



Moody's Investors Service

## Issuer Comment: **Moody's comments on MBIA's fourth quarter earnings and ongoing litigations**

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### Global Credit Research - 05 Mar 2010

There were few surprises in MBIA Inc's ('MBIA') fourth quarter earnings announcement. Deterioration in the performance of the company's residential mortgage risks continues to affect the MBIA Insurance Corp's ('MBIA Corp', B3 IFS rating, negative outlook) operating results. National Public Finance Guarantee's ('National', Baa1 IFS rating, developing outlook) large legacy portfolio produced \$186 million of pretax earnings in the fourth quarter of 2009 and the statutory capital position of the company improved. However, National did not write material new business in 2009 - mainly due to the ongoing litigations challenging the transformation.

**MBIA Corp: High claims rate in the mortgage space could affect liquidity**

Since 2007, MBIA Corp has paid \$3.8 billion in claims related to its residential mortgage securitization deals, and the company expects additional collateral losses of \$2billion, mainly in the next 2 years. In its GAAP 2009 financial report, MBIA Corp estimates benefit related to put back credit and recovery from excess spread to be \$3billion. As Moody's has previously stated, ultimate losses for the monoline insurers could be meaningfully lower than expected claims from defaulted mortgages due to the putback claims, but there is substantial uncertainty about the recovery values. Moody's notes that legal resolution of such disputes is generally a lengthy process, a factor that could motivate MBIA Corp to pursue negotiated settlements. In the meantime, mounting claim payments could pressure the liquidity position of MBIA Corp, with the 2009 cash flow statement providing some early evidence of the strain- MBIA Corp's cash position declined from \$1.9 billion to \$1.2 billion at year end 2009. If the claims rate remains elevated, MBIA Corp might have to consider asset sales and/or early repayment of the secured loan (\$1.5billion loan to the ALM business) to boost its liquidity position.

**Commercial real estate risks - losses are likely**

MBIA Corp has not yet created loss provisions for any of its pooled CMBS/ CRE CDO exposure but Moody's believes that some transactions could suffer losses. For most part, the underlying risks in these transactions are tranches of CMBS securitizations, some of which have suffered multi notch rating downgrades. Given the highly leveraged transaction structures and large transaction sizes, high losses in a few deals could materially affect MBIA Corp's capital position.

**Operating companies do not have dividend capacity**

Due to its negative unassigned surplus position, National currently cannot pay dividends, but the company has petitioned New York insurance regulator to reset the negative earned surplus, presumably to allow dividend payments in 2011. Ultimately, National's ability to pay dividends will also be influenced by the outcome of the litigation and the company's own capital needs in the event of a relaunch into the municipal market.

MBIA Corp also reported negative unassigned surplus in its recent statutory statement and therefore will not be able to pay dividends to its preferred (instrument rated Ca) or common stock holders in the near term.

MBIA expects to retain a \$222 million of the \$502 million tax refund at the holding company which to some extent makes up for lack of dividend capacity at the operating companies.

**Litigation developments - negative but not unexpected**

On February 17th, the Supreme Court of the State of New York ruled against the motion to dismiss that had been filed by MBIA and its affiliates, thereby allowing the lawsuit filed by 21 large banks and financial institutions to move forward. Earlier this month, a motion to dismiss submitted by MBIA in the case filed by Aurelius Capital Partners was rejected by the District Court of the Southern District of New York.

In addition to these two lawsuits, MBIA faces two other cases challenging the restructuring, which took place in February of 2009. Third Avenue Trust et al - the holders of surplus notes issued by MBIA Corp -- has filed a lawsuit against the MBIA companies in the New York State Supreme Court. The bank group also filed an Article 78 proceeding against MBIA and the New York Insurance Department challenging the department's approval of the restructuring.

Recent court rulings on the litigation challenging the restructuring are unfavorable to MBIA but not unexpected. Our ratings for National and MBIA Corp already reflect the uncertainty caused by ongoing litigation, including -- but not limited to-- the potential reallocation of capital resources within the group in the event of an adverse outcome to MBIA, and the extended timeframe over which such uncertainty may persist. In recent investor calls, MBIA's management said that they anticipate an expeditious resolution of the Article 78 proceeding because of the nature of the process. The outcome of the Article 78 proceeding will likely affect the direction of the other lawsuits as it could either add credence to or weaken the plaintiffs' allegations.

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