



WISDOM IN ACTIONSM

February 11, 2008

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Ladies and Gentlemen:

We have completed a review of the letter you received on January 30, 2008 from William A. Ackman of Pershing Square Capital Management, LP, captioned "Bond Insurer Transparency; Open Source Research". We would like to share with you our comments on the letter, including our response to its major errors and omissions.

The letter and the model itself are used as support for estimates of the potential for bond insurers MBIA and AMBAC to incur claims on credit enhancement contracts we've written on collateralized debt obligations (CDOs) and residential mortgage backed securities (RMBS). Mr. Ackman has a large short position in the shares and credit default



swaps (CDS) of AMBAC and MBIA by his own admission, and the letter is clearly intended to influence the prices on those interests to his gain. Consistent with this, Mr. Ackman develops potential loss estimates that are a **multiple** of those estimated by MBIA, the ratings agencies and other serious analysts. The “Open Source Model” is an attempt to add credibility to those estimates, as is his assertion that the work of identifying the collateral underlying the CDOs was conducted by “a global bank.” We can only speculate as to the reasons the “global bank” desires to remain anonymous; but we are mystified as to how research conducted anonymously, and disclaimed by the party bringing it to the public could aid in enhancing transparency.

The model and the data appear to have some major deficiencies, as follows:

- The model is described as a “security by security” analysis, while it actually uses an averaging of 1267 randomly selected securities to estimate losses. This is a much less specific approach than the **loan by loan** analysis undertaken by MBIA on most of our portfolio in formulating our loss reserves and capital forecasts.
- Assumptions driving loss estimates are proprietary to “Global Bank’s” trading model. This is a particularly opaque approach to enhancing transparency.
- The model does not take account of the structures of CDOs and our contracts that provide us protections. The model does not appropriately capture the triggers and cash diversion mechanisms that support the senior interests, nor the fact that we cannot be compelled to settle contracts in 2 years, as assumed. The ultimate principal payments on many of our contracts will take place 30-45 years in the future, and in 8 of the 16 deals we’ve done in 2007, we only guarantee payments that would occur at ultimate maturity.
- The model doesn’t take account of the tax impact of losses.
- The analysis of RMBS transactions employs a steadily increasing default rate which increases by the trend established in the three most recent months. In effect, the model assumes that the elevated default rates expected in the next 18-24 months continue for the rest of the lives of the securities. Although it’s not fully described, it seems likely that this will result in default rates being *in excess* of those listed in the appendix.

In addition to using a simplistic model that ignores many protections built into the CDOs and applying highly conservative assumptions to generate sensational “headline” numbers, Mr. Ackman also makes other specific points, which are also incorrect. A brief analysis follows:



- It is asserted that by using internal estimates of credit losses, the bond insurers are somehow “determining the amount of statutory capital.” This is peculiar. All financial institutions who take and manage credit risk in buy and hold positions are required to make estimates of uncollectibility or credit impairment. MBIA has a rigorous process for determining the amount of credit losses in our portfolio of financial guaranty policies and our CDS contracts (it must be remembered that our CDS have the character of financial guaranty insurance policies, not tradable CDS as transacted by most market participants). The process of recognizing loss on our contracts for statutory reporting is governed by SSAP 5, which is consistent with FAS 5 (Accounting for Contingencies). Our reserves are based on reasonable estimates of probable losses, in accordance with the guidance. There is no provision in GAAP or statutory reporting for reserving based on worst case hypothetical losses. In no way does the fact of internal estimates permit a bond insurer to “determine statutory capital.”
- It is also alleged that MBIA has said that “all mark to market losses would reverse to zero.” This is incorrect. We have consistently stated that **in the absence of credit impairment**, the mark to market would reverse over time. We have made that disclosure since the advent of FAS 133, and only in Q4 2007 have we had an impairment of a contract subject to FAS 133.
- Mr. Ackman has been consistent in his suggestion that his estimates of loss are more accurate than the company’s. He alleged, in his 2002 attack on the company, that our portfolio subject to FAS 133 would have \$2 - \$3 billion of losses. That portfolio, which has largely amortized or been prepaid at this time, experienced **no loss**. We don’t believe there’s any basis for giving his current estimates any more credibility than those from 6 years ago.
- Mr. Ackman also suggests that the holding companies that own the bond insurers should be starved of dividends, and that that would be a positive development for the insurers. This is incorrect. The holding companies facilitate capital markets access for the insurance companies, and contribute to their financial strength. For example, MBIA Inc. has raised \$1.5 billion in equity from Warburg Pincus and the capital market in the past two weeks. We have injected all of Warburg’s initial \$500 million investment into the insurance company; and most of the proceeds of our successful \$1 billion public offering of equity will provide additional capital to the insurer, for the purpose of helping to ensure its very high capital adequacy. In addition to this very obvious fact, the ratings of the holding company are dependent upon dividends from its subsidiary



- businesses. In the event that the bond insurers' holding companies were to be deprived of all cash flow from subsidiaries, their rating would fall, which would likely trigger downgrades at the insurance companies – the very event that the companies and the regulators are seeking to avoid. Mr. Ackman purports an interest in “Saving the Bond Insurers,” but his cynically self serving proposals offer no such salvation.
- Finally, Mr. Ackman incorrectly suggests that MBIA had some scheme to avoid taking “live questions” during its fourth quarter earnings call. Our four hour call consisted of a two hour management presentation and two hours of questions – about 80% of the questions, including Mr. Ackman's, were received in advance of the call, but every one of them, and virtually all the questions received during the call were answered.

Like Mr. Ackman, we would welcome the opportunity to meet with you to discuss any or all of these points. MBIA has been a Triple A company for 34 years, and we are now, and expect to continue to manage our business in a prudent manner, deal forthrightly with any problems that arise in our portfolio, and provide disclosure to the market that enhances an understanding of our business model and our industry.

Sincerely,

cc:

Moody's Investor Service:
Jack Dorer
Stanislas Rouyer

Standard and Poor's:
Dick Smith
David Veno

Fitch Ratings:
Keith Buckley
Tom Abruzzo