

**MBIA UK INSURANCE LIMITED**

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**Company Registration No. 04401508 (England and Wales)**

**MBIA UK INSURANCE LIMITED  
DIRECTORS' REPORT AND FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

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# MBIA UK INSURANCE LIMITED

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<b>Directors</b>	C E Chaplin T G McLoughlin R D Wertheim P C Sullivan C E Weeks D M Zurkow G H C Wakefield K G Cox A F Sykes
<b>Secretaries</b>	R D Wertheim S Biscardi
<b>Company number</b>	04401508
<b>Registered office</b>	1 Great St Helen's London EC3A 6HX
<b>Auditors</b>	PricewaterhouseCoopers LLP Hay's Galleria 1 Hay's Lane London SE1 2RD
<b>Bankers</b>	The Bank of New York Montoyerstraat 46 Rue Montoyer B-1040 Brussels  Lloyds TSB Bank plc PO Box 1000 BX1 1LT  HSBC Paris Trocadero 112 Avenue Kleber 75016 Paris

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# MBIA UK INSURANCE LIMITED

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# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2007

The directors present their report and the audited financial statements for the year ended 31 December 2007.

### Principal activity

MBIA UK Insurance Limited ("the company") conducts its principal line of trade which is the guarantee of financial obligations, principally securitisations, structured finance and project finance-related obligations. The company is authorised to write financial guarantee business in the European Union ("EU"). The company guarantees both structured finance and public finance obligations in selected international markets.

### Business review

#### Results and performance

The company continued to grow its business in an encouraging manner up until Q3 2007. New business production in the third and fourth quarters was significantly impacted by turmoil in the capital markets which has continued into 2008. Gross written premium of £121 million represents a decline of 12% over the prior year however this performance represented strong business production for three quarters of the year. As at 31 December 2007, the company had guaranteed financial obligations with a gross par outstanding of £22.1 billion (2006: £7.8 billion), of which 16% is reinsured to third parties.

The directors note that an error in the 2006 financial statements was identified by management regarding the earnings profile on one policy. Comparative information has been restated as set out in note 1.8. The results of the company for the year, as set out on page 10, show a profit on ordinary activities after tax of £7.7 million (2006 restated: loss after tax of £0.1 million).

On 28 December 2007, the company accepted the transfer of the assets, liabilities and obligations of MBIA Assurance SA, the former French subsidiary of MBIA Insurance Corporation ("MBIA Insurance Corp"). As a consequence the company has become the principal insurer in the EU within the MBIA group. From the date of transfer the company will operate in France through a Branch. This transaction was accounted for as a group reconstruction under UK generally accepted accounting principles ("GAAP") and had a significant impact on the balance sheet as at 31 December 2007 with net assets of £106.7 million transferred in. As a result the company's total shareholders' funds were £189.6 million as at 31 December 2007 (2006 restated: £70.1 million) as set out on page 11. The company's results were not impacted materially as the transfer occurred close to the year end. The directors expect the future reported profitability of the company to improve as a result of this transaction, see note 17.

As at 31 December 2007, the company had not established any gross or net loss reserves (2006: nil). The directors note the continuing deterioration in the US mortgage market and the fact that the company has indirect exposure to that market through a specific structured finance CDO which it has guaranteed. As outlined in note 2, the directors draw attention to the uncertainty regarding claims reserving in relation to this CDO.

In light of the market conditions faced by the company in the second half of 2007, the directors are satisfied with the results for the year and believe that the company's net asset position has been improved at year end as a result of the transfer of business from MBIA Assurance SA. The company's future plans are addressed later in this report.

### Key performance indicators 'KPIs'

Significant progress has been made by the company throughout the year in relation to key elements of our strategy. The Board monitors the progress of the company by reference to the following KPIs:

KPI	2007	2006 restated	Commentary
	£million	£million	
Net written premiums	105.6	128.6	Gross premiums written less outward reinsurance in respect of insurance contracts
Underwriting loss	(0.7)	(2.7)	Balance on technical account for general business
Claims paying resources	767.2	221.5	Shareholders' funds, net unearned premium reserve and future ceding commission (undiscounted)
Regulatory solvency margin	802%	297%	The company's capital resources as a percentage of its capital resources requirement under FSA rules

# **MBIA UK INSURANCE LIMITED**

## **DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2007**

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### **Business environment**

The company achieved improved financial and operating results and business production was acceptable, despite a challenging market environment especially in the second half of 2007 which saw a tightening of credit markets and reduced activity in the capital markets.

The business engaged in by the company is highly competitive. The company continues to face competition from other financial guarantee insurance companies, other providers of third-party credit enhancement, such as multi-line insurance companies, credit derivative and swap providers and banks, and alternative financing structures that do not employ third-party credit enhancement. Increased competition, either in terms of price, alternative structures, or the emergence of new providers of credit enhancement, could have an adverse effect on the company's business.

In addition, the company's competitive position may suffer due to having the rating of MBIA Insurance Corp and its insurance affiliates being placed on review for a possible downgrade by Fitch Inc. ("Fitch"), Moody's Investor Service, Inc. ("Moody's") and Standard & Poor's ("S&P"). On 5 February 2008, Fitch placed the AAA insurer financial strength ratings of MBIA Insurance Corp. and its insurance affiliates (including the company) on rating watch negative. On 25 February 2008, S&P affirmed the AAA insurance financial strength ratings of MBIA Insurance Corp. and its insurance affiliates (including the company), with a negative outlook. On 26 February 2008, Moody's affirmed the Aaa insurance financial strength ratings of MBIA Insurance Corp. and its insurance affiliates (including the company), with a negative rating outlook. The company's ability to attract new business and to compete with other triple-A rated financial guarantors has been adversely affected by these rating agency actions and would be materially adversely affected by any actual reduction, or additional suggested possibility of a reduction, in ratings. On 7 March 2008, MBIA Insurance Corp. requested that Fitch cease providing insurer financial strength ratings for MBIA Insurance Corp. and its insurance affiliates (including the company). The ratings of the company have mirrored the above rating changes of MBIA Insurance Corp.

### **Strategy**

The company's success is dependent on the proper selection, pricing and ongoing management of the risks it guarantees. The company remains committed to pursuing only those business opportunities that meet its strict underwriting and return standards. The group structure permits the company the freedom to pursue opportunities that meet its underwriting and pricing standards without undue pressure to book business it cannot live with in the years to come. Consistent with this approach, on 25 February 2008, MBIA Insurance Corp announced (i) the suspension of writing new structured finance business for an estimated six month period in order to both increase capital safety margins and to evaluate and revise the credit and risk management criteria and policies; (ii) the cessation of issuing insurance policies for new credit derivative swap transactions ("CDS") except in transactions related to the reduction of existing derivative exposure and (iii) the elimination of certain structured finance product lines. This announcement impacts the activities of the company.

Market cycles may ebb and flow but the enduring value of the company's credit risk management franchise is centered on creating value from a broad range of products, services and geographies. The company will seek to develop its position in the European and other markets and seek out new opportunities for growth which fit the company's high standards. The company aims to improve efficiency in all areas of its operations through cost reduction, more streamlined underwriting and focused, intelligent investment in technological solutions and human resources.

### **Principal risks and uncertainties**

#### *Market factors*

The demand for financial guarantees depends upon many factors, some of which are beyond the control of the company. The major rating agencies have recently changed the ratings outlook for certain financial guarantors to "negative," placed certain financial guarantors on review for a possible downgrade, downgraded certain financial guarantors and affirmed a "stable" outlook for other major financial guarantors. Investors from time to time distinguish among financial guarantors on the basis of various factors, including rating agency assessment, size, insured portfolio concentration and financial performance.

These distinctions may result in differentials in trading levels for securities insured by particular financial guarantors which, in turn, may provide a competitive advantage to those financial guarantors with better trading characteristics. In addition, various investors may, due to regulatory or internal guidelines, lack additional capacity to purchase securities guaranteed by certain financial guarantors, which may provide a competitive

## **MBIA UK INSURANCE LIMITED**

### **DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2007**

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advantage to financial guarantors with fewer guaranteed obligations outstanding. Differentials in trading values or investor capacity constraints that do not favor the company would have an adverse effect on the company's ability to attract new business at appropriate pricing levels, and in recent months the company has experienced a decline in new business which may be attributable to recent rating agency actions and their impact on investor perception.

Additionally, in the face of the disruption in the credit markets and the recent announcements by Fitch, Moody's and S&P concerning financial guarantors generally and MBIA Insurance Corp. and its insurance affiliates in particular, there has been a widening of spreads on credit default swaps. This recent widening of spreads on the company's credit default swaps could impact the perception of its financial condition by the company's and MBIA Insurance Corp.'s guaranteed bondholders and counterparties and could affect their willingness to purchase the company's guaranteed bonds and to continue to enter into transactions with the company.

The recent actions by the rating agencies are likely to have contributed to the recent decline in demand for financial guarantees generally. Should the reliability of one or more of the rating agency capital models be questioned or should the financial guarantee industry suffer from further downgrades in financial strength ratings or some other deterioration in investors' confidence, demand for financial guarantees would be reduced significantly.

#### *Risk acceptance and risk management*

The process of risk acceptance and risk management is addressed through a framework of policies, procedures and internal controls. All risk management policies are developed and adopted by MBIA Insurance Corp for the MBIA group with input from UK risk management personnel. Those risk management policies specific to the company are approved by the Board prior to acceptance and to ongoing review by management, Risk Management, Insured Portfolio Management ("IPM") and Internal Audit. Compliance with regulation, legal and ethical standards is a high priority for the company and the legal compliance team and finance department take an important oversight role in this regard. The Audit Committee is responsible for satisfying itself that a proper internal control framework exists to manage financial risks and that controls operate effectively.

The company has developed a framework for identifying the risks that each business sector, and the company as a whole, is exposed to and their impact on economic and regulatory capital. This process is risk based and uses Individual Capital Assessment principles to manage the company's capital requirements and to ensure that it has the financial strength and capital adequacy to support the growth of the business and to meet the requirements of policyholders, regulators and ratings agencies.

The company has identified those risks which it considers to have the most potential negative impact and on which it should concentrate its mitigating procedures and controls. These principal risks from its financial guarantee business arise from fluctuations in the timing, frequency and severity of claims compared with the company's expectations; failure to assess and manage group risk; inadequate controls and procedures over outsourced functions; and failure to retain key personnel.

In light of the unprecedented losses currently being experienced by MBIA Insurance Corp. on certain residential mortgage backed securities ("RMBS") transactions and the mark-to-market and impairment shown on certain CDS transactions, MBIA Insurance Corp. and its insurance affiliates (including the company) have ceased writing certain types of business (see "**Strategy**" above) and are undergoing a review of their underwriting process and risk strategy. Pending the outcome of this review, certain enhancements or other modifications may be implemented.

#### **Future outlook**

The turmoil in the capital markets demonstrated in the second half of 2007 has continued into 2008 and continues to affect the demand for and use of financial guarantees. The directors believe that going forward a number of areas will continue to be available to the company to pursue its longer term strategy.

While the Public Finance sector is currently being impacted by conditions in the credit markets, the company believes that this sector remains fundamentally healthy and possesses reasonable growth prospects. Ongoing privatisation efforts have shifted the burden of financing new projects from the government to the capital markets, where investors can benefit from the security of financial guarantees. In light of the turmoil in the Structured Finance markets, activity in this sector is likely to be substantially reduced through at least the end of 2008. Additionally, as outlined above in the section headed "**Strategy**" above, the company has suspended writing new structured finance business for an estimated six month period and has ceased writing certain types

## MBIA UK INSURANCE LIMITED

### DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2007

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of Structured Finance business. While, the company expects that the Structured Finance market will eventually recover, there is a high degree of uncertainty as to the timing and scope of such recovery.

#### Results and dividends

The retained profit for the year was £7.7 million (2006 restated: loss of £0.1 million). The directors do not recommend the payment of a dividend for the year (2006: nil).

#### Directors

The following directors held office in 2007:

C E Chaplin	
G C Dunton	Resigned 28 March 2008
T G McLoughlin	Appointed 28 March 2008
R D Wertheim	
N G Budnick	Resigned 1 March 2007
P C Sullivan	
C E Weeks	
D M Zurkow	
G H C Wakefield	
K G Cox	
A F Sykes	

#### Directors' interests

In accordance with the Companies (Disclosures of Directors' Interests) (Exceptions) Regulations 1985 (SI 1985/802), the directors' interests in MBIA Inc., the ultimate parent undertaking, are not disclosed in these financial statements.

#### Financial risk management objectives

The company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. In particular, the key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from financial guarantees as they fall due. The most important components of this financial risk are: insurance risk, interest rate risk, currency risk, credit risk and liquidity risk. Two primary goals of the company's investment guidelines are the preservation of capital and the maintenance of reasonable liquidity.

#### Insurance risk

The financial guarantees issued by the company are unconditional commitments to guarantee timely payment on guaranteed obligations to holders of the guaranteed obligations. The company provides financial guarantee principally in the EU but also in other select international markets. The company recognizes that there are particular risks related to each country and region. These risks include the legal, economic and political situation, the varying levels of sophistication of the local capital markets and currency exchange risks. The company evaluates and monitors these risks carefully.

The company manages the resulting insurance risk in three main ways: underwriting standards, risk transfer and subsequent monitoring.

*Underwriting standards:* the creditworthiness of each guaranteed issue is evaluated prior to the issuance of a financial guarantee, and each guaranteed issue must comply with the company's underwriting guidelines. Further, the payments to be made by the issuer on the bonds or notes may be backed by a pledge of revenues, reserve funds, letters of credit, investment contracts or collateral in the form of mortgages or other assets. The right to such funds or collateral would typically become the company's upon the payment of a claim by the company.

For public finance transactions, the risk selection criteria used to underwrite transactions may include economic and social trends, debt management, financial management, adequacy of anticipated cash flows, satisfactory legal structure and other security provisions, viable tax and economic bases, adequacy of loss coverage and project feasibility, including a satisfactory consulting engineer's report, if applicable. Some risk types within public finance also require cash flow sensitivity testing to analyze cash flow coverage under various scenarios.

For structured finance transactions, the risk selection criteria, analysis and due diligence focus on counterparty credit and operational quality, the historical and projected performance of the collateral and the strength of the

## MBIA UK INSURANCE LIMITED

### DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2007

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structure, including legal segregation of the assets, the size and source of first loss protection, asset performance triggers and financial covenants and cash flow analysis and sensitivity testing using a scenario-based analysis, "Monte Carlo" probability analysis, or both, to examine the impact of remote events on credit performance.

Financial guarantors use a variety of approaches to assess the underlying credit risk profile of their guaranteed portfolios. The company utilises certain of MBIA Inc.'s systems, including both an internally developed credit rating system and third-party rating sources in the analysis of credit quality measures of its guaranteed portfolio. In evaluating credit risk, the company obtains, when available, the underlying rating of the guaranteed obligation before the benefit of its financial guarantee from nationally recognised rating agencies (Moody's and S&P).

The company operates within the MBIA group limits as regards its exposure to a single counterparty, or groups of counterparties, and to geographical and industry segments. (See "*Risk Transfer*" below.)

*Risk transfer:* The company further manages its exposure to insurance risk by means of reinsurance. Reinsurance enables the company to cede exposure for purposes of increasing its capacity to write new business while complying with its single risk and credit guidelines. The rating agencies continuously review reinsurers providing coverage to the financial guarantee industry. The company monitors the results of these reviews and adjusts its exposure to its reinsurers accordingly. In addition, the company has entered into an excess of loss reinsurance arrangement with MBIA Insurance Corp., whereby MBIA Insurance Corp. undertakes to reimburse the company for losses incurred in each calendar year which exceed in aggregate US\$100,000,000 (£50,236,109 at year end rates) (see "**Support Agreements with MBIA Insurance Corp**" below). As outlined in the section headed "**Business Environment**" above, the AAA rating of MBIA Insurance Corp has been affirmed with a negative outlook by both S&P and Moodys. The directors perform an annual review of the creditworthiness of MBIA Insurance Corp. and believe that MBIA insurance Corp is still a suitable counterparty for the company in respect of the excess of loss reinsurance arrangements.

*Subsequent monitoring:* The company has its own Insured Portfolio Management ("IPM") staff and also utilises MBIA Inc.'s IPM Division, which is responsible for monitoring MBIA guaranteed issues. The directors, in turn, monitor IPM's performance. The level and frequency of MBIA's monitoring of any guaranteed issue depends on the type, size, rating and performance of the guaranteed issue.

The IPM Division's primary function is to detect any deterioration in credit quality or changes in the economic, regulatory or political environment which could adversely affect a guaranteed obligation, including interrupting the timely payment of debt service. If a problem is detected, the group works with the issuer, trustee, bond counsel, servicer, underwriter and other interested parties in an attempt to alleviate or remedy the problem in order to minimize potential defaults. The IPM Division works closely with the Risk Management division and the applicable business unit to analyse guaranteed obligation performance and credit risk parameters, both before and after an obligation is guaranteed.

Once an obligation is guaranteed, the company typically requires the issuer, servicer (if applicable) and the trustee to furnish periodic financial and asset related information, including audited financial statements, to IPM for review. Potential problems uncovered through this review, such as poor financial results, low fund balances, covenant or trigger violations, trustee or servicer problems, or excessive litigation, could result in an immediate surveillance review and an evaluation of possible remedial actions. IPM also monitors general economic and regulatory conditions, budget developments and evaluates their impact on issuers.

During the underwriting process, each guaranteed transaction is assigned an internal credit rating. Credits are monitored according to a frequency of review schedule that is based on risk type, internal rating, performance and credit quality. Issues that experience financial difficulties, deteriorating economic conditions, excessive litigation or covenant or trigger violations are placed on the appropriate review list and are subject to surveillance reviews at intervals commensurate to the problem which has been detected. If IPM identifies concerns with respect to the performance of a guaranteed issue it may designate such guaranteed issue as "Caution List-Low," "Caution List-Medium" or "Caution List-High" based on the nature and extent of these concerns. It may also require increased monitoring and, if needed, a remediation plan be implemented for the related guaranteed issue.

*Claims reserving* Any specific case basis claims reserves are established by the company's Loss Reserve Committee and the need for any such reserves is monitored on a quarterly basis. Claims reserves are established in accordance with the accounting policy set out in note 1.2 to the financial statements. The

## MBIA UK INSURANCE LIMITED

### DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2007

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company typically does not establish any case basis reserves for credits that are listed as "Caution List-Low," "Caution List-Medium" or "Caution List-High." In the event that the company determines that it must pay a claim or that a claim is probable and estimable with respect to a guaranteed issue, it places the issue on its "Classified List" and establishes a case basis reserve for that policy. As of December 31, 2007, the company had no financial guarantees on the Classified List.

#### **Interest rate risk**

Interest rate risk arises primarily from investments in fixed interest securities. In formulating an investment strategy for the company's asset portfolio, the directors lay out a target band for the duration of the asset portfolio which requires the company's investment advisers to maintain the asset portfolio's interest rate sensitivity within acceptable risk limits.

#### **Currency risk**

The company is exposed to currency risk in respect of assets and liabilities under financial guarantees denominated in currencies other than Sterling. The most significant currencies to which the company is exposed are the US Dollar and the Euro. The company seeks to mitigate the risk by matching the estimated foreign currency denominated capital requirements and liabilities with assets denominated in the same currency.

#### **Credit risk**

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the company is exposed to credit risk are:

- fixed income investments in the company's portfolio of financial assets
- credit risks embedded in public finance and structured finance transactions which the company guarantees
- amounts due from MBIA Insurance Corp. under the Excess of Loss Reinsurance Agreement and the Net Worth Maintenance Agreement described in the section headed "**Support Agreements with MBIA Insurance Corp.**" below;
- third party re-insurers' share of insurance liabilities; and
- amounts due from insurance contract holders.

The company and MBIA Insurance Corp. are exposed to credit risks in its portfolio that may arise from deterioration in the credit worthiness of an individual issuer or a more general deterioration in the credit markets. At present, such deterioration in credit performance is being observed in certain Structured Finance sectors, notably the US RMBS and Structured Finance CDO (referred to as CDOs of ABS) sectors. The company has no direct exposure to US RMBS. It does have indirect exposure to US RMBS through certain Structured Finance CDOs that it has guaranteed. While the company has sought to underwrite CDOs of ABS with levels of subordination and other credit enhancements designed to protect it from loss in the event of poor performance of the underlying assets, no assurance can be given that such credit enhancements will prove to be adequate to protect the company from incurring losses in view of the current significantly higher rates of delinquency, foreclosure and losses being observed among US residential mortgages, particularly among securitizations containing US sub-prime and second lien collateral. (Note: Losses incurred on guaranteed transactions are covered by the Excess of Loss Reinsurance Agreement and the Net Worth Maintenance Agreement described in the section headed "**Support Agreements with MBIA Insurance Corp.**" below (subject to the terms of such agreements)).

The creditworthiness of MBIA Insurance Corp. is impacted by many of the same factors that impact the company, especially with respect to credit risks embedded in transactions which MBIA Insurance Corp. has guaranteed. Similar to the company, MBIA Insurance Corp. seeks to underwrite Structured Finance transactions with levels of subordination and other credit enhancements designed to protect it from loss in the event of poor performance of the underlying assets collateralising the securities in its insured portfolio. In light of the current high rates of delinquency, foreclosure and losses being observed among US residential mortgages (sub-prime and second lien in particular), no assurance can be given that such credit enhancements will prove to be adequate to protect MBIA Insurance Corp. from incurring losses on transaction with such collateral. In fact, MBIA Insurance Corp. has already made case loss reserves for certain second lien RMBS transactions and recognized impairment on certain CDOs of ABS. Additionally, while further deterioration in these sectors is generally expected, the extent and duration of any future continued deterioration, and impact on MBIA Insurance Corp. is unknown. Similarly, while a number of governmental and private sector initiatives are being contemplated to address the credit deterioration observed in the US residential mortgage market, at this stage one cannot predict what effect, if any, such initiatives will have on the credit performance over time of the actual securities that MBIA Insurance Corp. guarantees.

## MBIA UK INSURANCE LIMITED

### DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2007

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As a primary insurer, the company is required to honour its obligations to its policyholders whether or not MBIA Insurance Corp. or third party re-insurers perform their obligations to the company. The financial position and financial strength of all the company's third party re-insurers are monitored by the company on a regular basis. The downgrade or default of one or more of the company's third party re-insurers is not expected to have a material adverse impact on the company's ratings, financial condition or results of operations. Additionally, losses incurred as a result of lack of performance by a third-party re-insurers are covered by the Excess of Loss Reinsurance Agreement and the Net Worth Maintenance Agreement described in the section headed "**Support Agreements with MBIA Insurance Corp.**" below (subject to the terms of such agreements).

#### **Support Agreements with MBIA Insurance Corp.**

MBIA Insurance Corp. has entered into two support agreements with the company: The Excess of Loss Reinsurance Agreement and the Net Worth Maintenance Agreement. These are the key support agreements that determine the ratings of the company. The purpose of these agreements is to provide the company with additional capital and reinsurance support in the event of excess losses not covered by its available capital and by third party reinsurance. As at 31 December 2007, the company had guaranteed financial obligations with a gross par outstanding of £22.1 billion before allowance for third party reinsurance and support agreements with MBIA Insurance Corp..

Given the importance of these agreements their key features are highlighted below:

1. The Excess of Loss Reinsurance Agreement provides for coverage for losses in any one calendar year above \$100 million in aggregate or non performance of any third party reinsurer. The limit under this agreement is 20% of MBIA UK's retained liability at the previous year end plus the principal sum outstanding under the company's two largest financial guarantees and equates to a limit of approximately £5.95 billion as at 31 December 2007.
2. The Net Worth Maintenance Agreement restores the company's net worth on an annual basis if required to an amount equal to the higher of the amount required by UK regulators or \$100 million. This agreement has a limit of 35% of MBIA Insurance Corp.'s policyholder surplus. The limit is estimated at £920 million at 25 February 2008 based on the capital raised by MBIA group to date.

#### **Liquidity risk**

Liquidity risk is the risk that cash may not be available to pay the company's obligations as they fall due. The company has put in place support arrangements, through its Net Worth Maintenance and Excess of Loss Reinsurance Agreements with MBIA Insurance Corp. (described under the section headed "**Support Agreements with MBIA Insurance Corp.**" above) to cover anticipated liabilities and unexpected levels of claims. In addition, it is an objective of the company's investment guidelines to maintain reasonable liquidity in the company's investment portfolio.

#### **Auditors**

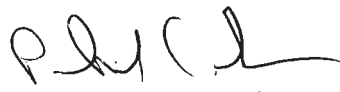
The company's auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office. On 29 October 2003, the company passed an elective resolution to dispense with the obligation to appoint auditors annually.

#### **Statement of disclosure of information to auditors**

Each of the persons who is a director at the date of this report confirms that:

- 1) so far as each of them is aware, there is no information relevant to the audit of the company's financial statements for the year ended 31 December 2007 of which the auditors are not aware; and
- 2) the director has taken all steps that he/she ought to have taken in his/her duty as a director in order to make him/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

P Sullivan  
Director  
Dated:

  
31-03-07

## **MBIA UK INSURANCE LIMITED**

### **STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE YEAR ENDED 31 DECEMBER 2007**

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#### **Directors' responsibilities**

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently, with the exception of changes arising on the adoption of new accounting standards in the year;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going-concern basis, unless it is inappropriate to presume that the Company will continue in business.

The directors confirm they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## MBIA UK INSURANCE LIMITED

### INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MBIA UK INSURANCE LIMITED

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We have audited the financial statements of MBIA UK Insurance Limited for the year ended 31 December 2007 which comprise the Profit and Loss Account, the Balance Sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

#### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

#### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

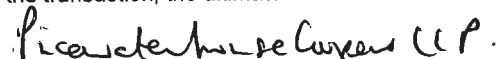
#### **Opinion**

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2007 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

#### **Emphasis of matter – significant uncertainty**

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosures made at note 2 to the financial statements. The company is exposed to US Residential Mortgage Backed Securities and CDOs with underlying US mortgage collateral through one of the Structured Finance transactions which it has guaranteed. As explained further in note 2, no claims provision has been established in respect of this contract on the basis that the expected losses currently anticipated on the underlying collateral will not result in losses on the financial guarantee. There is significant uncertainty as to the final outcome on this Structured Finance transaction, which is dependent on the rates of loss on the US mortgage collateral underlying the transaction, the ultimate outcome of which could result in material adjustments to this estimate.



PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors, London

Dated: 31 March 2008

# MBIA UK INSURANCE LIMITED

## PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2007

Technical account - general business	Notes	2007 £	2007 £	2006 restated £	2006 restated £
Gross Premiums written		120,840,142		137,114,774	
Outward reinsurance premiums		(15,206,814)		(8,495,938)	
Net premiums written			105,633,328		128,618,836
Change in gross provision for unearned premiums		(115,783,954)		(135,506,559)	
Change in provision for unearned premiums, reinsurers' share		13,783,149		7,250,557	
			(102,000,805)		(128,256,002)
<b>Earned premiums, net of reinsurance</b>			3,632,523		362,834
Other technical income			145,364		102,570
Net operating expenses	6		(4,461,214)		(3,160,507)
<b>Balance on the general business technical account</b>			(683,327)		(2,695,103)
<b>Non-technical account</b>					
Balance on the general business technical account			(683,327)		(2,695,103)
Other income/(expense)	4		5,289,191		(893,022)
Investment income	7		5,786,694		3,658,076
Investment expenses and charges			(122,290)		(81,337)
Profit/(loss) on ordinary activities before taxation	4		10,270,268		(11,386)
Tax on profit/(loss) on ordinary activities	9		(2,534,387)		(124,537)
<b>Retained profit/(loss) for the financial year</b>			<b>7,735,881</b>		<b>(135,923)</b>
<b>Statement of Total Recognised Gains and Losses</b>			£		
Retained profit/(loss) for the financial year			7,735,881		
Impact of restatement			(3,199,776)		
Total recognised gains and losses since last financial statements			<b>4,536,105</b>		

All of the above results derive from continuing operations. There is no difference between the profits on ordinary activities before taxation and the retained profit for the financial periods stated above and their historical cost equivalents.

Comparative information has been restated as set out in note 1.8.

# MBIA UK INSURANCE LIMITED

## BALANCE SHEET AS AT 31 DECEMBER 2007

	Notes	2007 £	2007 £	2006 restated £	2006 restated £
<b>Assets</b>					
Tangible fixed assets	10		118,291		-
Investments	11		337,760,801		84,598,598
<b>Reinsurers' share of technical provisions</b>					
Provision for unearned premiums			146,160,060		8,621,752
<b>Debtors</b>					
Debtors arising out of direct insurance operations: policyholders			484,394,692		138,401,121
Other debtors	12		13,536,877		6,628,607
Other assets			8,608,495		3,493,049
Prepayments and accrued income	13		48,480,693		7,161,523
<b>Total assets</b>			<b><u>1,039,059,909</u></b>		<b><u>248,904,650</u></b>
<b>Liabilities</b>					
<b>Capital and reserves</b>					
Called up share capital	15	69,000,000		68,000,000	
Share premium account	16	17,038,254		-	
Capital reserve	16	5,000,000		-	
Other reserves	16	88,667,986		-	
Profit and loss account	16	<u>9,863,572</u>		<u>2,127,691</u>	
Total shareholders' funds			189,569,812		70,127,691
<b>Technical provisions</b>					
Provision for unearned premiums			692,858,681		157,976,851
<b>Creditors - amounts falling due within one year</b>					
Creditors arising out of reinsurance operations			103,386,710		7,353,609
Other creditors including taxation and social security	14		22,301,760		11,461,474
Accruals and deferred income			30,942,946		1,985,025
<b>Total liabilities</b>			<b><u>1,039,059,909</u></b>		<b><u>248,904,650</u></b>

Comparative information has been restated as set out in note 1.8.

The financial statements on pages 10 to 23 were approved by the Board on 31 March 2008 and were signed on its behalf by:

  
 P Sullivan  
 Director

# MBIA UK INSURANCE LIMITED

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

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### 1 Accounting policies

#### 1.1 Basis of preparation

The financial statements have been prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985 ('the Act'), and in accordance with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers (the 'ABI SORP') as amended in December 2006 and applicable accounting standards in the United Kingdom.

The company has taken advantage of the exemption in Financial Reporting Standard (FRS) No 1 (revised) from the requirement to produce a cash flow statement on the grounds that it is a subsidiary undertaking where 90 percent or more of the voting rights are controlled within the group. Details of the parent undertakings of the company are given in note 18 to the accounts.

The company did not fall in scope of any new accounting standards having a material impact in the year ended 31 December 2007.

During the year, the company accepted the transfer of the assets, liabilities and obligations of MBIA Assurance SA, the former French subsidiary of MBIA Insurance Corporation ("MBIA Insurance Corp"). This transaction was accounted for as a group reconstruction under UK generally accepted accounting principles ("GAAP"). On 8 October 2007, the company issued shares to its immediate parent, MBIA UK (Holdings) Limited as part of this transaction as set out in note 16. On 28 December 2007, the individual assets and liabilities were transferred at book value under UK GAAP and an amount representing the book value of the assets and liabilities transferred from MBIA Assurance SA less the cost of investment in MBIA Assurance SA was recognized in other reserves as set out in notes 16 and 17.

#### 1.2 Basis of accounting for underwriting activities

All classes of business written are accounted for on an annual basis whereby the incurred costs of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

##### **Premium income and unearned premiums**

Premiums written, which are stated gross of acquisition costs but exclusive of premium taxes, relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued.

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on an outstanding risk basis as detailed below.

## **MBIA UK INSURANCE LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2007**

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Where the premium on a policy is received up front, the premium is recognised as written at the date of inception. When the premium on a policy is received in instalments, an assessment is made of the anticipated total billing stream and this amount is recognised as written at inception. Both types of premium are earned in the technical account, having regard to the incidence of risk, on a basis proportionate to the remaining scheduled periodic maturity of principal and payment of interest to the original total principal and interest insured. When an issue insured by the company has been refunded or called, the remaining unrecognised premium is recognised at that time. If the company changes its estimate of total expected written premium during a year, it recognizes the change in the year it arises.

Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the related insurance business.

#### **Other technical income**

Other technical income represents advisory or surveillance fees, which are recognised as earned over the period of the agreement.

#### **Acquisition costs and ceding commission income**

Certain incurred costs which are primarily related to the production of business are deferred over the period in which the related premiums are earned. These costs include direct expenses related to underwriting and policy issuance. Acquisition costs and ceding commission income which relate to a subsequent financial year are deferred and charged or credited to the accounting periods in which the related premiums are earned. Deferred acquisition costs included as balance sheet assets represent the proportion of acquisition costs incurred that corresponds to the proportion of premiums written which are unearned at the balance sheet date. Future ceding commission receivable is included as a debtor in the balance sheet. Deferred ceding commission income included as balance sheet liabilities represent the proportion of ceding commission received and future ceding commission receivable that corresponds to the proportion of reinsurance premiums which are unearned at the balance sheet date.

#### **Claims**

The financial guarantees issued by the company insure the financial performance of the obligations guaranteed over an extended period of time, in some cases over 50 years, under policies that the company has, in most circumstances, no right to cancel. As a result of the lack of statistical paid loss data due to the low level of paid claims in the company's financial guarantee business and in the financial guarantee industry in general, particularly, until recently, in the structured asset-backed area, the company does not use traditional actuarial approaches to determine its loss reserves. The establishment of the appropriate level of loss reserves is an inherently uncertain process involving numerous estimates and subjective judgments by management and therefore, there can be no assurance that actual paid claims in the company's insured portfolio will not exceed its loss reserves.

A case basis loss provision is established for insured obligations when, in the judgement of the directors, it is more likely than not that a monetary default in the timely payment of debt service as to both interest and principal, will result in the company incurring a loss. A case basis loss provision is established in an amount that is sufficient to cover the present value of the anticipated debt service payments, as to both interest and principal, over the expected period of default and estimated expenses associated with settling the claim less estimated recoveries.

## **MBIA UK INSURANCE LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2007**

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Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years.

A number of variables are taken into account in establishing specific case basis reserves for individual policies. These variables include the creditworthiness of the underlying issuer of the insured obligation, whether the obligation is secured or unsecured and the expected recovery rates on the insured obligation, the projected cash flow or market value of any assets that support the insured obligation and the historical and projected loss rates on such assets. Factors that may affect the actual ultimate realised losses for any policy include the state of the economy, changes in interest rates, rates of inflation and the salvage values of specific collateral. The methodology for determining when a case basis reserve is established may differ from other financial guarantee insurance companies, as well as from other property and casualty insurance enterprises.

The directors believe that the company's reserves are adequate to cover the ultimate net cost of claims including on a portfolio basis. However, because the reserves are based on management's judgment and estimates, there can be no assurance that the ultimate liability will not exceed such estimates.

#### **1.3 Investments**

Bonds and other fixed-income securities are stated at amortised cost, excluding interest accrued at the date of acquisition. Amortised cost represents the purchase price of a fixed income security adjusted by a proportion of the difference between the purchase price and the fixed redemption proceeds, having regard for the period the investment has been held and the period remaining until the redemption date. A provision is recorded if the company has reason to believe that the issuer will be unable to fulfil its obligations in terms of the payment of principal or interest.

It is the company's policy not to hold derivatives for investment purposes. The company may use derivatives for the purpose of managing risk and/or facilitating efficient portfolio management. The company remains exempt from FRS 26 and associated standards FRS 23, FRS 25 and FRS 29.

Investment return comprises all investment income, which includes the amortisation charge in respect of the investments carried at amortised cost.

#### **1.4 Fixed assets**

Fixed assets are recognized at cost and depreciated over their useful economic lives. The depreciation rates applied are:

Leasehold improvements	2% - 2.5% straight line
Office equipment	25% straight line
Computer equipment	50% straight line
Office furniture	20% straight line

#### **1.5 Foreign Currency**

Monetary assets and liabilities held in foreign currency are translated into sterling at the rates of exchange ruling at the balance sheet date and the exchange differences are taken to the profit and loss account non-technical account. Non-monetary assets and liabilities are translated into sterling using the rate of exchange prevailing at the time of the transaction. Foreign currency transactions during the year are translated into sterling using the rates of exchange applicable at the transaction

## **MBIA UK INSURANCE LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2007**

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date, with the exchange gains and losses included in the profit and loss account non-technical account in "Other income/(expenses)".

#### **1.6 Deferred taxation**

Deferred taxation is provided in full in respect of taxation deferred by timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is calculated at the tax rates which are expected to apply in the periods when the timing differences will reverse. The deferred tax balance has not been discounted.

#### **1.7 Accounting for share based payments**

The group issues equity-settled payments to certain employees. The group has a scheme whereby certain employees of the company are granted restricted shares in the ultimate parent company. These awards have a restriction period lasting three, four or five years depending on the type of award, after which time the awards fully vest. During the vesting period these shares may not be sold. If the employee leaves the group before the awards vest then the awards are forfeited.

Restricted Stock equity-settled share-based payments are originally measured at fair value which is based on the market price of the shares as at the date of the grant. The fair value determined at the grant date of the restricted stock grants is expensed on a straight-line basis over the vesting period, based on the group's estimate of shares that will eventually vest and adjusted for the effect of non market-based vesting conditions if applicable.

The group has a share option scheme which applies to some employees of the company. Options are exercisable at a price equal to the closing quoted market price of the ultimate parent company's shares on the date of grant. The vesting period is four or five years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Options are forfeited if the employee leaves the group before the options vest. No options have been issued to UK employees since the company commenced operations.

The fair value for stock options is measured by use of the Black-Scholes pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

#### **1.8 Restatement of 2006 comparatives**

The 2006 comparatives have been restated as an error was identified by management regarding the earnings profile on one policy. This had the impact of overstating earned premium net of reinsurance by £4,688,394. In addition, the deferred acquisition cost amortization charge was overstated by £117,285 and the deferred acquisition cost asset understated by a similar amount. Profit before tax was overstated by £4,571,109 and the resulting tax charge was correspondingly overstated by £1,371,333. The impact of restating the 2006 comparatives is to reduce profit after tax by £3,199,776 from £3,063,853 to a loss after tax of £135,923, retained earnings from £5,327,467 to £2,127,691, and reduce total shareholders' funds from £73,327,467 to £70,127,691.

#### **2 Claims – significant uncertainty**

As set out in the Accounting policies at note 1.2, the establishment of the appropriate level of claims provisions is an inherently uncertain process involving numerous estimates and subjective judgments by management and, therefore, there can be no assurance that actual paid claims in the company's insured portfolio will not exceed amounts reserved. As at 31 December 2007, the company has not established any claims provisions (2006: nil).

## **MBIA UK INSURANCE LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2007**

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The company has indirect exposure to US Residential Mortgage Backed Securities and CDOs through a particular Structured Finance CDOs it has guaranteed, which includes recent vintages of underlying mortgage collateral, including sub-prime exposures. Significantly higher rates of delinquency, foreclosure and losses are being observed among US residential mortgages, and consequently among securitizations containing US sub-prime and second lien collateral, including this CDO. 9.5% of the transaction is reinsured to Channel Re.

The CDO has breached an Event of Default provision due to collateral performance triggers that provides the company with certain structural benefits and remediation options to enhance its position, the most important of which is the diversion of cash flows from the uninsured elements of the transaction to the guaranteed obligation. The company has performed analysis including cash flow analysis, review of trustee and ratings reports and consideration of market information in order to assess the potential impact that varying rates of delinquency and losses would have on the Structured Finance CDO it has guaranteed. The CDO has experienced deterioration in performance and this deterioration has been factored into the analysis. The analysis has also considered the levels of subordination and other credit enhancements incorporated in the structure of the CDO, which are designed to protect the company from loss in the event of poor performance of the underlying assets. Based upon this analysis the company has not established any claims provision as it believes that it is not probable that losses will be incurred on this transaction on the basis that expected losses currently anticipated on the underlying collateral will not result in losses on the financial guarantee.

The extent and duration of any future continued deterioration in the US mortgage market, and therefore the impact on the specific transaction that the company has guaranteed is uncertain. The company believes that there is significant uncertainty as to the final outcome on this CDO and that there is therefore a wide range of possible outcomes on the transaction guaranteed by the company which could be significant in the context of reported profit after tax and shareholders' funds of the company although the net exposure is limited to US\$100 million, in the aggregate, under the support agreements with MBIA Insurance Corp., as set out in the Directors' report.

The significant uncertainty arises as (a) no assurance can be given that credit enhancements will prove to be adequate to protect the company from incurring losses; (b) there is significant uncertainty as to the future rates of delinquency, foreclosure and losses and the timings thereof; and (c) while a number of governmental and private sector initiatives are being contemplated to address the credit deterioration observed in the US residential mortgage market, at this stage one cannot predict what effect, if any, such initiatives will have on the credit performance over time of the actual securities that the company has guaranteed.

### **3 Segmental information**

The company writes only one class of business, namely suretyship insurance from the United Kingdom. Gross written premiums by destination were UK: £59,070,505; other EMEA £48,342,474; and US and Asia Pacific £13,427,163 (2006: UK: £91,137,375; other EMEA £27,560,000; and Asia Pacific £18,417,399).

The company has branches in France and Italy.

**MBIA UK INSURANCE LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
AS AT 31 DECEMBER 2007**

<b>4</b>	<b>Profit/(loss) on ordinary activities before taxation</b>	<b>2007</b>	<b>2006 restated</b>
		<b>£</b>	<b>£</b>
	Profit/(loss) on ordinary activities before tax is stated after charging:		
	Depreciation	892	-
	Foreign currency exchange gains/(losses)	5,289,191	(893,022)
	Auditors' remuneration (note 5)	380,929	242,825
	Directors' remuneration (note 8)	980,280	992,977
		<u>980,280</u>	<u>992,977</u>
<b>5</b>	<b>Auditors' remuneration</b>	<b>2007</b>	<b>2006</b>
		<b>£</b>	<b>£</b>
	Fees payable to the company's auditor for the audit of the company's annual accounts	297,131	140,012
	Fees for other services supplied pursuant to legislation	22,913	22,913
	Other services relating to taxation	60,885	79,900
		<u>380,929</u>	<u>242,825</u>
<b>6</b>	<b>Net operating expenses</b>	<b>2007</b>	<b>2006 restated</b>
		<b>£</b>	<b>£</b>
	Acquisition costs	4,017,428	3,223,749
	Change in deferred acquisition costs	(3,587,450)	(3,143,732)
		<u>429,978</u>	<u>80,017</u>
	Administrative expenses	4,374,960	3,666,981
	Gross operating expenses	4,804,938	3,746,998
	Reinsurance commissions (after deferral)	(343,724)	(586,491)
	Net operating expenses	<u>4,461,214</u>	<u>3,160,507</u>
<b>7</b>	<b>Investment income - non-technical account</b>	<b>2007</b>	<b>2006</b>
		<b>£</b>	<b>£</b>
	Income from investments	4,693,712	3,254,321
	Bank interest	905,587	365,183
	Amortisation of investments	187,395	38,572
		<u>5,786,694</u>	<u>3,658,076</u>

# MBIA UK INSURANCE LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2007

### 8 Staff Costs

Up until 1 July 2007, the company received seconded staff services from a parent undertaking, MBIA Insurance Corp, and was recharged for the salary costs of such staff. On 1 July 2007, the seconded staff became employees of the company. For the year ended 31 December 2007, the average number of seconded staff (up to 30 June 2007) and employees (from 1 July 2007) was 26.5 excluding the directors. The average number of staff seconded in 2006 was 24. Costs for 2006 disclosed below relate to costs recharged from MBIA Insurance Corp.

	2007 £	2006 £
Wages and salaries	4,181,434	3,345,372
Social security costs	626,826	196,336
Other pension costs and long-term incentives	912,366	198,598
	<u>5,720,626</u>	<u>3,740,306</u>

The directors received total remuneration of £980,280 (2006: £992,977). The highest-paid director received total remuneration of £354,387 (2006: £330,859).

### 9 Taxation

	2007 £	2006 restated £
<b>Domestic current year tax</b>		
Current tax charge	3,200,688	8,073
Taxation in respect of prior years	(666,301)	(257,959)
	<u>2,534,387</u>	<u>(249,886)</u>
<b>UK Corporation tax</b>		
Deferred tax		
Deferred tax debit current year	-	374,423
	<u>2,534,387</u>	<u>124,537</u>
<b>Tax on profit/(loss) on ordinary activities</b>		
<b>Factors affecting the tax charge for the year</b>		
Profit/(loss) on ordinary activities before taxation	<u>10,270,268</u>	<u>(11,386)</u>
Profit/(loss) on ordinary activities before taxation multiplied by standard rate of UK corporation tax of 30% (2006: 30%)	<u>3,081,080</u>	<u>(3,416)</u>
Effects of:		
Permanent differences	119,608	11,489
Taxation in respect of prior years	(666,301)	(257,959)
	<u>2,534,387</u>	<u>(249,886)</u>
<b>Current tax charge</b>		

**MBIA UK INSURANCE LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
AS AT 31 DECEMBER 2007**

**10 Tangible fixed assets**

	Leasehold Improvements	Office Furniture & Equipment	Computer Equipment	Total
	£	£	£	£
<b>Cost or valuation</b>				
At 1 January 2007	-	-	-	-
Additions	-	-	7,139	7,139
Transferred from MBIA Assurance SA	1,608,333	427,257	174,310	2,209,900
At 31 December 2007	<u>1,608,333</u>	<u>427,257</u>	<u>181,449</u>	<u>2,217,039</u>
<b>Depreciation and amortisation</b>				
At 1 January 2007	-	-	-	-
Charge for year	-	-	892	892
Transferred from MBIA Assurance SA	1,526,053	397,493	174,310	2,097,856
At 31 December 2007	<u>1,526,053</u>	<u>397,493</u>	<u>175,202</u>	<u>2,098,748</u>
<b>Net book value</b>				
At 31 December 2007	<u>82,280</u>	<u>29,764</u>	<u>6,247</u>	<u>118,291</u>
At 31 December 2006	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

# MBIA UK INSURANCE LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2007

11 Investments	Short-term < 1 year £	Long-term > 1 year £	Total £
<b>Cost</b>			
At 1 January 2007	18,929,281	65,548,847	84,478,128
Additions	8,458,047	42,190,838	50,648,885
Transfer	10,128,000	(10,128,000)	-
Investments maturing during the year	(9,997,500)	-	(9,997,500)
Transferred from MBIA Assurance SA (at amortised cost)	23,158,421	189,167,299	212,325,720
At 31 December 2007	<u>50,676,249</u>	<u>286,778,984</u>	<u>337,455,233</u>
<b>Amortisation</b>			
At 1 January 2007	(2,297)	(118,173)	(120,470)
Charge/(credit) for the year	1,284	(188,679)	(187,395)
Transfer	84,361	(84,361)	-
Eliminated on maturity	2,297	-	2,297
At 31 December 2007	<u>85,645</u>	<u>(391,213)</u>	<u>(305,568)</u>
<b>Carrying value</b>			
At 31 December 2007	<u>50,590,604</u>	<u>287,170,197</u>	<u>337,760,801</u>
At 31 December 2006	<u>18,931,578</u>	<u>65,667,020</u>	<u>84,598,598</u>

The market value of current asset investments, maturing within 1 year, as at 31 December 2007 was £50,566,224 (2006: £18,920,271).

Investments maturing in greater than one year comprise UK and French government gilts and other investments maturing between 2009 and 2056 as at 31 December 2007, of which 71% will mature by 2012. The market value of these fixed asset investments amount to £288,271,938 (2006: £64,929,688). The market value is below the carrying value of the investments above since a policy of amortised cost is being applied. No provision has been made for the diminution in the value of these assets since it is expected that the carrying value will be recovered via investment income and redemption proceeds.

The company did not hold any derivatives for investment purposes at 31 December 2007.

**MBIA UK INSURANCE LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
AS AT 31 DECEMBER 2007**

12	<b>Other debtors</b>	<b>2007</b>	<b>2006 restated</b>
		£	£
	Accrued interest receivable	4,531,905	946,398
	Amounts owed by parent and fellow subsidiary undertakings	838,578	2,024,058
	Other debtors including deferred tax asset	8,166,394	3,658,151
		<u>13,536,877</u>	<u>6,628,607</u>

**Deferred tax asset**

	Balance at 1 January	-	374,423
	Tax on unrealised investment (losses)/gains	-	(374,423)
	Transferred from MBIA Assurance SA	8,138,010	-
	Balance at 31 December	<u>8,138,010</u>	<u>-</u>

The deferred tax asset transferred from MBIA Assurance SA arises due to timing differences in profit recognition between local accounting policy and the related tax method. The deferred tax asset is expected to be realised as profit recognition is aligned in future periods.

13	<b>Prepayments and accrued income</b>	<b>2007</b>	<b>2006 restated</b>
		£	£
	Deferred acquisition costs	18,572,383	5,058,233
	Other prepayments and accrued income	29,908,310	2,103,290
		<u>48,480,693</u>	<u>7,161,523</u>

14	<b>Creditors: amounts falling due within one year</b>	<b>2007</b>	<b>2006 restated</b>
		£	£
	Amounts owed to parent and fellow subsidiary undertakings	1,128,742	10,810,512
	Other creditors	21,173,018	650,962
		<u>22,301,760</u>	<u>11,461,474</u>

The amounts owed to parent and fellow subsidiary undertakings are non-interest bearing current accounts which are repayable on demand.

15	<b>Share capital</b>	<b>2007</b>	<b>2006</b>
		£	£
	<b>Authorised</b>		
	100,000,000 Ordinary shares of £1 each	<u>100,000,000</u>	<u>100,000,000</u>
	<b>Allotted, called up and fully paid</b>		
	69,000,000 Ordinary shares of nominal value of £1 each (2006: 68,000,000)	<u>69,000,000</u>	<u>68,000,000</u>

## MBIA UK INSURANCE LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2007

#### 16 Reconciliation of movements in shareholders' funds

	Share Capital £	Share Premium £	Capital reserve £	Other reserves £	Profit and loss account £	Total £
At 1 January 2006	68,000,000	-	-	-	2,263,614	70,263,614
Profit for the year	-	-	-	-	3,063,853	3,063,853
At 31 December 2006 - as originally stated	68,000,000	-	-	-	5,327,467	73,327,467
Impact of 2006 restatement (see note 1.8)	-	-	-	-	(3,199,776)	(3,199,776)
At 1 January 2007 - as restated	68,000,000	-	-	-	2,127,691	70,127,691
Shares issued during the year	1,000,000	17,038,254	-	-	-	18,038,254
Capital contribution in year	-	-	5,000,000	-	-	5,000,000
Transfer of assets and liabilities of MBIA Assurance SA	-	-	-	88,667,986	-	88,667,986
Profit for the year	-	-	-	-	7,735,881	7,735,881
At 31 December 2007	69,000,000	17,038,254	5,000,000	88,667,986	9,863,572	189,569,812

The opening and closing shareholders' funds represent equity interests only.

In April 2007, MBIA UK (Holdings) Limited made a capital contribution in cash of £5 million to the company to improve the UK group's capital resources position.

On 8 October 2007, 1,000,000 ordinary shares of £1 each were issued by the company to its immediate parent company, to MBIA UK (Holdings) Limited in consideration for the transfer of MBIA UK (Holdings) Limited's 100% shareholding in MBIA Assurance SA. This transaction was treated as a group restructure and the shares issued by the company were valued at £18,038,254, representing the original cost of the shares in MBIA Assurance SA. Share premium of £17,038,254 was recognised.

On 28 December 2007, the individual assets and liabilities of MBIA Assurance SA were transferred under French law to the company by voluntary dissolution and liquidation. The amount representing the book value of the assets and liabilities transferred from MBIA Assurance SA less the cost of investment in MBIA Assurance SA was recognised in other reserves - see note 17.

## MBIA UK INSURANCE LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2007

#### 17 Transfer from MBIA Assurance SA

As noted above, the assets and liabilities of MBIA Assurance SA were transferred at book value to MBIA UK Insurance Limited. The individual assets and liabilities transferred are set out below:

	£
<b>Assets</b>	
Investments	212,325,720
Reinsurers' share of technical provisions - provision for unearned premiums	123,755,158
Debtors arising out of direct insurance operations: policyholders	262,520,864
Other debtors	12,758,873
Other assets	5,061,842
Prepayments and accrued income	13,670,016
<b>Total assets</b>	<b><u>630,092,473</u></b>
<b>Liabilities</b>	
Technical provisions - provision for unearned premiums	419,097,876
Creditors arising out of reinsurance operations	82,566,125
Other creditors including taxation and social security	19,632,747
Accruals and deferred income	2,089,485
<b>Total liabilities</b>	<b><u>523,386,233</u></b>
<b>Net assets</b>	106,706,240
Less: cost of investment in MBIA Assurance SA - see note 16	(18,038,254)
<b>Amount recognised in other reserves</b>	<b><u>88,667,986</u></b>

The profit after tax of MBIA Assurance SA under UK GAAP for the period from 1 January 2007 to 27 December 2007 was £28.0 million (2006: £12.5 million).

#### 18 Immediate parent undertaking and controlling party

The immediate parent undertaking is MBIA UK (Holdings) Limited, a company incorporated and registered in England and Wales. Copies of consolidated group financial statements for MBIA UK (Holdings) Limited can be obtained from MBIA, 1 Great St. Helen's, London EC3A 6HX.

The ultimate parent company and controlling party is MBIA Inc., a company incorporated in the state of Connecticut, United States. Copies of consolidated group financial statements for MBIA Inc. can be obtained from 113 King Street, Armonk, New York, 10504, USA.

#### 19 Related party transactions

The company has availed of the exemption in Financial Reporting Standard 8 from the requirement to disclose transactions with MBIA group entities as the consolidated group financial statements are publicly available. MBIA group entities include Channel Re, a reinsurance company in which MBIA Insurance Corp has a 17.4% equity ownership.

#### 20 Post balance sheet events

Subsequent to the balance sheet date, certain policies have matured or been terminated earlier than anticipated. Of the net unearned premium reserve at the balance sheet date, £4.7 million relates to policies which have either terminated or matured by the date of approval of these financial statements.