

**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 2008**

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# MBIA UK INSURANCE LIMITED

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<b>Directors</b>	C E Chaplin W C Fallon 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 25 Gresham Street London EC2V YHN  HSBC Paris Trocadero 112 Avenue Kleber 75016 Paris

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# MBIA UK INSURANCE LIMITED

## TABLE OF CONTENTS

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	Page(s)
Directors' report	1-10
Statement of directors' responsibilities	11
Independent auditors' report	12
Profit and loss account	13-14
Balance sheet	15
Notes to the financial statements	16-25

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# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

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The directors present their report and the audited financial statements for the year ended 31 December 2008.

### I. Principal activity

The principal line of business of MBIA UK Insurance Limited ("the Company") is the guarantee of both structured finance and public finance debt obligations in selected international markets.

Public finance obligations guaranteed by the Company include bonds or bank loans backed by publicly or privately owned public-purpose projects, investor-owned utilities as well as bonds issued by sovereign and sub-sovereign entities. Structured finance obligations include asset-backed securities ("ABS"), mortgage-backed securities ("MBS") and collateralized debt obligations ("CDOs"). Collateral supporting structured finance securities can include corporate bonds and loans, consumer loans, commercial or residential mortgages, leases, equipment and other operating assets and other contractual undertakings.

The financial guarantees issued by the Company in substantially all cases provide unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due. The obligations are generally not subject to acceleration, except that the Company may have the right, at its discretion, to accelerate insured obligations upon default or otherwise. The Company has also acted as a credit support provider for Credit Default Swaps issued by special purpose vehicles. In such cases, the Company's payment obligations are structured to mirror payment obligations under a typical financial guarantee.

#### **Regulatory environment**

The Company is regulated and supervised by the Financial Services Authority ("FSA") in the UK and is authorised to carry out insurance business in the UK and in the European Economic Area ("EEA") on a cross border services basis in accordance with Section 37 of the Financial Services and Markets Act 2000 ("FSMA") and Part III of Schedule 3 to FSMA. The Company operates in France through a French branch in accordance with specific provisions of the EC third non-life insurance directive (No. 92/49/EEC). The Company must, under Principle 4 of the FSA's Principles for Business Rules, maintain adequate financial resources, which are assessed by both the FSA and the Company through the Individual Capital Adequacy Standards ("ICAS") framework.

### II. Business and Financial Review

#### **Business environment**

##### *Economic and Financial Market Trends*

The Company experienced an extremely challenging market environment in 2008. The year started with a weakening of credit markets which ultimately resulted in the collapse of certain financial institutions together with unprecedented levels of volatility and uncertainty in markets around the world. As a financial guarantee insurance company, our business, and that of MBIA Insurance Corp. ("MBIA Corp."), who, as described below, provides certain support agreements (see "**Credit risk, Support Agreements with MBIA Corp.**") is materially affected by conditions in global financial markets and particularly by the deteriorating performance of residential mortgage-backed securities ("RMBS") and collateralized debt obligations ("CDOs"). Concerns about the potential impact of such exposures on financial guarantors served to reduce the demand for and use of financial guarantees. While global structured finance activity has been significantly curtailed, our activity has been further reduced by the decision in early 2008 to suspend writing new structured finance business. In the international public finance sector, where demand for financing still exists, activity has been reduced due to the prohibitively high cost of debt and the lack of available longer term funding as well as the ratings downgrade of the Company (see below) which resulted in the Company writing no new financial guarantee business in public finance during 2008.

In summary, new business activity in 2008 and projected new business for 2009 has been adversely impacted by:

- Downgrade of the credit ratings of MBIA Corp. and the Company (see below);
- Concerns about credit deterioration in financial guarantee insurers' insurance portfolios;
- Severe financial market dislocation impacting the structured finance activity, and

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

- Lack of competitive funding terms combined with reduction in appetite for longer-dated financial guarantees which severely limited new issuance in public finance.

### *Credit Ratings*

The Company experienced significant credit rating downgrades during 2008 and 2009 resulting in a dramatic reduction in new business activity. Due to the support agreements with MBIA Corp., the ratings of the Company mirror the ratings of MBIA Corp. The loss of Triple-A ratings by MBIA Corp. during the second quarter of 2008 resulted in a comparable reduction in ratings for the Company.

MBIA Corp's downgrades were triggered by several factors including credit deterioration in structured finance exposures during the first half of 2008 leading to negative actions by rating agencies for most financial guarantors. The ratings downgrades were also the result of factors other than measures of capital or claims-paying resources and included the rating agencies' views regarding a diminished outlook for new business generation, reduced financial flexibility, vulnerability to further stress in the residential mortgage sector, and declines in share price and CDS spreads. To that effect, Standard and Poor's ("S&P") and Moody's Investors Services, Inc. ("Moody's"), downgraded MBIA Corp.'s (and the Company's) triple-A insurance financial strength ratings in the second quarter of 2008. At MBIA's request, Fitch, Inc. ("Fitch") withdrew its rating of MBIA Corp. including the Company. In November 2008, Moody's issued a subsequent downgrade of MBIA Corp. including the Company. This action resulted in equivalent downgrades of the Company.

On 18 February 2009, MBIA Inc. announced that it had established a new U.S. public finance financial guarantee insurance company within the MBIA Inc. group by restructuring (the "Transformation") its principal insurance subsidiary, MBIA Corp. As part of the Transformation, the stock of MBIA Insurance Corp. of Illinois, a public finance financial guarantee insurance Company, was transferred by MBIA Corp. to a newly established intermediate holding Company, which is itself a subsidiary of MBIA Inc. This operating structure will facilitate both transparency and future capital raising efforts. MBIA Insurance Corp. of Illinois is expected to be renamed National Public Finance Guarantee Corporation ("MBIA Illinois" or "National") (see "**Strategy and future outlook, the Transformation**"). Further downgrades of MBIA Corp. and the Company occurred as a consequence of the Transformation. More specifically, S&P downgraded MBIA Corp. and the Company from AA to BBB+ Negative outlook and Moody's downgraded MBIA Corp. and the Company from Baa1 to B3 Developing outlook.

Financial strength ratings of the Company, MBIA Corp. and MBIA Inc. as at 25 March 2009 are summarized below:

Agency	Rating / Outlook		
	MBIA UK Insurance Limited	MBIA Corp.	MBIA Inc.
S&P	BBB+ / Negative Outlook	BBB+ / Negative Outlook	BB+ / Negative outlook
Moody's	B3 / Developing outlook	B3 / Developing outlook	Ba1 / Developing outlook
Fitch	Withdrawn	Withdrawn	Withdrawn

### **Balance sheet review**

As at 31 December 2008, the Company had guaranteed financial obligations with a gross par outstanding of £22.0 billion (2007: £22.1 billion), of which 14.5% is reinsured to third parties. Net par outstanding is £18.8 billion. The Company had 146 policies in issue (2007: 158 policies) as at 31 December 2008.

As at 31 December 2008, 81% (2007: 84%) of the Company's outstanding net par insured was rated A or above before giving effect to MBIA's guarantee. As at 31 December 2008, 69% (2007: 70%) of the outstanding public finance net par insured was rated A or above before the Company's guarantee while 94% (2007: 100%) of the outstanding structured finance net par insured was rated A or above before giving effect to the Company's guarantee. MBIA uses both an internally developed credit rating system as well as third-party rating sources in the analysis of credit quality measures of its insured portfolio. All ratings are as of the period end and represent S&P ratings. If transactions are not rated by S&P, a Moody's equivalent rating is used. If transactions are not rated by either S&P or Moody's, an MBIA equivalent rating is used.

As outlined in detail in the section "**Insurance Risk Management, claims reserving**", in the event that the Company determines that it must pay a claim or that a claim is probable and estimable with respect to an insured issue, it places the transaction on its "Classified List" and establishes a case basis reserve for that insured issue. As of December 31 2008 the Company had no financial guarantees on the Classified List.

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

The Company manages its capital resources to minimize its cost of capital while maintaining appropriate claims paying resources. The net assets of the Company are £228.9 million as at 31 December 2008 (2007: £189.6 million) while it had undiscounted claims paying resources of £782.6 million as at 31 December 2008 (2007: £767.2 million) reflecting net unearned premium reserves and unearned ceding commission.

The investment portfolio comprises high-quality fixed interest securities (UK and French government gilts) and short-term investments. As at 31 December 2008, the Company had unencumbered cash and investments of £406.2 million valued at amortised cost, of which £137.0 million (2007: £59.2 million) comprised cash and cash equivalents and short-term investments. The fair value of the investment portfolio as at 31 December 2008 was £413.1 million (book value: £397.2 million) based on quoted market values.

### **Key performance indicators 'KPIs'**

The Board monitors the progress of the Company by reference to the following KPIs:

KPI	2008	2007	Commentary
Net premiums written (£million)	8.2	105.6	Gross premiums written less outward reinsurance
Earned premiums, net of reinsurance (£million)	30.5	3.6	
Underwriting loss (£million)	(4.5)	(0.7)	Balance on technical account for general business
Claims paying resources (£million)	782.6	767.2	Shareholders' funds, net unearned premium reserve and unearned ceding commission (undiscounted)
Regulatory solvency margin (%)	1028%	802%	The Company's capital resources as a percentage of its capital resources requirement under FSA return rules

Claims paying resources reflecting the discounting of future installment premiums and ceding commission was £681.0 million as at 31 December 2008. A discount rate of 4.5% was used.

### **Results, performance and dividends**

Due to the adverse market conditions outlined above, the Company only issued one new policy in 2008. A combination of policy terminations, policy commutation and revisions to estimates of future premium resulted in negative gross written premium of £24.6 million for 2008 (2007: positive £120.8 million). Despite the challenging market environment, as outlined in last year's annual report, the maturity of the portfolio transferred from MBIA Assurance SA had a significant positive impact on earnings resulting in an increase in net premium earned from £3.6 million to £30.5 million.

The Company paid a net claim of £24.6 million (2007: nil) in order to commute a guarantee contract with a counterparty. The Company has no remaining exposure to this guarantee contract. As at 31 December 2008, the Company had no loss reserves (2007: nil).

Administration and acquisition expenses, excluding change in deferred acquisition costs, (as set out in note 6 to the financial statements) amounted to £10.1 million (2007: £8.4 million). Reduced levels of new business and a reduction in headcount to 26.1 employees (2007: 26.5 employees) resulted in expense savings which were offset by advisory fees associated with remediation activities. Note that 2007 employee numbers do not include the employees of the French and Italian branches who transferred with the MBIA Assurance SA business in December 2007.

Sterling weakened against the other two main currencies (the Euro and U.S. dollar) in which the Company operates, resulting in an unrealised foreign exchange gain of £44.5 million (2007: £5.3 million) being recognised for the year. This gain arises from the retranslation of the Company's investments which are denominated in Euro and U.S. dollar and also from the retranslation of future premium receivables denominated in foreign currency. As outlined in note 1.5, investments and premium receivable are considered to be a monetary asset and amounts denominated in foreign currency are retranslated at the rates of exchange prevailing at each balance sheet date. Unearned premium reserves are considered to be non-monetary liabilities and are not subject to retranslation.

The transfer of the business from MBIA Assurance SA resulted in a significant increase in the investment portfolio of the Company and investment income increased to £18.6 million (2007: £5.8 million).

The results of the Company for the year, as set out on page 14, show a retained profit on ordinary activities after tax of £45.7 million (2007: £7.7 million). The directors do not recommend the payment of a dividend for the year (2007: nil).

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

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### III. Strategy and future outlook

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, pricing and capital utilisation standards over the full life of the transaction. On 25 February 2008, MBIA Corp. announced the suspension of writing new structured finance business for a period of six months in order to i) increase capital safety margins and ii) evaluate and revise the credit and risk management criteria and policies, which resulted in the elimination of certain structured finance product lines. This announcement impacted the activities of the Company.

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. While the current dislocation in the credit market has either put projects on hold or shifted infrastructure funding back to the governments, over the longer term, privatisation and continued growth and development requirements should resume. This, in turn, should shift the burden of financing new projects back to the capital markets, where investors can benefit from the security of financial guarantees. As outlined above, the Company has suspended writing new 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.

The Company aims to improve efficiency in all areas of its operations through cost reduction; more streamlined underwriting; focused and intelligent investment in technological solutions; and human resources. In addition, the Company will continue to execute insurance portfolio management actions to de-lever risk exposure and improve the Company's overall capital adequacy.

#### *The Transformation*

In February 2009, after receiving the required regulatory approvals, MBIA Inc. transformed its principal insurance subsidiary, MBIA Corp., by transferring the existing and future U.S. public finance financial guarantee insurance business to MBIA Insurance Corp. of Illinois, an existing public finance financial guarantee insurance company now wholly owned by MBIA Inc. The separation of the U.S. public finance business from structured finance and international public finance businesses is a significant step towards re-entering and competing in these markets.

### IV. Insurance Risk Management

The financial guarantees issued by the Company in substantially all cases provide unconditional and irrevocable guarantees of the payment of the principal of, and interest or other amounts owing on, insured obligations when due. The obligations are generally not subject to acceleration, except that the Company may have the right, at its discretion, to accelerate insured obligations upon default. This form of payment obligation serves to mitigate (see "**Liquidity Risk**" below). The Company provides financial guarantees principally in the European Union but also in other select international markets. The Company recognises 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 five ways: risk management framework, underwriting standards, risk transfer, subsequent monitoring by the Insured Portfolio Management ("IPM") Group and claims reserving.

#### *Risk management framework*

The process of risk acceptance and risk management is addressed through a framework of policies, procedures and internal controls. In general, risk management policies are developed by MBIA Corp. with input from UK risk management personnel ("Risk Management"). Those risk management policies specific to the Company are approved by the Company's Board prior to acceptance and to ongoing review by management, Risk 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 Company's Audit Committee is responsible for satisfying itself that a proper internal control framework exists within the Company 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 best ensure that it has the financial strength and capital adequacy to meet the requirements of policyholders.

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

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The Company has identified those risks which it considers to have the greatest potential to have a material negative impact on its business. These principal risks include fluctuations in the timing, frequency and severity of financial guarantee claims compared with the Company's expectations, losses from the investment portfolio, failure to assess and manage operational risk (including inadequate controls and procedures over outsourced functions), and failure to retain key personnel.

### *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. 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 and regulatory structures and other security provisions, viable tax and economic bases and/or project feasibility, including a satisfactory consulting engineer's report, if applicable. Some risk types within public finance also require cash flow sensitivity testing to analyse 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 structure, including legal segregation of the assets, the size and source of first loss protection, asset performance triggers and financial covenants. Cash flow analysis of the underlying collateral and sensitivity testing using a scenario-based analysis, "Monte Carlo" probability analysis, or both, to examine the impact of remote events on credit performance form a key part of the analysis.

Financial guarantors use a variety of approaches to assess the underlying credit risk profile of their guaranteed portfolios. The Company utilizes 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 (Fitch, Moody's and S&P).

The Company operates within MBIA Corp. 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 has utilised reinsurance to further manage its exposure to its insurance portfolio. 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 and the Company's credit analysts continuously review the 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 Corp., whereby MBIA Corp. undertakes to reimburse the Company for losses incurred in each calendar year which exceed in aggregate U.S.\$100,000,000 (£69,553,000 at December 31, 2008 rates) (see "**Credit Risk, Support agreements with MBIA Corp.**" below). As outlined in the section headed "**Business Environment, Credit Ratings**" above, the rating of MBIA Corp. has been reduced to BBB+ negative outlook /B3- Developing by S&P and Moody's, respectively. The directors of the Company review the creditworthiness of MBIA Corp., at least annually or as circumstances require.

### *Subsequent monitoring*

The Company has its own IPM staff and also utilises MBIA Corp.'s IPM Division. The directors of the Company, 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 IPM Division works, as appropriate, with the issuer, trustee, bond counsel, servicer, underwriter and other interested parties in an attempt to alleviate or remedy the problem in order to minimise potential defaults. The IPM Division works closely with Risk

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

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Management 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. The IPM Division 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 the IPM Division 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 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 2008 the Company had no financial guarantees on the "Classified List" and one financial guarantee on "Caution List-High".

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.

## V. Financial Risk Management

A key financial management goal is to ensure that the proceeds from financial assets are sufficient to fund the obligations arising from financial guarantees as they fall due and to be able to make such payments without incurring losses on the investment portfolio. Thus, in the first instance, achieving this objective requires managing risk within the insurance portfolio (see **Insurance Risk Management**, above). Sources of claims payments include the investment portfolio, reinsurance assets, MBIA Corp. support agreements and policyholder liabilities (meaning future premium obligations). All of these are subject to **Credit risk** (see below). In addition, the investment portfolio is subject to market risk, particularly **Interest rate risk** and **Currency risk** (see below). The two primary goals of the Company's investment guidelines are the preservation of capital and the maintenance of reasonable liquidity (see **Liquidity risk** below).

### **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. In periods of rising and/or volatile interest rates and credit spreads, profitability could be adversely affected should the Company have to liquidate these securities.

The Company minimises its exposure to interest rate risk through active portfolio management to ensure a proper mix of the types of securities held and to stagger the maturities of its fixed-income securities.

### **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 significant currencies to which the Company is exposed are the U.S. 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.

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

### **Credit risk**

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

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

### *Insured portfolio*

The Company is exposed to credit risks in their 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 U.S. RMBS and Structured Finance CDO (referred to as CDOs of ABS or Multi-Sector CDOs) sectors. The Company has no direct exposure to U.S. RMBS. It does have indirect exposure to U.S. 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 U.S. residential mortgages, particularly among securitisations containing U.S. sub-prime and second lien collateral.

The Company is also exposed to European structured finance risk, principally in the form of RMBS, Commercial Real Estate, Collateralised Loan Obligations and ABS, either directly or through CDOs. Thus, far European structured finance has not shown the deterioration seen in the US structured finance. Nonetheless, this is being monitored carefully.

As at the date of this report, the Company believes that the remainder of its insured portfolio is performing satisfactorily. As outlined in "Insurance Risk Management, subsequent monitoring", individual credits are monitored and reviewed on a regular basis, and any individual credit may, from time-to-time, be subject to stress or other volatility. The potential for such volatility can increase during times of economic stress.

### *Investment portfolio*

The Company manages the investment portfolio in a conservative manner to maintain cash and liquid securities. The Company values its investments at amortised cost. The fair value of the investment portfolio as at 31 December 2008 was £413.1 million (book value: £397.2 million) based on quoted market values. 97% of the Company's fixed-income portfolio (by book value) is either rated triple-A or in short term liquidity. An analysis of the investment portfolio as at 31 December 2008 is set out below:

<u>Investment type</u>	<u>Rating</u>	<u>Percentage of portfolio</u>
Sovereign (Zone A) bonds	AAA	76.8%
Short term liquidity	N/a	9.8%
Supra/Sovereign agency (non-guaranteed) bonds	AAA	4.0%
Sovereign (Zone A) guaranteed entity bonds	AAA	3.6%
Structured Finance RMBS bonds	AAA	2.3%
Sovereign (Zone A) guaranteed RMBS bond	AAA	0.9%
Corporate bond	AA	1.9%
Sub sovereign/regional government (Zone A) bond	AA	0.7%
Total		<u>100.0%</u>

Zone A comprises all the EC Member States and all other countries which are full members of the Organisation for Economic Cooperation and Development (OECD) and those countries which have concluded special lending arrangements with the International Monetary Fund.

70% of the investment portfolio is denominated in GBP while 27% is in Euro. 85% of the portfolio is fixed interest with 5% floating rate and the remainder in short term liquidity.

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

### *Third party Reinsurance*

Reinsurance enables the Company to cede exposure for purposes of syndicating risk and increasing its capacity to write new business while complying with its single risk and credit guidelines. When a reinsurer is downgraded by one or more of the rating agencies, less capital credit is given to the Company under rating agency models and the overall value of the reinsurance to the Company is reduced. The Company generally retains the right to reassume the business ceded to reinsurers under certain circumstances, including a reinsurer's rating downgrade below specified thresholds. In 2008, the Company recaptured business from three reinsurers as a result of their ratings downgrades. Additionally, business from another reinsurer was recaptured during 2008 unrelated to their ratings. The Company will continue to evaluate its use of reinsurance during 2009, which may result in future commutations with reinsurers.

As a primary insurer, the Company is required to honour its obligations to its policyholders whether or not MBIA 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 reinsurers are monitored by the Company on a regular basis. The downgrade or default of one or more of the Company's third party reinsurers 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 third party reinsurers are covered by the Excess of Loss Reinsurance Agreement and the Net Worth Maintenance Agreement described in the section headed "Support Agreements with MBIA Corp." below (subject to the terms of such agreements).

The aggregate amount of insured par ceded by the Company to third party reinsurers under reinsurance agreements was £3.2 billion (2007: £3.6 billion). The decrease from 2007 is due to the maturity and termination of insured par and the reinsurance commutations executed during 2008. The following table presents the credit ratings, ratings status and percentage of outstanding par ceded by reinsurer as of 31 December 2008.

<u>Reinsurers</u>	<u>Standard &amp; Poor's Rating (Status)</u>	<u>Moody's Rating (Status)</u>	<u>Percentage of Gross Par</u>
Channel Reinsurance Ltd.	AA- (Negative Outlook)	Baa1 (Negative Outlook)	7.5%
Ambac Assurance Corporation	A (Negative Outlook)	Baa1 (Developing)	2.9%
Mitsui Sumitomo Insurance Company Ltd.	AA (Stable)	Aa3 (Stable)	1.5%
Swiss Reinsurance Company	AA- (Stable)	Aa2 (Negative Outlook)	1.2%
Assured Guaranty Corp.	AAA (Stable)	Aa2 (Stable)	0.8%
Assured Guaranty Re Ltd.	AA (Stable)	Aa3 (Stable)	0.2%
Syncora Guarantee Re Ltd.	B (Watch Developing)	Caa1 (Rating Under Review)	0.4%
Total			<u>14.5%</u>

Several of the Company's reinsurers, including Channel Reinsurance Ltd, Ambac Assurance Corporation, Assured Guaranty Corp., Assured Guaranty Re Ltd., Swiss Reinsurance Company and Syncora Guarantee Re Ltd. (formerly known as XL Financial Assurance), have had their credit ratings either downgraded or put on negative watch by one or more of the major rating agencies between December 2007 and December 2008. Although there was no material impact on the Company for any of the rating agency actions through December 2008 relating to these reinsurers, a further downgrade of one or more of these reinsurers could require the establishment of reserves against any receivables due from the reinsurers. Channel Reinsurance Ltd's rating by S&P and Moody's has been withdrawn since year end.

### *Support Agreements with MBIA Corp.*

MBIA 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 in addition to its own available capital and by third party reinsurance.

The creditworthiness of MBIA Corp. is impacted by many of the same factors that impact the Company, especially with respect to credit risks embedded in transactions which MBIA Corp. has guaranteed. Similar to

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

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the Company, MBIA 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 U.S. residential mortgages (sub-prime and second lien in particular), MBIA Corp. has already made case loss reserves for certain second lien RMBS transactions and recognized incurred credit impairment estimates on certain Multi-Sector CDOs. Additionally, while further deterioration in these sectors is generally viewed as possible and further deterioration in other structured finance sectors could occur, the extent and duration of any future continued deterioration and impact on MBIA Corp. and the magnitude of additional claims it might have to pay is unknown. Similarly, while a number of governmental and private sector initiatives are being contemplated to address the credit deterioration observed in the U.S. and international credit markets, 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 Corp. and the Company guarantee.

As at 31 December 2008, the Company had guaranteed financial obligations with a gross par outstanding of £22.0 billion before allowance for third party reinsurance and support agreements with MBIA 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 the Company's retained liability at the previous year end plus the principal sum outstanding under the Company's two largest financial guarantees and equates to an annual limit of approximately £5.95 billion as at 31 December 2008.
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 Corp.'s policyholder surplus. The limit is estimated at £750 million as at 28 February 2009 based on the pro forma capital position of MBIA Corp. at 31 December 2008 reflecting the separation of the U.S. public finance business announced in February 2009.

The Company has not made any claim under either the Excess of Loss Reinsurance Agreement or Net Worth Maintenance Agreement to date.

The Company remains liable on a primary basis for all reinsured risk whether to third party reinsurers and/or MBIA Corp., and although the Company believes that its reinsurers remain capable of meeting their obligations, there can be no assurance of such in the future.

### **Liquidity risk**

As a financial services company, we carefully manage liquidity risk, which is the probability that an enterprise will not have sufficient resources to meet contractual payment obligations when due. Management of liquidity risk is of critical importance to financial services companies, and most failures of financial institutions have occurred in large part due to their inability to maintain sufficient liquidity resources under adverse circumstances. Generally, a lack of sufficient resources results from an enterprise's inability to sell assets at values necessary to satisfy payment obligations and/or an unexpected acceleration of payments to settle liabilities.

Liquidity risk arises in our insurance operations when claims on insured exposures result in payment obligations, when operating cash inflows fall due primarily to depressed writings of new insurance or lower investment income, or when assets experience credit defaults or significant declines in fair value. Prior to 2008, the Company had not made any loss payments. The Company's financial guarantee insurance business model is built upon the premise of "pay-as-you-go" cash flows. Its financial guarantee contracts cannot be accelerated (absent an insolvency or payment default of the Company), thereby mitigating liquidity risk. However, when a default or impairment of an insured obligation occurs, the Company encounters liquidity risk resulting from its irrevocable pledge to pay principal and interest, or other amounts owing on insured obligations, when due. Additionally, the Company encounters liquidity risk in its insurance operations associated with the payment of operating expenses.

Our liquidity risk management framework monitors cash and liquid asset resources. Members of the Company's senior management undertake regular reviews, at least quarterly, which consider the financial position of the Company, the profile and liquidity of the investment portfolio, results of stress scenarios and potential contingency plans with the aim of anticipating the liquidity needs of the Company. As at 31 December 2008, the Company has determined that the liquidity position of the Company was sufficient to meet cash

# MBIA UK INSURANCE LIMITED

## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

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requirements under both stress scenarios and probabilistic measurements. In addition, it is an objective of the Company's investment guidelines to maintain reasonable liquidity in the Company's investment portfolio.

In addition, the Company has support arrangements in place, through its Net Worth Maintenance and Excess of Loss Reinsurance Agreements with MBIA Corp. (described under the section headed "*Support Agreements with MBIA Corp.*" above) to cover unexpected levels of claims.

We believe that we have adequate resources to meet our ongoing liquidity needs in both the short-term and the long-term. However, if the current market dislocation and economic conditions persist for an extended period of time or worsen, the Company's liquidity resources could experience further stress.

### Directors and directors' interests

The following directors held office in 2008:

C E Chaplin	D M Zurkow
T G McLoughlin (resigned 5 March 2009)	G H C Wakefield
R D Wertheim	K G Cox
P C Sullivan	A F Sykes
C E Weeks	W C Fallon (appointed 5 March 2009)

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.

### 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 2008 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.

  
C E Weeks  
Director

Dated: 25 March 2009

## **MBIA UK INSURANCE LIMITED**

### **STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE YEAR ENDED 31 DECEMBER 2008**

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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 2008 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 2008 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.

*PricewaterhouseCoopers LLP*

**PricewaterhouseCoopers LLP**

Chartered Accountants and Registered Auditors, London

Dated: 25 March 2009

# MBIA UK INSURANCE LIMITED

## PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008

### Technical account - general business

	Notes	2008 £'000	2008 £'000	2007 £'000	2007 £'000
Gross premiums written		(24,560)		120,840	
Outward reinsurance premiums		<u>32,734</u>		<u>(15,207)</u>	
Net premiums written			8,174		105,633
Change in gross provision for unearned premiums		59,441		(115,784)	
Change in provision for unearned premiums, reinsurers' share		<u>(37,153)</u>		<u>13,784</u>	
			22,288		(102,000)
<b>Earned premiums net of reinsurance</b>			<u>30,462</u>		<u>3,633</u>
Other technical income			761		145
<b>Total technical income</b>			<u>31,223</u>		<u>3,778</u>
Claims paid, net of salvage recovery					
- gross amount		(27,149)		-	
- reinsurers' share		<u>2,585</u>		<u>-</u>	
<b>Claims incurred, net of reinsurance</b>	2		(24,564)		-
Net operating expenses	6		(11,172)		(4,461)
<b>Total technical charges</b>			<u>(35,736)</u>		<u>(4,461)</u>
<b>Balance on the general business technical account</b>			<u>(4,513)</u>		<u>(683)</u>

## MBIA UK INSURANCE LIMITED

### PROFIT AND LOSS ACCOUNT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

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Non-technical account	Notes	2008 £'000	2007 £'000
<b>Balance on the general business technical account</b>		(4,513)	(683)
Other income	4	44,459	5,289
Investment income	7	18,573	5,786
Investment expenses and charges		<u>(514)</u>	<u>(122)</u>
<b>Profit on ordinary activities before taxation</b>	4	58,005	10,270
Tax on profit on ordinary activities	9	<u>(12,336)</u>	<u>(2,534)</u>
<b>Retained profit for the financial year</b>		<u><u>45,669</u></u>	<u><u>7,736</u></u>

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.

# MBIA UK INSURANCE LIMITED

## BALANCE SHEET AS AT 31 DECEMBER 2008

	Notes	2008 £'000	2008 £'000	2007 £'000	2007 £'000
<b>Assets</b>					
Tangible fixed assets	10		25		118
Investments	11		397,181		337,761
Reinsurers' share of technical provisions					
Provision for unearned premiums			108,919		146,160
<b>Debtors arising out of direct insurance operations:</b>					
- policyholders			449,555		484,395
- reinsurers			14,221		-
Other debtors	12		17,715		13,537
Cash and cash equivalents			9,065		8,608
Prepayments and accrued income	13		36,467		48,481
<b>Total assets</b>			<u>1,033,148</u>		<u>1,039,060</u>
<b>Liabilities</b>					
<b>Capital and reserves</b>					
Called up share capital	15	69,000		69,000	
Share premium account	16	17,038		17,038	
Capital reserve	16	5,000		5,000	
Other reserves	16	7,324		88,668	
Profit and loss account	16	130,533		9,864	
Total shareholders' funds			228,895		189,570
<b>Technical provisions</b>					
Provision for unearned premiums			633,084		692,858
<b>Creditors - amounts falling due within one year</b>					
Creditors arising out of reinsurance operations			77,037		103,387
Other creditors including taxation and social security	14		64,546		22,302
Deferred commission income			29,586		30,943
<b>Total liabilities</b>			<u>1,033,148</u>		<u>1,039,060</u>

The financial statements on pages 13 to 25 were approved by the Board on 25 March 2009 and were signed on its behalf by:

  
C E Weeks  
Director

# **MBIA UK INSURANCE LIMITED**

## **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008**

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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 2007 and applicable accounting standards in the United Kingdom.

The Company has availed 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 17 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 2008.

#### **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.

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 recognises the change in the year it arises.

##### **Other technical income**

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

## **MBIA UK INSURANCE LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2008**

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#### **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. Provision has been made for any deficiencies arising when unearned premiums are insufficient to cover deferred acquisition costs.

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 interest and/or 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. The discount rate used to calculate the present value of the anticipated debt service payments takes account of the expected investment income receivable between inception and settlement on the assets held to cover the provisions. Any case basis loss provision is calculated gross of any reinsurance recoveries.

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. Where applicable, deductions are made for salvage and other recoveries.

When the Company becomes entitled to the underlying collateral of an insured credit under salvage and subrogation rights as a result of a claim payment and the recovery of such salvage is probable and reasonably estimable, it records salvage and subrogation as an asset. Such amounts are included within "Other assets" and corresponding salvage and subrogation amounts due to reinsurers are included within "Other liabilities" in the Company's balance sheet. Any salvage and other recoveries are calculated based on the present value of the anticipated cash inflows over the expected period of recovery less any estimated expenses associated with collecting the estimated recoveries. The amount the Company records as salvage and subrogation may be influenced by several factors during

## **MBIA UK INSURANCE LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2008**

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any period, such as the level of claim payments made for which the Company is entitled to reimbursements, amounts collected and impairment write-downs.

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.

#### **Reinsurance**

Contracts entered into by the Company with reinsurers, under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts. Contracts that do not meet these classification requirements are classified as financial instruments. The Company does not have any contracts that do not meet the classification requirements for insurance contracts. Insurance contracts entered into by the Company under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts, provided there is significant transfer of insurance risk.

The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability. Reinsurance recoveries in respect of estimated claims incurred but not reported are assumed to be consistent with the historical pattern of such recoveries, adjusted to reflect changes in the nature and extent of the Company's reinsurance programme over time. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies. The reinsurers' share of claims incurred, in the profit and loss account, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are accounted in the profit and loss account as 'Outward reinsurance premiums' in the same accounting period as the premiums for the related insurance business.

#### **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.

# MBIA UK INSURANCE LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2008

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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	straight line over the remaining term of the lease
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 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 date, with the exchange gains and losses included in the profit and loss 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.

# MBIA UK INSURANCE LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2008

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.

### 2 Claims incurred, net of reinsurance

During the year the Company commuted a contract in respect of a Structured Finance CDO it had guaranteed. No claim provision had been in place in respect of this contract as at 31 December 2007. The CDO had suffered deterioration in performance of the underlying collateral and the Company established a claim provision of £24.6 million during 2008. In order to mitigate the risk of incurring further losses and to reduce exposure to this CDO, the Company agreed to commute the contract and paid a net claim after reinsurance and salvage recovery of £24.6 million. 9.5% of this contract was reinsured to Channel Re. The amount owing from Channel Re was outstanding at year end and is shown as a reinsurance debtor in the balance sheet.

As at 31 December 2008, the commutation claim had been paid in full and the salvage recovery had been received. The Company has no remaining exposure to this guarantee contract.

### 3 Segmental information

The Company writes only one class of business, namely suretyship insurance from the United Kingdom. The Company did not write any substantial amount of new business and a combination of policy terminations, commutations and revisions to estimates of future premium resulted in negative gross written premium of £24.6 million (2007: positive £120.8 million) for the year. Gross written premiums by destination were UK: £16.5 million negative; other European Monetary Economic Area (EMEA) £4.1 million negative; and US and Asia Pacific £4.0 million negative (2007: UK: £59.1 million positive; other EMEA £48.3 million positive; and Asia Pacific £13.4 million positive).

The Company has a branch in France. The Italian branch was closed for operational purposes on 31 May 2008.

4	Profit on ordinary activities before taxation	2008 £'000	2007 £'000
	Profit on ordinary activities before tax is stated after charging/(crediting):		
	Depreciation	122	1
	Foreign currency exchange gains	(44,459)	(5,289)
	Auditors' remuneration (note 5)	328	381
	Directors' remuneration (note 8)	1,109	1,101
		<u>1,109</u>	<u>1,101</u>
5	Auditors' remuneration	2008 £'000	2007 £'000
	Fees payable to the Company's auditor for the audit of the Company's annual accounts	264	297
	Fees for other services supplied pursuant to legislation	14	23
	Other services relating to taxation	50	61
		<u>328</u>	<u>381</u>

# MBIA UK INSURANCE LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2008

6	<b>Net operating expenses</b>	<b>2008</b>	<b>2007</b>
		<b>£'000</b>	<b>£'000</b>
	Acquisition costs	121	4,017
	Change in deferred acquisition costs	2,558	(3,587)
		<u>2,679</u>	<u>430</u>
	Administrative expenses	10,008	4,375
	Gross operating expenses	<u>12,687</u>	<u>4,805</u>
	Reinsurance commissions (after deferral)	(1,515)	(344)
	Net operating expenses	<u><u>11,172</u></u>	<u><u>4,461</u></u>
7	<b>Investment income - non-technical account</b>	<b>2008</b>	<b>2007</b>
		<b>£'000</b>	<b>£'000</b>
	Income from investments	17,661	5,219
	Bank and other interest	423	380
	Amortisation of investments	489	187
		<u>18,573</u>	<u>5,786</u>

### 8 Staff costs

For the year ended 31 December 2008 the average number of employees (including the French branch) was 26.1. The average number of seconded staff (up to 30 June) and employees (from 1 July) in 2007 was 26.5. These employee numbers exclude the directors.

	<b>2008</b>	<b>2007</b>
	<b>£'000</b>	<b>£'000</b>
Wages and salaries	5,269	4,182
Social security costs	801	627
Other pension costs and long-term incentives	(220)	912
	<u>5,850</u>	<u>5,721</u>

The directors received total remuneration of £1,108,917 (2007: £1,100,584). The highest-paid director received total remuneration of £540,993 (2007: £472,094).

# MBIA UK INSURANCE LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2008

9	Taxation	2008 £'000	2007 £'000
	<b>UK corporation tax at 28.5% (2007: 30%)</b>		
	Current tax on income for the period	16,385	3,200
	Taxation in respect of prior years	(1,184)	(666)
	Foreign tax - current tax on income for the period	(412)	-
	<b>Current tax charge</b>	<u>14,789</u>	<u>2,534</u>
	<b>Deferred tax</b>		
	Deferred tax credit - current year	(2,453)	-
	<b>Tax on profit on ordinary activities</b>	<u>12,336</u>	<u>2,534</u>
	<b>Factors affecting the tax charge for the year</b>		
	Profit on ordinary activities before taxation	<u>58,005</u>	<u>10,270</u>
	Profit on ordinary activities before taxation multiplied by standard rate of UK corporation tax of 28.5% (2007: 30%)	<u>16,531</u>	<u>3,081</u>
	Effects of:		
	Permanent differences	(558)	119
	Taxation in respect of prior years	(1,184)	(666)
	<b>Current tax charge</b>	<u>14,789</u>	<u>2,534</u>

The relevant standard rate of UK corporation tax for the Company was changed from 30% to 28% with effect from 1 April 2008. For the purpose of reconciliation of the tax charge for the year, a quarterly average rate of 28.5% has been applied as a standard rate.

### 10 Tangible fixed assets

	Leasehold Improvements £'000	Office Furniture & Equipment £'000	Computer Equipment £'000	Total £'000
<b>Cost or valuation</b>				
At 1 January 2008	1,608	427	182	2,217
Additions	-	28	1	29
At 31 December 2008	<u>1,608</u>	<u>455</u>	<u>183</u>	<u>2,246</u>
<b>Depreciation and amortisation</b>				
At 1 January 2008	1,526	398	175	2,099
Charge for year	82	35	5	122
At 31 December 2008	<u>1,608</u>	<u>433</u>	<u>180</u>	<u>2,221</u>
<b>Net book value</b>				
At 31 December 2008	<u>-</u>	<u>22</u>	<u>3</u>	<u>25</u>
At 31 December 2007	<u>82</u>	<u>29</u>	<u>7</u>	<u>118</u>

**MBIA UK INSURANCE LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
AS AT 31 DECEMBER 2008**

11 Investments	Short-term < 1 year £'000	Long-term > 1 year £'000	Total £'000
<b>Cost</b>			
At 1 January 2008	50,676	286,779	337,455
Additions	51,733	52,457	104,190
Transfer	68,109	(68,109)	-
Investments maturing during the year	(43,965)	(619)	(44,584)
At 31 December 2008	<u>126,553</u>	<u>270,508</u>	<u>397,061</u>
<b>Amortisation</b>			
At 1 January 2008	85	(391)	(306)
Charge/(credit) for the year	(330)	(159)	(489)
Transfer	(868)	868	-
Eliminated on maturity	(269)	944	675
At 31 December 2008	<u>(1,382)</u>	<u>1,262</u>	<u>(120)</u>
<b>Carrying value</b>			
<b>At 31 December 2008</b>	<u>127,935</u>	<u>269,246</u>	<u>397,181</u>
<b>At 31 December 2007</b>	<u>50,591</u>	<u>287,170</u>	<u>337,761</u>

The market value of current asset investments, maturing within 1 year, as at 31 December 2008 was £129,064,000 (2007: £50,566,000).

Investments maturing in greater than one year comprise UK and French government gilts and other investments maturing between 2010 and 2056 as at 31 December 2008, of which 69% will mature by 2013. The market value of the long term investments was £284,065,000 (2007: £288,272,000). The market value is above the carrying value of the investments 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 2008.

# MBIA UK INSURANCE LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2008

<b>12</b>	<b>Other debtors</b>	<b>2008</b>	<b>2007</b>
		<b>£'000</b>	<b>£'000</b>
	Accrued interest receivable	5,435	4,532
	Amounts owed by parent and fellow subsidiary undertakings	53	839
	Deferred tax asset (see below)	12,170	8,138
	Other debtors	57	28
		<u>17,715</u>	<u>13,537</u>

The amounts owed by MBIA group entities to the Company are interest bearing on amounts over six months old and are repayable within 30 days on receipt of a written request from the Company.

	<b>2008</b>	<b>2007</b>
	<b>£'000</b>	<b>£'000</b>
<b>Deferred tax asset</b>		
Balance at 1 January	8,138	-
Adjustment to amount transferred from MBIA Assurance SA	1,579	-
Credit to profit and loss account	2,453	-
Transferred from MBIA Assurance SA	-	8,138
Balance at 31 December	<u>12,170</u>	<u>8,138</u>

The deferred tax asset arises due to timing differences in profit recognition in the French branch 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.

<b>13</b>	<b>Prepayments and accrued income</b>	<b>2008</b>	<b>2007</b>
		<b>£'000</b>	<b>£'000</b>
	Deferred acquisition costs	15,894	18,572
	Other prepayments and accrued income	20,573	29,909
		<u>36,467</u>	<u>48,481</u>

<b>14</b>	<b>Creditors: amounts falling due within one year</b>	<b>2008</b>	<b>2007</b>
		<b>£'000</b>	<b>£'000</b>
	Amounts owed to parent and fellow subsidiary undertakings	40,675	1,129
	Other creditors including tax and social security	23,871	21,173
		<u>64,546</u>	<u>22,302</u>

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

<b>15</b>	<b>Share capital</b>	<b>2008</b>	<b>2007</b>
		<b>£'000</b>	<b>£'000</b>
	<b>Authorised</b>		
	100,000,000 Ordinary shares of £1 each	<u>100,000</u>	<u>100,000</u>
	<b>Allotted, called up and fully paid</b>		
	69,000,000 Ordinary shares of nominal value of £1 each (2007: 69,000,000)	<u>69,000</u>	<u>69,000</u>

## MBIA UK INSURANCE LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) AS AT 31 DECEMBER 2008

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

	Share Capital £'000	Share Premium £'000	Capital reserve £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
At 1 January 2008	69,000	17,038	5,000	88,668	9,864	189,570
Adjustment in year	-	-	-	(6,344)	-	(6,344)
Transfer in year	-	-	-	(75,000)	75,000	-
Profit for the year	-	-	-	-	45,669	45,669
At 31 December 2008	69,000	17,038	5,000	7,324	130,533	228,895

The opening and closing shareholders' funds represent equity interests only. The adjustment to "Other reserves" in the year reflects adjustments to the carrying value of the deferred commission income and related deferred tax assets transferred from MBIA Assurance SA on 28 December 2007.

The directors consider that a significant proportion of the "Other reserves" representing the net assets transferred from MBIA Assurance SA in December 2007 are now realised and have therefore transferred an amount of £75 million to "Profit and Loss account" reserve. Other reserves are non-distributable.

#### 17 Immediate parent undertaking and controlling party

The immediate parent undertaking is MBIA UK (Holdings) Limited, a company incorporated and registered in England and Wales.

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 or on the ultimate parents' website [www.mbia.com](http://www.mbia.com).

#### 18 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 Corp. has a 17.4% equity ownership.

#### 19 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, £32.5 million relates to policies which have either terminated or matured by the date of approval of these financial statements.