business is primarily operated through National Public Finance Guarantee Corporation (National) and its international and structured finance insurance business is primarily operated through MBIA Insurance Corporation and its subsidiaries (MBIA Corp.). 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 Mexico).

Business Developments

Sale of MBIA UK and Cutwater

In September of 2016, MBIA Insurance Corporation announced that its wholly-owned subsidiary, MBIA UK (Holdings) Limited, entered into an agreement to sell MBIA UK to Assured Guaranty Corp. (Assured), a subsidiary of Assured Guaranty Ltd. (the Sale Transaction). The Sale Transaction consists of the transfer to the Company of notes issued by Zohar II 2005-1, Limited (Zohar II) collateralized debt obligation (CDO), (the Zohar II Notes), with an aggregate outstanding principal amount of approximately $347 million (the Assured Zohar II Notes), in exchange for the shares of MBIA UK and a cash payment to Assured of $23 million. The Sale Transaction is subject to certain closing conditions, including the receipt of regulatory approvals from the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) of the United Kingdom, the New York State Department of Financial Services (NYSDFS) and the Maryland Insurance Administration.

The sale of MBIA UK is part of MBIA Corp. s strategy to address the maturity of the Zohar II Notes on January 20, 2017 (the Zohar Maturity Date), which are insured by MBIA Corp. and had $770 million of insured gross par outstanding as of September 30, 2016. MBIA Insurance Corporation expects that on the Zohar Maturity Date, it will be required to pay a claim under its policy for the amount due on the Zohar II Notes (the Zohar II Claim). MBIA Insurance Corporation does not expect to have sufficient liquidity to pay such claim on the Zohar II Notes unless it arranges third-party financing to enable it to pay the claim, which it is currently working to arrange. There is no assurance that the Sale Transaction will be completed, that third-party financing will be available, or that MBIA Corp. s strategies will be successful. Accordingly, closing of this sale is uncertain. Should the Company satisfactorily resolve these uncertainties, the Sale Transaction is scheduled to close in early January of 2017.

Effective on January 1, 2015, the Company exited its advisory services business through the sale of Cutwater Holdings, LLC and its subsidiaries (Cutwater) to a subsidiary of The Bank of New York Mellon Corporation. Refer to Note 10: Business Segments for further information about the Company s operating segments.

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 the rating agencies. As of September 30, 2016, National had the following ratings: AA+ with a stable outlook by Kroll Bond Rating Agency; AA- with a stable outlook by Standard & Poor s Financial Services LLC (S&P); and A3 with a negative outlook by Moody s Investors Service, Inc. (Moody s).

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 insured portfolio.

Risks and Uncertainties

The Company s financial statements include estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The outcome of certain significant risks and uncertainties could cause the Company to revise its estimates and assumptions or could cause actual results to differ from the Company s estimates. The discussion below highlights the significant risks and uncertainties that could have a material effect on the Company s financial statements and business objectives in future periods.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

U.S. Public Finance Market Conditions

National s insured portfolio continued to perform satisfactorily against a backdrop of strengthening domestic economic activity. While a stable or growing economy will generally benefit tax revenues and fees charged for essential municipal services which secure National s insured bond portfolio, some state and local governments and territory obligors National insures remain under financial and budgetary stress. This could lead to an increase in defaults by such entities on the payment of their obligations and losses or impairments on a greater number of the Company s insured transactions. The Company monitors and analyzes these situations and other stressed credits closely, and the overall extent and duration of this stress is uncertain.

In particular, the Commonwealth of Puerto Rico is experiencing significant fiscal stress and constrained liquidity due to, among other things, Puerto Rico s structural budget imbalance, limited access to the capital markets, a stagnating local economy, net migration of people out of Puerto Rico and a high debt burden. Although Puerto Rico has tried to address its challenges through various fiscal policies, it continues to experience significant fiscal stress. On July 1, 2016, Puerto Rico defaulted on scheduled debt service for certain National insured bonds and National paid gross claims in the aggregate of $173 million as a result. The Company continues to believe, based on its analysis of Puerto Rico s fiscal and structural circumstances, the details of its insured exposures, and its legal and contractual rights, that all of National s insured Puerto Rico related debt, and any claims National has made thereon, will ultimately be substantially repaid.

MBIA Corp. Insured Portfolio

MBIA Corp. s primary objectives are to satisfy any claims of its policyholders, and to maximize future recoveries, if any, for its surplus note holders and, thereafter, its preferred stock holders. MBIA Corp. is executing this strategy by reducing and mitigating potential losses on its insurance exposures and pursuing various actions focused on maximizing the collection of recoveries. The Company does not expect to write new business in its international and structured finance insurance segment for the foreseeable future.

MBIA Corp. s insured portfolio could deteriorate and result in additional significant loss reserves and claim payments. MBIA Corp. s ability to meet its obligations is limited by available liquidity and its ability to secure additional liquidity through financing and other transactions. There can be no assurance that MBIA Corp. will be successful in generating sufficient cash to meet its obligations.

Zohar

At this time, MBIA Insurance Corporation is particularly focused on the policy it issued on the Zohar II Notes. According to the sponsor and former collateral manager of Zohar II (the Zohar Sponsor), the assets of Zohar II include, among other things, loans made to, and equity interests in, companies that the Zohar Sponsor purports to control (the Zohar II Collateral). MBIA Insurance Corporation expects that on the Zohar Maturity Date, it will be required to pay a claim under its policy for the Zohar II Claim. MBIA Insurance Corporation does not expect to have sufficient liquidity to pay such claim on the Zohar II Notes unless it arranges third-party financing to enable it to pay the claim.

MBIA Insurance Corporation is currently seeking to arrange third-party financing to increase its liquid assets to ensure that it has sufficient liquidity to pay the Zohar II Claim. MBIA Insurance Corporation s ability to arrange such financing, however, is constrained, and there is no assurance that it will be able to secure financing on acceptable terms. MBIA Insurance Corporation believes that any third-party financing will require approval by the NYSDFS. MBIA Insurance Corporation anticipates that the approval by the NYSDFS of the sale of MBIA UK, described herein, and of any third-party financing, if granted, would be based on (among other things) the NYSDFS concluding that MBIA Insurance Corporation will successfully execute its strategies to meet its obligations on the Zohar II Notes in a manner acceptable to the NYSDFS.

MBIA Insurance Corporation believes that if the NYSDFS concludes at any time that MBIA Insurance Corporation will not be able to satisfy its obligations under the Zohar II Notes on terms satisfactory to the NYSDFS, while maintaining sufficient assets to readily pay other policyholder claims, the NYSDFS would likely put MBIA Insurance Corporation into a rehabilitation or liquidation proceeding under Article 74 of the New York Insurance Law (NYIL) and/or take such other actions as the NYSDFS may deem necessary to protect the interests of MBIA Insurance

Corporation s policyholders. The determination to commence such a proceeding or take other such actions is within the exclusive control of the NYSDFS. The NYSDFS enjoys broad discretion in this regard, and any determination they may make would not be limited to consideration of the matters described above. No assurance is given as to what action, if any, the NYSDFS may take. MBIA Insurance Corporation has also commenced preparing contingency plans with respect to a potential rehabilitation proceeding in the event that it is unable to restructure the Zohar II Notes or arrange financing to pay the amounts due on the Zohar II Notes on the Zohar Maturity Date, in each case on terms acceptable to MBIA Insurance Corporation.

In the event that MBIA Insurance Corporation makes any payment in respect of the Zohar II Notes, it will be entitled to reimbursement of such payment plus interest. MBIA Insurance Corporation believes that the primary source of such reimbursement will come from the liquidation of the Zohar II Collateral.

In addition, MBIA Insurance Corporation insured the class A-1 and A-2 notes (the Zohar I Insured Notes) issued by Zohar CDO 2003-1, Limited (Zohar I), a high yield corporate CDO, the assets of which also include, among other things, loans made to, and equity interests in, companies purportedly controlled by the Zohar Sponsor (all the assets of Zohar I, the Zohar I Assets). The Zohar I Insured Notes matured on November 20, 2015 and, after Zohar I failed to pay the amounts due on the Zohar I Insured Notes, MBIA Insurance Corporation paid a claim of $149 million on such Zohar I Insured Notes. As a result, MBIA Insurance Corporation is entitled to seek reimbursement of such claim plus interest and expenses (the MBIA Zohar I Claim) from Zohar I and/or to exercise certain rights and remedies to seek recovery of such claim. In connection with the exercise of its rights and remedies, MBIA Insurance Corporation has directed the trustee for Zohar I to commence an auction (the Auction) of all of the Zohar I Assets. All bids in the Auction are scheduled to be submitted by no later than November 29, 2016. MBIA Insurance Corporation has the right to submit a credit bid in the Auction for some or all of the Zohar I Assets up to the amount of the MBIA Zohar I Claim (the MBIA Credit Bid). In the event that any cash bids submitted in the Auction exceeds the MBIA Credit Bid, the Zohar I Assets will be sold for cash, and the cash will be applied pursuant to the Zohar I indenture priority of payments and the amounts remaining after payment of any senior expenses will be distributed to MBIA Insurance Corporation as reimbursement for the MBIA Zohar I Claim. In the event the MBIA Credit Bid is the highest bid submitted in the Auction, the Zohar I Assets will be transferred to MBIA Insurance Corporation in satisfaction of the MBIA Zohar I Claim.

While MBIA Insurance Corporation will seek to recover any payments it makes (plus interest and expenses) with respect to the Zohar I Notes and the Zohar II Notes, there can be no assurance that the value of the Zohar I Assets and/or Zohar II Assets will be sufficient to permit MBIA Insurance Corporation to recover all or substantially all of any such payments.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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

RMBS Recoveries

The amount and timing of projected collections from excess spread from residential mortgage-backed securities (RMBS) and the put-back recoverable from Credit Suisse Securities (USA) LLC, DLJ Mortgage Capital, Inc., and Select Portfolio Servicing Inc. (collectively, Credit Suisse) are uncertain. Refer to Note 5: Loss and Loss Adjustment Expense Reserves for information about MBIA Corp. s loss reserves and recoveries.

Corporate Liquidity

As of September 30, 2016 and December 31, 2015, the liquidity position of MBIA Inc. was $237 million and $416 million, respectively. The term liquidity position refers to cash and liquid assets available for general liquidity purposes. During the nine months ended September 30, 2016, $105 million was released to MBIA Inc. and National paid $73 million for estimated 2016 taxes under the MBIA group s tax sharing agreement and related escrow agreement (the Tax Escrow Account). The $105 million released to MBIA Inc. represented National s tax liability under the tax sharing agreement for the 2013 tax year. Subsequent to September 30, 2016, National declared and paid a dividend of $118 million to its ultimate parent, MBIA Inc. Based on the Company s projections of National s dividends, payments into the Tax Escrow Account, and other cash inflows, the Company expects that MBIA Inc. will have sufficient cash to satisfy its debt service and general corporate needs. However, MBIA Inc. continues to have liquidity risk which could be triggered by deterioration in the performance of invested assets, interruption of or reduction in dividends or tax payments received from operating subsidiaries, impaired access to the capital markets, as well as other factors which cannot be anticipated at this time. Furthermore, failure by MBIA Inc. to settle liabilities that are also insured by MBIA Corp. could result in claims on MBIA Corp.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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, 2015. The following significant accounting policies provide an update to those included in the Company s Annual Report on Form 10-K.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America (GAAP) for annual periods. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2015. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the Company s consolidated financial position and results of operations. All material intercompany balances and transactions have been eliminated.

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

The results of operations for the three and nine months ended September 30, 2016 may not be indicative of the results that may be expected for the year ending December 31, 2016. The December 31, 2015 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 did not materially impact total revenues, expenses, assets, liabilities, shareholders equity, operating cash flows, investing cash flows, or financing cash flows for all periods presented.

Note 3: Recent Accounting Pronouncements

Recently Adopted Accounting Standards

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 Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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 was effective for interim and annual periods beginning January 1, 2016. The adoption of ASU 2014-12 did not affect the Company s consolidated financial statements.

Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity (ASU 2014-13)

In August of 2014, the FASB issued ASU 2014-13, Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity. ASU 2014-13 applies to a consolidated collateralized financing entity defined as a consolidated variable interest entity (VIE) that holds financial assets and issues beneficial interests in those financial assets that are classified as financial liabilities. The Company may elect to measure the financial assets and the financial liabilities of a consolidated collateralized financing entity using a measurement alternative provided in ASU 2014-13. The measurement alternative requires both the financial assets and the financial liabilities of the consolidated collateralized financing entity to be measured using the more observable of the fair value of the financial assets and the fair value of the financial liabilities with the changes in fair value recognized to earnings. Upon adoption, a reporting entity may apply the measurement alternative to existing consolidated collateralized financing entities. ASU 2014-13 was effective for interim and annual periods beginning January 1, 2016. The adoption of ASU 2014-13 did not affect the Company s consolidated financial statements.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 3: Recent Accounting Pronouncements (continued)

Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03)

In April of 2015, the FASB issued ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 requires debt issuance costs related to a debt liability measured at amortized cost to be reported in the balance sheet as a direct deduction from the face amount of the debt liability. ASU 2015-03 was effective for interim and annual periods beginning January 1, 2016. The adoption of ASU 2015-03 was applied retrospectively and all previously reported amounts have been conformed to the current presentation. The adoption of ASU 2015-03 did not materially impact 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

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

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 does not apply to financial guarantee insurance contracts within the scope of Topic 944, Financial Services Insurance. In August of 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606) Deferral of the Effective Date. ASU 2015-14 defers the effective date of ASU 2014-09 to interim and annual periods beginning January 1, 2018, and is applied on a retrospective or modified retrospective basis. The adoption of ASU 2014-09 is not expected to materially impact the Company s consolidated financial statements.

Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern (ASU 2014-15)

In August of 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern. ASU 2014-15 requires management to evaluate whether there are conditions or events that raise substantial doubt about the entity s ability to continue as a going concern, and to provide certain disclosures when it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. ASU 2014-15 is effective for the annual period ending December 31, 2016 and for annual periods and interim periods thereafter with early adoption permitted. The adoption of ASU 2014-15 is not expected to materially impact the Company s consolidated financial statements.

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

In January of 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 requires certain equity investments other than those accounted for under the equity method of accounting or result in consolidation of the investee to be measured at fair value with changes in fair value recognized in net income, and permits an entity to measure equity investments that do not have readily determinable fair values at cost less any impairment plus or minus adjustments for certain changes in observable prices. An entity is also required to evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale (AFS) debt securities in combination with the entity s other deferred tax assets. ASU 2016-01 requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability that results from a change in the instrument-specific credit risk for financial liabilities that the entity has elected to measure at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 is effective for interim and annual periods beginning January 1, 2018, and is applied on a modified retrospective basis. Early adoption is not permitted with the exception of early application of the guidance that requires separate presentation in other comprehensive income of the change in the instrument-specific credit risk for financial liabilities measured at fair value in accordance with the fair value option is permitted as of the beginning of the fiscal year of adoption of the standard. The Company is evaluating the impact of adopting ASU 2016-01.

10

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 3: Recent Accounting Pronouncements (continued)

Leases (Topic 842) (ASU 2016-02)

In February of 2016, the FASB issued ASU 2016-02, Leases (Topic 842) that amends the accounting guidance for leasing transactions. ASU 2016-02 requires a lessee to classify lease contracts as finance or operating leases, and to recognize assets and liabilities for the rights and obligations created by leasing transactions with lease terms more than twelve months. ASU 2016-02 substantially retains the criteria for classifying leasing transactions as finance or operating leases. For finance leases, a lessee recognizes a right-of-use asset and a lease liability initially measured at the present value of the lease payments, and recognizes interest expense on the lease liability separately from the amortization of the right-of-use asset. For operating leases, a lessee recognizes a right-of-use asset and a lease liability initially measured at the present value of the lease payments, and recognizes lease expense on a straight-line basis. ASU 2016-02 is effective for interim and annual periods beginning January 1, 2019 with early adoption permitted, and is applied on a modified retrospective basis. The adoption of ASU 2016-02 is not expected to materially impact the Company s consolidated financial statements.

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

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

Note 4: Variable Interest Entities

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

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

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.

Nonconsolidated VIEs

Insurance

The following tables present the total assets of nonconsolidated VIEs in which the Company holds a variable interest as of September 30, 2016 and December 31, 2015, through its insurance operations. The following tables also present the Company s maximum exposure to loss for nonconsolidated VIEs and carrying values of the assets and liabilities for its interests in these VIEs as of September 30, 2016 and December 31, 2015. 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.

			September 30, 2016					
			Carrying Value of Assets			Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Investments(1)	Premiums Receivable(2)	Insurance Loss Recoverable(3)	Unearned Premium Revenue(4)	Loss and Loss Adjustment Expense Reserves(5)	Derivative Liabilities(6)
Insurance:								
Global structured finance:								
Collateralized debt obligations	$ 3,487	$ 2,095	$ 49	$ 3	$ -	$ 1	$ 58	$ 1
Mortgage-backed residential	9,857	5,085	22	28	347	27	339	-
Mortgage-backed commercial	270	158	-	-	-	-	-	-
Consumer asset-backed	5,021	1,397	-	7	1	6	7	-
Corporate asset-backed	3,560	2,517	4	21	-	23	-	-
Total global structured finance	22,195	11,252	75	59	348	57	404	1
Global public finance	44,313	12,802	-	143	-	161	-	-
Total insurance	$ 66,508	$ 24,054	$ 75	$ 202	$ 348	$ 218	$ 404	$ 1

(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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 4: Variable Interest Entities (continued)

			December 31, 2015					
			Carrying Value of Assets			Carrying Value of Liabilities		
In millions	VIE Assets	Maximum Exposure to Loss	Investments(1)	Premiums Receivable(2)	Insurance Loss Recoverable(3)	Unearned Premium Revenue(4)	Loss and Loss Adjustment Expense Reserves(5)	Derivative Liabilities(6)
Insurance:								
Global structured finance:								
Collateralized debt obligations	$ 5,712	$ 3,046	$ 51	$ 9	$ -	$ 6	$ 108	$ 6
Mortgage-backed residential	11,524	6,072	23	31	416	30	306	-
Mortgage-backed commercial	319	219	-	1	-	1	-	-
Consumer asset-backed	5,538	1,712	-	13	-	11	4	-
Corporate asset-backed	5,218	3,446	-	26	2	30	-	-
Total global structured finance	28,311	14,495	74	80	418	78	418	6
Global public finance	44,162	14,579	-	160	-	186	-	-
Total insurance	$ 72,473	$ 29,074	$ 74	$ 240	$ 418	$ 264	$ 418	$ 6

(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.

Consolidated VIEs

The carrying amounts of assets and liabilities of consolidated VIEs were $2.8 billion and $2.3 billion, respectively, as of September 30, 2016, and $5.4 billion and $5.1 billion, respectively, as of December 31, 2015. The carrying amounts of assets and liabilities are presented separately in Assets of consolidated variable interest entities and Liabilities of consolidated variable interest entities on the Company s consolidated balance sheets. VIEs are consolidated or deconsolidated based on an ongoing reassessment of controlling financial interest, when events occur or circumstances arise, and whether the ability to exercise rights that constitute power to direct activities of any VIEs are present according to the design and characteristics of these entities. One additional VIE was consolidated during the nine months ended September 30, 2016 and one additional VIE was consolidated during the nine months ended September 30, 2015.

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

Note 5: Loss and Loss Adjustment Expense Reserves

Loss and Loss Adjustment Expense Process

U.S. Public Finance Insurance

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

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

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 in greater amounts on the Company s insured transactions. The Company monitors and analyzes these situations closely, however, the overall extent and duration of such events are uncertain. Also, the filing for protection under the United States Bankruptcy Code or entering state statutory proceedings does not necessarily result in a default or indicate that an ultimate loss will occur.

International and Structured Finance Insurance

The international and structured finance insurance segment s case basis reserves and insurance loss recoveries recorded in accordance with GAAP do not include estimates for policies insuring credit derivatives or on financial guarantee VIEs that are eliminated in consolidation. Policies insuring credit derivative contracts are accounted for as derivatives and are carried at fair value in the Company s consolidated financial statements under GAAP. The fair values of insured credit 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 credit 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. As 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, under Statutory accounting, in the same way that it estimates loss and LAE for its financial guarantee policies. Refer to Note 8: Derivative Instruments for a further discussion of the Company s use of derivatives and their impact on the Company s consolidated financial statements.

RMBS Case Basis Reserves (Financial Guarantees)

The Company s RMBS reserves and recoveries relate to financial guarantee insurance policies. The Company s first-lien RMBS case basis reserves primarily relate to RMBS backed by alternative A-paper and subprime mortgage loans. The Company s second-lien RMBS case basis reserves relate to RMBS backed by home equity lines of credit and closed-end second mortgages. The Company calculated RMBS case basis reserves as of September 30, 2016 for both first and second-lien RMBS transactions using a process called the Roll Rate Methodology. The Roll Rate Methodology is a multi-step process using databases of loan level information, proprietary internal cash flow models, and commercially available models to estimate potential losses and recoveries on insured bonds. Refer to Note 6: Loss and Loss Adjustment Expense Reserves in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2015, for additional information on the Company s first and second-lien mortgage loan Roll Rate Methodology.

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 current levels for six additional months compared to the probability-weighted outcome currently used by the Company, the addition to its second-lien case basis reserves would be approximately $26 million.

RMBS Recoveries

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

Excess Spread

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Second-lien Put-Back Claims Related to Ineligible Mortgage Loans

To date, MBIA has settled the majority of the Company s put-back claims. Only its claims against Credit Suisse remain outstanding. To date, settlement amounts have been consistent with the put-back recoveries that had been included in the Company s financial statements at the time preceding the settlement.

The contract claim remaining with Credit Suisse is related to the inclusion of ineligible mortgage loans in the 2007-2 Home Equity Mortgage Trust 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.

Based on the Company s assessment of the strength of its contractual put-back rights against Credit Suisse, which it is pursuing through litigation claims, as well as on its prior settlements with other sellers/servicers and success of other monolines put-back settlements, the Company believes it will prevail in enforcing its contractual rights and that it is entitled to collect the full amount of its incurred losses, which totaled $432 million through September 30, 2016. The Company is also entitled to collect interest on amounts paid; it believes that in context of its put-back litigation, the appropriate interest rate should be the New York State statutory rate. However, the Company currently calculates its put-back recoveries using the contractual interest rate, which is lower than the New York State statutory rate.

Notwithstanding the foregoing, uncertainty remains with respect to the ultimate outcome of the litigation with Credit Suisse, which is contemplated in the probability-weighted cash flow 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. Most of the probability weight is assigned to partial recovery scenarios and are discounted using the current risk-free discount rates associated against the underlying transaction s cash flows.

The Company continues to consider all relevant facts and circumstances in developing its assumptions on expected cash inflows, probability of potential recoveries (including the outcome of litigation) and recovery period. The estimated amount and likelihood of potential recoveries are expected to be revised and supplemented to the extent there are developments in the pending litigation and/or changes to the financial condition of Credit Suisse. While the Company believes it will be successful in realizing its recoveries from its contract claims against Credit Suisse, the ultimate amount recovered may be materially different from that recorded by the Company given the inherent uncertainty of the manner of resolving the claims (i.e., litigation and/or negotiated out-of-court settlement) and the assumptions used in the required estimation process for accounting purposes which are based, in part, on judgments and other information that are not easily corroborated by historical data or other relevant benchmarks.

CDO Reserves

The Company also has loss and LAE reserves on certain transactions within its CDO portfolio, including its multi-sector CDO and high yield corporate CDO asset classes that were insured in the form of financial guarantee policies. MBIA s insured multi-sector CDOs are transactions that include a variety of collateral ranging from corporate bonds to structured finance assets (which includes, but are not limited to, RMBS-related collateral, multi-sector and corporate CDOs). MBIA s high yield corporate CDO portfolio comprises middle-market/special-opportunity corporate loan transactions.

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, 2015, for additional information on the Company s loss reserving process including risk-management activities.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Summary of Loss and LAE Reserves and Recoveries

The Company s loss and LAE reserves and recoveries, along with amounts that were eliminated as a result of consolidating VIEs, as of September 30, 2016 and December 31, 2015, are presented in the following table:

In millions	As of September 30, 2016	As of December 31, 2015
U.S. Public Finance Insurance Segment:		
Loss and LAE reserves	$ 72	$ 45
Insurance loss recoverable	174	4
International and Structured Finance Insurance Segment:		
Second-lien RMBS:		
Loss and LAE reserves after VIE elimination	33	51
Loss and LAE reserves VIE elimination	15	16
Excess Spread after VIE elimination(1)	318	406
Excess Spread VIE elimination(2)	63	93
Put-Back Claims(3)	404	396
First-lien RMBS:		
Loss and LAE reserves after VIE elimination	322	277
Loss and LAE reserves VIE elimination	17	5
Excess Spread after VIE elimination(4)	77	80
Excess Spread VIE elimination(5)	21	8
CDOs:		
Loss and LAE reserves after VIE elimination	77	133
Loss and LAE reserves VIE elimination	191	190
Insurance Loss Recoverable after VIE elimination	-	148
Insurance Loss Recoverable VIE elimination	147	-
Other:		
Loss and LAE reserves after VIE elimination	9	10
Loss and LAE reserves VIE elimination	28	-
Insurance Loss Recoverable	5	9

(1) - As of September 30, 2016 and December 31, 2015, $309 million and $382 million were included in Insurance loss recoverable and $9 million and $24 million were included in Loss and loss adjustment expense reserves on the Company s consolidated balance sheets, respectively.

(2) - As of September 30, 2016 and December 31, 2015, $62 million and $87 million were eliminated from Insurance loss recoverable and $1 million and $6 million were eliminated from Loss and loss adjustment expense reserves on the Company s consolidated balance sheets, respectively.

(3) - Reflected in Loan repurchase commitments presented under the heading Assets of consolidated variable interest entities on the Company s consolidated balance sheets.

(4) - As of September 30, 2016 and December 31, 2015, $40 million and $34 million were included in Insurance loss recoverable and $37 million and $46 million were included in Loss and loss adjustment expense reserves on the Company s consolidated balance sheets, respectively.

(5) - As of September 30, 2016 and December 31, 2015, $16 million and $8 million were eliminated from Insurance loss recoverable . As of September 30, 2016, $5 million was eliminated from Loss and loss adjustment expense reserves on the Company s consolidated balance sheets.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Changes in Loss and LAE Reserves

The following table presents changes in the Company s loss and LAE reserves for the nine months ended September 30, 2016. Changes in loss and LAE reserves attributable to the accretion of the claim liability discount, changes in discount rates, changes in amount and timing of estimated claim payments and recoveries, changes in assumptions and changes in LAE reserves are recorded in Losses and loss adjustment expenses in the Company s consolidated statements of operations. As of September 30, 2016, the weighted average risk-free rate used to discount the Company s loss reserves (claim liability) was 1.31%. LAE reserves are generally expected to be settled within a one-year period and are not discounted. As of September 30, 2016 and December 31, 2015, the Company s gross loss and LAE reserves included $54 million and $46 million, respectively, related to LAE.

In millions Gross Loss and LAE Reserves as of December 31, 2015	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(1)	Gross Loss and LAE Reserves as of September 30, 2016
$ 516	$ (113)	$ 6	$ 31	$ 13	$ (8)	$ 8	$ 60	$ 513

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

Changes in Insurance Loss Recoverable and Recoveries on Unpaid Losses

Current period changes in the Company s estimate of potential recoveries may be recorded as an insurance loss recoverable asset, netted against the gross loss and LAE reserve liability, or both. The following table presents changes in the Company s insurance loss recoverable and changes in recoveries on unpaid losses reported within the Company s claim liability for the nine months ended September 30, 2016. 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. As of September 30, 2016 and December 31, 2015, the Company s insurance loss recoverable included $1 million and $6 million, respectively, related to LAE.

In millions	Gross Reserve as of December 31, 2015	Collections for Cases with Recoveries	Accretion of Recoveries	Changes in Discount Rates	Changes in Assumptions	Changes in LAE Recoveries	Other(1)	Gross Reserve as of September 30, 2016

Insurance loss recoverable	$	577	$	(60)	$	4	$	9	$	58	$	(5)	$	(55)	$	528
Recoveries on unpaid losses		100		-		1		8		(31)		5		-		83
Total	$	677	$	(60)	$	5	$	17	$	27	$	-	$	(55)	$	611

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

The decrease in the Company s insurance loss recoverable and recoveries on unpaid losses during 2016 was primarily due to a decrease in expected future recoveries on CDOs as the result of the consolidation and elimination of a VIE, partially offset by an increase in changes in assumptions on certain Puerto Rico exposures.

Table of Contents

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 (Excluding Insured Credit Derivative and Consolidated VIEs)

The Company s financial guarantee insurance losses and LAE, net of reinsurance for the three and nine months ended September 30, 2016 and 2015 are presented in the following table:

In millions	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
U.S. Public Finance Insurance Segment	$ 28	$ (7)	$ 46	$ (5)
International and Structured Finance Insurance Segment:				
Second-lien RMBS	44	24	78	52
First-lien RMBS	-	18	61	2
CDOs	(23)	5	(46)	39
Other[(1)]	1	(1)	10	(9)
Losses and LAE expense (benefit)	$ 50	$ 39	$ 149	$ 79

(1) - Includes non-U.S. public finance and other issues.

For the three months ended September 30, 2016, losses and LAE primarily related to increases in actual and expected payments on certain Puerto Rico exposures and second-lien RMBS transactions. These were partially offset by increases in recoveries of expected payments on certain Puerto Rico exposures and decreases in expected payments on CDOs.

For the nine months ended September 30, 2016, losses and LAE primarily related to increases in actual and expected payments on certain Puerto Rico exposures and insured first and second-lien RMBS transactions and decreases in projected collections from excess spread within insured second-lien RMBS securitizations. These were partially offset by increases in recoveries of expected payments on certain Puerto Rico exposures and decreases in expected payments on CDOs.

For the three months ended September 30, 2015, losses and LAE primarily related to decreases in projected collections from excess spread within insured second-lien RMBS securitizations and increases in expected payments on first-lien RMBS transactions.

For the nine months ended September 30, 2015, losses and LAE primarily related to decreases in projected collections from excess spread within insured second-lien RMBS securitizations and increases in expected payments on CDOs.

Costs associated with remediating insured obligations assigned to the Company s surveillance categories are recorded as LAE and included in Losses and loss adjustment expenses on the Company s consolidated statements of operations. For the three months ended September 30, 2016 and 2015, gross LAE related to remediating insured obligations were $6 million and $5 million, respectively. For the nine months ended September 30, 2016 and 2015, gross LAE related to remediating insured obligations were $34 million and $10 million, respectively.

18

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

Surveillance Categories

The following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of September 30, 2016:

	Surveillance Categories				
$ in millions	**Caution List Low**	**Caution List Medium**	**Caution List High**	**Classified List**	**Total**
Number of policies	82	7	5	327	421
Number of issues[1]	14	5	3	124	146
Remaining weighted average contract period (in years)	7.3	5.0	7.3	7.1	7.2
Gross insured contractual payments outstanding:[2]					
Principal	$ 3,013	$ 64	$ 338	$ 7,205	$ 10,620
Interest	2,843	17	117	2,840	5,817
Total	$ 5,856	$ 81	$ 455	$ 10,045	$ 16,437
Gross Claim Liability	$ -	$ -	$ -	$ 670	$ 670
Less:					
Gross Potential Recoveries	-	-	-	686	686
Discount, net[3]	-	-	-	14	14
Net claim liability (recoverable)	$ -	$ -	$ -	$ (30)	$ (30)
Unearned premium revenue	$ 9	$ 1	$ 8	$ 70	$ 88

(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 following table provides information about the financial guarantees and related claim liability included in each of MBIA s surveillance categories as of December 31, 2015:

	Surveillance Categories				
$ in millions	**Caution List**	**Caution List**	**Caution List**	**Classified List**	**Total**

	Low	Medium	High		
Number of policies	57	18	171	165	411
Number of issues[1]	12	6	5	117	140
Remaining weighted average contract period (in years)	7.6	6.7	9.6	6.7	7.4
Gross insured contractual payments outstanding:[2]					
Principal	$ 2,591	$ 147	$ 1,996	$ 6,426	$ 11,160
Interest	2,733	57	1,038	2,419	6,247
Total	$ 5,324	$ 204	$ 3,034	$ 8,845	$ 17,407
Gross Claim Liability	$ -	$ -	$ -	$ 797	$ 797
Less:					
Gross Potential Recoveries	-	-	-	752	752
Discount, net[3]	-	-	-	116	116
Net claim liability (recoverable)	$ -	$ -	$ -	$ (71)	$ (71)
Unearned premium revenue	$ 8	$ 2	$ 33	$ 55	$ 98

(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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

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

The increase in the Company s number of policies on the classified list reflected in the preceding tables was primarily related to certain Puerto Rico policies. The gross claim liabilities in the preceding tables represent the Company s estimate of undiscounted probability-weighted estimated future claim payments. As of September 30, 2016 and December 31, 2015, the gross claim liability primarily related to insured first-lien RMBS transactions.

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 September 30, 2016, the gross potential recoveries principally related to insured second-lien RMBS and U.S. public finance transactions. As of December 31, 2015, the gross potential recoveries principally related to insured second-lien RMBS. 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 estimated future claim payments. As claim payments are made, the recorded amount of potential recoveries may exceed the remaining amount of the claim liability for a given policy. The gross claim liability and gross potential recoveries reflect the elimination of claim liabilities and potential recoveries related to VIEs consolidated by the Company. As of September 30, 2016 and December 31, 2015, reinsurance recoverable on paid and unpaid losses was $7 million and $6 million, respectively, and were included in Other assets on the Company s consolidated balance sheets.

Note 6: Fair Value of Financial Instruments

Fair Value Measurement

Fair value is a market-based measurement 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 measurement 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.

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 available information. The fair value hierarchy is categorized 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.

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

The availability of observable inputs can vary from financial instrument to financial instrument 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, along with its third-party portfolio manager, reviews the assumptions, inputs and methodologies used by pricing services and brokers to obtain reasonable assurance that the prices used in its valuations reflect fair value. When the Company and its third-party portfolio manager believe a third-party quotation differs significantly from its internally developed expectation of fair value, whether higher or lower, the Company reviews its data or assumptions with the provider. This review includes comparing significant assumptions such as prepayment speeds, default ratios, forward yield curves, credit spreads and other significant quantitative inputs to internal assumptions, and working with the price provider to reconcile the differences. The price provider may subsequently provide an updated price. In the event that the price provider does not update its price, and the Company still does not agree with the price provided, its third-party portfolio manager will obtain a price from another third-party provider or use an internally developed price which it believes represents the fair value of the investment. The fair values of investments for which internal prices were used were not significant to the aggregate fair value of the Company s investment portfolio as of September 30, 2016 or December 31, 2015. All challenges to third-party prices are reviewed by staff of the Company as well as its third-party portfolio manager with relevant expertise to ensure reasonableness of assumptions. A pricing analysis is reviewed and approved by the Company s Valuation Committee.

Financial Liabilities (excluding derivative liabilities)

Financial liabilities, excluding derivative liabilities, issued by the Company primarily consist of debt issued for general corporate purposes within its corporate segment, medium-term notes (MTNs), investment agreements, debt issued by consolidated 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.

Derivative Liabilities

The Company s derivative liabilities are primarily interest rate swaps and insured credit derivatives. 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.

Internal Review Process

All significant financial assets and liabilities are reviewed by a committee 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. This valuation committee reviews, among other things, key assumptions used for internally developed prices, significant changes in sources and uses of inputs, including changes in model approaches, and any adjustments from third-party inputs or prices to internally developed inputs or prices. The committee also reviews any significant impairment or improvements in fair values of the financial instruments from prior periods. The committee is comprised of senior finance team members with relevant experience in the financial instruments their committee is responsible for. For each quarter, the committee documents their agreement with the fair values developed by management of the Company as reported in the quarterly and annual financial statements.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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, state and municipal bonds, foreign governments, corporate obligations, mortgage-backed securities (MBS), asset-backed securities (ABS), money market securities, and perpetual debt and equity securities.

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.

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, money market securities and perpetual debt and equity securities. Quoted market prices of investments in less active markets, as well as investments which are valued based on other than quoted prices for which the inputs are observable, such as interest rate yield curves, are categorized in Level 2 of the fair value hierarchy. Investments that contain significant inputs that are not observable are categorized as Level 3.

Cash and Cash Equivalents, Receivable for Investments Sold, Securities Sold, Not Yet Purchased, Payable for Investments Purchased, and Accrued Investment Income

The carrying amounts of cash and cash equivalents, receivable for investments sold, securities sold, not yet purchased, 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, corporate and commercial loans. Fair values of residential mortgage loans are determined using quoted prices for MBS issued by the respective VIE and adjusted for the fair values of the financial guarantees provided by MBIA Corp. on the related MBS. Fair values of corporate and commercial loans are either obtained from a pricing service and determined using actively quoted prices obtained from multiple market participants, or based on discounted cash flow methodologies. Loans receivable at fair value are categorized in Level 3 of the fair value hierarchy based on the input that is significant to the fair value measurement in its entirety.

Loan Repurchase Commitments

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

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 these or similar securities. The fair value of the accrued interest expense on the surplus notes due in 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 Insurance Corporation obtains approval to make such payment.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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.

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.

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 contractual cash flows are not observable, these investment agreements are categorized as Level 3 of the fair value hierarchy.

Variable Interest Entity Notes

The fair values of VIE notes are determined based on recently executed transaction prices or quoted prices where observable. When position-specific quoted prices are not observable, fair values are based on quoted prices of similar securities. Fair values based on quoted prices of similar securities may be adjusted for factors unique to the securities, including any credit enhancement. 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.

Derivatives

The corporate segment 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 agreements covering derivative transactions in the corporate segment. These agreements allow the Company to contractually net amounts due from a counterparty with those amounts due to such counterparty when certain triggering events occur. The Company only executes swaps under master netting agreements, which typically contain mutual credit downgrade provisions that generally provide the ability to require assignment or termination in the event either 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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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 agreements, 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.

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 validate the fair value estimates determined by the valuation models and to determine the best available estimate of fair value from the perspective of a market participant.

Approximately 97% of the balance sheet fair value of insured credit derivatives as of September 30, 2016 was valued based on the Binomial Expansion Technique (BET) Model. Approximately 3% of the balance sheet fair value of insured credit derivatives as of September 30, 2016 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.

Valuation Model Overview

The Company uses the BET Model to estimate 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, credit spreads, recovery rates and nonperformance risk.

As of September 30, 2016 and December 31, 2015, the Company s net insured CDS derivative liability was $85 million 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 $55 million and $99 million lower than the net liability that would have been estimated if MBIA Corp. excluded nonperformance risk in its valuation as of September 30, 2016 and December 31, 2015, respectively.

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.

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 as 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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

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.

Significant Unobservable Inputs

The following tables provide quantitative information regarding the significant unobservable inputs used by the Company for assets and liabilities measured at fair value on a recurring basis as of September 30, 2016 and December 31, 2015. 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 September 30, 2016	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	$ 995	Market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee	0% - 24% (2%)
		Discounted cash flow	Multiples(1)	
Loan repurchase commitments	404	Discounted cash flow	Recovery rates(2)	
			Breach rates(2)	
Liabilities of consolidated VIEs:				
Variable interest entity notes	498	Market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 56% (23%)
Credit derivative liabilities, net:				
CMBS	82	BET Model	Recovery rates	25% - 90% (44%)
			Nonperformance risk	22% - 39% (39%)
			Weighted average life (in years)	0.8 - 3.4 (1.9)
			CMBS spreads	0% - 49% (34%)
Multi-sector CDO	2	Direct Price Model	Nonperformance risk	58% - 58% (58%)
Other	1	BET Model and Dual Default	Nonperformance risk	51% - 51% (51%)
			Weighted average life (in years)	5.7 - 5.7 (5.7)
Other derivative liabilities	19	Discounted cash flow	Cash flows	$0 - $83 ($42)(3)

(1) - Unobservable inputs are not developed by the Company.

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

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

25

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

In millions	Fair Value as of December 31, 2015	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Assets of consolidated VIEs:				
Loans receivable at fair value	$ 1,292	Market prices adjusted for financial guarantees provided to VIE obligations	Impact of financial guarantee	0% - 5% (1%)
Loan repurchase commitments	396	Discounted cash flow	Recovery rates(1)	
			Breach rates(1)	
Liabilities of consolidated VIEs:				
Variable interest entity notes	1,267	Market prices of VIE assets adjusted for financial guarantees provided	Impact of financial guarantee	0% - 37% (14%)
Credit derivative liabilities, net:				
CMBS	72	BET Model	Recovery rates	25% - 90% (66%)
			Nonperformance risk	33% - 55% (54%)
			Weighted average life (in years)	1.1 - 3.2 (1.6)
			CMBS spreads	0% - 59% (19%)
Multi-sector CDO	3	Direct Price Model	Nonperformance risk	59% - 59% (59%)
Other	10	BET Model and Dual Default	Recovery rates	42% - 45% (43%)
			Nonperformance risk	59% - 59% (59%)
			Weighted average life (in years)	0.5 - 7.3 (1.9)
Other derivative liabilities	18	Discounted cash flow	Cash flows	$0 - $83 ($42)(2)

(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.

Sensitivity of Significant Unobservable Inputs

The significant unobservable inputs used in the fair value measurement of the Company s loans receivable at fair value of consolidated VIEs are the impact of the financial guarantee and multiples. The fair value of loans receivable are calculated by subtracting the value of the financial guarantee from the market value of VIE liabilities and by discounted cash flow methodologies. 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.

Table of Contents

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 commercial mortgage-backed securities (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.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Fair Value Measurements

The following tables present the fair value of the Company s assets (including short-term investments) and liabilities measured and reported at fair value on a recurring basis as of September 30, 2016 and December 31, 2015:

In millions	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of September 30, 2016
	Fair Value Measurements at Reporting Date Using Significant				
Assets:					
Fixed-maturity investments:					
U.S. Treasury and government agency	$ 1,059	$ 119	$ -	$ -	$ 1,178
State and municipal bonds	-	1,584	4(1)	-	1,588
Foreign governments	112	50	6(1)	-	168
Corporate obligations	-	1,753	1(1)	-	1,754
Mortgage-backed securities:					
Residential mortgage-backed agency	-	922	-	-	922
Residential mortgage-backed non-agency	-	44	-	-	44
Commercial mortgage-backed	-	43	1(1)	-	44
Asset-backed securities:					
Collateralized debt obligations	-	8	17(1)	-	25
Other asset-backed	-	366	38(1)	-	404
Total fixed-maturity investments	1,171	4,889	67	-	6,127
Money market securities	190	-	-	-	190
Perpetual debt and equity securities	23	17	-	-	40
Cash and cash equivalents	191	-	-	-	191
Derivative assets:					
Non-insured derivative assets:					
Interest rate derivatives	-	4	-	(1)	3

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of September 30, 2016
Assets of consolidated VIEs:					
Corporate obligations	-	31	3(1)	-	34
Mortgage-backed securities:					
Residential mortgage-backed non-agency	-	156	-	-	156
Commercial mortgage-backed	-	49	3(1)	-	52
Asset-backed securities:					
Collateralized debt obligations	-	9	1(1)	-	10
Other asset-backed	-	17	1(1)	-	18
Cash	25	-	-	-	25
Loans receivable at fair value:					
Residential loans receivable	-	-	995	-	995
Other loans receivable	-	-	147(1)	-	147
Loan repurchase commitments	-	-	404	-	404
Derivative assets:					
Currency derivatives	-	-	13(1)	-	13
Total assets	$ 1,600	$ 5,172	$ 1,634	$ (1)	$ 8,405
Liabilities:					
Medium-term notes	$ -	$ -	$ 106(1)	$ -	$ 106
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	2	85	-	87
Non-insured derivatives:					
Interest rate derivatives	-	296	-	(19)	277
Other	-	-	19	-	19
Other liabilities:					
Warrants	-	13	-	-	13
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	935	498	-	1,433
Total liabilities	$ -	$ 1,246	$ 708	$ (19)	$ 1,935

(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.

29

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of December 31, 2015**
Assets:					
Fixed-maturity investments:					
U.S. Treasury and government agency	$ 866	$ 110	$ -	$ -	$ 976
State and municipal bonds	-	1,685	41(1)	-	1,726
Foreign governments	153	43	2(1)	-	198
Corporate obligations	-	1,450	7(1)	-	1,457
Mortgage-backed securities:					
Residential mortgage-backed agency	-	993	-	-	993
Residential mortgage-backed non-agency	-	51	-	-	51
Commercial mortgage-backed	-	31	-	-	31
Asset-backed securities:					
Collateralized debt obligations	-	5	29(1)	-	34
Other asset-backed	-	281	38(1)	-	319
Total fixed-maturity investments	1,019	4,649	117	-	5,785
Money market securities	354	-	-	-	354
Perpetual debt and equity securities	18	190	-	-	208
Cash and cash equivalents	464	-	-	-	464
Derivative assets:					
Non-insured derivative assets:					
Interest rate derivatives	-	4	-	(1)	3

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

	Fair Value Measurements at Reporting Date Using				
In millions	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Counterparty and Cash Collateral Netting**	**Balance as of December 31, 2015**
Assets of consolidated VIEs:					
Corporate obligations	-	39	11(1)	-	50
Mortgage-backed securities:					
Residential mortgage-backed non-agency	-	172	-	-	172
Commercial mortgage-backed	-	672	-	-	672
Asset-backed securities:					
Collateralized debt obligations	-	13	1(1)	-	14
Other asset-backed	-	18	6(1)	-	24
Cash	58	-	-	-	58
Loans receivable at fair value:					
Residential loans receivable	-	-	1,185	-	1,185
Other loans receivable	-	-	107	-	107
Loan repurchase commitments	-	-	396	-	396
Derivative assets:					
Currency derivatives	-	-	11(1)	-	11
Total assets	$ 1,913	$ 5,757	$ 1,834	$ (1)	$ 9,503
Liabilities:					
Medium-term notes	$ -	$ -	$ 161(1)	$ -	$ 161
Derivative liabilities:					
Insured derivatives:					
Credit derivatives	-	3	85	-	88
Non-insured derivatives:					
Interest rate derivatives	-	240	-	(32)	208
Other	-	-	18	-	18
Other liabilities:					
Warrants	-	18	-	-	18
Securities sold, not yet purchased	18	-	-	-	18
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	1,095	1,267	-	2,362
Derivative liabilities:					
Interest rate derivatives	-	45	-	-	45
Total liabilities	$ 18	$ 1,401	$ 1,531	$ (32)	$ 2,918

(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 September 30, 2016 and December 31, 2015 represented approximately 19% of total assets measured at fair value. Level 3 liabilities at fair value as of September 30, 2016 and December 31, 2015 represented approximately 37% and 52%, respectively, of total liabilities measured at fair value.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

The following tables present the fair values and carrying values of the Company s assets and liabilities that are disclosed at fair value but not reported at fair value on the Company s consolidated balance sheets as of September 30, 2016 and December 31, 2015:

In millions	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Balance as of September 30, 2016	Carry Value Balance as of September 30, 2016
Assets:					
Other investments	$ -	$ -	$ 3	$ 3	$ 3
Accrued investment income[(1)]	-	41	-	41	41
Receivable for investments sold[(1)]	-	23	-	23	23
Assets of consolidated VIEs:					
Investments held-to-maturity	-	-	573	573	890
Total assets	$ -	$ 64	$ 576	$ 640	$ 957
Liabilities:					
Long-term debt	$ -	$ 976	$ -	$ 976	$ 1,975
Medium-term notes	-	-	485	485	826
Investment agreements	-	-	571	571	418
Payable for investments purchased[(2)]	-	50	-	50	50
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	-	777	777	890
Total liabilities	$ -	$ 1,026	$ 1,833	$ 2,859	$ 4,159
Financial Guarantees:					
Gross	$ -	$ -	$ 3,141	$ 3,141	$ 1,329
Ceded	-	-	107	107	52

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

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

In millions	Fair Value Measurements at Reporting Date Using

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Balance as of December 31, 2015	Carry Value Balance as of December 31, 2015
Assets:					
Other investments	$ -	$ -	$ 3	$ 3	$ 3
Accrued investment income[1]	-	38	-	38	38
Receivable for investments sold[1]	-	26	-	26	26
Assets of consolidated VIEs:					
Investments held-to-maturity	-	-	2,401	2,401	2,689
Total assets	$ -	$ 64	$ 2,404	$ 2,468	$ 2,756
Liabilities:					
Long-term debt	$ -	$ 762	$ -	$ 762	$ 1,889
Medium-term notes	-	-	534	534	855
Investment agreements	-	-	595	595	462
Payable for investments purchased[2]	-	36	-	36	36
Liabilities of consolidated VIEs:					
Variable interest entity notes	-	-	2,596	2,596	2,689
Total liabilities	$ -	$ 798	$ 3,725	$ 4,523	$ 5,931
Financial Guarantees:					
Gross	$ -	$ -	$ 3,093	$ 3,093	$ 1,530
Ceded	-	-	94	94	56

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

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

The following tables present information about changes in Level 3 assets (including short-term investments) and liabilities measured at fair value on a recurring basis for the three months ended September 30, 2016 and 2015:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended September 30, 2016

In millions	Balance, Beginning of Period	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[1]	Transfers out of Level 3[1]	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of September 30, 2016
Assets:													
Foreign governments	$ 7	$ -	$ -	$ -	$ -	$ 5	$ -	$ (6)	$ -	$ -	$ -	$ 6	$ -
Corporate obligations	2	-	-	-	-	-	-	(1)	-	-	-	1	-
Commercial mortgage-backed	-	-	-	-	-	-	-	-	-	1	-	1	-
Collateralized debt obligations	20	-	-	-	-	-	-	(3)	-	-	-	17	-
Other asset-backed	41	-	-	-	-	-	-	-	-	-	(3)	38	-
State and municipal bonds	124	-	-	-	-	-	-	-	-	2	(122)	4	-
Assets of consolidated VIEs:													
Corporate obligations	3	-	-	-	-	-	-	-	-	-	-	3	-
Residential mortgage- backed non-agency	1	-	(1)	-	-	-	-	-	-	-	-	-	-
Commercial mortgage-backed	2	-	(1)	-	-	-	-	-	-	2	-	3	(1)
Collateralized debt obligations	1	-	-	-	-	-	-	-	-	-	-	1	-
	4	-	-	-	-	-	-	-	-	-	(3)	1	-

Other asset-backed													
Loans receivable-residential	1,045	-	25	-	-	-	-	(75)	-	-	-	995	25
Loans receivable-other	147	-	-	-	-	-	-	-	-	-	-	147	-
Loan repurchase commitments	401	-	3	-	-	-	-	-	-	-	-	404	3
Currency derivatives, net	9	-	-	-	4	-	-	-	-	-	-	13	4
Total assets	$ 1,807	$ -	$ 26	$ -	$ 4	$ 5	$ -	$ (85)	$ -	$ 5	$ (128)	$ 1,634	$ 31

In millions	Balance, Beginning of Period	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[(1)]	Transfers out of Level 3[(1)]	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of September 30, 2016
Liabilities:													
Medium-term notes	$ 161	$ -	$ -	$ -	$ 2	$ -	$ -	$ (57)	$ -	$ -	$ -	$ 106	$ 2
Credit derivatives, net	104	5	(19)	-	-	-	-	(5)	-	-	-	85	12
Other derivatives	21	-	(2)	-	-	-	-	-	-	-	-	19	(2)
Liabilities of consolidated VIEs:													
VIE notes	523	-	2	-	-	-	-	(27)	-	-	-	498	2
Total liabilities	$ 809	$ 5	$ (19)	$ -	$ 2	$ -	$ -	$ (89)	$ -	$ -	$ -	$ 708	$ 14

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

33

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended September 30, 2015

In millions	Balance, Beginning of Period	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[(1)]	Transfers out of Level 3[(1)]	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of September 30, 2015
Assets:													
Foreign governments	$ 5	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 5	$ -
Corporate obligations	8	-	-	-	-	-	-	-	-	-	-	8	-
Commercial mortgage-backed	1	-	-	-	-	-	-	-	-	-	(1)	-	-
Collateralized debt obligations	67	-	-	1	-	-	-	(4)	-	-	(3)	61	-
Other asset-backed	83	-	-	-	-	-	-	(2)	-	-	(24)	57	-
State and municipal bonds	5	-	-	-	-	45	-	(3)	-	-	-	47	-
Assets of consolidated VIEs:													
Corporate obligations	35	-	1	-	-	-	-	-	-	3	(28)	11	-
Residential mortgage- backed non-agency	5	-	-	-	-	-	-	-	-	-	(5)	-	-
Collateralized debt obligations	4	-	5	-	-	-	-	-	-	-	(9)	-	-
Other asset-backed	17	-	-	-	-	-	-	(1)	-	-	(7)	9	-
Loans receivable-residential	1,318	-	(12)	-	-	-	-	(62)	-	-	-	1,244	(12)
Loans receivable-other	108	-	(1)	-	-	-	-	-	-	-	-	107	(1)

Loan repurchase commitments	388	-	6	-	-	-	-	-	-	-	-	394	6
Currency derivatives, net	2	-	1	-	3	-	-	-	-	-	-	6	4
Total assets	$ 2,046	$ -	$ -	$ 1	$ 3	$ 45	$ -	$ (72)	$ -	$ 3	$ (77)	$ 1,949	$ (3)

In millions	Balance, Beginning of Period	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[(1)]	Transfers out of Level 3[(1)]	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of September 30, 2015
Liabilities:													
Medium-term notes	$ 166	$ -	$ 4	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 170	$ 4
Credit derivatives, net	144	18	(21)	-	-	-	-	(20)	-	-	-	121	(21)
Other derivatives, net	21	-	1	-	-	-	-	-	-	-	-	22	1
Liabilities of consolidated VIEs:													
VIE notes	1,374	-	1	-	-	-	-	(65)	-	-	-	1,310	1
Total liabilities	$ 1,705	$ 18	$ (15)	$ -	$ -	$ -	$ -	$ (85)	$ -	$ -	$ -	$ 1,623	$ (15)

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

For the three months ended September 30, 2016, transfers into Level 3 and out of Level 2 were principally related to commercial mortgage-backed and state and municipal bonds, where inputs, which are significant to their valuation, became unobservable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. State and municipal bonds and other asset-backed comprised the instruments transferred out of Level 3 where inputs, which are significant to their valuation, became observable during the quarter. There were no transfers into or out of Level 1 for the three months ended September 30, 2016.

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

For the three months ended September 30, 2015, transfers into Level 3 were principally related to corporate obligations, where inputs, which are significant to their valuation, became unobservable during the quarter. Corporate obligations, other ABS and CDOs comprised the majority of the instruments transferred out of Level 3 where inputs, which are significant to their valuation, became observable during the quarter. These inputs included spreads, prepayment speeds, default speeds, default severities, yield curves observable at commonly quoted intervals, and market corroborated inputs. There were no transfers into or out of Level 1 for the three months ended September 30, 2015.

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

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months Ended September 30, 2016

In millions	Balance, Beginning of Year	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3(1)	Transfers out of Level 3(1)	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of September 30, 2016
Assets:													
Foreign governments	$ 2	$ -	$ -	$ -	$ (1)	$ 10	$ -	$ (5)	$ -	$ -	$ -	$ 6	$ -
Corporate obligations	7	-	-	-	-	-	-	-	-	-	(6)	1	-
Commercial mortgage-backed	-	-	-	-	-	-	-	-	-	1	-	1	-
Collateralized debt obligations	29	-	-	18	-	-	-	(30)	-	-	-	17	-
Other asset-backed	38	(1)	(1)	8	-	-	-	(3)	-	-	(3)	38	(1)
State and municipal bonds	41	-	-	-	-	122	-	(39)	-	2	(122)	4	-
Assets of consolidated VIEs:													
Corporate obligations	11	-	(4)	-	-	-	-	(1)	-	2	(5)	3	-
	-	-	(1)	-	-	-	-	-	-	1	-	-	-

Residential mortgage- backed non-agency													
Commercial mortgage-backed	-	-	(1)	-	-	-	-	-	-	4	-	3	(1)
Collateralized debt obligations	1	-	-	-	-	-	-	-	-	-	-	1	-
Other asset-backed	6	-	(6)	-	-	-	-	-	-	4	(3)	1	-
Loans receivable-residential	1,185	-	(5)	-	-	-	-	(185)	-	-	-	995	(5)
Loans receivable-other	107	-	1	-	-	146	-	-	(107)	-	-	147	1
Loan repurchase commitments	396	-	8	-	-	-	-	-	-	-	-	404	8
Currency derivatives net	11	-	(2)	-	4	-	-	-	-	-	-	13	2
Total assets	$ 1,834	$ (1)	$ (11)	$ 26	$ 3	$ 278	$ -	$ (263)	$ (107)	$ 14	$ (139)	$ 1,634	$ 4

In millions	Balance, Beginning of Year	Realized (Gains) / Losses	Unrealized (Gains) / Losses Included in Earnings	Unrealized (Gains) / Losses Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[(1)]	Transfers out of Level 3[(1)]	Ending Balance	Change in Unrealized (Gains) Losses for the Period Included in Earnings for Liabilities still held as of September 30, 2016
Liabilities:													
Medium-term notes	$ 161	$ -	$ (4)	$ -	$ 6	$ -	$ -	$ (57)	$ -	$ -	$ -	$ 106	$ 2
Credit derivatives, net	85	21	-	-	-	-	-	(21)	-	-	-	85	9
Other derivatives, net	18	-	1	-	-	-	-	-	-	-	-	19	(1)
Liabilities of consolidated VIEs:													
VIE notes	1,267	-	(41)	-	-	9	-	(106)	(631)	-	-	498	(41)
Total liabilities	$ 1,531	$ 21	$ (44)	$ -	$ 6	$ 9	$ -	$ (184)	$ (631)	$ -	$ -	$ 708	$ (31)

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

Table of Contents

MBIA Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 6: Fair Value of Financial Instruments (continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months Ended September 30, 2015

In millions	Balance, Beginning of Year	Realized Gains / (Losses)	Unrealized Gains / (Losses) Included in Earnings	Unrealized Gains / (Losses) Included in OCI	Foreign Exchange Recognized in OCI or Earnings	Purchases	Issuances	Settlements	Sales	Transfers into Level 3[1]	Transfers out of Level 3[1]	Ending Balance	Change in Unrealized Gains (Losses) for the Period Included in Earnings for Assets still held as of September 30, 2015
Assets:													
Foreign governments	$ 6	$ -	$ -	$ -	$ (1)	$ -	$ -	$ -	$ -	$ -	$ -	$ 5	$ -
Corporate obligations	10	-	-	-	-	-	-	-	-	15	(17)	8	-
Commercial mortgage-backed	2	-	-	-	-	-	-	-	-	1	(3)	&nb	