



U.S. Securities and Exchange Commission

U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 19982 / January 29, 2007

Accounting and Auditing Enforcement Release No. 2547 / January 29, 2007

SEC v. MBIA Inc., 07 Civ. 658 (JGK) (SDNY), January 29, 2007

MBIA to Pay \$50 Million to Settle Securities Fraud Charges for Misuse of Reinsurance Contracts

On January 29, 2007, the Securities and Exchange Commission announced today that it filed a settled civil action in the United States District Court for the Southern District of New York alleging securities fraud charges against MBIA Inc., one of the nation's largest insurers of municipal bonds, arising out of a sham reinsurance transaction that was restated in 2005, which the Company had previously entered into to avoid having to recognize a \$170 million loss. MBIA suffered the loss when, in 1998, the Allegheny Health, Education and Research Foundation ("AHERF") defaulted on bonds guaranteed by MBIA and MBIA was forced to make good on its guarantee. MBIA addressed analyst concerns about its expected losses on the AHERF bonds by representing that it had obtained reinsurance to cover them. In fact, MBIA had agreed through concessions on other reinsurance agreements to compensate the reinsurers for the losses they were certain to incur on the AHERF contracts. The improper use of the reinsurance contracts enabled MBIA to convert what would otherwise have been the company's first-ever quarterly loss into a profit and reverse the decline in MBIA's stock price.

Under the settlement, MBIA consents to the entry of a final judgment directing it to pay a \$50 million penalty plus \$1 in disgorgement and, in a related administrative proceeding, consents to a cease-and-desist order and to retain an independent consultant to examine a number of other specified transactions to which MBIA was a party.

The Commission's complaint, filed today, alleges that MBIA learned in 1998 that AHERF would default on \$256 million of municipal bonds that MBIA had guaranteed, which would have resulted in MBIA's first-ever quarterly loss. To mask the financial effect of this loss, MBIA's then-senior management devised a scheme to obtain reinsurance that would cover the entire net present value of the anticipated loss, or about \$170 million, for a nominal premium. The effect was to offset the entire \$170 million loss MBIA recorded in the third quarter with a roughly equivalent reinsurance recovery, thus

converting a loss in the quarter to an apparent gain.

The AHERF reinsurance consisted of three contracts under which the reinsurers agreed to provide coverage of up to \$170 million for the AHERF loss. In order to pass scrutiny with MBIA's accountants and obtain their approval for the desired accounting treatment, these contracts were written as if it was unclear whether the reinsurers would have to pay out under them. In fact, however, MBIA and the reinsurers knew that the reinsurers would be called upon to pay, making the \$170 million received by MBIA from the reinsurance companies ineligible for reinsurance accounting.

MBIA reimbursed the reinsurers for the \$170 million they paid to MBIA by entering into other reinsurance agreements on hundreds of millions of dollars of future MBIA business. Although the reinsurers undertook some risk under these other agreements, they were nevertheless reimbursed for their payments to MBIA on the AHERF contracts because the other agreements entailed so much premium and so little risk to the reinsurers.

In addition, MBIA secretly entered a side agreement with one of the reinsurers whereby it orally agreed to re-assume virtually all of the risk given to the reinsurer on the future business, leaving the reinsurer with all the premiums and virtually no risk.

In March 2005, MBIA restated \$70 million related to these agreements, after an internal investigation concluded that it appeared likely that the oral side agreement existed. In November 2005, MBIA restated the remaining \$100 million.

In connection with the settlement, MBIA has agreed, without admitting or denying the allegations in the Commission's complaint, to pay a \$50 million penalty, plus \$1 in disgorgement. In a related administrative proceeding, MBIA has agreed, without admitting or denying the Commission's findings, to the issuance of a cease-and-desist order that requires MBIA to cease and desist from further violations of Section 17(a) of the Securities Act of 1933 and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act of 1934 and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, and 13b2-1 thereunder, and to comply with various undertakings, including an undertaking to retain an independent consultant to examine a number of specified transactions. The corporate penalty in this case was negotiated before the Commission issued its Statement Concerning Financial Penalties (<http://www.sec.gov/news/press/2006-4.htm>). The Commission has therefore elected not to apply that Statement to this corporate penalty.

The Commission acknowledges the assistance of the New York Attorney General in connection with this matter.

► [SEC Complaint in this matter](#); [Administrative Proceeding No. 33-8776](#)

<http://www.sec.gov/litigation/litreleases/2007/lr19982.htm>

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