



MBIA Written Testimony



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Written Testimony - MBIA

The Financial Guarantee Insurance Industry

Financial guarantee insurance companies are referred to as “monolines” because they are legally authorized to sell only one line of insurance: their financial guarantee. This guarantee is unconditional and irrevocable, and it assures the timely payment of contracted principal and interest to investors holding insured bonds. Central to the business strategy of the monoline financial guarantors is the companies’ Triple-A ratings. All of the other activities of the financial guarantee companies, including risk management and deal review, portfolio monitoring and remediation activities, are designed to protect it.

Benefits to Issuers and Investors

The financial guarantee industry provides an important service to debt issuers, investors and the global capital markets. For example, both issuers and investors benefit from the transparency and uniformity that MBIA’s guarantee brings to an otherwise complex and opaque market, as bond insurance helps “commoditize” municipal securities from different parts of the country under different governing laws and regulations that are both taxable and tax-exempt. For issuers, the Triple-A rating on a bond reduces borrowing costs, makes the bond more marketable, and provides easier and more effective access to the capital markets while ensuring a streamlined execution. Additionally, in the case of municipal bonds, bond insurance benefits taxpayers because it lowers overall borrowing costs and enables local projects to be funded at reduced costs.

Monoline credit enhancement plays an important role in deepening capital market access for complex, large scale, and long tenor funding requirements (typically, infrastructure and public projects) which are traditionally outside the scope of bank or unwrapped financing. In addition the financial guarantee product increases efficiency by providing capital market liquidity for funding of otherwise illiquid credits.

Investors are protected with bond insurance on their investments in at least two ways: they have the insurer’s unconditional guarantee of timely payment of interest and contracted principal in the event of a default, and they have added protection from the provisions

monolines negotiate into the transaction, enabling the guarantors to monitor the credit and effectively remediate it. Additionally, the Triple-A “wrap” protects against downgrade and credit losses on the underlying security.

Background on the Industry

The financial guarantee industry has its roots in the public sector, where bond insurance helps finance essential public works projects such as hospitals, bridges, roads, and airports. In the early 1990s, the monoline insurers began providing credit enhancement to structured finance transactions, which are securities backed by assets such as credit card receivables and mortgages, as well as pools of corporate bonds and loans. Today the industry guarantees financings around the world for a wide variety of debt instruments, including projects for private finance initiatives and public-private partnerships. The industry has guaranteed nearly \$6 trillion in public- and private-sector debt during its 36-year history, and according to the Association for Financial Guaranty Insurers, has saved U.S. municipalities an estimated \$40 billion in interest costs since 1971.

MBIA

MBIA, the world’s leading monoline financial guarantee insurance company, began writing financial guarantees for municipal bonds in 1974. MBIA guarantees municipal bonds, structured finance and asset-backed obligations, payments due under credit and other derivative securities, obligations of sovereign and sub-sovereign issuers, and privately issued bonds used for financing public purpose projects overseas. MBIA’s structured finance business serves a diverse client base that includes many of the world’s leading specialty finance companies, commercial banks, insurance companies and investment banks. MBIA has been an innovator in the structured finance market, as it was the first monoline to guarantee securitizations for a variety of asset classes.

As of December 31, 2007, MBIA insures over \$1 trillion of total debt service outstanding, and employs over 480 people in Armonk, New York, and in eleven other locations around the world. The Company has an admirable track record in selecting, underwriting, managing and remediating credit risk. Conservative underwriting is MBIA’s hallmark. MBIA’s prudent underwriting approach has led to the Company rejecting some of the largest exposures

currently impacting the mortgage market. For example, MBIA ceased doing business with lower quality subprime issuers in 2004 and has written only a low volume of Triple-A-rated deals in the subprime mortgage space, all with underlying Triple-A ratings, since that time. The Company's "remote-loss" underwriting standard anticipates no losses under a worst probable case scenario. Each transaction must meet MBIA's stringent credit structuring and legal criteria and, in virtually all cases, must be rated at least investment-grade by the rating agencies as well as by MBIA's internal standards, prior to MBIA insuring it.

MBIA's portfolio of insured issues is highly diversified with strict limits imposed on its exposure to specific asset classes, sectors, geographies, seller/servicers and deal structures. The portfolio is heavily weighted toward public finance, which comprises 65 percent of the insured book of business as of 12/31/07. Thirty-nine percent of the public finance issues that the Company has insured (25 percent of the total insured portfolio) is in the safest and most predictable category – General Obligation municipal bonds.

MBIA believes that diversification is key to sound credit management: it limits exposure to any particular sector which reduces loss severity to MBIA if a systemic problem were to occur in that sector. (For example, during the California energy crisis, PG&E and SoCal Edison credits came under significant stress, but MBIA's insurance portfolio was able to withstand the higher capital charges assigned to those credits.) Diversification can also reduce correlation risk. As such, the Company utilizes portfolio analysis and constructs sector exposure limits to contain potential risk exposures. Notwithstanding the diversity in the Company's portfolios (insured and investment), MBIA is selective in determining which sectors, countries, markets and structures it will insure; much the same as it culls through the high quality investment-grade-rated universe for attractive deals to wrap.

Structured Finance Products Insured By MBIA

The balance of MBIA's insured portfolio – 35 percent – is in structured finance transactions. MBIA's approach to underwriting structured finance credits follows the same remote loss standards/objectives that underlie the Company's public finance insured business. As part of this, MBIA endeavors to assess the ability and the willingness of the creditor to repay on its obligation. This portfolio consists of, among other sectors, consumer asset-backed and commercial real estate transactions, as well as residential mortgage-backed securities

(RMBS) and collateralized debt obligations (CDOs). The RMBS and asset-backed CDO portfolios, in particular, have received a great deal of focus both internally and externally in recent months, as the U.S. mortgage and housing sectors have rapidly deteriorated.

RMBS

MBIA's direct RMBS portfolio is about \$43 billion, net of reinsurance, or approximately 6 percent of MBIA's total book of business. There are two separate types of RMBS-related deals that the Company insures: prime and subprime.

MBIA's prime RMBS business consists of first- and second-lien mortgages to top-tier, high quality borrowers with strong credit scores. This business focuses on two areas: (1) transactions that are backed by Triple-A-rated underlying collateral and are conservatively structured and solid performers, and (2) prime home equity lines of credit (HELOC) and closed-end second (CES) mortgages. Both the HELOCs and CESs are generally second-lien products. HELOCs are floating rate revolving loans that generally require interest-only payments through a period of time before amortizing principal, and CESs are fixed-rate second mortgages that generally amortize principal from the outset.

In contrast to MBIA's prime RMBS business, the Company's subprime business is comprised of mortgages made to lower credit quality borrowers. In response to the weakening underwriting trends MBIA observed in the subprime space during the post-2002 housing boom, MBIA enacted a conservative strategy towards subprime RMBS collateral and issuers, given the material market growth and the potential fragility of the business models of second- and third-tier issuers. Since the beginning of 2004, MBIA has limited its insurance of subprime mortgage transactions to first-lien products with top-tier originators and servicers, and only if the deal was rated Triple-A. Due to substantial subordination and loss protection on these deals and the selective strategy the Company took towards direct subprime exposure, MBIA considers the risk of material loss from this portion of its portfolio to be minimal at this time.

Historically, MBIA has had a very successful track record with prime HELOC and CES mortgage deals, experiencing solid returns and performance for a number of years. HELOC loans in particular were of high quality with very low defaults and highly predictable

performance. This has not been the recent experience, however, as the majority of the loss reserves MBIA established in the fourth quarter of 2007 are for HELOC deals that were insured in 2006 and 2007. It appears that more recent HELOC transactions consisted of greater proportions of borrowers who were more active in speculative purchases and more attracted to an interest-only loan product. The mortgage lenders' relaxed underwriting guidelines were a significant factor as well, as they permitted loans related to non-owner-occupied investor properties, lower documentation and higher Combined Loan-to-Value products. This ultimately decreased the overall quality of the HELOC portfolio, resulting in claims and expectations of future losses. The CES deals are generally a more recent vintage and fixed-rate product. These transactions may well contain more primary residence borrowers and a lower level of investor properties; nonetheless MBIA is keeping a watchful eye on these transactions.

CDOs

Financial institutions use collateralized debt obligations (CDOs), a structured finance tool, to manage credit exposure and capital (regulatory or economic). CDOs involve the transfer of credit risk within large, well-diversified pools of corporate loans and bonds, asset-backed securities and sovereign bonds and loans to special purpose vehicles (SPVs), which in turn issue bonds – the CDOs – that are broadly distributed. Structured properly, CDOs can be of great benefit to the economy as they are an extremely efficient method of distributing risk across the financial system.

Like securitizations of mortgages, auto loans, credit cards, trade receivables and other financial assets, the credit risk associated with a CDO is tranching into several "risk" layers, with investors buying into each of the different levels based on differing appetites for credit risk, liquidity risk and duration risk and, as a consequence, accepting different corresponding levels of return.

CDOs can include both cash assets (bonds or loans) and/or synthetic assets (credit default swaps). Synthetic CDOs are mainly used to transfer credit risk (as is the case in funded CDOs) and/or for arbitrage purposes. They do not own cash assets like bonds or loans. Instead, synthetic CDOs gain credit exposure to a portfolio of fixed-income assets without owning those assets through the use of credit default swaps, a derivatives instrument.

(Under such a swap, the CDO receives periodic premiums in exchange for assuming the risk of loss on an asset.) Synthetic CDOs have the advantage of allowing for the transfer of credit risk without requiring a transfer of ownership of the underlying assets.

MBIA's overall business strategy is to participate in the most senior layer of the CDO capital structure, whether the CDO is funded or synthetic, while creating a balanced book of business across multiple underlying asset classes including investment-grade corporates, high yield loans, asset-backed securities, RMBS, commercial mortgage-backed securities (CMBS) and emerging markets debt.

Post 1999, MBIA has focused on insuring 1) funded CDOs having, at minimum, Double-A shadow ratings by both Moody's and S&P (although almost all funded CDOs the Company has insured in the last five years have been, at minimum, rated Triple-A) and 2) synthetic CDOs at the "Super Triple-A" credit support levels by virtue of a rated Triple-A tranche subordinate to MBIA, or by virtue of a credit support level that is a multiple (most often 1.5 to 2.5 times) of the Triple-A requirement imposed by the rating agencies.

Additionally, MBIA is an active participant in the multi-sector CDO market, which are CDOs backed by diversified asset-backed securities (ABS) collateral pools that could include: RMBS-including subprime, CMBS, consumer (credit cards, autos, manufactured housing, student loans) corporate bonds and loans, as well as other CDOs.

MBIA, along with most market participants, segments this sector into two categories of deals: "High Grade" and "Mezzanine," reflecting the credit ratings and seniority of the underlying structured finance bonds supporting the CDO. High Grade refers to transactions in which the underlying collateral credit ratings on a standalone basis are, with few exceptions, Single-A or higher, and Mezzanine refers to transactions in which the underlying collateral credit ratings on a standalone basis are below Single-A (generally Triple-B).

Beginning in 2004, MBIA elected to insure mezzanine CDOs on a more selective basis due to concerns regarding structural provisions as well as concerns over the underlying collateral and weak pricing. MBIA has been a much more active player in High Grade deals, which are characterized by much stronger collateral, better structural provisions, and more attractive risk-adjusted pricing. Typically, the Company guarantees multi-sector CDOs transacted at

the “Super Triple-A” credit support level, which means that there are tranches of debt that are rated Triple-A below the MBIA-insured tranche.

Whether provided by an insurance policy or by a credit default swap, MBIA’s guarantee is not subject to an acceleration of full payment.

In terms of exposure and potential losses, the CDO sector of most concern is the multi-sector CDOs. Multi-sector CDOs are deals that consist of a diverse array of structured finance asset classes, vintages, issuers and servicers in the collateral pool. The collateral backing MBIA’s multi-sector CDOs consists of ABS, which are securitizations of auto receivables, credit cards, commercial mortgage tax securities, other CDOs and various types of RMBS including prime and subprime RMBS. However, because the RMBS asset class was a dominant share of the ABS market, these deals contain a large proportion of RMBS collateral, much of which is subprime RMBS.

MBIA’s multi-sector CDO book performed as expected through September 2007, but the U.S. residential mortgage market downturn began to directly impact the multi-sector book in the fall of 2007 as the rating agencies downgraded thousands of investment-grade RMBS deals due to deteriorating performance. To date, the majority of MBIA-wrapped multi-sector CDOs and the underlying collateral remain investment-grade-rated. But further deterioration is anticipated based upon projected U.S. housing mortgage trends in 2008. MBIA will continue to monitor and reevaluate the collateral, mindful that additional rating agency downgrades may be ahead.

MBIA’s CDOs of CDOs, or CDO², are diversified transactions generally anchored by CLOs, which are collateralized loan obligations consisting of investment-grade corporate debt. CDO² transactions are a sub-category of multi-sector CDOs. They often contain other collateral, including subprime RMBS, and may include highly rated tranches of CDOs of asset-backed collateral. As of December 2007, there has not been any material rating agency action in this portfolio segment. However, MBIA’s own analysis has determined that three deals it insured within this segment will result in permanent losses totaling \$200 million.

Development Of Housing Crisis

For several years prior to 2007, the credit markets benefited from a benign loss environment, allowing for greater issuance of ABS and corresponding tighter spreads and pricing. This environment fostered an erosion in underwriting standards by mortgage originators, and less effective security structures and covenant packages across the fixed-income market.

As 2006 came to a close, some signs of stress began to emerge in the subprime mortgage market. This stress accelerated into crisis as 2007 progressed, due to a spike in losses and loss expectations on securities backed by subprime mortgages and the disappearance of liquidity for structured products, including asset-backed commercial paper, and ABS, both of which helped finance the housing boom.

Single-Asset Crisis

Notably, recent issues are attributable to one sector, or asset class, RMBS, rather than being a systemic or multi-asset-class problem. The rapid deterioration of underlying residential mortgage performance and its impact on these securities in the second half of 2007 surprised MBIA as much as it surprised most other market participants. Unfortunately, the Company's underwriting process and procedures did not anticipate the problem or insulate it from the magnitude of losses projected today. While it is conceivable that a slowing economy and a tapped out consumer will lead to some additional stress in other asset classes, given the unique set of circumstances that gave rise to the housing crisis, the Company believes it is unlikely that problems would rise to anywhere near what is being seen in the mortgage sector.

Today MBIA and most other analysts are projecting losses on mortgage collateral that have not been seen since the Great Depression. Note that these are projected losses, not actual losses. Actual cumulative loss rates on subprime securities in December 2007 were 1.4 percent as reported by Standard & Poor's. The projections of eventual losses are now on the order of 20 percent. While the magnitude of projected losses is significant, it does not suggest an overall breakdown in management or controls in the monoline industry or any

failure on the part of the regulators, or even the rating agencies. The magnitude and speed of this housing crisis surprised almost everyone in the market.

Because MBIA's insured exposure sits at the very top of the capital structure in this industry sector (at the Triple-A or Super Triple-A level), as it does in the other sectors, the Company should not experience the loss levels that will be sustained by other players – including banks – who are further down the capital tower.

Financial Impact of Housing Crisis on MBIA

The financial impact on MBIA of the current crisis in the mortgage and housing markets has been substantial, particularly in light of the extremely low level of losses the Company had experienced over the first 33 years of its history. Until the fourth quarter of 2007, MBIA had experienced only 0.04 percent losses on over 93,000 issues insured since inception. In dollar terms, that means on over \$2.3 trillion in debt service insured over 33 years, MBIA's losses amounted to just \$916 million. Including fourth quarter 2007 losses, MBIA's losses now amount to just 0.07 percent debt service insured.

For the fourth quarter of 2007, the Company announced increases to loss reserves totaling \$814 million. Of this amount, \$614 million represents losses that the Company has specifically identified in its insured portfolio, while the additional \$200 million represents losses that are expected, but have not yet been attributed to specific transactions. Virtually all of these losses were associated with MBIA's exposure to securitizations of prime second lien products.

In addition, MBIA recorded a \$3.4 billion mark-to-market loss in connection with its insured credit derivatives portfolio in the fourth quarter of 2007. Of that amount, approximately \$3.2 billion of this mark-to-market loss reflects "book" losses required to be recorded under GAAP accounting rules and the Company believes will reverse over time absent further credit impairment. The remaining \$200 million represents a permanent impairment in value. The majority of the mark-to-market loss was associated with changes in the fair value of MBIA's insured credit derivatives portfolio, particularly structured finance transactions backed by commercial mortgage backed and residential mortgage backed securities.

Mark-to-Market Losses

Mark-to-market losses as they pertain to bond insurers deserve some additional explanation. Accounting rules, specifically FAS 133, require that changes in the fair value of all derivative exposures be marked-to-market on MBIA's income statement. The mark essentially reflects the profit or loss that would accrue to the holder if the portfolio were sold or unwound at a particular point in time. As such, the concept is perhaps most applicable to portfolios that can be actively traded over time. In the case of the credit derivatives insured by MBIA, like all of its financial guarantees, the Company's obligation runs to the maturity of the instrument and there is no ability or need for MBIA to terminate or sell its obligation early. However, as FAS 133 has no provision for hold-to-maturity portfolios such as the credit derivative exposures that MBIA has insured, the Company must mark these positions to market price each quarter with the expectation that the mark will, in most cases, reverse over time.

The only instances in which the mark would not reverse would be those where a permanent loss is expected, as was the case for \$200 million of MBIA's total \$3.7 billion mark in the third and fourth quarters of 2007. Most of the companies in the financial guarantee industry have had a similar experience in 2007. While this is analogous to the mark-to-market losses taken by the banks and investment banks, the impact on MBIA is far different. Under no circumstances can the Company be required to pay off these contracts at those prices. Bond insurers cannot trade their positions, and do not guarantee market value. MBIA's insurance policies remain on its books until the bonds mature, and it makes payments only if there are actual defaults on the bonds. This is a case where the accounting requirements do not follow the economics of the business. As a result, credit analysts, including the rating agencies, tend to focus on analysis of the potential for actual losses, not these accounting losses, to assess MBIA's capital adequacy. In fairness, changes in fair values can be indicators of underlying credit performance, but they are by no means dispositive.

Since the mark on MBIA's insured credit derivatives is highly sensitive to changes in market spreads, it can introduce significant short-term volatility into MBIA's reported results even when no ultimate losses are expected.

Liquidity

It is important to note that MBIA's obligation to pay claims on an insured issue is almost exclusively on an "as due" basis. Essentially this means that upon a default of an insured issue MBIA will pay principal and interest to the holder according the original schedule. Thus in the case of a 30-year bond, MBIA would be obligated to pay the principal and interest over the full 30-year life of the bond, and would not be required to pay off the full outstanding balance at the time it defaults. This is an important feature in all of MBIA's insured exposures. It is designed to minimize liquidity exposure and prevent a "run on the bank".

An insurer's exposure under an insurance policy or a credit default swap is virtually identical. Under either form there are no requirements to post collateral, nor any requirements or rights to accelerate payment against MBIA.

The permanent losses estimated by MBIA, and reflected in its financial estimates, are equal to the present value of the expected future claim payments over the life of the bond issue. Consequently, MBIA recorded significant losses in the fourth quarter of 2007, only a small fraction of that (\$44 million, net of reinsurance) was actually paid out to date. The remainder will be paid out over the next few years as the underlying transactions continue to pay down.

Role of the Rating Agencies

MBIA carries Triple-A ratings from each of the three major U.S. and one international rating agencies: Standard & Poor's (S&P), Moody's Investors Service and Fitch Ratings, as well as Rating and Investment Information, Inc. The Triple-A ratings are, in the opinion of MBIA's management, important to its business model, and the Company believes that investors who purchase insured bonds are primarily interested in obtaining the highest rating possible – the Triple-A.

Although the specifics behind how each rating agency determines the standard that must be met in order to secure and maintain its respective Triple-A rating differ from agency to agency, there are, not surprisingly, several dominant themes common to all of them. First and foremost is capitalization. As the Triple-A implies that a company has the ability to meet all of its obligations as they come due even under extremely unlikely and stressful

circumstances, the agencies are quite rightly focused on ensuring that each bond insurer has a level of claims paying resources consistent with its Triple-A.

Capital Sufficient to Support Extreme Stress

It is important to note that when the rating agencies are determining the appropriate level of capitalization for a bond insurer, they do so in the context of the monolines' ability to meet extremely stressful theoretical loss scenarios, and not simply its ability to meet an expected level of losses. Therefore, a Triple-A insurer must hold capital in an amount equal to a substantial multiple of the losses that could reasonably be expected to occur, even in the stressful environment that the industry is now experiencing in the mortgage and housing sectors. For this reason, MBIA has raised \$2.65 billion in new capital and preserved \$500 million within eight weeks. Today, MBIA has \$17 billion in claims paying resources. This capital raising effort has been unprecedented and is so far unmatched by any other financial guarantee insurers. The Company continues to explore ways to expand its capitalization and manage its risk exposure.

During the Company's capital raise, its financial reports, risk reports, and portfolio details were reviewed in great depth by highly sophisticated investors such as Warburg Pincus, who analyzed the portfolio at the loan-level, and, after doing so, agreed to invest up to \$1 billion. The underwriters of MBIA's debt and equity securities also performed extensive "due diligence" before committing. That is, these independent parties got sufficiently comfortable with MBIA's exposure to the mortgage markets to invest billions of dollars into the Company. Through this process, MBIA has provided greater transparency into the details of its insured exposures, both publicly and privately, than ever before.

Given the rating agencies' Triple-A requirements, the bond insurers have constructed very low risk insured portfolios, with virtually all transactions rated in the investment-grade range, even without the benefit of insurance. Only a very small portion of the total portfolio is rated below investment grade, and virtually all of that represents situations where the credits were investment grade at inception but the credit deteriorated somewhat after closing. In MBIA's case, approximately 82 percent of the insured portfolio was rated Single-A or better as of year-end 2007, and only 1.4 percent was rated below investment grade on an S&P priority basis. (MBIA's below investment grade net par exposure includes \$10.6 billion of home

equity lines of credit and closed-end second RMBS and multi-sector CDOs of high grade CDOs, which were not rated below investment grade as of December 31, 2007.)

While strong capitalization represents a threshold standard for the Triple-A rating, it is by no means the only standard. The rating agencies also give substantial consideration to the qualifications and experience of a monoline's management team, the quality and track record of a company's underwriting, the reasonableness of the business plan, the sustainability of the business model over the long-term and other qualitative and quantitative factors.

Recent Events

In response to growing stress in the mortgage and housing markets, the rating agencies have spent substantial time over the past six-to-nine months analyzing the performance of transactions directly or indirectly backed by prime, non-prime and subprime mortgages. Their analysis has focused, in particular, on securitizations of prime and subprime first and second mortgages, prime HELOCs and CDOs backed by ABS that are exposed to these mortgage products. As the crisis in the mortgage and housing sectors continues to unfold, the rating agencies have, on several occasions, upwardly revised their projections of the amount of losses that mortgage market investors can expect to experience. For the bond insurers in general, and MBIA in particular, this has resulted in a gradual escalation in rating agency concern regarding the adequacy of bond insurer capitalization over the same period of time.

All three major rating agencies undertook extensive analyses of bond insurer capital adequacy in the fourth quarter of 2007, and they continue to revise their analyses on an almost weekly basis. In MBIA's case, this frequent reevaluation resulted in the agencies first affirming MBIA's Triple-A ratings in December but changing the outlook to negative, then placing its Triple-A ratings on review for possible downgrade in January and early.

MBIA's Capital Raising Activities

As losses in the mortgage market continued to increase in the third and fourth quarters of 2007 and increasing stress was observed in the transactions insured by MBIA, the Company responded along two fronts: 1) MBIA's Insured Portfolio Management Division, which is

responsible for monitoring MBIA's portfolio of insured credits, stepped up its efforts to identify problem credits, quantify potential losses to MBIA and develop remedial strategies to reduce or eliminate potential future policy claims; and 2) management proactively began the process of raising additional capital to support the Triple-A ratings that are critical to its franchise and of great importance to investors.

To date, MBIA has raised approximately \$2.65 billion in incremental capital consisting of:

- a \$500 million common stock investment by Warburg Pincus;
- a \$1 billion surplus note offering; and
- a \$1.15 billion common stock offering

In addition to the \$2.65 billion in capital outlined above, the Company preserved an additional \$500 million through a reduction in the common stock dividend, additional reinsurance on the insured portfolio and a reduction in new business activity to allow for the natural expiration of policy obligations over time, which frees up capital currently deployed in support of the existing portfolio of business.

The Company's prompt and proactive measures to secure external capital for the benefit of policyholders were critical to the ultimate success in doing so. Others in the industry who may have started the process later have found the market increasingly less receptive and more expensive as mortgage market stress has continued to rise.

Activist Activity: Coincidence or Calculated?

As has been widely reported in the media, certain parties such as Mr. William Ackman of the hedge fund Pershing Square Capital Management LP, also known as "activist short sellers" stand to realize significant financial gains from declines in MBIA's stock price and/or increases in the price of credit default swaps they hold that are connected to MBIA.

Ultimately, their goal would be to see MBIA become insolvent, which would maximize their profits by driving the stock price to near zero and triggering payments on the credit default swaps they executed.

To achieve this end, these self-interested parties have gone to substantial effort to undermine the market confidence that is critical to MBIA's business. Their efforts have

included raising questions about MBIA's capitalization, the losses it will likely sustain, its liquidity position, the legality of its operations and the viability of its business model. They have published attacks on MBIA containing material misstatements of fact, used the media to create "noise" around MBIA's solvency and ratings, written letters to regulators and rating agencies seeking action against MBIA, and held meetings with investors with the intent, the Company believes, to dissuade them from purchasing MBIA's debt or equity. They may also have extensively lobbied this committee. MBIA notes that Mr. William Ackman is appearing at the hearing on February 14th as an "industry expert." Mr. Ackman is in fact not involved in the industry in any capacity except that of a short-seller, and accordingly, MBIA questions the characterization of Mr. Ackman's expertise.

While some estimates of MBIA's ultimate losses have been reported in the media as exceeding \$10 billion, in reality these estimates are provided to the media by short-sellers and others who are not familiar with the actual deals and do not have the information necessary to estimate losses with any degree of accuracy (they do not have access to the terms and conditions of those deals, such as cash flow diversion triggers, etc.). Instead, they have taken market estimates of the industry, or of a particular financial institution's experience, and applied it to bond insurers' portfolios to derive a loss estimate.

For example, Mr. Ackman developed potential loss estimates through what he refers to as the "Open Source Model." This model uses loss estimates that are a multiple of those estimated by MBIA, the rating agencies and other objective analysts. Mr. Ackman stated that his model is meant to provide greater transparency to the market, when in fact the model is a black box driven by undisclosed loss assumptions derived from the proprietary trading desk of an anonymous "Global Bank." The extreme assumptions in the model produced Mr. Ackman's desired effect of sensational headline loss numbers for the firms evaluated. Mr. Ackman states that the model is a detailed collateral analysis, while it actually uses averages and simplified macro-loss assumptions about certain product types and vintages. This stands in stark contrast to MBIA's approach, which has been a detailed loan-level modeling exercise that more accurately looks at the characteristics of each individual piece of RMBS collateral and the individual loans backing it. Mr. Ackman's model is purported to be a more accurate representation of the risks, but in fact it does not factor in the actual deal structures for any of the ABS CDO, HELOC or CES exposures.

Similarly, a small, upstart rating agency with no information about the deals MBIA insures has been providing commentary to the media that suggests MBIA faces losses in excess of \$10 billion. In fact, in a recent online column, an investor reported that he learned in a conversation with a principal from this rating agency that the principal's projections were essentially a "back of the envelope" calculation, with little applicability to MBIA's portfolio.

As MBIA has taken steps over the past two months to raise additional capital for the benefit of policyholders, these same self-interested parties have stepped up their attacks at critical points in each part of the process, with the apparent goal of increasing the cost of capital to MBIA or worse, making it completely unavailable. An attached timeline outlines the activities of Mr. Ackman and others in the short seller community, and demonstrates how their actions were carefully timed to coincide with individual elements of MBIA's capital raising program.

While he has not succeeded to date, there is no question that he has made the capital raising process considerably more difficult and expensive to the detriment of our legitimate investors and policyholders.

Lessons Learned

MBIA's strategies in writing RMBS and CDO business appeared sound at the time, because the Company attached at the highest levels of the capital structure. In retrospect, the Company missed some of the warning signs and is now paying the price, both through expected claims on its policies and through a loss of confidence in the value of its product, the financial guarantee. As an organization, MBIA is responding to the lessons learned from this crisis, as is the whole market, by reviewing its underwriting standards and due diligence processes, by examining for appropriateness the products it underwrites, and by examining how the Company manages its capital so that it is poised to ride out such a credit crisis should it ever happen again.

As the Company examines what it could have done differently, it has thus far arrived at three important lessons learned:

- Investment grade, historically sound loan originators/servicers are as likely as newer, start-up companies to succumb to market pressures to modify loan origination

practices. MBIA's practice was to work with large, investment-grade servicers with historically strong origination and loan performance attributes. Unfortunately in the heat of the recent market, even some of these servicers relaxed their standards.

- Bond insurers guarantee payment of timely interest and contracted principal. They do not post collateral upon downgrade, and their guarantees and premium streams typically are not subject to changes in the insurers' ratings. This has proven to be a key factor in the current crisis as the monolines have not had material liquidity calls on their guarantees. These provisions are essential features of the financial guarantee industry that, for exactly the reasons evidenced today, must be retained for market stability.

- Bond insurers must avoid large concentrations of risk, whether it is risk connected to a single issuer, a single servicer or asset manager, a single asset class, or to a single vintage of collateral.

Where MBIA Is Today

With the most significant parts of MBIA's capital raising plan complete and the remaining components well underway, the Company is currently awaiting feedback from the rating agencies on their respective reviews. The Company expects this process will be largely complete within the next four weeks. Although MBIA believes it has more than sufficiently addressed the capital necessary to support its Triple-A ratings, the standard has been somewhat of a moving target.

There have been numerous media reports of various so-called "bailout" plans for the bond insurers, including some debate about the possibility of a Federal bailout. First, the notion of a "bail out" of highly credit-worthy companies who, at most, are at risk of losing the very highest ratings available, is misplaced. For this reason MBIA does not see the need for a Federal bailout of the financial guarantee industry. The Company believes that MBIA is more than adequately capitalized to meet obligations to policyholders.

Similarly, MBIA does not believe there is a need for Federal oversight of the industry as a result of the current housing and mortgage market dislocation. The Company is confident

that the rigorous oversight it has always been subject to from state regulators and the rating agencies will continue to be more than adequate going forward.

Conclusion

Looking forward, the Company sees more demand than ever for its financial guarantee product, both in the municipal and infrastructure part of the business, and in the structured finance market. The American Society of Civil Engineers has estimated that the U.S. needs to spend \$1.6 trillion on infrastructure in the next five years, while the Urban Institute projects that maintenance of surface transportation alone will require \$185 billion over the same time period. The needs outside the United States are even larger.

On the structured side, today the American consumer is financed through the ABS market. From the consumer credit cards – to auto loans – to mortgages, the ABS market has been, for well over the last 15 years, the source of liquidity that promoted operating efficiency for banks and other loan originators, and lowered borrowing costs for consumers, the backbone of the nation's economy. The bond insurance product makes financing these enormous needs more cost efficient, and MBIA is working hard to ensure that there's a strong and viable industry here to facilitate.

MBIA has been a Triple-A company for 34 years, and it expects to remain so now and for the foreseeable future. Despite the unexpected and rapid deterioration in the performance of its prime second lien mortgage portfolio, the Company believes that its credit underwriting practices and risk management infrastructure will result in a high quality and well-diversified insurance portfolio over time. As always occurs during such credit cycle downturns, the Company has had opportunities to learn from its mistakes and improve the risk profile of its future portfolio.

MBIA has been working closely with its primary regulator, the New York State Department of Insurance, to review lessons learned, and to discuss new guidelines on acceptable products and portfolio guidelines. MBIA appreciates and commends Superintendent Dinallo for his efforts to date to ensure the stability of the financial guarantee industry's participants.

MBIA will continue to manage its business in a prudent manner, deal forthrightly with any problems that arise in its portfolio, discuss all issues and concerns openly with the rating agencies and regulators, and provide disclosure to the market in the hopes of enhancing the understanding of its business model and its industry. MBIA must continue to manage to a conservative capital position to maintain its Triple-A rating and the confidence of the marketplace. MBIA's Triple-A rating is its most important tool for delivering comfort and protection to policyholders and creditors, and returns to its shareholders. With a steady focus on these principles, the Company is well positioned to continue to be a leader in its industry.