

JUDGE KAPLAN

03 CV 2242

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Aurelius Capital Master, Ltd., Aurelius Capital Partners, LP, Fir Tree Value Master Fund, L.P., Fir Tree Capital Opportunity Master Fund, L.P., and Fir Tree Mortgage Opportunity Master Fund, L.P., individually, and on behalf of a class of similarly situated persons pursuant to Fed. R. Civ. P. Rule 23,

Case No. 09-_____

Plaintiffs,

CLASS ACTION COMPLAINT

JURY TRIAL DEMANDED

MAR 11 2009
U.S.D.C. S.D. N.Y.
CASHIERS

-against-

MBIA Inc., MBIA Insurance Corporation., and MBIA Insurance Corporation of Illinois

Defendants.

Plaintiffs Aurelius Capital Master, Ltd., Aurelius Capital Partners, LP, Fir Tree Value Master Fund, L.P., Fir Tree Capital Opportunity Master Fund, L.P., and Fir Tree Mortgage Opportunity Master Fund, L.P., by their attorneys, Simpson Thacher & Bartlett LLP, on behalf of themselves and all others similarly situated, for their Class Action Complaint against defendants MBIA Inc. ("MBIA Inc."), MBIA Insurance Corporation ("MBIA Insurance"), and MBIA Insurance Corporation of Illinois ("MBIA Illinois") (collectively, the "MBIA Defendants") allege, on information and belief as to all facts other than as to themselves, as follows:

NATURE OF THIS ACTION

1. This class action is filed on behalf of Plaintiffs, in their individual capacities and on behalf of all holders of securities, instruments, and/or other obligations for which MBIA Insurance issued financial guaranty insurance other than United States municipal/government bond securities, including but not limited to residential mortgage-backed securities (“RMBS”), commercial mortgage-backed securities (“CMBS”), other asset backed securities (“ABS”), collateralized debt obligations (“CDOs”), international public finance obligations, guaranteed investment contracts (“GICs”), and medium-term notes (“MTNs”) guaranteed by MBIA Insurance financial guaranty policies (the “Class”). The outstanding net par amount of these insurance policies was \$241 billion at December 31, 2008 (even without counting additional amounts reinsured with a captive reinsurer of dubious financial wherewithal).

2. This action arises out of a massive fraudulent conveyance transaction engaged in by the MBIA Defendants in breach of their covenant of good faith and fair dealing with their financial guaranty policyholders, including the Plaintiffs and the Plaintiff Class. In this transaction, described below, the MBIA Defendants stripped over \$5.4 billion of assets from MBIA Insurance, in a calculated and cynical effort to enrich structurally junior economic stakeholders of the parent company, MBIA Inc., including its senior executives and shareholders, while leaving some \$241 billion of policyholders stranded in a denuded insurer that will be unable to meet its obligations as they come due. The majority of these stranded policies guarantee “structured-finance” securities, such as RMBS, CMBS, ABS, and CDOs. These are the very types of so-called “toxic securities”

that are at the epicenter of the current financial crisis, burdening the balance sheets of countless financial institutions and, increasingly, the Federal government.

3. By guaranteeing payment of principal and interest on hundreds of billions of dollars of these “toxic securities” – more than any other monoline insurance company – MBIA Insurance was already a central contributor to the present financial crisis. The MBIA Defendants have now compounded the crisis by stripping billions of dollars from an already-distressed MBIA Insurance and giving those billions of dollars to a new venture that seeks to profit the MBIA Inc. parent company and its executives and shareholders at the expense of the most at-risk policyholders of MBIA Insurance. This looting of MBIA Insurance thus runs directly at cross-purposes to the Federal government’s efforts to stabilize banks and insurance companies, since those types of institutions hold the bulk of the affected securities insured by MBIA Insurance. Indeed, the Federal government is one of the largest victims of this looting, since it has tens of billions of dollars of exposure to the affected securities by virtue of loss-sharing arrangements it recently entered into with certain banks – even before taking into account the hundreds of billions of dollars (and counting) of Federal taxpayer dollars being invested directly in the banks themselves.

4. On February 18, 2009, Defendant MBIA Inc., the publicly traded parent company, announced that it had “restructured” its principal insurance subsidiary, MBIA Insurance. This “restructuring” was achieved by funneling MBIA Insurance’s United States municipal bond insurance business, along with over \$5.4 billion in assets, to MBIA Illinois, which had up until that point been a direct subsidiary of MBIA Insurance. At the same time, MBIA Inc. also stripped from MBIA Insurance its 100% ownership of

MBIA Illinois, and transferred it to a new holding company owned solely by Defendant MBIA Inc. MBIA Illinois thus became a sister subsidiary to MBIA Insurance, in which MBIA Insurance no longer has any ownership interest.

5. The net result of this “restructuring” was to split an already distressed MBIA Insurance company into two entities – a healthy and well-capitalized United States municipal bond insurance company, which hopes to write new such policies, and a moribund and insolvent MBIA Insurance company left largely with guaranty exposures to toxic securities and instruments and no prospect of writing new business. The newly super-capitalized MBIA Illinois (to be renamed National Public Finance Guarantee Corporation), the ownership and assets of which were stripped from MBIA Insurance and its policyholders, will heretofore operate to benefit solely MBIA Inc. and its senior executives through their bonuses, options, and restricted stock programs to the exclusion of MBIA Insurance and its policyholders. By contrast, MBIA Insurance policyholders, including Plaintiffs and the Plaintiff Class, are now “insured” by an insurance company that, as a result of having billions of dollars of assets and United States municipal bond insurance business stripped from it in the transaction, has no source of future income generating business itself and will be unable to pay the massive insurance claims arising from the current financial crisis when they become due.

6. The cynical and avaricious nature of this transaction is best illustrated by the intentional decision not only to transfer over \$5.4 billion of assets and the United States municipal bond business to MBIA Illinois, but to transfer ownership of MBIA Illinois away from MBIA Insurance to a holding company directly below MBIA Inc. such that the equity value of MBIA Illinois will now be available solely to MBIA Inc.,

its executives, bondholders, and shareholders, rather than to the policyholders of MBIA Insurance. If MBIA Illinois had been kept as a subsidiary of MBIA Insurance, then at least the multi-billion-dollar equity in MBIA Illinois as so recapitalized, and as enhanced by new business, would have been owned by MBIA Insurance, and would have inured to the benefit of the ultimate parent, MBIA Inc., only after all policyholders of MBIA Insurance were properly provided for.

7. In conspicuous contrast, the structure MBIA Inc. employed represents the height of insidious greed because now the full equity value of MBIA Illinois inures only to MBIA Inc. and not at all to MBIA Insurance and its policyholders. The motivation for this choice could not be clearer – MBIA Inc. seeks to benefit its shareholders, bondholders, and senior executives by diverting value that would otherwise be needed to pay the policyholders stranded at MBIA Insurance. This choice of structure belies all pretense by MBIA Inc. that MBIA Insurance is solvent. If MBIA Insurance were solvent and had retained its ownership of MBIA Illinois, each dollar of equity value of MBIA Illinois would generate a dollar of equity value for MBIA Insurance and would equivalently increase the value of MBIA Inc. as MBIA Insurance's shareholder. The only scenario where the equity value of MBIA Illinois (had it remained a subsidiary of MBIA Insurance) would not so "pass through" to MBIA Inc. would be if MBIA Insurance were insolvent – in which event the policyholders of MBIA Insurance would need every dollar of value they could get. Plainly, MBIA Inc. was not prepared to run the risk of such an insolvency – preferring to shift it instead solely to the policyholders left behind at MBIA Insurance.

8. The market swiftly reflected the adverse effects of the transaction on MBIA Insurance and its policyholders. Some RMBS guaranteed by MBIA Insurance immediately tumbled in value by approximately 40%. Even before the transaction was announced, credit default swaps (“CDS”) on MBIA Insurance – for protection against default on its policies within the next five years – were trading at 50 points (meaning an up front price of 50 percent of the face amount of protection), reflecting a very high risk of default and a low expected recovery in a resulting insolvency proceeding. After the transaction and MBIA Insurance’s year-end earnings were announced, the price for this CDS moved to 70 points (meaning an up front price of 70% of the face amount of protection) – extreme even by the standards of distressed companies that have no regulators to ensure financial health. So, too, despite bearing a 14% interest rate, MBIA Insurance’s surplus notes – issued just a year ago – traded down from about 55% of face amount to approximately 35% on the news.

9. The “restructuring” leaves behind MBIA Insurance policyholders who own RMBS, CMBS, ABS, CDO, MTN, GIC, and international public finance obligations to be insured by an insolvent insurance company that has no realistic means of raising additional capital and no hope of being able to pay all of its claims. As a result, the conveyances that were made as part of the “restructuring” were fraudulent conveyances and must be returned.

10. Additionally, the “restructuring” breaches the implied covenant of good faith and fair dealing. The transaction frustrates the very substance and purpose of what MBIA Inc. and MBIA Insurance themselves marketed as “credit enhancement” financial guaranty insurance policies issued for the benefit of the Plaintiffs and the Plaintiff

Class. Monoline insurers, such as MBIA Insurance, guarantee payments of principal and interest in securities and other financial instruments against issuer defaults. MBIA Insurance certificates were explicitly marketed as “credit enhancement” insurance that would provide the securities with the credit rating of MBIA Insurance that would stand behind them, which had always been an AAA or other similar top investment grade rating from independent rating services such as Moody’s Investors Service (“Moody’s”), Standard & Poor’s Rating Services (“Standard & Poor’s”), and/or Fitch Ratings. In this manner, MBIA Inc. and MBIA Insurance marketed MBIA Insurance financial guaranty insurance as enhancing the credit of the securities above that of the underlying pool of assets securing the bond or structured finance credit instrument guaranteed. Indeed, it was the existence of such credit enhancement insurance that enabled issuers to market their securities.

11. As the MBIA Defendants’ knew in advance would occur, the MBIA Defendants’ “restructuring” transaction immediately caused MBIA Insurance’s credit ratings to plummet from investment grade to “junk territory.” Moody’s, for example, downgraded MBIA Insurance’s credit rating from Baa1 to B3, six steps below investment grade. And Barclays Capital (“Barclays”) promptly issued a report recognizing that the “restructuring” reduced “the potential recovery for policyholders and surplus note holders.” Tellingly, while MBIA Inc. has expressed its intention to “capitalize MBIA Illinois at a level well in excess of the historical capital requirements for Triple-A ratings,” it has expressed no such intent for MBIA Insurance and its policyholders.

12. In sum, Defendants’ decisions to loot MBIA Insurance egregiously and unlawfully subverted the policyholder rights and reasonable expectations of the

Plaintiffs and the Plaintiff Class left behind in MBIA Insurance. The MBIA Defendants' actions frustrated the entire "credit enhancement" purpose of the insurance policies issued by MBIA Insurance. The whole notion of credit enhancement financial guaranty insurance, as expressly marketed by MBIA Insurance, is completely frustrated if the insurance company can intentionally transfer away billions of dollars of assets, business, and a subsidiary company it had owned such that it must know that its credit ratings – and thus the ratings and value of the insured securities – will drop substantially.

13. Moreover, the distressed condition that MBIA Insurance faced before the challenged transaction was largely caused by the gross misassessment on the part of the senior management of the MBIA Defendants of the risks inherent in the toxic securities guaranteed by MBIA Insurance. This same management cannot now be believed when they say that after looting from MBIA Insurance over \$5.4 billion of assets and the ownership of its MBIA Illinois subsidiary, there remains sufficient capital to pay MBIA Insurance's remaining insurance policy obligations.

THE PARTIES

14. Plaintiff Aurelius Capital Master, Ltd., is an exempted company organized under the laws of the Cayman Islands, with its headquarters located on Grand Cayman Island.

15. Plaintiff Aurelius Capital Partners, LP is a limited partnership organized under the laws of Delaware, with its headquarters located in New York.

16. Plaintiffs Fir Tree Value Master Fund, L.P., Fir Tree Capital Opportunity Master Fund, L.P., and Fir Tree Mortgage Opportunity Master Fund, L.P. are

exempted limited partnerships organized under the laws of the Cayman Islands, with their headquarters located on Grand Cayman Island.

17. Plaintiffs each own RMBS, CMBS, ABS, CDO securities and/or other obligations insured by MBIA Insurance financial guaranty insurance.

18. Defendant MBIA Inc. is a Connecticut corporation with its principal place of business in Armonk, New York. MBIA Inc. is the publicly traded parent company of Defendants MBIA Insurance and (through an intermediate holding company) MBIA Illinois. In addition to operating an insurance business through MBIA Insurance and MBIA Illinois, MBIA Inc. also engages in an asset management business.

19. Defendant MBIA Insurance is a New York-domiciled financial guaranty insurance company with its principal place of business in Armonk, New York. Prior to the transaction at issue here, MBIA Insurance was the world's largest "monoline" insurer, meaning that it engaged solely in financial guaranty insurance to the exclusion of property, casualty, life, health, or disability insurance. MBIA Insurance's guarantees insured, among other things, "public finance bonds" such as municipal and other domestic and foreign government bonds, and "structured finance" products such as ABS, RMBS, CMBS, and CDOs.

20. Defendant MBIA Illinois is an Illinois-domiciled financial guaranty insurance company with its principal place of business in Armonk, New York. Pursuant to the "restructuring," MBIA Illinois will be renamed National Public Finance Guarantee Corporation and redomiciled from Illinois to New York. Prior to the transaction at issue here, MBIA Illinois was a wholly owned subsidiary of MBIA Insurance. In the transaction at issue, the Defendants stripped MBIA Illinois from MBIA Insurance,

transferred it to the ownership of a newly formed holding company subsidiary of Defendant MBIA Inc., and then transferred to it over \$5.4 billion of assets of MBIA Insurance, together with the MBIA Insurance United States public finance insurance business, leaving all the rest of the policyholders of MBIA Insurance – such as its RMBS, CMBS, ABS, CDO, MTN, GIC, and foreign government finance policyholders – in a now looted company with much reduced credit ratings and without the ability to pay all of its likely policyholder claims, while purportedly insulating the assets of MBIA Illinois from the claims of these policyholders.

JURISDICTION AND VENUE

21. This Court possesses federal subject matter jurisdiction over the action pursuant to 28 U.S.C. § 1332, as amended by the Class Action Fairness Act of 2005, for the following reasons:

- a. the number of members of the proposed plaintiff class is 100 or more;
- b. there is diversity of citizenship between at least any one member of the plaintiff class (named and unnamed) and the defendants. Plaintiffs are citizens of Grand Cayman Island, and defendants are citizens of New York, Connecticut, and Illinois; and
- c. the amount in controversy – which may be calculated by aggregating the claims of the class members – exceeds \$5 million, exclusive of interests and costs.

22. Venue is properly placed in this district pursuant to 28 U.S.C. § 1391(a)(1) and (2). A substantial part of the events and the omissions giving rise to Plaintiffs' claims occurred in this district. Furthermore, the MBIA Defendants reside and have consented to venue in this district.

FACTUAL ALLEGATIONS

Financial Guaranty Insurance Issued by MBIA Insurance

23. This proceeding involves securities, instruments, and/or other obligations that are unconditionally and irrevocably insured by MBIA Insurance, including RMBS, CMBS, ABS, and CDOs, all of which are currently at the center of the global financial crisis.

24. The sole business of MBIA Insurance has been to issue financial guaranty insurance policies, guaranteeing the payment of principal and interest on a wide range of securities and other instruments in exchange for very large premiums paid by the issuer or the policyholder, depending on the circumstances. MBIA Insurance has expressly marketed these policies as providing “credit enhancement” to the underlying securities and other instruments such that the credit of MBIA Insurance would enhance the credit rating of the subject instruments. MBIA Insurance’s credit rating from the independent rating agencies such as Moody’s, Standard & Poor’s and Fitch was AAA (or other similar highest possible rating) when virtually all of these policies were issued. A guaranty by MBIA Insurance enabled the guaranteed security to receive an AAA or equivalent credit rating. This, in turn, provided a number of benefits:

- The guaranteed securities were marketed more easily and at a lower interest rate. Notably, on the strength of AAA guarantees from MBIA Insurance, many financial institutions and individuals felt they could purchase what became “toxic securities” without fully bearing the risks of the securities themselves.

- For regulated investors such as banks, broker-dealers, and insurance companies, the guaranteed securities received a lower risk-weighting for regulatory purposes. As a result, less regulatory capital was required to be maintained as a buffer against possible loss on the securities, thereby permitting the regulated entities to be more levered coming into the present financial crisis. As MBIA Insurance's credit rating deteriorates, this benefit dissipates, putting further pressure on the capital adequacy of banks, broker-dealers, and insurance companies. Indeed, by reducing both the credit ratings and the market values of approximately \$241 billion of securities guaranteed by MBIA Insurance, the transaction challenged in this Complaint will, if allowed to stand, significantly exacerbate the present financial crisis.

25. Offering documents for the securities insured by MBIA Insurance prominently featured MBIA Insurance's role. For example, prospectuses for RMBS certificates highlighted the fact that the securities had "credit enhancement" from MBIA Insurance policies. In sections for which MBIA Insurance accepted responsibility for the accuracy of the statements, the prospectuses stated that MBIA Insurance would "unconditionally and irrevocably guarantee" timely payments of interest and principal. In those same sections, the prospectuses touted the fact that MBIA Insurance had high financial strength ratings from Moody's, Standard & Poor's, and Fitch Ratings and that "any downward revision" of those ratings would "have an adverse effect on the market

price” for the RMBS insured by MBIA Insurance. The prospectuses included financial statements for MBIA Insurance showing the solidity of its balance sheet.

26. During 2008, as the financial crisis unfolded, the rating agencies lowered MBIA Insurance’s credit rating down from AAA, but still within “investment grade” levels. However, as set forth in greater detail below, upon the announcement of the challenged “restructuring” transaction, the rating agencies lowered the credit ratings of MBIA Insurance to “junk” or “near-junk” levels, reflecting the immediately perceived increased risk of insolvency from the transaction.

MBIA Insurance Products

27. A large focus of the MBIA Insurance business was always its municipal bond insurance business, insuring for hefty premiums the payment of principal and interest on municipal bond and other United States and foreign government bond insurance.

28. More recently, “structured finance products” became a large growth area for MBIA Insurance. In return for enormous premiums, MBIA Insurance issued policies guaranteeing payment of principal and interest on a vast range of bundled debt securities, including RMBS, CMBS, CDOs, and ABS (backed by mortgage loans, car loans, credit card loans, and manufactured-housing contracts). MBIA Insurance and MBIA Inc. actively marketed these policies as “credit enhancement” financial guaranty insurance. The MBIA Insurance policy certificates “wrapping” these securities resulted in these offerings receiving investment grade ratings from the rating agencies without which the securities would not have been able to be sold on the terms offered.

29. Also in the “structured finance” area, MBIA Insurance issued or guaranteed policies and credit default swap (“CDS”) unconditionally guaranteeing CDOs covering pools of asset-backed notes, bonds, or other fixed income securities. For regulated investors such as banks, broker-dealers, and insurance companies, the MBIA Insurance guaranteed CDOs received a lower risk-weighting for regulatory purposes, allowing less regulatory capital to be maintained as a buffer against possible loss on the securities.

30. In addition to such “structured finance” products, MBIA Insurance issued financial guaranty insurance on GICs and MTNs issued through MBIA Inc.’s asset liability management business.

MBIA Insurance Policy Certificates and Agreements

31. The financial guaranty insurance policies issued by MBIA Insurance “wrapping” instruments purchased by the Plaintiffs and the Plaintiff Class all explicitly guarantee unconditionally the payment of principal and interest due on the subject instruments and specifically state that they cover the instrument holder. Since the sole and central purpose of these MBIA Insurance policies was to provide “credit enhancement” to the “wrapped” instruments with the investment grade financial ratings of MBIA Insurance, the MBIA Insurance agreements or certificates provided representations that MBIA Insurance’s financial statements over the preceding years fairly presented the financial condition of MBIA Insurance. Without the financial condition of MBIA and its financial ratings, the MBIA Insurance policies had no purpose.

Importance of MBIA Insurance Ratings and Financial Strength

32. In the past, MBIA Insurance received top investment grade financial strength ratings, without which financial guaranty insurance would not be purchased. MBIA Inc. repeatedly stated that maintaining MBIA Insurance's AAA credit ratings is essential to the continued success and survival of its business. MBIA Inc. previously touted, on numerous occasions, MBIA Insurance's long history with a AAA rating in its SEC Form 10-K's, noting: "MBIA [Insurance] has triple-A financial strength ratings from Standard and Poor's Corporation ("S&P"), which the Association [the predecessor to MBIA Insurance] received in 1974; from Moody's, which the Association received in 1984; from Fitch, Inc. ("Fitch"), which MBIA [Insurance] received in 1995; and from Rating and Investment Information, Inc. ("RII"), which MBIA [Insurance] received in 1998."

The Credit Crisis's Impact on MBIA Insurance and MBIA Inc.

33. The credit crisis that began in late summer of 2007 and the economic upheaval that followed throughout 2008 devastated MBIA Inc. and MBIA Insurance's structured finance insurance business.

34. MBIA Inc. and MBIA Insurance's credit ratings dropped in 2008. Between February and June of 2008, MBIA Insurance's financial strength ratings were downgraded by Standard & Poor's from AAA to AA, and downgraded by Moody's from Aaa to A2. In the same period, MBIA Inc.'s senior debt ratings were downgraded by Standard & Poor's from AA- to A-, and by Moody's from Aa3 to Baa2. These downgraded ratings, which were still investment grade, adversely affected MBIA Insurance's ability to attract new financial guaranty business.

35. MBIA Insurance has stopped writing policies on structured credit and has been virtually shut out of the business of guaranteeing municipal bonds. MBIA Insurance's market share of all financial guaranty insurance provided to the new issue United States finance market decreased to approximately 2.2% in 2008, a striking decrease when compared with the figure of approximately 23% for 2007. Meanwhile, the needs of municipal bond issuers for financial guaranties are being met by monoline insurers that have managed their affairs more prudently and treated their policyholders more honorably than has MBIA Insurance, by new entrants such as a AAA rated insurance company owned by Berkshire Hathaway, and by banks that guarantee municipal bonds by issuing letters of credit.

36. In the midst of this economic turmoil and deteriorating business prospects, MBIA Inc. and its senior executives determined to enrich themselves through a fraudulent conveyance transaction that loots MBIA Insurance of over \$5.4 billion of assets and its United States municipal bond insurance business, destroys the already precarious financial condition of MBIA Insurance, and significantly favors its domestic municipal bond policyholders over its other policyholders, all at the expense of Plaintiffs and the Plaintiff Class.

The MBIA Defendants' "Restructuring" Transaction

37. Before February 18, 2009, MBIA Insurance operated the entirety of MBIA Inc.'s financial guaranty insurance business: United States municipal bonds, foreign government bonds, "structured finance" RMBS, CMBS, ABS, and CDOs and CDS, GICs, and MTNs. All MBIA Insurance policyholders and beneficiaries looked to the entirety of that business and its credit rating for the "credit enhancement" insurance that they directly or indirectly purchased.

38. On February 18, 2009, in an attempt to house its unwanted “bad liabilities” comprising its structured finance and foreign government securities insurance business in one entity walled off from all other entities and liabilities, MBIA Inc. announced the “restructuring” of its financial guaranty insurance operations that was nothing short of a looting of MBIA Insurance. This transaction improperly transferred from MBIA Insurance over \$5.4 billion in assets and MBIA Insurance’s more promising municipal bond insurance business to a separate (and separately capitalized) company, MBIA Illinois, a former subsidiary of MBIA Insurance that was also transferred away from it in the transaction. MBIA Illinois is to be renamed National Public Finance Guarantee Corporation. The net result of the transaction is to leave MBIA Insurance with billions of dollars less in assets to insure the remainder of its portfolio, including the very structured finance and international finance exposures most in need of insurance in this financial crisis. This arrangement also stripped from MBIA Insurance the only even potentially viable part of its financial guaranty business in the current environment: its United States municipal bond business.

39. The specifics of the “restructuring” transaction are as follows: Prior to the transaction, MBIA Inc. was the parent of MBIA Insurance, while MBIA Insurance was the parent of MBIA Illinois. In the transaction, MBIA Inc. caused MBIA Insurance to transfer all of the stock of MBIA Illinois to MBIA Inc., which subsequently transferred that stock to a newly created and wholly owned subsidiary of MBIA Inc.

40. The looting of MBIA Insurance did not stop there. At a time when far stronger financial institutions are cutting their dividends and eliminating stock repurchases to husband capital, an already distressed MBIA Insurance distributed to its

parent company shareholder, MBIA Inc., \$2.085 billion of cash and investment securities (which MBIA Inc. then contributed to MBIA Illinois). This distribution was so extreme that it could not have been accomplished as a dividend – even with an obliging regulator’s consent – without violating Section 4105 of the New York Insurance Law. That section prohibits the payment of dividends except from earned surplus. To circumvent this statutory protection, MBIA labeled \$938 million of the distribution as a “stock redemption” rather than a dividend.¹ However, since MBIA Inc. would continue to own 100% of the stock of MBIA Insurance after the so-called “redemption,” the entire distribution was, in essence, a dividend.²

41. In connection with this transaction, MBIA Insurance and MBIA Illinois also entered into a 100% Quota Share Reinsurance Agreement whereby MBIA Insurance transferred its valuable United States municipal bond business to MBIA Illinois. The Quota Share Reinsurance Agreement contains a cut-through provision, enabling municipal bond policyholders to make claims for payment directly against MBIA Illinois. MBIA Insurance transferred to MBIA Illinois \$2.89 billion in net unearned premiums, net of ceding commissions, and loss and loss adjustment expense reserves associated with its municipal bond portfolio.

¹ Plaintiffs, on behalf of themselves and the Plaintiff Class, reserve all rights to assert claims allowed under Section 4105 of the New York Insurance Law against Defendants and others with respect to the propriety of these distributions.

² As part of the “restructuring,” MBIA Insurance also transferred to MBIA Illinois the assets and liabilities associated with an asset swap facility MBIA Insurance had entered into with MBIA Inc.’s asset/liability management subsidiary.

42. Additionally, MBIA Illinois entered into a second-to-pay policy to make it crystal clear that MBIA-insured municipal bonds would be paid by MBIA Illinois even if MBIA Insurance became insolvent.

43. However, even under these agreements, MBIA Insurance still remains obligated to pay the reinsured municipal bond policyholders if MBIA Illinois were to default, a fact not disclosed in the MBIA Defendants' announcements of the transaction.

44. As a result of the "restructuring" transaction and its attendant stripping of MBIA Insurance assets, MBIA Insurance, which is facing the likelihood of a crushing amount of claims on its policies insuring RMBS, CMBS, ABS, CDO, CDS, GIC, MTN, and international public finance obligations, is or continues to be insolvent and is engaging in a business for which it has an unreasonably small amount of capital. MBIA Insurance agreed to the transaction at the direction of MBIA Inc. despite knowing that the transaction would make it unable to pay its debts because MBIA Insurance is wholly controlled by MBIA Inc. The "restructuring" benefits the MBIA Inc. senior executives, shareholders, and bondholders at the severe expense of MBIA Insurance policyholders, subverting their policyholder rights and severely damaging their investments.

45. As discussed more fully below, this improper looting of MBIA Inc.'s assets and funds is doubly devastating to the policyholders left behind in the transaction. Not only have these policyholder investors been deprived of the central benefit of the "credit enhancement" financial guaranty insurance they purchased because the credit ratings of MBIA Insurance have been lowered to "junk" status, but they are "insured" by an insolvent insurance company which will not be able to pay claims on all of the more than \$241 billion in RMBS, CMBS, ABS, CDO, CDS, GIC, MTN, and

international public finance obligations it has insured in this continually deteriorating economy. In other words, the transaction violated the covenant of good faith and fair dealing implied in every MBIA Insurance contract and has resulted in a massive fraudulent conveyance of assets from MBIA Insurance.

The MBIA Defendants Knew that the Transaction Would Harm the Policyholders Left Behind

46. The MBIA Defendants' restructuring of their financial guaranty insurance business was carried out despite the fact that the MBIA Defendants knew that it would harm MBIA Insurance's stranded policyholders, including Plaintiffs and the Plaintiff Class. Jay Brown, MBIA Inc.'s Chairman of the Board and CEO, admitted as much by stating in an interview given when the transaction was announced that he "would expect some [policyholders] would be far more interested in commuting [their insurance policies]," now that most of the company's claims-paying capital has been walled off from exposure to claims by holders of structured finance securities. This statement makes all too clear that Brown was well aware of the tremendous adverse impact the transaction had on these policyholders. There is no reason for the policyholders to be "far more interested" in commuting their insurance contracts unless they recognize what Brown recognizes – that following the "restructuring" transaction MBIA Insurance is insolvent and without the ability to pay all of the insurance claims that are and will be made.

47. It did not have to be this way. Even if there were a business reason to split the MBIA municipal bond insurance business from its structured finance insurance business, MBIA Inc. could have capitalized MBIA Illinois with the \$452 million of cash and short term investments MBIA Inc. had on its own balance sheet as of year-end 2008. Yet, MBIA Inc. contributed none of that cash or any other assets to MBIA Illinois (other

than what it looted from MBIA Insurance). Instead, in the middle of the current credit crisis, MBIA Inc. spent over \$130 million in the fourth quarter of 2008 alone repurchasing its own shares.

48. The MBIA Defendants also could have accomplished all of the legitimate goals of the restructuring in a simple manner that would have allowed for holders of MBIA Insurance's insured securities holders to benefit from any increase in the newly transferred MBIA Illinois municipal bond insurance business. MBIA Inc. could have utilized its already existing "stacked structure" by simply transferring the MBIA Insurance municipal bond insurance business to MBIA Illinois, which was already a subsidiary of MBIA Insurance prior to the restructuring. This stacked structure would have allowed the non-United States-based government bond policyholders to benefit from the equity value of MBIA Illinois – including any value contributed to it in the restructuring and any future value generated by its municipal bond guaranty business. By contrast, the MBIA Defendants affirmatively chose to embark on a transaction that removed MBIA Illinois as a subsidiary of MBIA Insurance, thereby ensuring that its equity value would inure only to MBIA Inc. and not to MBIA Insurance or its stranded policyholders.

49. The difference in the structure the MBIA Defendants chose to adopt versus the more equitable stacked structure it could have selected was not accidental. In a February 22, 2008 letter to Eric Dinallo, the New York Superintendent of Insurance, MBIA Inc.'s Brown stated that he was in no uncertain terms opposed to a stacked structure, declaring that such a reorganization would be a "draconian step" because it

would prevent MBIA Inc. – the parent company – from getting dividends from the municipal business before all structured finance policyholders were paid.

50. MBIA’s largest competitor was not so irresponsible. The parent company of Ambac Assurance Corporation (“Ambac”), a similar and competing monoline insurer, has recently formed and contributed capital to a separate municipal bond insurance subsidiary, Everspan Financial Guarantee Corporation (“Everspan”). However, Ambac chose to have the existing monoline insurer own all of Everspan’s stock, to ensure that Everspan’s equity value, and any dividends or other distributions Everspan makes on its stock, would become assets of Ambac’s existing insurer, supporting legacy policyholders. Moreover, Ambac retained all of its existing policies rather than transferring some of them to Everspan. This ensures that all of Ambac’s legacy policy liabilities will be treated equally. In fact, Ambac has proudly publicized its protection of all existing Ambac policyholders. On a recent earnings call, the chief executive of Everspan, Doug Renfield-Miller, said:

“[T]he value creation within Everspan does accrue to the benefit of Ambac Assurance [the pre-existing monoline] before falling back to shareholders. And Wisconsin [Ambac’s primary regulator] has taken a very strong view, which is perfectly understandable, that they owe a duty to all policyholders. They cannot discriminate among policyholders, and so that is effectively what this structure achieves.”

51. By contrast with Ambac, the senior executives at MBIA Inc. intentionally determined to engage in a transaction that favors themselves and MBIA Inc. shareholders at the expense of MBIA Insurance policyholders who they are obligated to protect, to discriminate in the protection of existing municipal bond versus structured finance policyholders, to renege on the “credit enhancement” purpose of MBIA Insurance

policies, and to leave MBIA Insurance insolvent and without adequate capital to meet more than \$241 billion in policy obligations remaining in MBIA Insurance.

MBIA Insurance And Its Remaining Policyholders Are Left To Be Insured By A “Junk” Rated, Insolvent Insurance Company

52. Unsurprisingly, given its shocking nature, the restructuring plan resulted in immediate (i.e., same-day) downward revisions to MBIA Insurance’s credit ratings from Moody’s and Standard & Poor’s. Moody’s reacted to the news by downgrading MBIA Insurance from Baa1 to B3 (which is six steps below investment grade, or “junk territory,” as a Reuters article called it); Standard & Poor’s lowered its counterparty credit and financial strength ratings on MBIA Insurance from AA- to BBB+ (the third lowest investment grade) with a “negative outlook” portending a coming further downgrade.

53. Analysts at Barclays stated in a report dated February 19, 2009 that MBIA Inc.’s decision to separate its municipal bond insurance arm from its other insurance operations set a dangerous precedent by favoring some policyholders over others. “We are concerned that the New York regulator’s approval of this corporate split sends a dangerous message to financial guarantee policyholders in general,” Barclays stated in a report issued the day after MBIA Inc. announced its restructuring plan. As well, Barclays declared that, in its view, “*this transaction increases the likelihood of insolvency at MBIA Insurance Corp. and reduces the potential recovery for policyholders and surplus note holders.*” Indeed, as Barclays stated in no uncertain terms, “[i]his move clearly disadvantages policyholders in the structured finance book, who presumably expected that their financial guarantee policy would be backed by the cumulative financial resources of MBIA Insurance Corp.” (Emphasis supplied).

54. After having more time to digest the results of the “restructuring” and MBIA Inc.’s fourth quarter 2008 earnings report, Barclays was even more pessimistic about MBIA Insurance’s future, stating in a report dated March 3, 2009 that the transaction “leaves the policyholders at MBIA [Insurance] that much closer to potential regulatory seizure.” Barclays predicts that statutory capital will “turn negative by the end of 2010” and MBIA Insurance “will face a solvency issue in the coming 24 months.”

55. Moody’s, in a report dated February 18, 2009, also recognized that the “restructuring” leaves MBIA Insurance with a “reduction in claims-paying resources relative to the remaining higher-risk exposures in its insured portfolio” – particularly given “the removal of capital, and the transfer of unearned premium reserves associated with the ceding of its municipal portfolio to MBIA Illinois.” Moody’s stated that its downgrade reflected the “deterioration of MBIA’s insured portfolio of largely structured credits, with stress reaching sectors beyond residential mortgage-related securities.”

56. Demonstrating just how devastating the transaction is to the MBIA Insurance “credit enhancement” policyholders, Moody’s also stated that it would position the ratings of all structured transactions wrapped by MBIA Insurance at the higher of the underlying rating of the structured security – regardless of whether the underlying rating is published or not – and MBIA Insurance’s B3 “junk” rating.

57. Similarly, Standard & Poor’s explained in a February 18, 2009 report that it downgraded MBIA Insurance because it believed that MBIA Insurance’s structured exposures “are subject to continued adverse loss development that could erode capital adequacy.”

58. In 2008 alone, MBIA Insurance paid out close to \$1.4 billion in insurance claims related to just RMBS securities and another \$558 million to commute policies guaranteeing credit derivatives. In light of the state of the current financial markets, analysts predict similar or even greater pay outs on these and other securities that MBIA Insurance continues to “insure.” As just one example, Barclays is predicting as much as over \$6.5 billion in losses on CMBS, yet, MBIA Insurance has not reserved any money to account for these predicted losses.

59. What is more, fully one-third of MBIA Insurance’s remaining assets consist of a “secured” loan by MBIA Insurance to MBIA Inc.’s asset/liability management subsidiary. C. Edward Chaplin, President and Chief Financial Officer of MBIA Inc., recently admitted on an analyst call that the market value of the portfolio of securities “securing” that loan is “about 10% short of the amount advanced.”

60. Tellingly, immediately after announcement of the “restructuring” transaction, the value of RMBS insured by MBIA Insurance plummeted, with some trading down by 40% of their pre-transaction value. By contrast, MBIA Inc.’s stock price shot up 30% on the day the transaction was announced

CLASS ALLEGATIONS

61. Plaintiffs bring this action pursuant to Federal Rule of Civil Procedure 23(a), (b)(1), (b)(2), and (b)(3) on behalf of the Class, consisting of all holders of securities, instruments, and/or other obligations insured by MBIA Insurance at the time of the transaction described herein, except holders of United States municipal/government bond securities. Excluded from the Class are the MBIA Defendants and any entity in

which any excluded person has a controlling interest, and the legal representatives, heirs, successors and assigns of any excluded person.

62. The members of the Class are so numerous that joinder of all members is impracticable. Upon information and belief, hundreds, if not thousands, of investors own securities insured by MBIA.

63. Plaintiffs' claims are typical of the claims of the members of the Class. Plaintiffs and all members of the Plaintiff Class sustained damages as a result of the claims alleged herein.

64. Plaintiffs will fairly and adequately protect the interests of the members of the Class and has retained competent and experienced counsel.

65. A class action is superior to other available methods for the fair and efficient adjudication of this controversy.

66. Prosecuting separate actions by Class members would create a risk of inconsistent or varying adjudications with respect to individual Class members that would establish incompatible standards of conduct for the MBIA Defendants.

67. Prosecuting separate actions by Class members would create a risk of adjudications with respect to individual Class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests.

68. The MBIA Defendants have acted or refused to act, with respect to some or all issues presented in this Complaint, on grounds generally applicable to the Class, thereby making appropriate final injunctive or declaratory relief with respect to the Class as a whole.

69. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting only individual members. Among the questions of law and fact common to the Class are:

- (a) whether the MBIA Defendants engaged in actual fraudulent conveyance;
- (b) whether the MBIA Defendants engaged in constructive fraudulent conveyance;
- (c) whether the MBIA Defendants breached the implied covenant of good faith and fair dealing;
- (d) whether MBIA Insurance is undercapitalized and insolvent such that it is unable to satisfy the claims of its policyholders;
- (e) whether MBIA Insurance agreed to the transaction at the direction of MBIA Inc. despite knowing that the transaction would make it unable to pay its debts; and
- (f) whether Plaintiffs and the other members of the Plaintiff Class have sustained damages and, if so, the appropriate method to measure such damages.

70. Plaintiffs know of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

COUNT I

(Actual Fraudulent Conveyance)

71. Plaintiffs repeat and incorporate the allegations in paragraphs 1 through 70 as if set forth fully herein.

72. Through the “restructuring” transaction, the MBIA Defendants have knowingly and purposefully stripped from MBIA Insurance over \$5.4 billion in assets, its ownership interests in MBIA Illinois, and its municipal bond insurance business and conveyed these assets to MBIA Illinois without adequate consideration.

73. These conveyances were made at a time when MBIA Insurance was insolvent or caused MBIA Insurance to become insolvent.

74. These transfers and the restructuring transaction as a whole were undertaken and designed with the intent to hinder, delay, and defraud MBIA Insurance's present and future creditors, including Plaintiffs and the Plaintiff Class.

75. Therefore, the MBIA Defendants have violated New York Debtor and Creditor Law (“N.Y.D.C.L.”) § 276.

COUNT II

(Constructive Fraudulent Conveyance)

76. Plaintiffs repeat and incorporate the allegations in paragraphs 1 through 70 as if set forth fully herein.

77. As part of the “restructuring” transaction, MBIA Insurance conveyed to MBIA Inc. and/or MBIA Illinois approximately \$5.4 billion, its ownership interests in MBIA Illinois, and its municipal bond insurance business without fair consideration.

78. These conveyances were made at a time when MBIA Insurance was insolvent or caused MBIA Insurance to become insolvent. Therefore, the MBIA Defendants have violated N.Y.D.C.L. § 273.

79. Also as a result of the conveyances, MBIA Insurance is engaged in the financial guaranty insurance business with an unreasonably small amount of capital. Therefore, the MBIA Defendants have violated N.Y.D.C.L. § 274.

80. Additionally, MBIA Insurance believes that it has or will incur debts – including claims on insurance policies it issued – that it will be unable to pay as result of the conveyances. Therefore, the MBIA Defendants have violated N.Y.D.C.L. § 275.

COUNT III

(Breach of Implied Covenant of Good Faith and Fair Dealing)

81. Plaintiffs repeat and incorporate the allegations in paragraphs 1 through 70 as if set forth fully herein.

82. MBIA Insurance policies, agreements and certificates were issued to provide unconditional financial guaranty insurance to policyholders, including Plaintiffs and the Plaintiff Class as beneficiaries under those policies. A central purpose of the policies, as expressly marketed by MBIA Insurance and MBIA Inc. was to provide “credit enhancement” of these securities and instruments based on the credit ratings of MBIA Insurance.

83. Under New York law, all contracts contain an implied covenant of good faith and fair dealing that requires a party to a contract not to frustrate the purpose of the contract or deprive another party of the benefits of the contract.

84. By engaging in the “restructuring” transaction, MBIA Defendants have breached this implied covenant by frustrating the “credit enhancement” and unconditional guaranty purposes of the insurance policies as described above and have deprived Plaintiffs and the Plaintiff Class of the right to receive the benefits they bargained for under the policy contracts.

85. By reason of the foregoing, Plaintiffs and the Plaintiff Class have been damaged, and are entitled to recover from MBIA Defendants compensatory damages in an amount to be determined at trial, including interest thereon.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs pray for relief and judgment as follows:

- A. Determining that this action is appropriate for class certification, certifying Plaintiffs as class representatives under Rule 23 of the Federal Rules of Civil Procedure, and Plaintiffs' counsel as Class Counsel;
- B. Declaring the fraudulent conveyances null and void and setting them aside pursuant to N.Y.D.C.L. § 279(c);
- C. Declaring that MBIA Illinois is responsible for the insurance policies issued by MBIA Insurance up to the date of the "restructuring" transaction for the benefit of Plaintiffs and the Plaintiff Class pursuant to N.Y.D.C.L. § 279(d) and as a result of the breach of the implied covenant of good faith and fair dealing;
- D. Awarding Plaintiffs and Plaintiff Class all damages sustained as a result of the MBIA Defendants' fraudulent conveyances and breach of the implied covenant of good faith and fair dealing, in an amount to be proven at trial, including interest thereon;
- E. Awarding Plaintiffs and the Plaintiff Class their reasonable costs and expenses incurred in this action, including counsel fees pursuant to N.Y.D.C.L. § 276-a and as otherwise permitted by law; and

F. Such other and further relief as the Court may deem just and proper.

JURY DEMAND

Plaintiff hereby demands a trial by jury of all claims so triable.

Dated: New York, New York
March 11, 2009

SIMPSON THACHER & BARTLETT LLP

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