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ISSUER COMMENT

MBIA'S Comprehensive Settlement with Bank of America Is Credit Positive

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Summary Rating Rationale

On 6 May, MBIA Inc. (Caa1 review for downgrade) announced a comprehensive settlement with the Bank of America Corporation (BAC; Baa2 negative). This is credit positive for the MBIA group and its main insurance subsidiaries, National Public Finance Guarantee Corporation (National, financial strength Baa2 review for downgrade) and MBIA Insurance Corporation (financial strength Caa2 review for downgrade).

Although the settlement is positive for the group, material risks remain for MBIA Corp., which had approximately $21.7 billion of below-investment-grade insured exposures at year end, excluding the exposures with BAC.[1] Our continuing rating review of MBIA will consider the potential losses of its remaining insured exposures and their risks to National and MBIA.

The settlement, which is subject to regulatory approval, involves the following:

1) BAC will pay MBIA Corp. approximately $1.7 billion[2] consisting of approximately $1.6 billion in cash and the $137 million principal amount of MBIA Inc.'s 5.70% senior notes of 2034

2) MBIA Corp. will dismiss putback litigation against BAC's Countrywide Home Loans, Inc. and BAC relating to breached representations and warranties on certain MBIA-insured RMBS

3) The commutation (at no additional cost to MBIA) of all MBIA Corp. policies held by BAC, including $6.1 billion of policies insuring credit default swaps referencing commercial real estate (CRE) exposures

4) BAC's dismissal of several outstanding litigations against MBIA including the one challenging the group's 2009 restructuring and BAC's withdrawal of the alleged "notice of default" in connection with a 2012 MBIA Inc. senior debt consent solicitation

5) BAC's receipt of warrants to purchase about 10 million shares of MBIA Inc. at $9.59

[1] Estimated as total below investment grade par outstanding (2012 10-K) less $7.4 billion notional insured amount commuted (MBIA's press release on 6 May 2013).

[2] Please see MBIA's press release of 6 May 2013 and its 2012 10-K for data used in this article.

In addition, BAC extended MBIA Corp. a $500 million three-year revolving credit agreement secured by the collateral currently securing a loan from National to MBIA Corp. and by MBIA Corp.'s equity interest in MBIA UK (Holdings) Limited (financial strength B3 stable). MBIA Corp. will repay the National loan from the settlement proceeds.

For MBIA Corp., the settlement will extinguish anticipated claims from the $6.1 billion CRE policies, which could have overwhelmed its liquidity and driven the company into insolvency in short order. The $500 million line of credit from BAC will also substantially improve MBIA Corp's liquidity: liquid assets stood at $345 million at year-end 2012. Additionally, with the commutation of BAC's large and volatile CRE positions, MBIA Corp.'s portfolio losses should become more predictable. The settlement with BAC is likely to prompt other counterparties to commute with MBIA, further reducing portfolio losses and uncertainty around the losses. We expect MBIA Corp.'s statutory capital position to be essentially unaffected by the transactions, because MBIA indicated that the terms of the settlement are broadly consistent with amounts recorded on MBIA Corp.'s statutory balance sheet at year-end 2012.

The settlement is also credit positive for National. The net BAC settlement payment will be used to repay in full the secured loan from National to MBIA Corp., substantially reducing intercompany linkages. The secured loan balance was about $1.6 billion this week, down from about $1.7 billion as of year-end as a result of $110 million putback settlement with Flagstar Bank earlier this month. In addition, BAC's withdrawal from litigation challenging MBIA's 2009 restructuring leaves only one remaining plaintiff, increasing the likelihood of an ultimate resolution favorable to MBIA.

MBIA Inc., the group's parent company, will also benefit from the lower litigation risks and improved credit condition of its subsidiaries, which could lead to the resumption of dividends from National and more stable performance at the group's wind-down operations.

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