MBIA INC
Form 10-K
March 08, 2006
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United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2005

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

Commission file number 1-9583

MBIA INC.

(Exact name of registrant as specified in its charter)

Connecticut	**06-1185706**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**
113 King Street, Armonk, New York	**10504**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (914) 273-4545

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $1 per share	**New York Stock Exchange**
MBIA Capital/Claymore Managed Duration Investment Grade Municipal Fund	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10 -K. x

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the Registrant is shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 30, 2005 was $7,949,618,222.

As of March 1, 2006, 134,008,680 shares of Common Stock, par value $1 per share, were outstanding.

Documents incorporated by reference. Portions of the Definitive Proxy Statement of the Registrant, which will be filed on or before March 31, 2006, are incorporated by reference into Parts I and III.

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INTRODUCTORY NOTE

In the fourth quarter of 2005, MBIA Inc. (the Company) restated it consolidated financial statements as of and for the years ended December 31, 2004, 2003, 2002, 2001, 2000, 1999 and 1998, and the Notes related thereto, as further discussed in Note 2: Restatement Of Consolidated Financial Statements in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries included in Part II, Item 8 and Management s Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7.

In connection with potential settlements of investigations by the Securities and Exchange Commission (the SEC) and the New York Attorney General s Office (NYAG) regarding agreements entered into by its subsidiary, MBIA Insurance Corporation, in 1998 with AXA Re Finance S.A. (ARF), Muenchener Rueckversicherungs-Gesellshaft (Munich Re) and Converium Re (previously known as Zurich Reinsurance North America) in connection with losses incurred by MBIA Insurance Corporation on insured bonds issued by Allegheny Health, Education and Research Foundation (AHERF), as announced on March 8, 2005, the Company restated its financial statements with respect to the agreements with Converium Re. At that time, the Company believed that the accounting for the agreements with ARF and Munich Re was appropriate under Statement of Financial Accounting Standards (SFAS) 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts. As announced on November 8, 2005, the Company restated its financial statements for the agreements with ARF and Munich Re, made in connection with the potential settlements, to correct and restate its accounting for these agreements because, taking into account developments in the regulatory investigations since March and further accounting analyses, these agreements did not satisfy the risk transfer requirements for reinsurance accounting under SFAS 113. As a result, the Company restated its previously issued financial statements to reflect the agreements with Munich Re and ARF under deposit accounting in accordance with Statement of Position (SOP) 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Risk instead of under reinsurance accounting. The Company also corrected and restated its 2004 statutory financial statements because they did not satisfy the requirements for reinsurance accounting under Regulation 108 of the New York State Insurance Department (NYSID).

Additionally, in the third quarter of 2005, the Company completed a detailed review of its derivative instruments for which it applied shortcut method hedge accounting under SFAS 133, Accounting for Derivative Instruments and Hedging Activities , as amended. Shortcut method hedge accounting allows the assumption that the change in fair value of a hedged item exactly offsets the change in fair value of the related derivative. After completing its review, the Company determined that certain hedging relationships did not meet every technical aspect of shortcut method hedge accounting, although, such hedging relationships would have qualified for basic hedge accounting. Since the documentation that the Company prepared was designed to support shortcut method hedge accounting, it was not sufficient to support basic hedge accounting. As a result, the Company must account for these derivatives, from 2001 to the present, as if they were not part of hedging relationships, which requires the change in fair value of these derivatives to be reflected in the Company s income statement without an offsetting change in fair value of the hedged items. The Company restated its financial statements to correct the accounting for these derivatives for the year ended December 31, 2001 and subsequent periods through June 30, 2005. As of October 1, 2005, all of the subject hedging relationships met the requirements for basic hedge accounting and have been recorded as such in the Company s financial statements for the year ended December 31, 2005.

The restatements were included in the Company s Amendment No. 1 to Form 10-K filed on Form 10-K/A with the SEC on November 14, 2005 (the Amended Annual Report). For a further discussion of the restatements of the Company s financial statements, see the Amended Annual Report as well as Management s Discussion and Analysis of Financial Condition and Results of Operation Restatement of Consolidated Financial Statements in Part II, Item 7 and Note 2: Restatement Of Consolidated Financial Statements in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries in Part II, Item 8.

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PART I

Item 1. Business

MBIA Inc. (MBIA or the Company) was incorporated as a business corporation under the laws of the state of Connecticut in 1986. The Company is engaged in providing financial guarantee insurance, investment management services and municipal and other services to public finance and structured finance clients on a global basis. Financial guarantee insurance provides an unconditional and irrevocable guarantee of the payment of the principal of, and interest or other amounts owing on, insured obligations when due. The Company conducts its financial guarantee business through its wholly owned subsidiary MBIA Insurance Corporation (MBIA Corp.) and provides investment management products and financial services through its wholly owned subsidiary MBIA Asset Management, LLC (MBIA Asset Management).

MBIA Corp. is the successor to the business of the Municipal Bond Insurance Association (the Association) which began writing financial guarantees for municipal bonds in 1974. MBIA Corp. is the parent of MBIA Insurance Corp. of Illinois (MBIA Illinois) and Capital Markets Assurance Corporation (CapMAC), both financial guarantee companies that were acquired by MBIA Corp. MBIA Corp. also owns MBIA Assurance S.A. (MBIA Assurance), a French insurance company, and MBIA UK Insurance Limited (MBIA UK), a financial guarantee insurance company licensed in the United Kingdom. MBIA UK and MBIA Assurance write financial guarantee insurance in the member countries of the European Union. Generally, throughout the text, references to MBIA Corp. include the activities of its subsidiaries, MBIA UK, MBIA Assurance, MBIA Illinois and CapMAC.

MBIA Corp. primarily insures financial obligations which are sold in the new issue and secondary markets. It also provides financial guarantees for debt service reserve funds. As a result of the Triple-A ratings assigned to insured obligations, the principal economic value of financial guarantee insurance is the lower interest cost of an insured obligation relative to the same obligation on an uninsured basis. In addition, for complex financings and for obligations of issuers that are not well-known by investors, insured obligations receive greater market acceptance than uninsured obligations.

MBIA Corp. issues financial guarantees for municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, bonds backed by publicly or privately funded public purpose projects, bonds issued by sovereign and sub-sovereign entities and obligations collateralized by diverse pools of corporate loans and credit default swaps, and also pools of corporate and asset-backed bonds, both in the new issue and secondary markets. The municipal obligations that MBIA Corp. insures include tax-exempt and taxable indebtedness of states, counties, cities, utility districts and other political subdivisions, as well as airports, higher education and health care facilities and similar authorities and obligations issued by private entities that finance projects that serve a substantial public purpose. The asset-backed and structured finance obligations insured by MBIA Corp. typically consist of securities that are payable from or which are tied to the performance of a specified pool of assets that in most cases have a defined cash flow, such as residential and commercial mortgages, proceeds of insurance policies, a variety of consumer loans, corporate loans and bonds, trade and export receivables, equipment, aircraft and real property leases, and infrastructure projects.

MBIA Corp. also insures privately issued bonds used for the financing of public purpose projects which are primarily located overseas and include toll roads, bridges, airports, public transportation facilities and other types of infrastructure projects that serve a substantial public purpose. While in the United States projects of this nature are financed through the issuance of tax-exempt bonds by special purpose, government sponsored tax-exempt entities, the general absence of tax-advantaged financing, among other reasons, has led to the transfer of the operation of many such public purpose projects to the private sector. Generally, the private entities operate under a concession agreement with the sponsoring government agency, which maintains a level of regulatory oversight and control over the project.

MBIA Corp. has Triple-A financial strength ratings from Standard and Poor s Corporation (S&P), which the Association received in 1974; from Moody s Investors Service, Inc. (Moody s), which the Association received in 1984; from Fitch, Inc. (Fitch), which MBIA Corp. received in 1995; and from Rating and Investment Information, Inc. (RII), which MBIA Corp. received in 1998. Both MBIA Assurance and MBIA UK have Triple-A financial strength ratings from S&P, Moody s and Fitch. Obligations which are guaranteed by MBIA Corp., MBIA Assurance and MBIA UK are rated Triple-A primarily based on these financial strength ratings. Both S&P and Moody s have also continued the Triple-A rating on MBIA Illinois and CapMAC guaranteed bond issues. The Triple-A ratings are important to the operation of the Company s business and any reduction in these ratings could have a material adverse effect on MBIA Corp. s ability to compete and could also have a material adverse effect on the business, operations and financial results of the Company.

MBIA Asset Management offers cash management, customized asset management and investment consulting services to local governments, school districts and other institutional clients. It offers fixed-income asset management services for the investment portfolios of the Company, MBIA Corp. and other affiliates and also for third-party clients. MBIA Asset Management raises funds for investment management through the

issuance of investment agreements, which are issued by the Company and guaranteed by MBIA Corp., to states and municipalities and as part of asset-backed or structured securities for the investment of bond proceeds and other

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funds. It also raises funds through the issuance of medium-term notes (MTNs) which are issued by its affiliate MBIA Global Funding, LLC (GFL) and guaranteed by MBIA Corp. MBIA Asset Management invests the proceeds of the investment agreements and MTNs in high quality eligible investments both in the United States and abroad. MBIA Asset Management offers these services and products through MBIA Municipal Investors Service Corporation (MBIA-MISC), MBIA Investment Management Corp. (IMC), MBIA Capital Management Corp. (CMC), GFL, Euro Asset Acquisition Limited (EAAL) and MBIA Asset Management UK Limited (AM-UK).

MBIA Asset Management also administers three multi-seller conduit financing vehicles, Triple-A One Funding Corp., Meridian Funding Company, LLC and Polaris Funding Company, LLC (together, the Conduits) through MBIA Asset Finance, LLC. The Conduits provide funding for multiple customers through special purpose vehicles that issue primarily commercial paper and MTNs.

MBIA MuniServices Company (MuniServices) provides revenue enhancement services and products, such as discovery, audit, collections/recovery and information (data) services, to state and local governments. Through MuniServices the Company also owns Capital Asset Holdings GP, Inc. and certain affiliated entities (collectively, Capital Asset). Capital Asset was in the business of acquiring and servicing tax liens. The Company has subsequently exited the tax lien business and Capital Asset s primary activity is servicing a tax lien securitization insured by MBIA Corp.

Statements included in this Form 10-K which are not historical or current facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words believe, anticipate, project, plan, expect, intend, will likel or will continue, and similar expressions identify forward-looking statements. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. We wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of their respective dates. The following are some of the factors that could cause actual results to differ materially from estimates contained in or underlying the Company s forward-looking statements: (1) fluctuations in the economic, credit, interest rate or foreign currency environment in the United States or abroad; (2) level of activity within the national and international credit markets; (3) competitive conditions and pricing levels; (4) legislative or regulatory developments; (5) technological developments; (6) changes in tax laws; (7) the effects of mergers, acquisitions and divestitures; and (8) uncertainties that have not been identified at this time. The Company undertakes no obligation to publicly correct or update any forward-looking statement if it later becomes aware that such result is not likely to be achieved.

MBIA Corp. Insured Portfolio

At December 31, 2005, the net par amount outstanding on MBIA Corp. s insured obligations (including insured obligations of MBIA Illinois, MBIA Assurance, MBIA UK and CapMAC, but excluding $15.6 billion of MBIA insured investment agreements and MTNs for MBIA Asset Management) was $585 billion. Net insurance in force, which includes all insured debt service, at December 31, 2005 was $889 billion. Net insurance in force, which is net of cessions to reinsurers, is also net of other reimbursement agreements that relate to certain contracts under which MBIA Corp. is entitled to reimbursement of losses on its insured portfolio but which do not qualify as reinsurance under accounting principles generally accepted in the United States of America (GAAP).

Because MBIA Corp. generally guarantees to the holder of the underlying obligation the timely payment of amounts due on such obligation in accordance with its original payment schedule, in the case of a default on an insured obligation, payments under the insurance policy cannot be accelerated against MBIA Corp., except in certain limited circumstances, unless MBIA Corp. consents to the acceleration. Otherwise, MBIA Corp. is required to pay principal, interest or other amounts only as originally scheduled payments come due. However, MBIA Corp. may from time to time insure obligations under credit default swaps which by their terms require that termination payments be paid at the time of the default of the underlying reference obligation(s). Termination payments are generally calculated by deducting the market value of the reference obligation on the termination date from the specified amount of the reference obligation. The Company estimates that the liquidity needs arising from future termination payments are modest due to MBIA Corp. s strategy of insuring such obligations with high levels of subordination and credit enhancement.

MBIA Corp. seeks to maintain a diversified insured portfolio and has designed the insured portfolio to manage and diversify risk based on a variety of criteria including revenue source, issue size, type of asset, industry concentrations, type of bond and geographic area. As of December 31, 2005, MBIA Corp. had 27,081 policies outstanding (excluding 1,026 policies relating to MBIA Asset Management transactions guaranteed by MBIA Corp.). These policies are diversified among 10,717 credits, which MBIA Corp. defines as any group of issues supported by the same revenue source.

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The table below sets forth information with respect to the original par amount insured per issue in MBIA Corp. s portfolio as of December 31, 2005:

MBIA Corp. Original Par Amount Per Issue as of December 31, 2005 (1) (2)

Original Par Amount Written Per Issue	Number of Issues Outstanding	% of Total Number of Issues Outstanding	Net Par Amount Outstanding (In billions)	% of Net Par Amount Outstanding
Less than $10 million	17,238	63.6%	$ 46.2	7.9%
$10-25 million	4,062	15.0	53.2	9.1
$25-50 million	2,457	9.1	66.4	11.4
$50-100 million	1,627	6.0	82.4	14.1
Greater than $100 million	1,697	6.3	336.8	57.5
Total	27,081	100.0%	$ 585.0	100.0%

(1) Excludes $15.6 billion relating to investment agreements and MTNs issued by affiliates of MBIA Asset Management and guaranteed by MBIA Corp.

(2) Net of reinsurance and other reimbursement agreements. The reimbursement agreements result in a $7.2 billion reduction of outstanding par.

MBIA Corp. underwrites its policies on the assumption that the insurance will remain in force until maturity of the insured obligations. MBIA Corp. estimates that the average life (as opposed to the stated maturity) of its insurance policies in force at December 31, 2005 was 10.4 years. The average life was determined by applying a weighted-average calculation, using the remaining years to maturity of each insured obligation and weighting them on the basis of the remaining debt service insured. No assumptions were made for any future refundings of insured issues. Average annual insured debt service on the portfolio at December 31, 2005 was $69.5 billion.

MBIA Corp. writes financial guarantees for municipal issuers in the United States. Municipal bonds consist of both taxable and tax-exempt bonds and notes that are issued by states, cities, political subdivisions, utility districts, airports, health care institutions, higher educational facilities, housing authorities and other similar agencies, as well as private entities that issue obligations to fund projects that serve a substantial public purpose. These types of obligations are supported by taxes, assessments, fees or tariffs related to use of projects, lease payments or other similar types of revenue streams. MBIA Corp. also guarantees structured finance and asset-backed obligations. In general, structured finance obligations are secured by or payable from a specific pool of assets having an ascertainable future cash flow. MBIA Corp. also insures payments due under credit and other derivatives, including termination payments that may become due upon the occurrence of certain events.

MBIA Corp. also insures privately issued bonds used for the financing of public purpose projects, which are primarily located overseas and that include toll roads, bridges, airports, public transportation facilities and other types of infrastructure projects serving a substantial public purpose. While in the United States, projects of this nature are primarily financed through the issuance of tax-exempt bonds by special purpose, government sponsored tax-exempt entities, the general absence of tax-advantaged financing, among other reasons, has led to the transfer of the operation of many such public purpose projects to the private sector. Generally, the private entities operate under a concession agreement with the sponsoring government agency, which maintains a level of regulatory oversight and control over the project.

Structured finance obligations are either undivided interests in the related assets, or debt obligations collateralized by the related assets. Structured finance transactions are often structured such that the insured obligations benefit from some form of credit enhancement to cover credit risks such as over-collateralization, subordination, excess cash flow or first loss protection. Structured finance obligations contain certain risks including asset risk, which relates to the amount and quality of asset coverage, structural risk, which relates to the extent to which the transaction structure protects the interests of the investors from the bankruptcy of the originator of the underlying assets or the issuer of the

securities, and servicer risk, which relates to problems with the transaction servicer (the entity which is responsible for collecting the cash flow from the asset pool) that could affect the servicing of the underlying assets. In general, the asset risk is addressed by sizing the asset pool and its associated protection level based on the historical and expected future performance of the assets. Structural risks primarily involve bankruptcy risks, such as whether the sale of the assets by the originator to the issuer would be upheld in the event of the bankruptcy or insolvency of the originator and whether the servicer of the assets may be required to delay the remittance of any cash collections held by it or received by it after the time it becomes subject to bankruptcy or insolvency proceedings. Structured finance transactions are usually structured to insulate the investors from the bankruptcy or insolvency of the entity that originated the underlying assets, as well as from the bankruptcy or insolvency of the servicer, and to minimize the likelihood of the bankruptcy or insolvency of the issuer of the obligation. The ability

of the servicer to properly service and collect on the underlying assets is also a factor in determining future asset performance. MBIA Corp. addresses these issues through its servicer due diligence and underwriting guidelines, its formal credit review and approval process and its post-closing servicing review and monitoring.

Outside of the United States, sovereign and sub-sovereign issuers, structured finance issuers, utilities and other issuers, including private issuers who are financing projects with a substantial public purpose, are increasingly using financial guarantee insurance to guarantee their public finance and structured finance obligations. Ongoing privatization efforts have shifted the burden of financing new projects from the government to the capital markets, where investors can benefit from the security of financial guarantee insurance. There is also growing interest in asset-backed securitization. While the principles of securitization have been increasingly applied in overseas markets, the rate of development in particular countries has varied due to the sophistication of the local capital markets and the impact of financial regulatory requirements, accounting standards and legal systems. It is expected that securitization will continue to expand internationally, at varying rates in each country. MBIA Corp. insures both structured finance and public finance obligations in selected international markets. MBIA Corp. believes that the risk profile of the international business it insures is generally the same as in the United States, but recognizes that there are particular risks related to each country and region. These risks include the legal, economic and political situation, the varying levels of sophistication of the local capital markets and currency exchange risks. MBIA Corp. evaluates and monitors these risks carefully.

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The following table shows the diversification of MBIA Corp. s insured portfolio by bond type:

MBIA Corp. Insured Portfolio by Bond Type

as of December 31, 2005 (1) (2)

(In billions)

	Net Par Amount Outstanding	% of Net Par Amount Outstanding
Bond Type		
Global Public Finance		
United States		
General obligation	$ 157.2	26.9%
Utilities	68.4	11.7
Special revenue	42.4	7.2
Transportation	32.1	5.5
Health care	30.8	5.3
Higher education	21.8	3.7
Housing	15.0	2.6
Investor-owned utilities	9.4	1.6
Total United States	377.1	64.5
Non-United States		
Sovereign	9.0	1.6
Transportation	8.3	1.4
Utilities	4.3	0.7
Investor-owned utilities	3.4	0.6
Sub-sovereign	0.7	0.1
Health care	0.3	0.0
Housing and higher education	0.2	0.0
Total Non-United States	26.2	4.4
Total Global Public Finance	403.3	68.9
Global Structured Finance		
United States		
Collateralized debt obligations	41.9	7.1
Asset-backed:		
Other	12.7	2.2
Auto	9.3	1.6
Credit cards	4.0	0.7
Leasing	0.4	0.1
Mortgage-backed:		
Home equity	17.2	2.9
Other	6.2	1.1
First mortgage	2.7	0.5
Pooled corp. obligations & other	18.3	3.1
Financial risk	1.3	0.2

Total United States	114.0	19.5
Non-United States		
Collateralized debt obligations	37.0	6.3
Mortgage-backed:		
First mortgage	13.0	2.2
Other	4.6	0.8
Home equity	0.6	0.1
Pooled corp. obligations & other	7.0	1.2
Asset-backed:		
Other	3.5	0.6
Leasing	0.6	0.1
Auto	0.3	0.1
Credit cards	0.3	0.1
Financial risk	0.8	0.1
Total Non-United States	67.7	11.6
Total Global Structured Finance	181.7	31.1
Total	$ 585.0	100.0%

(1) Excludes $15.6 billion relating to investment agreements and MTNs issued by affiliates of MBIA Asset Management and guaranteed by MBIA Corp.

(2) Net of reinsurance and other reimbursement agreements. The reimbursement agreements result in a $7.2 billion reduction of outstanding par.

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As of December 31, 2005, of the $585 billion outstanding net par amount of obligations insured, $403.3 billion, or 68.9%, were insured in the global public finance market and $181.7 billion, or 31.1%, were insured in the global structured finance market.

The table below shows the diversification by type of insurance written by MBIA Corp. in each of the last five years:

MBIA Corp. Net Par Amount Written by Bond Type (1)

(In millions)

	2001	2002	2003	2004	2005
Bond Type					
Global Public Finance					
United States					
General obligation	$ 15,848	$ 23,533	$ 25,802	$ 27,753	$ 27,586
Utilities	6,350	8,101	14,058	9,453	10,783
Special revenue	5,567	7,307	8,057	7,425	7,591
Transportation	1,098	3,930	3,877	4,055	5,266
Higher education	2,110	2,026	1,272	2,729	4,370
Housing	2,723	2,318	2,807	1,657	3,248
Health care	1,244	1,655	1,928	1,746	1,609
Investor-owned utilities	1,652	172		1,002	608
Total United States	36,592	49,042	57,801	55,820	61,061
Total Non-United States	2,923	3,280	8,938	4,105	3,102
Total Global Public Finance	39,515	52,322	66,739	59,925	64,163
Global Structured Finance					
United States					
Mortgage backed:					
Home equity	7,206	5,367	2,901	8,793	8,465
Other	2,234	1,429	1,218	1,335	80
First mortgage	2,561	1,049	771	955	708
Corporate debt obligations	10,492	18,476	5,000	8,759	7,830
Pooled corp. obligations & other	3,282	4,109	4,573	6,230	6,324
Asset backed:					
Auto	14,443	7,279	6,264	3,867	4,335
Other	1,958	1,132	874	903	1,610
Credit Cards	8,418	1,787	1,010	1,109	
Leasing	2,307	448	853	304	
Financial risk	149	1,256	212	5	
Total United States	53,050	42,332	23,676	32,260	29,352
Total Non-United States	11,114	17,982	18,385	15,385	17,343
Total Global Structured Finance	64,164	60,314	42,061	47,645	46,695
Total	$ 103,679	$ 112,636	$ 108,800	$ 107,570	$ 110,858

(1)

Par amount insured by year, net of reinsurance and other reimbursement agreements that relate to contracts under which MBIA Corp. is entitled to payment in the event of losses on its insured portfolio but which do not qualify as reinsurance under GAAP.

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MBIA Corp. is licensed to write business in all 50 states, the District of Columbia, Guam, the Northern Mariana Islands, the U.S. Virgin Islands, Puerto Rico, the Kingdom of Spain and the Republic of France. MBIA Assurance is licensed to write business in France and in certain member countries of the European Economic Area. MBIA UK is licensed to write business in the United Kingdom and in member countries of the European Economic Area. The following table sets forth the geographic distribution of MBIA Corp. s net par outstanding, including the ten largest states in the United States:

MBIA Corp. Insured Portfolio Outstanding by Geographic Location

As of December 31, 2005 (1) (2)

	Net Par Amount Outstanding (In billions)	% of Net Par Amount Outstanding
United States		
California	$ 66.9	11.4%
New York	39.9	6.8
Florida	25.5	4.4
Texas	20.7	3.5
New Jersey	18.5	3.2
Illinois	16.6	2.8
Pennsylvania	14.3	2.4
Massachusetts	14.3	2.4
Washington	12.2	2.1
Michigan	12.1	2.1
Sub-Total	241.0	41.1
Other States & Territories	141.6	24.3
Nationally Diversified	108.5	18.5
Total United States	491.1	83.9
Non-United States		
Regional Specific	48.3	8.3
Internationally Diversified	45.6	7.8
Total Non-United States	93.9	16.1
Total	$ 585.0	100.0%

(1) Excludes $15.6 billion relating to investment agreements and MTNs issued by affiliates of MBIA Asset Management and guaranteed by MBIA Corp.

(2) Net of reinsurance and other reimbursement agreements. The reimbursement agreements result in a $7.2 billion reduction of outstanding par.

MBIA Corp. underwriting guidelines limit the net insurance in force for any one insured credit. In addition, MBIA Corp. is subject to both rating agency and regulatory single-risk limits with respect to any insured bond issue. As of December 31, 2005, MBIA Corp. s net par amount outstanding for its ten largest insured public finance credits totaled $23.5 billion, representing 4.0% of MBIA Corp. s total net par amount

outstanding, and the net par outstanding for its ten largest structured finance credits (without aggregating common issuers), was $20.5 billion, representing 3.5% of the total.

MBIA Corp. Insurance Programs

MBIA Corp. offers financial guarantee insurance in both the new issue and secondary markets on a global basis. At present, no new financial guarantee insurance is being offered by MBIA Illinois or CapMAC, but it is possible that either of those entities may insure transactions in the future. MBIA Corp., MBIA UK and MBIA Assurance offer financial guarantee insurance in Europe, Asia, Latin America and other areas outside the United States.

Transactions in the new issue market are sold either through negotiated offerings or competitive bidding. In negotiated transactions, either the issuer or the underwriter purchases the insurance policy directly from MBIA Corp. For municipal bond issues involving competitive bidding, the insurance is offered as an option to the underwriters bidding on the transaction. The successful bidder would then have the option to purchase the insurance.

In the secondary market, MBIA provides credit enhancement through two programs. The RAPSS program (Rapid Asset Protection for Secondary Securities) guarantees the payment of principal and interest on an individual security or class

of securities traded in the secondary market in response to requests from bond traders and investors. Securities insured in the RAPSS program have the benefit of MBIA Corp. s guarantee until maturity. The Portfolio Insurance program enables an investor to insure a specific portfolio of bonds and is offered as an ongoing program with investment banks, financial service companies and conduit sponsors. For each insured portfolio, MBIA Corp. establishes specific underwriting criteria for the inclusion of new assets in the program portfolio. The Portfolio Insurance program is a while-in-trust program which provides the benefits of an MBIA Corp. guarantee to securities only during the time they are held in a particular insured portfolio, although in some cases, MBIA Corp. may offer insurance to maturity for an additional premium.

Operations

The worldwide insurance operations of MBIA Corp. are conducted through the Global Public Finance Division, the Global Structured Finance Division, the Risk Management Division and the Insured Portfolio Management Division. Public Finance and Structured Finance operations outside of the United States are conducted in coordination with the International Division.

The Global Public Finance Division has underwriting authority with respect to certain categories of business up to pre-determined par amounts based on a risk-ranking system. In order to ensure that the guidelines are followed, Risk Management monitors and periodically reviews underwriting decisions made by the Global Public Finance Division and also participates in many transactions depending on the risk ranking. Larger, complex, or unique transactions are also then reviewed and approved at MBIA Corp. s most senior level, the Executive Risk Committee, which consists of the Company s Chairman, the Chief Executive Officer, the President of MBIA Corp., the Chief Risk Officer, the head of the Structured Finance new business division, the head of the Portfolio Management Group within the Risk Management Division, the head of the Insured Portfolio Management Division and the head credit officer in each of the International and Public Finance Divisions.

For all transactions done by the Global Structured Finance Division (and all Global Public Finance Transactions without decentralized underwriting approval), MBIA Corp. s review and approval procedure has two stages. The first stage consists of screening, credit review and structuring by the appropriate business unit, in consultation with Risk Management officers. The second stage, consisting of the final review and approval of credit and structure, is performed by an underwriting committee consisting of the head of the applicable business unit, one officer from Risk Management and a third officer from either the Risk Management Division or the Insured Portfolio Management Division. Certain transactions, based on size, complexity, or other factors, are also approved by the Executive Risk Committee.

Premium rates for the Global Public, Global Structured Finance and International Divisions are established by a Pricing Committee with representation from the relevant business unit and from the Pricing Group, which provides pricing and other analysis.

Risk Management

MBIA Corp. s risk culture and policies are set by the Executive Risk Committee, which includes the members of senior management listed above. The Executive Risk Committee periodically approves and reviews, at least annually, the Risk Management systems and processes for measuring and managing credit, market and liquidity risks. The Executive Risk Committee also appoints qualified voters at MBIA Corp. s various committees focused on credit risk, market risk, liquidity exposure and portfolio management. The chairperson of the Executive Risk Committee is also the head of MBIA Corp. s Risk Management Division, which is responsible for developing and implementing MBIA Corp. s underwriting guidelines, policies and procedures to ensure an overall diversified insured portfolio with low risk characteristics.

MBIA Corp. establishes underwriting guidelines based on those aspects of credit quality that it deems important for each category of obligation considered for insurance. For public finance transactions, these aspects may include economic and social trends, debt management, financial management, adequacy of anticipated cash flow, satisfactory legal structure and other security provisions, viable tax and economic bases, adequacy of loss coverage and project feasibility, including a satisfactory consulting engineer s report, if applicable. For structured finance transactions, MBIA Corp. s underwriting guidelines, analysis and due diligence focus on seller/servicer credit and operational quality, the historical and projected performance of the asset pool, and the strength of the structure, including legal segregation of the assets, cash flow analysis, the size and source of first loss protection, asset performance triggers and financial covenants. For all transactions involving a non-U.S. issuer, non-U.S. assets, non-U.S. sources of cash flow or which are not denominated in U.S. dollars also include an assessment of country risk. Most transactions also undergo extensive cash flow analysis and sensitivity testing using scenario-based analysis, Monte Carlo probability analysis or both to examine the impact of remote events on credit performance. MBIA Corp. s underwriting guidelines are subject to periodic review by the Executive Risk Committee, which is responsible for establishing and maintaining underwriting standards and criteria for all insurance products.

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In addition to the risk underwriting officers, the Risk Management Group has several other units. The Credit Analysis Group analyzes and monitors MBIA Corp. s embedded exposure to financial institutions and corporate entities in the form of seller/servicer exposure or as obligors or counterparties on investment contracts, letters of credit, swaps, liquidity and other facilities supporting MBIA Corp. insured issues, and recommends terms and conditions, as well as capacity guidelines for such exposures. The Portfolio Management Group analyzes MBIA Corp. s insured portfolio using various quantitative tools to test for diversity, credit quality, liquidity and other portfolio characteristics and recommends guidelines for risk concentrations and for internal capital requirements. Recommendations for internal capital requirements are based on a portfolio model that measures risk-adjusted capital by transaction, by sector and for the aggregate portfolio. The Portfolio Management Group also monitors all insured exposure for obligor, country, seller/servicer and other concentrations to minimize the impact of any single risk and to ensure compliance with the applicable regulatory and internal guidelines. The Transaction Analytics Group uses various quantitative tools to test and measure stress resistance on transactions and the Market Risk Group measures and assesses market risk factors in the investment management business and any exposure to market risk factors within the insurance business.

Insured Portfolio Management

The Insured Portfolio Management Division (IPM or the IPM Division) is responsible for monitoring MBIA Corp. s outstanding insured obligations. This group s first function is to detect any deterioration in credit quality or changes in the economic, regulatory or political environment which could adversely affect an MBIA Corp. insured issue, including interrupting the timely payment of debt service. If a problem is detected, the group works with the issuer, trustee, bond counsel, servicer, underwriter and other interested parties in an attempt to alleviate or remedy the problem in order to minimize potential defaults. The IPM Division works closely with Risk Management and the applicable business unit to analyze insured issue performance and credit risk parameters.

Once an obligation is insured, MBIA Corp. typically requires the issuer, servicer (if applicable) and the trustee to furnish periodic financial and asset related information, including audited financial statements, to the IPM Division 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, state and municipal finances and budget developments and evaluates their impact on issuers.

During the underwriting process, each insured transaction is assigned an internal credit rating. Credits are monitored according to a frequency of review schedule that is based on risk type, internal rating, performance and credit quality. Issues that experience financial difficulties, deteriorating economic conditions, excessive litigation or covenant or trigger violations are placed on the appropriate review list and are subject to surveillance reviews at intervals commensurate to the problem which has been detected. If IPM identifies concerns with respect to the performance of an insured issue it may designate such insured issue as Caution List-Low, Caution List-Medium or Caution List-High based on the nature and extent of these concerns and requires that an increased monitoring and, if needed, a remediation plan be implemented for the related insured issue. The Company 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 MBIA Corp. determines that it must pay a claim or that a claim is probable and estimable with respect to an insured issue, it places the issue on its Classified List and establishes a case basis reserve for that insured issue. See Losses and Reserves; Remediation below.

There are three areas in the IPM Division. The IPM group which supports the Global Public Finance Division handles all types of domestic and international municipal issues such as general obligation, tax-backed, utility, health care, transportation and special revenue bonds, as well as investor-owned utility and project finance transactions. The IPM group which supports the Global Structured Finance Division is responsible for domestic and international structured finance transactions, including future flow transactions and collateralized debt obligations. Each group is responsible for processing waiver and consent requests and other deal modifications within their areas of responsibility. The third area, the Special Situations Group, is described below.

IPM personnel supporting the Global Public Finance Division review and report on the major credit quality factors, evaluate the impact of new developments on weaker insured credits and carry out remedial activity. In addition, this group performs analysis of financial statements and key operating data on a large-scale basis and maintains various databases for research purposes. This group is also responsible for preparing special reports which include analyses of regional economic trends, proposed tax limitations, the impact of employment trends on local economies, legal developments affecting bond security and the potential impact of events, such as natural disasters or headline events, on the insured portfolio. This unit is also responsible for all health care transactions.

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The IPM unit supporting the Global Structured Finance Division monitors insured structured finance issues, focusing on asset and servicer performance and transaction cash flows. Monitoring of insured issues typically involves review of monthly trustee, servicer and portfolio manager statements, compliance reviews with transaction documents and analysis of cash flow adequacy. Review of issuer and/or servicer performance can include site visits, forensic audits, management meetings and financial statement reviews. For problem credits, the team performs additional specialized cash flow analyses, conducts best practice reviews with servicers and facilitates loss mitigation strategies.

A separate unit within IPM (the Special Situations Group) assists in addressing insured exposures experiencing significant stress. The Special Situations Group is staffed with personnel with knowledge of, expertise in and experience with impaired credit situations. For issues that experience financial difficulties, deteriorating economic conditions, excessive litigation or covenant or trigger violations, the Special Situations Group works in conjunction with the related IPM personnel to assess and monitor the situation and determine the appropriate course of action, including, if necessary, developing and implementing a remediation strategy.

Investment Management Services

The Company also provides the following investment management products and financial services through its wholly owned subsidiary MBIA Asset Management.

MBIA Asset Management offers cash management, customized asset management and investment consulting services to local governments, school districts and other institutional clients through MBIA-MISC, an SEC-registered investment adviser. At December 31, 2005, $2.7 billion or 35% of the pooled investment programs managed or administered by MBIA-MISC have the benefit of commitments by the Company to cover losses incurred by these investment programs as a result of a decline in program asset values below a predetermined level. MBIA-MISC had $12.4 billion in assets under management at December 31, 2005, up 5% from $11.9 billion at December 31, 2004.

MBIA Asset Management offers fixed-income asset management services for the investment portfolios of the Company, MBIA Corp. and other affiliates and also for third-party clients through CMC, an SEC-registered investment adviser and National Association of Securities Dealers (NASD) member firm and through AM-UK, a Financial Services Authority registered investment advisor based in London and formed in November 2004. The market value of assets related to the Company s insurance and corporate investment portfolios managed by CMC were $10.2 billion at December 31, 2005, down 1% from $10.3 billion at December 31, 2004. In addition, CMC and AM-UK provides investment management services for third parties. The market value of CMC and AM-UK s third-party assets under management at December 31, 2005 was $5.5 billion, compared with $4.1 billion at December 31, 2004.

MBIA Asset Management raises funds for investment management through guaranteed investment agreements, which are issued by the Company and guaranteed by MBIA Corp., and which are offered to states and municipalities and as part of asset-backed or structured securities for the investment of bond proceeds and other funds. MBIA Asset Management also raises funds through its affiliate GFL. GFL raises funds for management through the issuance of MTNs with varying maturities (GFL MTNs), which are in turn guaranteed by MBIA Corp. GFL lends the proceeds of these GFL MTN issuances to the Company (GFL Loans). Under agreements between the Company and MBIA Corp., the Company invests the proceeds of the investment agreements and GFL Loans in eligible investments.

At December 31, 2005, principal and accrued interest outstanding on investment agreement and MTN obligations originated by MBIA Asset Management totaled $15.7 billion, compared with $12.5 billion at December 31, 2004. Assets supporting these programs had market values of $15.9 billion and $12.6 billion at December 31, 2005 and December 31, 2004, respectively. These assets are comprised of high-quality securities with an average credit quality rating of Double-A and are pledged to MBIA Corp. in support of its guarantees. MBIA Asset Management manages the programs within a number of risk and liquidity parameters monitored by the rating agencies, and maintains backup liquidity in order to ensure sufficient funds are available to make all payments due on the investment agreement and MTN obligations and to fund operating expenses. In addition, the Company has made a capital investment in these programs, which is available at any time to fund cash needs. In the event that the value of the assets is insufficient to repay the investment agreement and MTN obligations when due, the Company may incur a loss.

The Company manages its balance sheet to protect against a number of risks inherent in its business including liquidity risk, market risk (principally interest rate risk), credit risk, operational risk and legal risk. (See Management s Discussion and Analysis of Financial Condition and Results of Operation Market Risk in Part II, Item 7) The assets supporting the MBIA Asset Management programs are managed with the goal of matching the duration of the invested assets, including hedges, to the duration of the investment agreement and MTN obligations in order to minimize market and liquidity risk.

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MBIA Asset Management uses derivative financial instruments to manage interest rate risk and foreign currency risk. Credit default swaps are entered into as an extension of the group s investment business. Forward delivery agreements are offered and periodically sold to clients. The Company has established policies limiting the amount, type and concentration of such instruments. A source of liquidity risk arises from the ability of some investment agreement counterparties to withdraw moneys on dates other than those specified in the related draw-down schedule. This liquidity risk is somewhat mitigated by provisions in certain of the investment agreements that limit an issuer s ability to draw on the funds and by risk management procedures that require the regular re-evaluation and re-projection of draw-down schedules. Investments are restricted to fixed-income securities with a credit quality such that the overall minimum average portfolio credit quality is maintained at an average credit quality rating of Double-A. Based upon management s projections, MBIA Asset Management maintains liquidity sources which are more than sufficient to meet its projected short-term liquidity needs.

On September 30, 2003, the Company purchased the equity and acquired all controlling interests of the conduit financing vehicles it administers, Triple-A One Funding Corp., Meridian Funding Company, LLC and Polaris Funding Company, LLC (together, the Conduits). The Conduits, which issue primarily commercial paper and MTNs, are now reflected in the consolidated financial statements of the Company. (See Management s Discussion and Analysis of Financial Condition and Results of Operation Investment Management Services in Part II, Item 7).

The Conduits are used by banks and other financial institutions to raise funds for their customers in the capital markets. The Conduits provide funding for multiple customers through special purpose vehicles that issue primarily commercial paper and MTNs. The proceeds from the issuance of the commercial paper or MTNs are used to either make loans to customers which are secured by certain assets or to purchase the assets from the customers. All transactions in the Conduits are insured by MBIA Corp. and are subject to MBIA Corp. s standard underwriting process.

It is the Company s policy to obtain an underlying rating from both Moody s and S&P for each new transaction prior to the execution of such transactions within the Conduits. An underlying rating is the implied rating for the transaction without giving consideration to the MBIA Corp. guarantee. All transactions must be rated investment grade by both S&P and Moody s before they can be purchased into a Conduit. The weighted-average underlying ratings for transactions currently funded in the Conduits were A by S&P and A2 by Moody s at the time such transactions were funded in the Conduits. As set forth in the table below, without giving effect to the MBIA Corp. guarantee for transactions currently funded in the Conduits, the Company estimates that the current weighted-average underlying ratings of all outstanding Conduit transactions were A- by S&P and A3 by Moody s as of December 31, 2005. The ratings in the table below are the lower underlying rating assigned by S&P or Moody s when an underlying rating exists from either rating service, or when an external underlying rating is not available, the underlying rating is based on the Company s best estimate of the rating of such investment.

Underlying Rating of Conduit Transactions

Without Giving Effect to the MBIA Corp. Guarantee

as of December 31, 2005

	Fair Value (In thousands)	% of Total Conduit Transactions
Credit Quality Rating		
Aaa	$ 213,502	4.79%
Aa	432,254	9.70
A	1,811,929	40.67
Baa	1,998,039	44.84
Below Investment Grade		
	$ 4,455,724	100.00%

As a result of having to adhere to MBIA Corp. s underwriting standards and criteria, Conduit transactions have, in general, the same underlying ratings that similar non-Conduit transactions guaranteed by MBIA Corp. have at the time they are closed. Like all credits underwritten by MBIA Corp., the underlying ratings on Conduit transactions may be downgraded by either one or both rating agencies after they are closed. In general,

the underlying ratings on Conduit transactions have been downgraded no more frequently than similar non-Conduit transactions guaranteed by MBIA Corp.

The Conduits enter into derivative instruments primarily as economic hedges against interest rate and currency risks. It is expected that any change in the market value of the derivative instruments will be offset by a change in the market value of the hedged assets or liabilities. However, because the investments are accounted for as held-to-maturity, no change in market value, with the exception of the change in value of foreign currency assets due to changes in foreign currency rates, is recorded in the Company s

financial statements. Any change in the market value of derivative instruments that are not accounted for as hedges under SFAS 133 will be recorded as net gains or losses on derivative instruments and foreign exchange in the Company s consolidated income statement.

The consolidation of the Conduits has not impacted the Company s liquidity requirements because Triple-A One Funding Corp. has independently entered into liquidity agreements with third-party providers and because the assets and liabilities of Meridian and Polaris are structured on a match-funded basis.

At December 31, 2005, there were $4.6 billion of assets (the majority of which are investments valued at amortized cost) in the Conduits and $4.4 billion of liabilities issued through the Conduits.

Municipal Services

MBIA MuniServices Company (MuniServices) delivers revenue enhancement services and products to public-sector clients nationwide, consisting of discovery, audit, collections/recovery and information (data) services. The municipal services operations also includes Capital Asset Holdings GP, Inc. and certain affiliated entities (Capital Asset), a servicer of delinquent tax certificates.

MuniServices owns Capital Asset, which was in the business of acquiring and servicing tax liens. The Company became a majority owner of Capital Asset in December 1998. MuniServices became 100% owner of Capital Asset in December 2003. During the first two quarters of 1999, the Company attempted to sell its interest in Capital Asset. At the end of the second quarter of 1999, the Company ceased these efforts and decided to limit the activities of Capital Asset primarily to the servicing of the portfolios then being serviced by Capital Asset. In the second quarter of 1999, the Company completed an internal evaluation of Capital Asset s tax lien portfolio, as a result of which the Company determined that it was necessary to write down its investment in Capital Asset by $102 million. In the third quarter of 1999, Capital Asset engaged a specialty servicer of residential mortgages to help manage its business and operations and to assist in administering the tax lien portfolios serviced by Capital Asset and supporting the securitizations insured by MBIA Corp.

In the third quarter of 1999, Capital Asset also completed the refinancing of substantially all of its remaining tax liens. These liens were originally financed through a commercial paper warehouse facility that matured at the end of the third quarter of 1999, which was guaranteed by the Company. The refinancing was accomplished through a securitization transaction in which the tax liens were sold to a qualifying special purpose vehicle which in turn issued notes partially secured by those liens. The proceeds of the securitization were used primarily to extinguish the warehouse facility. This was Capital Asset s third securitization of tax liens, and MBIA Corp. has insured all of the notes issued by these securitizations. These securitizations were structured through the sale by Capital Asset of substantially all of its tax liens to off-balance sheet qualifying special purpose vehicles that were established in connection with these securitizations. The first transaction, done in 1997, had a revolving bank line of credit, guaranteed by MBIA Corp., to purchase subsequent liens against already encumbered real estate if necessary to protect previous securitized lien positions. This first transaction had an original gross par insured of $285.4 million and an available credit line of $70.0 million. The second transaction, done in 1998, also had a revolving bank line of credit, guaranteed by MBIA Corp., for the same purpose. This transaction had an original gross insured par of $175.6 million and an available credit line of $50.0 million. The final transaction, done in 1999, had an original gross par of $196.0 million. On June 30, 2004, in order to reduce ongoing carrying and other costs, a clean-up call was exercised for the Capital Asset Research Funding Series 1997A and Series 1998A tax lien securitizations. The clean-up call provisions permitted the issuer of the bonds to buy back any remaining tax liens when the principal amount of the bonds fell below ten percent of the original principal amount. In connection with the clean-up calls on June 30, 2004, MBIA Corp. paid $51.5 million (net of reinsurance) under its policies to the trustee for the securitizations, which defeased its remaining exposure to these transactions. Additionally, the payment made by MBIA Corp. related to the Capital Asset Research Funding Series 1997A and Series 1998A tax lien securitizations resulted in the Company consolidating the securitizations in its financial statements.

MBIA Corp. currently insures the third Capital Asset securitization, which is not consolidated. This transaction matures in 2008 and has an outstanding balance of $117 million, for which the Company has posted a case basis reserve of $68 million. Because the ultimate collectibility of tax liens is difficult to estimate, there can be no assurance that the case reserves established to date would be sufficient to cover all future claims under this policy. MBIA Corp. will continue to evaluate the performance of the remaining tax lien portfolio and adjust loss reserves or salvage as and when necessary. See Losses and Reserves; Remediation for additional information on the Company s loss reserving process.

Competition

The financial guarantee insurance business is highly competitive. Several other monoline insurance companies compete directly against MBIA Corp. in writing financial guarantee insurance, all of which, like MBIA Corp., have Triple-A financial strength ratings from Moody s and S&P. In addition, there are several other monoline insurance companies which compete with MBIA Corp. in writing financial guarantee insurance as a primary insurer which have lower ratings. MBIA Corp. also competes with composite (multi-line) insurers.

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Financial guarantee insurance also competes with other forms of credit enhancement, including senior-subordinated structures, credit derivatives, over-collateralization, letters of credit and guarantees (for example, mortgage guarantees where pools of mortgages secure debt service payments) provided by banks and other financial institutions, some of which are governmental agencies or have been assigned the highest credit ratings awarded by one or more of the major rating agencies. Letters of credit are most often issued for periods of less than 10 years, although there is no legal restriction on the issuance of letters of credit having longer terms. Thus, financial institutions and banks issuing letters of credit compete directly with MBIA Corp. to guarantee short-term notes and bonds with a maturity of less than 10 years. To the extent that banks providing credit enhancement may begin to issue letters of credit with commitments longer than 10 years, the competitive position of financial guarantee insurers, such as MBIA Corp., could be adversely affected. Letters of credit are also frequently used to assure the liquidity of a short-term put option for a long-term bond issue. This assurance of liquidity effectively confers on such issues, for the short term, the credit standing of the financial institution providing the facility, thereby competing with MBIA Corp. and other financial guarantee insurers in providing interest cost savings on such issues. Other highly rated institutions, including pension funds and government sponsored entities, also offer third-party credit enhancement on asset-backed and municipal obligations. Financial guarantee insurance and other forms of credit enhancement also compete in nearly all instances with the issuer s alternative of foregoing credit enhancement and paying a higher interest rate. If the interest savings from insurance or another form of credit enhancement are not greater than the cost of such credit enhancement, the issuer will generally choose to issue bonds without third-party enhancement.

Certain characteristics of the Triple-A rated financial guarantee insurance business act as barriers-to-entry to potential new competitors. For example, there are minimum capital requirements imposed on a financial guarantee insurance company by the rating agencies to obtain and maintain Triple-A financial strength ratings and these capital requirements may deter other companies from entering this market. However, there can be no assurance that these capital requirements will deter potential competitors from entering this market or that the market may increasingly accept guarantees provided by Double-A or lower rated insurers who have less stringent capital requirements. In addition, under New York law, multi-line insurers are prohibited from writing financial guarantee insurance in New York State. See Part I, Item 1. Business Insurance Regulation. However, there can be no assurance that major multi-line insurers or other financial institutions will not participate in financial guarantee insurance in the future, either directly or through monoline subsidiaries.

Reinsurance

State insurance laws and regulations, as well as the rating agencies who rate MBIA Corp., impose minimum capital requirements on financial guarantee companies, limiting the aggregate amount of insurance and the maximum size of any single risk exposure which may be written. MBIA Corp. decreases the insured exposure in its portfolio and increases its capacity to write new business by using treaty and facultative reinsurance to reduce its gross liabilities on an aggregate and single risk basis. Additionally, MBIA Corp. has entered into agreements under which it is entitled to reimbursement of losses on its insured portfolio but which do not qualify as reinsurance under GAAP.

MBIA Corp. s net retention on the policies it writes varies from time to time depending on its own business needs and the capacity available in the reinsurance market. From its reorganization in December 1986 through December 1987, MBIA Corp. reinsured a portion of each policy through quota and surplus share reinsurance treaties. Each treaty provides reinsurance protection with respect to policies written by MBIA Corp. during the term of the treaty, for the full term of the policy. Under its quota share treaty, MBIA Corp. ceded a fixed percentage of each policy insured. Since 1988, MBIA Corp. has entered into primarily surplus share treaties under which a variable percentage of risk over a minimum size is ceded, subject to a maximum percentage specified in the related treaty. Reinsurance ceded under the treaties is for the full term of the underlying policy.

MBIA Corp. also enters into facultative reinsurance arrangements from time to time primarily in connection with issues which, because of their size, require additional capacity beyond MBIA Corp. s retention and treaty limits. Under these facultative arrangements, portions of MBIA Corp. s liabilities are ceded on an issue-by-issue basis. MBIA Corp. may also use facultative arrangements as a means of managing its exposure to single issuers or counterparties to comply with regulatory and rating agency requirements, as well as internal underwriting and portfolio management criteria.

As a primary insurer, MBIA Corp. is required to honor its obligations to its policyholders whether or not its reinsurers and others perform their agreement obligations to MBIA Corp. The financial position and financial strength rating of all its reinsurers are monitored by MBIA Corp. on a regular basis. The downgrade or default of one or more of the Company s reinsurers is not expected to have a material adverse impact on the Company s ratings, financial condition or results of operations.

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As of December 31, 2005, MBIA Corp. has retained $585 billion or 87.9% of the gross par outstanding of all transactions insured by it and its insurance company affiliates and ceded approximately $80.7 billion or 12.1% under reinsurance contracts with reinsurers and other reimbursement agreements. The amounts of exposure ceded to reinsurers at December 31, 2005 and 2004 by bond type and by geographic location are set forth in Note 22: Reinsurance in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries.

The following table shows the reinsurers providing reinsurance to MBIA measured by outstanding par ceded to and reinsurance recoverables from reinsurers by rating levels at December 31, 2005:

Reinsurers	Standard & Poor s Rating	Moody s Rating	Percentage of Total Par Ceded	Reinsurance Recoverable (in thousands)
Channel Reinsurance Ltd.	AAA	Aaa	45.19%	$ 4,546
Assured Guaranty Corp.	AAA	Aa1	17.73	23,947
Ram Reinsurance Company, Ltd.	AAA	Aa3	12.20	4,386
Ambac Assurance Corporation	AAA	Aaa	9.40	
Mitsui Sumitomo Insurance Company Ltd.	AA-	Aa3	6.36	2
Swiss Reinsurance Company, Zurich, Switzerland	AA	Aa2	2.81	
Radian Asset Assurance Inc.	AA	Aa3	1.61	7,838
Assured Guaranty Re Ltd.	AA	Aa2	0.82	
Sompo Japan Insurance Inc.	AA-	Aa3	0.81	2
Transatlantic Reinsurance Company	AA-	Aa3	0.59	1,620
Other [(1)]	A or above	A1 or above	2.40	16,347
Not Currently Rated			0.08	277
Total			100.00%	$ 58,965

(1) Several reinsurers within this category are not rated by Moody s.

While Channel Reinsurance Ltd. (Channel Re) continues to be rated Triple-A, S&P has revised its rating outlook on Channel Re from stable to negative . As discussed below, the Company has an equity interest in both Channel Re and the holding company parent of Ram Reinsurance Company, Ltd. (RAM Re).

The financial strength ratings of certain of MBIA Corp. s reinsurers have been downgraded below Triple-A. While these reinsurers continue to remain on risk for potential losses on ceded insurance exposure, the value of the reinsurance to the Company is decreased due to the increased amounts of capital that MBIA Corp. is required to hold with respect to the ceded risks as a result of the reinsurers downgrade. Generally, MBIA Corp. has the right to terminate a reinsurance agreement when the reinsurer is downgraded below certain agreed-upon thresholds or if the capital credit received by MBIA Corp. for the reinsurance decreases below the agreed-upon thresholds and it may elect to take back ceded business so as to more effectively deploy its capital. However, in the event that MBIA Corp. elects to take back ceded business from a downgraded reinsurer, there can be no assurance that alternative reinsurance capacity will be available or that MBIA Corp. will be able to secure reinsurance on favorable terms. In the event that MBIA Corp. is unable to obtain reinsurance with a highly rated reinsurer, the amount of capital required to maintain MBIA Corp. s Triple-A rating could increase.

The Company has launched several initiatives in the past several years which were aimed at increasing its financial flexibility and Triple-A reinsurance capacity and reducing risks in its insured portfolio. These initiatives include making strategic investments in monoline reinsurers, entering into risk allocation arrangements with government entities and arranging for loss protection through other financial products.

In 2003, the Company invested $25 million for an 11.4% ownership interest in the holding company parent of RAM Re, a financial guarantee reinsurer located in Bermuda rated AAA by S&P and Aa3 by Moody s. The Company s investment, among other things, assisted RAM Re in maintaining its ratings.

In February 2004, the Company, together with RennaissanceRe Holdings, Ltd., Koch Financial Re, Ltd. and Partner Reinsurance Company Ltd., formed Channel Re, a new Bermuda-based financial guarantee reinsurance company rated Triple-A by S&P and Moody s. The Company invested $63.7 million for a 17.4% ownership interest in Channel Re.

In February 2004, MBIA Corp. and Channel Re entered into arrangements whereby Channel Re agreed to provide committed reinsurance capacity to MBIA Corp. at least through June 30, 2008. Under treaty and facultative reinsurance arrangements MBIA Corp. agreed to cede to Channel Re and Channel Re agreed to assume from MBIA Corp. varying percentages of designated policies issued by MBIA Corp. The amount of any policy subject to the committed reinsurance arrangements is based on the type of risk insured and on other factors. The reinsurance arrangements provide Channel Re with certain preferential terms, including those related to ceding commissions. The treaty reinsurance arrangement was renewed in 2005.

In September 2004, MBIA Corp. entered into an investment guaranty arrangement with a development agency of the United States government which helps domestic private sector businesses manage risks associated with direct foreign investment. In December 2005, MBIA Corp. entered into a facultative reinsurance arrangement with a development agency of a foreign government which promotes exports and assists domestic manufacturing. Under these arrangements, the agencies undertake to indemnify MBIA Corp. for their respective proportionate share of loss on ceded exposures.

MBIA Corp. may also look to reduce risks embedded in its insured portfolio by entering into derivative transactions or other types of hedging arrangements. In December 2004, MBIA Corp. executed a $550.8 million capital markets transaction in which it hedged a portion, or $275.8 million at closing, of the credit and market risk associated with its synthetic CDO portfolio. In 2004, MBIA Corp. received approval from the NYS Insurance Department for a derivative use plan which authorizes MBIA Corp. to hedge certain risks through the use of derivative instruments and may look to enter into hedging transactions to reduce risks on an individual and portfolio-wide basis.

In 1998, three reinsurers, Converium Reinsurance (North America) Inc. (Converium), AXA Re Finance S.A. (ARF) and Muenchener Rueckversicherungs-Gesellshaft (Munich Re) paid MBIA Corp. $170 million under three separate agreements (each, an Excess-of-Loss Agreement and, collectively, the Excess-of-Loss Agreements) in connection with losses MBIA Corp. incurred on $265 million of MBIA-insured bonds issued by the Pittsburgh-based Alleghany Health, Education and Research Foundation (AHERF). The Excess-of-Loss Agreements were structured as three successive excess-of-loss facilities that aggregated to $170 million. Under the Excess-of-Loss Agreements, Converium paid MBIA Corp. $70 million and Munich Re and ARF each paid MBIA Corp. $50 million.

In connection with the arrangements for the Excess-of-Loss Agreements, MBIA Corp. entered into quota share agreements with Munich Re, ARF and Converium (each a Quota Share Agreement and, collectively, the Quota Share Agreements). Under the Quota Share Agreements, MBIA Corp. agreed to cede to the three reinsurers new business written with an aggregate par sufficient to generate $297 million in gross premiums over a six year period ending October 1, 2004. Of the $297 million in premiums to be ceded under the Quota Share Agreements, MBIA Corp. agreed to cede to Converium cash premiums equal to $102 million, to ARF adjusted gross premiums of $97 million and to Munich Re adjusted gross premiums of $98 million over this period.

Under separate agreements, to which MBIA Corp. was not a party, Converium reinsured directly and indirectly to ARF (the Converium-ARF Retrocession Agreements) the risk that it had assumed from MBIA Corp. under its Quota Share Agreements with MBIA Corp. for losses in excess of $13.1 million. ARF contended that, in connection with its agreement to assume this risk from Converium under the Converium-ARF Retrocession Agreements, there was an oral agreement with MBIA Corp. under which MBIA Corp. would replace ARF as a reinsurer to Converium by no later than October 2005.

In October 2004, MBIA Corp. commuted and assumed from ARF the policies that ARF had assumed directly under its Quota Share Agreements with MBIA Corp. discussed above (the MBIA-ARF Agreements). At the same time, MBIA Corp. also assumed from ARF all of the risk that ARF assumed from Converium under the Converium-ARF Retrocession Agreements. AXA RE, S.A (AXA RE), ARF s parent, in turn agreed to reinsure MBIA Corp. for all losses in excess of $96.9 million assumed by MBIA Corp. from ARF under the Converium-ARF Retrocession Agreements up to an aggregate amount of $90 million. ARF paid MBIA Corp. $10 million for assuming from it the risk under the Converium-ARF Retrocession Agreements, and MBIA Corp. paid AXA RE $1 million for reinsuring MBIA Corp. for all losses in excess of $96.9 million assumed by MBIA Corp. from ARF under the Converium-ARF Retrocession Agreements up to an aggregate amount of $90 million.

In addition to the $10 million that MBIA Corp. received as described above, MBIA Corp. received approximately $19.5 million related to the commutation of the MBIA-ARF Agreement, consisting of statutory unearned premium reserves of $42.5 million less refunded ceding commissions of $13.9 million and fees of $9.1 million. In addition, MBIA Corp. will receive future installment premiums with a present value of approximately $21.5 million in connection with the commuted policies. As a result of this transaction, MBIA Corp. reassumed $21.3 billion in aggregate insured par. The commutation of the MBIA-ARF Agreement and the assumption by MBIA Corp. from ARF of the risk under the Converium-ARF Retrocession Agreements were done in order, among other reasons, to settle and resolve the disputes with ARF regarding the alleged oral agreement. In addition, MBIA Corp. entered into these agreements and agreed to assume the related policies due to the fact that it no longer received rating agency capital credit in connection with the exposures ceded to ARF and Converium because ARF no longer has a financial strength rating and the financial strength rating of Converium had been downgraded.

In October 2004, the Company s management recommended that the Audit Committee of the Company s Board of Directors undertake an investigation of the Excess-of-Loss Agreements and the Quota Share Agreements, including whether an oral agreement existed between MBIA Corp. and ARF that MBIA Corp. would assume the risk that Converium retroceded to ARF under the Converium-ARF Retrocession Agreements. The Audit Committee retained outside counsel and initiated an investigation in October 2004. On March 8, 2005, the Company announced that it was restating its financial statements for 1998 and subsequent years to correct the accounting for the transactions with Converium based on, among other considerations, a determination by the outside

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counsel investigation that it appeared likely that an oral agreement or understanding with ARF was made in 1998. The Company reflected this correction in the consolidated financial statements of its original Annual Report on Form 10-K for the year ended December 31, 2004. At that time, the Company believed that the accounting for the Excess-of-Loss Agreements and Quota Share Agreements with Munich Re and ARF was appropriate under SFAS 113.

On November 8, 2005, the Company announced its decision to correct and restate its previously issued financial statements for 1998 and subsequent years in connection with potential settlements of investigations by the SEC and the NYAG regarding the Excess-of-Loss Agreements and the Quota Share Agreements entered into with Munich Re and ARF. For a further discussion of the restatement of the Company s Financial Statements refer to Management s Discussion and Analysis of Financial Condition and Results of Operation in Part II, Item 7 and Note 2: Restatement Of Consolidated Financial Statements in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries in Part II, Item 8.

MBIA Corp. has entered into a reinsurance agreement with MBIA UK providing for MBIA Corp. s reimbursement of the losses incurred by MBIA UK in excess of a specified threshold and a net worth maintenance agreement in which MBIA Corp. agrees to maintain the net worth of MBIA UK, to remain its sole shareholder and not to pledge its shares. Under the reinsurance agreement, MBIA Corp. has agreed to reimburse MBIA UK on an excess-of-loss basis for losses incurred in each calendar year for net retained insurance liability, subject to certain contract limitations. Under the net worth maintenance agreement, MBIA Corp. agrees to maintain a minimum capital and surplus position at MBIA UK in accordance with United Kingdom and New York State legal requirements.

MBIA Corp. and MBIA Assurance have also entered into a reinsurance agreement providing for MBIA Corp. s reimbursement of the losses incurred by MBIA Assurance in excess of a specified threshold and a net worth maintenance agreement in which MBIA Corp. agrees to maintain the net worth of MBIA Assurance, to remain its sole shareholder and not to pledge its shares. Under the reinsurance agreement, MBIA Corp. has agreed to reimburse MBIA Assurance on an excess-of-loss basis for losses incurred in each calendar year for net retained insurance liability, subject to certain contract limitations. Under the net worth maintenance agreement, MBIA Corp. agrees to maintain a minimum capital and surplus position in accordance with French and New York State legal requirements.

MBIA Corp. and MBIA Illinois have entered into a reinsurance agreement under which MBIA Corp. reinsured 100% of all business written by MBIA Illinois, net of cessions by MBIA Illinois to third-party reinsurers, in exchange for MBIA Illinois transfer of the assets underlying the related unearned premium and contingency reserves. Pursuant to such reinsurance agreement, MBIA Corp. reinsured all of the net exposure of $30.9 billion, or approximately 68% of the gross debt service outstanding, of the municipal bond insurance portfolio of MBIA Illinois, the remaining 32% having been previously ceded to treaty and facultative reinsurers of MBIA Illinois. In 1990, 10% of this portfolio was ceded back to MBIA Illinois to comply with regulatory requirements. Effective January 1, 1999, MBIA Corp. and MBIA Illinois entered into a replacement reinsurance agreement whereby MBIA Corp. agreed to accept as reinsurance from MBIA Illinois 100% of the net liabilities and other obligations of MBIA Illinois, for losses paid on or after that date, thereby eliminating the 10% retrocession arrangement previously in place.

MBIA Corp. and CapMAC have entered into a reinsurance agreement, effective April 1, 1998, under which MBIA Corp. has agreed to reinsure 100% of the net liability and other obligations of CapMAC in exchange for CapMAC s payment of a premium equal to the ceded reserves and contingency reserves. Pursuant to such reinsurance agreement with CapMAC, MBIA Corp. reinsured all of CapMAC s then-current net exposure of $31.6 billion, or approximately 78% of CapMAC s gross debt service then outstanding, the remaining 22% having been previously ceded to treaty and facultative reinsurers of CapMAC.

Investments and Investment Policy

The Finance Committee of the Board of Directors of the Company approves the Company s general investment objectives and policies, and also reviews more specific investment guidelines. CMC manages all of MBIA Corp. s consolidated investment portfolios and substantially all of the Company s investment portfolios. Investment objectives, policies and guidelines related to CMC s investment activity on behalf of MBIA Corp. and its insurance company affiliates are also subject to review and approval by the respective Investment Committees of the Boards of Directors of MBIA Corp. and each of its insurance company affiliates.

To continue to provide strong capital resources and claims-paying capabilities for its insurance operations, the investment objectives and policies for insurance operations set quality and preservation of capital as the primary objective, subject to an appropriate degree of liquidity. Maximization of after-tax investment income and investment returns is an important but secondary objective. The insurance operations assets are managed by CMC subject to an agreement between CMC and MBIA Corp. and its subsidiaries.

Investment objectives, policies and guidelines related to MBIA Asset Management s investment agreement and other businesses are also subject to review and approval by the Finance Committee of the Board of Directors and the Executive Market Risk

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Committee, which includes various members of senior management. The primary investment objectives of MBIA Asset Management in these businesses are to preserve capital, to achieve an investment duration that closely approximates the expected duration of related liabilities, and to maintain appropriate liquidity.

The Company s consolidated investment portfolio as shown on its balance sheet at December 31, 2005 was $32.2 billion, of which $5.8 billion represented held-to-maturity investments at amortized cost. The information and tables contained below relate to the Company s consolidated investment portfolio (the Investment Portfolio).

For the year ending December 31, 2005, approximately 66% of the Company s net income was derived from after-tax earnings on its investment portfolio. The following table sets forth investment income and related data for the years ending December 31, 2003, 2004 and 2005:

Investment Income of the Company

(In thousands)

	2003	**2004**	**2005**
Investment income before expenses (1)	$ 839,948	$ 1,044,041	$ 1,357,541
Investment expenses	332,546	455,635	743,257
Net investment income before income taxes	507,402	588,406	614,284
Net realized gains (losses)	80,668	104,206	(7,867)
Total investment income before income taxes	$ 588,070	$ 692,612	$ 606,417
Total investment income after income taxes	$ 445,560	$ 517,395	$ 466,473

(1) Includes taxable and tax-exempt interest income.

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The tables below set forth the composition of the Company s investment portfolios. The references to Insurance in the tables below refer to the investment portfolio assets held by the Company s insurance operations, the references to Investment Management Services refers to investment portfolio assets held by the Company s investment management services operations and the references to Investments Held-to-maturity refer to assets held in the Conduits and certain variable interest entities. The weighted-average yields in the tables reflect the nominal yield on market value as of December 31, 2005, 2004 and 2003.

Investment Portfolio by Security Type

as of December 31, 2005

	Insurance		Investment Management Services		Investments Held-to-maturity	
	Fair Value (in thousands)	Weighted Average Yield (1)	Fair Value (in thousands)	Weighted Average Yield (1)	Fair Value (in thousands)	Weighted Average Yield (1)
Investment Category						
Fixed-income investments:						
Long-term bonds:						
Taxable bonds:						
U.S. Treasury & Agency obligations	$ 222,634	4.43%	$ 93,058	4.74%	$	%
GNMAs	183,212	5.28	82,149	5.17		
Other mortgage & asset-backed securities	1,328,851	5.56	6,082,367	4.63	911,253	3.48
Corporate obligations	1,746,580	5.59	8,722,090	5.17	4,823,082	3.21
Foreign obligations (2)	403,539	3.93	231,907	5.17		
Total	3,884,816	5.33	15,211,571	4.95	5,734,335	3.25
Tax-exempt bonds:						
State & municipal	5,379,889	4.19				
Total long-term investments	9,264,705	4.67	15,211,571	4.95	5,734,335	3.25
Short-term investments (3)	945,121	3.88	733,160	4.15		
Total fixed-income investments	10,209,826	4.24%	15,944,731	4.92%	5,734,335	3.25%
Other investments (4)	234,927					
Total investments	$ 10,444,753		$ 15,944,731		$ 5,734,335	

(1) Prospective market yields as of December 31, 2005. Yield on tax-exempt bonds is presented on a taxable bond equivalent basis using a 35% federal income tax rate.

(2) Consists of U.S. dollar denominated and other foreign government and corporate securities.

(3) Taxable and tax-exempt investments, including bonds with a remaining effective maturity of less than one year.

(4) Consists of equity investments and other fixed-income investments; yield information not meaningful.

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Investment Portfolio by Security Type

as of December 31, 2004

	Insurance		Investment Management Services		Investments Held-to-maturity	
	Fair Value (in thousands)	Weighted Average Yield (1)	Fair Value (in thousands)	Weighted Average Yield (1)	Fair Value (in thousands)	Weighted Average Yield (1)
Investment Category						
Fixed-income investments:						
Long-term bonds:						
Taxable bonds:						
U.S. Treasury & Agency obligations	$ 410,038	3.64%	$ 221,777	4.88%	$	%
GNMAs	138,989	5.05	81,278	4.42		
Other mortgage & asset-backed securities	1,473,126	5.16	3,924,261	2.12	419,188	3.00
Corporate obligations	1,715,933	4.97	5,565,288	4.59	7,116,599	2.49
Foreign obligations (2)	607,604	4.74	1,543,882	3.87		
Total	4,345,690	4.88	11,336,486	3.68	7,535,787	2.52
Tax-exempt bonds:						
State & municipal	4,728,599	3.88				
Total long-term investments	9,074,289	4.36	11,336,486	3.68	7,535,787	2.52
Short-term investments (3)	1,160,107	2.51	1,245,085	2.22		
Total fixed-income investments	10,234,396	3.87%	12,581,571	3.54%	7,535,787	2.52%
Other investments (4)	261,865					
Total investments	$ 10,496,261		$ 12,581,571		$ 7,535,787	

(1) Prospective market yields as of December 31, 2004. Yield on tax-exempt bonds is presented on a taxable bond equivalent basis using a 35% federal income tax rate.

(2) Consists of U.S. dollar denominated and other foreign government and corporate securities.

(3) Taxable and tax-exempt investments, including bonds with a remaining effective maturity of less than one year.

(4) Consists of equity investments and other fixed-income investments; yield information not meaningful.

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Investment Portfolio by Security Type

as of December 31, 2003

	Insurance		Investment Management Services		Investments Held-to-Maturity	
	Fair Value (in thousands)	Weighted Average Yield (1)	Fair Value (in thousands)	Weighted Average Yield (1)	Fair Value (in thousands)	Weighted Average Yield (1)
Investment Category						
Fixed-income investments:						
Long-term bonds:						
Taxable bonds:						
U.S. Treasury & Agency obligations	$ 232,964	4.21%	$ 230,293	4.60%	$	%
GNMAs	69,583	3.42	40,324	4.04		
Other mortgage & asset-backed securities	1,107,682	4.02	3,068,440	2.98	414,850	2.14
Corporate obligations	1,974,044	4.48	3,841,142	4.63	8,540,323	1.55
Foreign obligations (2)	468,151	4.40	1,285,341	4.46		
Total	3,852,424	4.30	8,465,540	4.01	8,955,173	2.12
Tax-exempt bonds:						
State & municipal	4,771,740	3.55				
Total long-term investments	8,624,164	3.89	8,465,540	4.01	8,955,173	2.12
Short-term investments (3)	975,836	2.32	937,640	1.32		
Total fixed-income investments	9,600,000	3.73%	9,403,180	3.75%	8,955,173	2.12%
Other investments (4)	357,346					
Total investments	$ 9,957,346		$ 9,403,180		$ 8,955,173	

(1) Prospective market yields as of December 31, 2003. Yield on tax-exempt bonds is presented on a taxable bond equivalent basis using a 35% federal income tax rate.

(2) Consists of U.S. dollar denominated and other foreign government and corporate securities.

(3) Taxable and tax-exempt investments, including bonds with a remaining effective maturity of less than one year.

(4) Consists of equity investments and other fixed-income investments; yield information not meaningful.

The duration of the insurance fixed-income portfolio was 5.3 years as of December 31, 2005 and December 31, 2004. The average maturity of the insurance fixed-income portfolio, excluding short-term investments, as of December 31, 2005 and December 31, 2004 was 7.96 years and 8.46 years, respectively.

The table below sets forth the distribution by contractual maturity of the Company s consolidated fixed-income investments. Contractual maturity may differ from expected maturity because the borrowers may have the right to call or prepay obligations.

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Fixed-Income Investments by Maturity

as of December 31, 2005

	Insurance		Investment Management Services		Investments Held-to-Maturity	
	Fair Value (In thousands)	% of Total Fixed-Income Investments	Fair Value (In thousands)	% of Total Fixed-Income Investments	Fair Value (In thousands)	% of Total Fixed-Income Investments
Within 1 year	$ 783,311	7.7%	$ 673,879	4.2%	$	%
Beyond 1 year but within 5 years	1,116,383	10.9	4,305,433	27.0	3,072,261	53.6
Beyond 5 years but within 10 years	2,213,029	21.7	3,667,527	23.0	825,466	14.4
Beyond 10 years but within 15 years	1,760,220	17.2	1,068,154	6.7	23,333	0.4
Beyond 15 years but within 20 years	694,069	6.8	835,405	5.2		
Beyond 20 years	2,298,886	22.5	3,981,244	25.0	902,022	15.7
Mortgage-backed	1,343,928	13.2	1,413,089	8.9	911,253	15.9
Total fixed-income investments	$ 10,209,826	100.0%	$ 15,944,731	100.0%	$ 5,734,335	100.0%

The credit quality distribution of the Company s fixed-income investments, which is based on ratings from Moody s (or from alternate rating sources, such as S&P, for a small percentage of securities that are not rated by Moody s), is presented in the following table:

Fixed-Income Investments by Credit Quality Rating

as of December 31, 2005 (1)

	Insurance		Investment Management Services		Investments Held-to-Maturity	
	Fair Value (In thousands)	% of Total Fixed-Income Investments	Fair Value (In thousands)	% of Total Fixed-Income Investments	Fair Value (In thousands)	% of Total Fixed-Income Investments
Aaa	$ 6,660,482	68%	$ 9,776,610	62%	$ 213,502	4%
Aa	1,921,187	20	3,010,035	19	910,865	16
A	1,103,850	11	2,964,670	19	2,611,929	45
Baa	55,862	1	85,149	0	1,998,039	35
Below Investment Grade			9,996	0		
Not Rated	2,513	0	0			
Total	$ 9,743,894	100%	$ 15,846,460	100%	$ 5,734,335	100%

(1) Excludes short-term investments with an original maturity of less than one year, but includes bonds having a remaining effective maturity of less than one year.

The Company s Investment Portfolio includes investments that are insured by MBIA Corp. (MBIA Insured Investments). As of December 31, 2005, MBIA Insured Investments, excluding Conduit investments, at fair value represented $4.4 billion or 14% of the total Investment Portfolio. Conduit investments represented $4.5 billion or 14% of the total Investment Portfolio. As set forth in the table below, without giving effect to the MBIA Corp. guarantee of the MBIA Insured Investments in the Investment Portfolio, as of December 31, 2005, based on the actual or estimated underlying ratings (i) the weighted average rating of the Investment Portfolio would be in the Double-A range, (ii) the weighted average rating of just the MBIA Insured Investments in the Investment Portfolio would be in the Single-A range and (iii) approximately 1% of the Investment Portfolio would be rated below investment grade.

Without giving effect to the MBIA guarantee of the MBIA Insured Investments, the underlying ratings (those given to an investment without the benefit of the MBIA Corp. guarantee) of the MBIA Insured Investments as of December 31, 2005 are reflected in the following table. Amounts represent the fair value of such investments including the benefit of the MBIA guarantee. The ratings in the table below are the lower underlying rating assigned by S&P or Moody s when an underlying rating exists from either rating service, or when an external underlying rating is not available, the underlying rating is based on the Company s best estimate of the rating of such investment.

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MBIA Insured Investments by Credit Quality Rating

Without Giving Effect to the MBIA Corp. Guarantee

as of December 31, 2005

Underlying Ratings Scale (In thousands)	Insurance Portfolio	Investment Management Services Portfolio	Held-to-Maturity Investment Portfolio	Total
Aaa	$ 9,716	$ 478,784	$ 213,502	$ 702,002
Aa	233,642	209,400	432,254	875,296
A	624,185	965,835	1,811,929	3,401,949
Baa	285,871	1,291,230	1,998,039	3,575,140
Below Investment Grade	107,047	155,198		262,245
Total	$ 1,260,461	$ 3,100,447	$ 4,455,724	$ 8,816,632

For a discussion surrounding the methodology used by financial guarantee insurance companies to account for investments similar to MBIA Insured Investments, see Part I, Item 1B. Unresolved Staff Comments.

Insurance Regulation

MBIA Corp. is licensed to do insurance business in, and is subject to insurance regulation and supervision by, the State of New York (its state of incorporation), the 49 other states, the District of Columbia, Guam, the Northern Mariana Islands, the U.S. Virgin Islands, Puerto Rico, the Kingdom of Spain, the United Kingdom and the Republic of France. MBIA Assurance is licensed to do insurance business in France and is subject to regulation under the corporation and insurance laws of the Republic of France. MBIA Assurance has used the provisions of the EC Third Non-life Insurance Directive (No. 92/49/EEC) to operate in the United Kingdom and in some of the other European Economic Area jurisdictions, both on a services and branch basis and is, to a limited extent, subject to supervision by the United Kingdom s Financial Services Authority. MBIA UK is licensed to do insurance business in the United Kingdom and is subject to the insurance regulation and supervision of the United Kingdom s Financial Services Authority. MBIA UK has used the provisions of the EC Third Non-life Insurance Directive to provide cross border services in all jurisdictions in the European Economic Area.

The extent of state insurance regulation and supervision varies by jurisdiction, but New York, Illinois and most other jurisdictions have laws and regulations prescribing minimum standards of solvency, including minimum capital requirements, and business conduct which must be maintained by insurance companies. These laws prescribe permitted classes and concentrations of investments. In addition, some state laws and regulations require the approval or filing of policy forms and rates. MBIA Corp. is required to file detailed annual financial statements with the NYSID and similar supervisory agencies in each of the other jurisdictions in which it is licensed. The operations and accounts of MBIA Corp. are subject to examination by these regulatory agencies at regular intervals.

MBIA Corp. is licensed to provide financial guarantee insurance under Article 69 of the New York Insurance Law. Article 69 defines financial guarantee insurance to include any guarantee under which loss is payable upon proof of occurrence of financial loss to an insured as a result of certain events. These events include the failure of any obligor on or any issuer of any debt instrument or other monetary obligation to pay principal, interest, premium, dividend or purchase price of or on such instrument or obligation when due. Under Article 69, MBIA Corp. is permitted to transact financial guarantee insurance, surety insurance and credit insurance and such other kinds of business to the extent necessarily or properly incidental to the kinds of insurance which MBIA Corp. is authorized to transact. In addition, MBIA Corp. is empowered to assume or reinsure the kinds of insurance described above.

As a financial guarantee insurer, MBIA Corp. is required by the laws of New York, California, Connecticut, Florida, Illinois, Iowa, Maryland, New Jersey and Wisconsin to maintain contingency reserves on its municipal bond, asset-backed securities and other financial guarantee liabilities. Under New Jersey, Illinois and Wisconsin regulations, contributions by such an insurer to its contingency reserves are required to equal 50% of earned premiums on its municipal bond business. Under New York law, such an insurer is required to contribute to contingency

reserves 50% of premiums as they are earned on policies written prior to July 1, 1989 (net of reinsurance), and, with respect to policies written on and after July 1, 1989, must make contributions over a period of 15 or 20 years (based on issue type), or until the contingency reserve for such insured issues equals the greater of 50% of premiums written for the relevant category of insurance or a percentage of the principal guaranteed, varying from 0.55% to 2.5%, depending upon the type of obligation guaranteed (net of collateral reinsurance, refunding, refinancings and certain insured securities). California, Connecticut, Florida, Iowa and Maryland laws impose a generally similar requirement, and in California the insurance commissioner can require an insurer to maintain additional reserves if the commissioner determines that the insurer s reserves are inadequate. In each of these states, MBIA Corp. may apply for release of portions of the contingency reserves in certain circumstances.

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The laws and regulations of these states also limit both the aggregate and individual securities risks that MBIA Corp. may insure on a net basis based on the type of obligations insured. California, Connecticut, Florida, Illinois, Maryland and New York, among other things, limit insured average annual debt service on insured municipal bonds with respect to a single entity and backed by a single revenue source (net of qualifying collateral and reinsurance) to 10% of policyholders surplus and contingency reserves. California, Connecticut, Florida, Illinois, Maryland and New York also limit the net insured unpaid principal on a municipal bond issued by a single entity and backed by a single revenue source to 75% of policyholders surplus and contingency reserves. California, Connecticut, Maryland and New York, among other things, require that the lesser of the insured average debt service and the insured unpaid principal (reduced by the extent to which unpaid principal of the supporting assets and, for New York and California, provided the insured risk is investment grade, exceed the insured unpaid principal), divided by nine, on each issue of asset-backed securities issued by a single entity shall not exceed 10% of policyholders surplus and contingency reserves, while Florida limits insured unpaid principal for any one risk to 10% of policyholders surplus and contingency reserves. In New Jersey, Virginia and Wisconsin, the average annual debt service on any single issue of municipal bonds (net of reinsurance) is limited to 10% of policyholders surplus. Other states that do not explicitly regulate financial guarantee or municipal bond insurance do impose single risk limits which are similar in effect to the foregoing.

Under New York, California, Connecticut, Florida, Illinois, Maryland, New Jersey and Wisconsin law, aggregate insured unpaid principal and interest under policies insuring municipal bonds (in the case of New York, California, Connecticut, Florida, Illinois and Maryland, net of reinsurance) are limited to certain multiples of policyholders surplus and contingency reserves. New York, California, Connecticut, Florida, Illinois, Maryland and other states impose a 300:1 limit for insured municipal bonds, although more restrictive limits on bonds of other types do exist. For example, New York, California, Connecticut, Florida and Maryland impose a 100:1 limit for certain types of non-municipal bonds. Under New York, California, Connecticut, Florida, Maryland and New Jersey law, aggregate insured unpaid principal and interest under policies insuring asset-backed securities (again, in the case of New York, California, Connecticut, Florida and Maryland, net of reinsurance) are limited to certain multiples of policyholders surplus and contingency reserves. New York, Maryland, California, Connecticut, and other states impose a 150:1 limit for insured investment grade asset-backed securities, although more restrictive limits on asset-backed securities of other types exist. For example, New York, California, Connecticut, Florida and Maryland impose a 50:1 limit for non-investment grade asset-backed securities.

The Company, MBIA Corp., MBIA Illinois, and CapMAC also are subject to regulation under insurance holding company statutes of New York, Illinois and other jurisdictions in which MBIA Corp., MBIA Illinois, and CapMAC are licensed to write insurance. The requirements of holding company statutes vary from jurisdiction to jurisdiction but generally require insurance holding companies, such as the Company, and their insurance subsidiaries, to register and file certain reports describing, among other information, their capital structure, ownership and financial condition. The holding company statutes also generally require prior approval of changes in control, of certain dividends and other inter-corporate transfers of assets, and of certain transactions between insurance companies, their parents and affiliates. The holding company statutes impose standards on certain transactions with related companies, which include, among other requirements, that all transactions be fair and reasonable and those transactions not in the ordinary course of business exceeding specified limits receive prior regulatory approval.

Prior approval by the NYSID is required for any entity seeking to acquire control of the Company, MBIA Corp., or CapMAC. Prior approval by the Illinois Department of Insurance is required for any entity seeking to acquire control of the Company, MBIA Corp., MBIA Illinois, or CapMAC. In many states, including New York and Illinois, control is presumed to exist if 10% or more of the voting securities of the insurer are owned or controlled by an entity, although the supervisory agency may find that control in fact does or does not exist when an entity owns or controls either a lesser or greater amount of securities.

The laws of New York regulate the payment of dividends by MBIA Corp. and provide that a New York domestic stock property/casualty insurance company (such as MBIA Corp.) may not declare or distribute dividends except out of statutory earned surplus. New York law provides that the sum of (i) the amount of dividends declared or distributed during the preceding 12-month period and (ii) the dividend to be declared may not exceed the lesser of (a) 10% of policyholders surplus, as shown by the most recent statutory financial statement on file with the NYSID, or (b) 100% of adjusted net investment income for such 12-month period (the net investment income for such 12-month period plus the excess, if any, of net investment income over dividends declared or distributed during the two-year period preceding such 12-month period), unless the New York Superintendent of Insurance approves a greater dividend distribution based upon a finding that the insurer will retain sufficient surplus to support its obligations and writings. See Note 17: Dividends and Capital Requirements in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries in Part II, Item 8.

The foregoing dividend limitations are determined in accordance with Statutory Accounting Practices (SAP), which generally produce statutory earnings in amounts less than earnings computed in accordance with GAAP. Similarly, policyholders surplus, computed on a SAP basis, will normally be less than net worth computed on a GAAP basis. See Note 10: Statutory Accounting Practices in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries for additional information.

MBIA Corp., MBIA Illinois, and CapMAC are exempt from assessments by the insurance guarantee funds in the majority of the states in which they do business. Guarantee fund laws in most states require insurers transacting business in the state to participate in guarantee associations, which pay claims of policyholders and third-party claimants against impaired or insolvent insurance companies doing business in the state. In most states, insurers licensed to write only municipal bond insurance, financial guarantee insurance and other forms of surety insurance are exempt from assessment by these funds and their policyholders are prohibited from making claims on these funds.

Investment Management Services Regulation

Subsidiaries of MBIA Asset Management are subject to various federal and state securities and investment regulation. As an SEC-registered investment adviser and an NASD member firm, CMC is subject to the requirements of the Investment Advisers Act of 1940, a Federal statute which regulates registered investment advisers, and to NASD rules and regulations. As an advisor to registered mutual fund investment companies, CMC is also responsible for compliance with the Investment Company Act of 1940. As sponsor/administrator of pooled investment programs, MBIA-MISC is subject to the requirements of the Investment Advisers Act of 1940, as well as certain state laws governing the operation of and permitted investments in local government investment pools in the various states. The activities of AM-UK are subject to supervision by the United Kingdom s Financial Services Authority.

Losses and Reserves; Remediation

MBIA Corp. establishes both loss and loss adjustment expense reserves to cover non-specific unallocated losses on its insured portfolio and specific case basis reserves with respect to actual and potential losses under specific insurance policies. The unallocated loss and loss adjustment expense reserve (ULR) and specific case basis reserves are established by MBIA Corp. s Loss Reserve Committee, which includes the Company s Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, head of IPM and other members of senior management.

The unallocated loss reserve is established on an undiscounted basis with respect to MBIA Corp. s entire insured portfolio. MBIA Corp. s unallocated loss reserve represents its estimate of losses that have occurred or are probable as a result of credit deterioration in MBIA Corp. s insured portfolio but which have not yet been specifically identified and applied to specific insured obligations. The unallocated loss reserve is increased on a quarterly basis using a formula that applies a loss factor to MBIA Corp. s scheduled net earned premium for the respective quarter. Each quarter MBIA Corp. calculates its provision for the unallocated loss reserve as a fixed percentage of scheduled net earned premium. Annually, the Loss Reserve Committee evaluates the appropriateness of the loss factor. In performing this evaluation, the Loss Reserve Committee considers the composition of MBIA Corp. s insured portfolio by municipal sector, structured asset class, remaining maturity and credit quality, along with the latest industry data, including historical default and recovery experience for the relevant sectors of the fixed-income market, in order to determine if a trend is developing that indicates the loss factor should be increased or decreased. The Loss Reserve Committee reviews the results of its annual evaluation over a period of several years to determine whether any long-term trends are developing. Since 2002, the Company calculated its provision for unallocated loss reserve as 12% of scheduled net earned premium. The Company s additions to specific case basis reserves in the years ending December 31, 2005 and December 31, 2004 exceeded the amounts reserved for by applying the 12% loss factor to scheduled net earned premium for those years. The Loss Reserve Committee is continuing to monitor this trend and evaluate whether an adjustment to the Company s current loss factor is appropriate. However, if a catastrophic or very unusual loss occurred, the Loss Reserve Committee would consider increasing the loss factor in order to maintain an adequate level of reserves. (See Management s Discussion and Analysis of Financial Condition and Results of Operation Losses and Loss Adjustment Expenses (LAE) in Part II, Item 7).

When a case basis reserve is established, MBIA Corp. reclassifies the estimated amount from its unallocated loss reserve in an amount equal to the specific case basis loss reserve. Therefore, the amount of available unallocated loss reserve at the end of each period is reduced by the actual case basis reserves established in the same period. In the event that case basis reserves develop at a significantly faster or slower rate than anticipated by applying the loss factor to net scheduled earned premium, MBIA Corp. will perform a qualitative evaluation with respect to the adequacy of the remaining unallocated loss reserve. In performing this evaluation, MBIA Corp. considers the anticipated amounts of future transfers to existing case basis reserves, as well as the likelihood those policies for which case basis reserves have not been established will require case basis reserves at a faster or slower rate than initially expected.

MBIA Corp. establishes new case basis reserves with respect to a specific insurance policy when the Loss Reserve Committee determines that (i) a claim has been made or is probable in the future with respect to such policy based on specific credit events that have occurred and (ii) the amount of the ultimate loss that MBIA will incur under such policy can be reasonably estimated. The amount of the case basis reserve with respect to any policy is based on the net present value of the expected ultimate losses and loss adjustment expense payments that MBIA Corp. expects to pay with respect to such policy, net of expected recoveries under salvage and subrogation rights. For years ending after December 31, 2002, the amount of the expected loss, net of expected recoveries, is discounted based on a discount rate equal to the actual yield of the fixed-income portfolio held by the Company s insurance

subsidiaries at the end of the preceding fiscal quarter. Prior to 2003 MBIA Corp. used a flat discount rate. MBIA Corp. believes this yield is an appropriate rate of return for calculating the present value of its reserves as it reflects the rate of return on the assets supporting future claim payments by MBIA Corp. When a case basis reserve is established for an insured obligation, MBIA Corp. continues to record premium revenue until it believes that premiums will no longer be collected on that obligation.

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 realized 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 used by the Company 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 Financial Accounting Standards Board (FASB) staff is considering whether additional guidance with respect to accounting for financial guarantee insurance should be provided and has agreed to consider the accounting by insurers for financial guarantee insurance. As part of this project, the FASB will consider several aspects of the insurance accounting model for financial guarantee insurers, including loss recognition and reserve methodology. (See Management s Discussion and Analysis of Financial Condition and Results of Operation Losses and Loss Adjustment Expenses (LAE) in Part II, Item 7).

The IPM Division is responsible for monitoring MBIA Corp. insured issues. The level and frequency of MBIA Corp. s monitoring of any insured issue depends on the type, size, rating and performance of the insured issue. If IPM identifies concerns with respect to the performance of an insured issue it may designate such insured issue as Caution List-Low, Caution List-Medium or Caution List-High based on the nature and extent of these concerns and requires that an increased monitoring and, if needed, a remediation plan be implemented for the related insured issue.

In the event MBIA Corp. determines that it must pay a claim or that a claim is probable and estimable with respect to an insured issue, it places the issue on its Classified List and establishes a case basis reserve for that policy. As of December 31, 2005, MBIA Corp. had 38 issues on the Classified List for which it has established $453.9 million in aggregate net case reserves.

At December 31, 2005, case basis reserves established for three credits, a health care facility in Pennsylvania, Enhanced Equipment Trust Certificates insured by MBIA Corp. and one tax lien transaction, comprised $316.6 million of the $453.9 million in total case basis reserves for future claims. The remaining case basis reserves are related to various insured obligations including collateralized debt obligations, mortgage-backed securities and obligations backed by manufactured housing. For more information on these insured issues and other insured exposes, see Management s Discussion and Analysis of Financial Condition and Results of Operation Losses and Loss Adjustment Expenses (LAE) in Part II, Item 7.

Both MBIA Illinois and CapMAC currently do not write new business. MBIA Corp. has reinsured their respective net liabilities on financial guarantee insurance business and maintains required reserves in connection therewith.

Management believes that MBIA Corp. s reserves, calculated on a GAAP and SAP basis, are adequate to cover the ultimate net cost of claims. 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.

In an effort to mitigate losses, IPM is regularly involved in the ongoing remediation of credits that may involve, among other things, waivers or renegotiations of financial covenants or triggers, waivers of contractual provisions, the granting of consents, and the taking of various other remedial actions. The nature of any remedial action is based on the type of the insured issue and the nature and scope of the event giving rise to the remediation. In most cases, as part of any such remedial activity, MBIA Corp. is able to improve its security position and to obtain concessions from the issuer of the insured bonds. From time to time, the issuer of an MBIA Corp. insured bond may, with the consent of MBIA Corp., restructure the insured bonds by extending the term, increasing or decreasing the par amount or decreasing the related interest rate, with MBIA Corp. insuring the restructured bonds. If, as the result of a restructuring, MBIA Corp. estimates that it will suffer an ultimate loss on the restructured issue, MBIA Corp. will record a case basis reserve for the restructured issue or, if it has already recorded a case basis reserve, it will re-evaluate the impact of the restructuring on the posted reserve and adjust the size of the reserve accordingly.

From inception, MBIA Corp. has had 82 insured issues requiring claim and/or liquidity payments. There are currently ten additional insured issues for which case loss reserves have been established for expected future claims but for which claims have not yet been paid. The Company s experience is that early detection and continued involvement by IPM are crucial in avoiding or minimizing potential draws on the related

insurance policy. There can be no assurance, however, that there will be no material losses in the future in respect of any issues guaranteed by MBIA Corp., MBIA UK, MBIA Assurance, MBIA Illinois or CapMAC or that the amount of reserves will be adequate to cover such losses.

MBIA Corp. Insurance Policies

Virtually all of the insurance policies issued by MBIA Corp. provide an unconditional and irrevocable guarantee of the payment to a designated paying agent for the holders of the insured obligations of an amount equal to the principal of, and interest or other amounts due on, the insured obligations that have not been paid. In the event of a default in payment of principal, interest or other insured amounts by an issuer, MBIA Corp. promises to make funds available in the amount of the default generally on the next business day following notification. MBIA Corp. has a Fiscal Agency Agreement with a bank which provides for this payment upon receipt of proof of ownership of the obligations due, as well as upon receipt of instruments appointing the insurer as agent for the holders and evidencing the assignment of the rights of the holders with respect to the payments made by the insurer. Even if the holders are permitted by the terms of the insured obligations to have the full amount of principal, accrued interest or other amounts due, declared due and payable immediately in the event of a default, MBIA Corp. is required to pay only the amounts scheduled to be paid, but not in fact paid, on each originally scheduled payment date. However, MBIA Corp. may from time to time insure obligations that are backed by credit default swaps which by their terms require that termination payments be paid at the time of the default of the underlying reference obligation(s). Termination payments are generally calculated by deducting the market value of the reference obligation on the termination date from the specified amount of the reference obligation. The Company estimates that the liquidity needs arising from future termination payments are modest due to MBIA Corp. s strategy of insuring such obligations with high levels of subordination and credit enhancement.

Rating Agencies

Moody s, S&P, Fitch and RII perform periodic reviews of MBIA Corp. and other companies providing financial guarantee insurance. Their reviews generally focus on the insurer s operations, financial conditions, underwriting guidelines, policies and procedures and on the underlying insured portfolio. Additionally, each rating agency has its own criteria as to exposure limits and capital requirements for financial guarantors.

The rating agencies have confirmed their Triple-A financial strength ratings assigned to MBIA Corp., CapMAC, MBIA Illinois, MBIA Assurance and MBIA UK in every year since those ratings were first assigned. The ratings for MBIA Illinois and CapMAC are based in significant part on the reinsurance agreements between MBIA Corp. and MBIA Illinois and MBIA Corp. and CapMAC, respectively. The ratings of MBIA UK and MBIA Assurance are based in significant part on the reinsurance agreements and net worth maintenance agreements MBIA Corp. has entered into with both MBIA UK and MBIA Assurance. See Part I, Item 1. Business-Reinsurance.

Capital Facilities

MBIA Corp. is party to a Credit Agreement, dated as of December 29, 1989 (the Credit Agreement), with various highly-rated banks to provide MBIA Corp. with an unconditional, irrevocable line of credit to cover losses in excess of a specified amount with respect to its public finance policies. The line of credit is available to be drawn upon by MBIA Corp., in an amount up to $450 million, after MBIA Corp. has incurred cumulative losses (net of any recoveries) in excess of $500 million or 5% of average annual debt service in respect of MBIA Corp. s public finance policies. The obligation to repay loans made under the Credit Agreement is a limited recourse obligation of MBIA Corp. payable solely from, and secured by a pledge of, recoveries realized on defaulted insured public finance obligations, from certain pledged installment premiums and other collateral. Borrowings under the Credit Agreement are repayable on the expiration date of the Credit Agreement.

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The current expiration date of the Credit Agreement is March 31, 2015. The Credit Agreement contains covenants that, among other things, restrict MBIA Corp. s ability to encumber assets or merge or consolidate with another entity.

MBIA Corp. has access to $400 million of Money Market Committed Preferred Custodial Trust securities (CPCT Securities) issued by eight trusts which were created for the primary purpose of issuing CPCT Securities and investing the proceeds in high quality commercial paper or short-term U.S. Government obligations. MBIA Corp. has a put option to sell to the trusts the perpetual preferred stock of MBIA Corp. If MBIA Corp. exercises its put option, the trusts will transfer the proceeds to MBIA Corp. in exchange for the preferred stock that will be held by the trusts. The trusts are vehicles for providing MBIA Corp. the opportunity to access new capital at its sole discretion through the exercise of the put options. The trusts are rated AA by S&P and Aa2 by Moody s. To date, MBIA Corp. has not exercised its put options under any of these arrangements.

On April 14, 2005, the Company and MBIA Corp. entered into a $500 million five-year unsecured revolving credit facility with a syndicate of banks. The facility replaced a previous facility comprised of two bank lines, a $167 million facility with a term of 364 days (which expired on its stated termination date) and a $333 million facility with a five-year term (which remained in place but which was extended for one year and increased to $500 million). The credit facility contains covenants that, among other things, restrict the Company s ability to encumber assets or merge or consolidate with another entity and require that the Company maintain a minimum net worth and a maximum debt-to-capital ratio. The expiration date for the facility is April 14, 2010. As of December 31, 2005, there were no balances outstanding under this facility.

Employees

As of February 27, 2006, the Company had 626 employees, 396 in MBIA Corp., 114 in MBIA Asset Management and 116 in MuniServices. No employee is covered by a collective bargaining agreement. The Company considers its employee relations to be satisfactory.

Available Information

The Company maintains a website at www.mbia.com. The Company is not including the information on its website as a part of, nor is it incorporating such information by reference into, this Form 10-K. The Company makes available through its website, free of charge, all of its SEC filings, including its annual Form 10-K, any of its quarterly filings on Form 10-Q and any current reports on Form 8-K, as soon as is reasonably practicable after these materials have been filed with the SEC. All such filings were timely posted to the website in 2005.

Executive Officers

The executive officers of the Company and their present ages and positions with the Company as of February 28, 2006 are set forth below.

Name	Age	Position and Term of Office
Joseph W. Brown	57	Chairman (officer since January, 1999)
Gary C. Dunton	50	President and Chief Executive Officer (officer since January, 1998)
Neil G. Budnick	51	Vice President (officer since 1992)
Ram D. Wertheim	51	Vice President, Secretary and General Counsel (officer since January, 2000)
Kevin D. Silva	52	Vice President and Chief Administrative Officer (officer since 1995)
Ruth M. Whaley	49	Vice President and Chief Risk Officer (officer since 1999)
Andrea E. Randolph	53	Vice President and Chief Technology Officer (officer since January, 2004)
Nicholas Ferreri	45	Vice President and Chief Financial Officer (officer since May, 2004)
Mark S. Zucker	57	Vice President (officer since November, 2000)
Mitchell I. Sonkin	53	Vice President (officer since April, 2004)
Clifford D. Corso	44	Vice President (officer since September, 2004)
Christopher E. Weeks	45	Vice President (officer since July, 2004)
Thomas G. McLoughlin	45	Vice President (officer since February, 2005)
William C. Fallon	46	Vice President (officer since July, 2005)
Willard I. Hill, Jr.	50	Vice President and Chief Compliance Officer (officer since January, 2006)

Joseph W. Brown is Chairman of the Company (effective January 7, 1999) and a director of the Company. Prior to joining the Company in January 1999, Mr. Brown was Chairman of the Board of Talegen Holdings, Inc. Mr. Brown served as Chief Executive Officer of the Company from January 1999 to May 2004.

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Gary C. Dunton is President and Chief Executive Officer of the Company and a director of the Company. Mr. Dunton has served as President of the Company since 1999 and served as Chief Operating Officer from 2000 to 2004. Mr. Dunton was, prior to joining the Company as an officer, a director of the Company and President of the Family and Business Insurance Group, USF&G Insurance.

Neil G. Budnick is Vice President of the Company and President of MBIA Corp. Mr. Budnick has been primarily involved in the insurance operations area of MBIA Corp. since joining the Company in 1983 and served as Chief Financial Officer from January 1999 to May 2004.

Ram D. Wertheim is Vice President, Secretary and General Counsel of the Company. From February of 1998 until January, 2000, he served in various capacities in the Structured Finance Division. Mr. Wertheim was, until February of 1998, the General Counsel of CapMAC Holdings Inc.

Kevin D. Silva is Vice President and Chief Administrative Officer of the Company. He has been in charge of the Management Services Division of MBIA Corp. since joining the Company in late 1995.

Ruth M. Whaley is Vice President and Chief Risk Officer of the Company. She was, until February of 1998, the Chief Underwriting Officer of CapMAC Holdings Inc.

Andrea E. Randolph is Vice President and Chief Technology Officer of the Company. Ms. Randolph was the Director of Infrastructure and Operations in the Information Technology Division of MBIA Corp. from February 2000 to January 2004, when she was named the Company s Chief Technology Officer. Prior to joining MBIA Corp. in February 2000, she was Director of Information Technology Corporate Investment Division at MetLife.

Nicholas Ferreri is Vice President and Chief Financial Officer of the Company. Until May of 2004 he was in charge of global public finance in MBIA Corp. s IPM Division and previously served in various capacities in MBIA Corp. s treasury and pricing groups. Prior to joining the Company in 1997, Mr. Ferreri was with Moody s Investors Service and Ernst & Young.

Mark D. Zucker is Vice President of the Company and head of the Structured Finance Division. Prior to joining the Company in March 2000, Mr. Zucker was Chief Credit Officer Investment Banking at Rabobank International.

Mitchell I. Sonkin is Vice President of the Company and head of the IPM Division. Prior to joining the Company in April 2004, Mr. Sonkin was senior partner and co-chair of the Financial Restructuring Group of the international law firm of King & Spalding.

Christopher E. Weeks is Vice President of the Company and head of the International Division. Mr. Weeks has served in various capacities since joining the Company in 1995, most recently as the business manager in MBIA Corp. s Structured Finance Division responsible for CDO and secondary markets activity.

Clifford D. Corso is Vice President of the Company, the Company s Chief Investment Officer and the president of MBIA Asset Management. He joined the Company in 1994 and has served as Chief Investment Officer since 2000.

Thomas G. McLoughlin is Vice President of the Company and head of the Public Finance Division. Since joining MBIA Corp. in 1994, he has been primarily involved in the public finance area.

William C. Fallon is Vice President of the Company and head of Corporate and Strategic Planning. Prior to joining the Company in 2005, Mr. Fallon was a partner at McKinsey & Company and co-leader of that firm s Corporate Finance and Strategy Practice.

Willard I. Hill, Jr. is Vice President and Chief Compliance Officer of the Company. Prior to being named Chief Compliance Officer in December 2005, Mr. Hill was in charge of equity investor relations, a position he has held since joining the Company in 2004. Previously, Mr. Hill was president of the government deferred compensation and domestic emerging markets business at ING US Financial Services. From 1980 to 2000, Mr. Hill held various positions at Aetna.

In February 2005, John Pizzarelli resigned as head of MBIA Corp. s Public Finance Division and was replaced by Thomas G. McLoughlin. Previously, Mr. McLoughlin had been the head of the Global Transportation and Infrastructure Group in MBIA Corp. s Public Finance Division.

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Item 1A. Risk Factors

In addition to the other information contained in this Form 10-K, the following risk factors should be considered carefully when evaluating the Company and its business. The Company s business, financial condition and results of operations could be materially adversely affected by any of these risks. Additional risks not presently known to us or that we currently deem immaterial individually may also adversely affect our business, financial condition and results of operations.

Reduction in MBIA Corp. s Financial Strength Ratings Would Materially and Adversely Affect Future Business

MBIA Corp. s ability to attract new business and to compete with other Triple-A rated financial guarantors is largely dependent on the Triple-A financial strength ratings assigned to it by the major rating agencies and the financial enhancement rating assigned by S&P. MBIA Corp. intends to comply with the requirements imposed by the rating agencies to maintain such ratings; however, no assurance can be given that these requirements will not change or that, even if MBIA Corp. complies with these requirements, one or more of such rating agencies will not lower or withdraw its financial strength ratings of MBIA Corp. or place MBIA Corp. on negative outlook, indicating that a downgrade may be considered in the future. MBIA Corp. s ability to attract new business and to compete with other Triple-A rated financial guarantors, and its results of operations and financial condition, would be materially adversely affected by any reduction, or suggested possibility of reduction, in its ratings. See Part I, Item 1. Business - Rating Agencies.

Competition May Have an Adverse Effect on MBIA Corp. s Business

The businesses engaged in by MBIA Corp. are highly competitive. MBIA Corp. faces competition from other financial guarantee insurance companies, other providers of third-party credit enhancement, such as multi-line insurance companies, credit derivative and swap providers and banks, and alternative financing structures that do not employ third-party credit enhancement. Increased competition, either in terms of price, alternative structures, or the emergence of new providers of credit enhancement, could have an adverse effect on MBIA Corp. s business. See Part I, Item 1. Business - Competition.

Market and Other Factors May Cause Investors and/or Issuers to Decrease Demand for MBIA Corp. s Products

The demand for financial guarantee insurance depends upon many factors, some of which are beyond the control of MBIA Corp. While all the major financial guarantee insurers have Triple-A financial strength ratings from the major rating agencies, investors may from time to time distinguish among financial guarantors on the basis of various factors, including size, insured portfolio concentration and financial performance. These distinctions may result in differentials in trading levels for securities insured by particular financial guarantors which, in turn, may provide a competitive advantage to those financial guarantors with better trading characteristics. In addition, various investors may, due to regulatory or internal guidelines, lack additional capacity to purchase securities insured by certain financial guarantors, which may provide a competitive advantage to guarantors with fewer insured obligations outstanding. Distinctions in trading values or investor capacity constraints that do not favor MBIA Corp. would have an adverse effect on MBIA Corp. s ability to attract new business at appropriate pricing levels.

Changes in Interest Rates Could Adversely Affect Financial Condition and Future Business

Increases in prevailing interest rate levels can adversely affect the value of the Investment Portfolio and, therefore, the Company s financial condition. In the event that investments must be sold in order to make payments on insured exposures, such investments would likely be sold at discounted prices. Additionally, increasing interest rates could lead to increased credit stress on transactions in MBIA Corp. s insured portfolio.

Prevailing interest rate levels can affect demand for financial guarantee insurance. Lower interest rates are typically accompanied by narrower spreads between insured and uninsured obligations. The purchase of insurance during periods of relatively narrower interest rate spreads will generally provide lower cost savings to the issuer than during periods of relatively wider spreads. These lower cost savings could be accompanied by a corresponding decrease in demand for financial guarantee insurance. Increased interest rates may decrease attractiveness for issuers to enter into capital markets transactions, resulting in a corresponding decreasing demand for financial guarantee insurance.

Demand for Financial Guarantee Insurance Would Decline if Investors Confidence in Financial Guarantor Financial Strength Declined

The perceived financial strength of financial guarantee insurers also affects demand for financial guarantee insurance. Should a major financial guarantee insurer, or the industry generally, have its financial strength rating lowered, or suffer for some other reason deterioration in investors confidence, demand for financial guarantee insurance may be reduced significantly.

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Regulatory Change Could Adversely Affect MBIA Corp. s Ability to Enter into Future Business

The financial guarantee insurance industry has historically been and will continue to be subject to the direct and indirect effects of governmental regulation, including insurance laws, securities laws, tax laws and legal precedents affecting asset-backed and municipal obligations, as well as changes in those laws. Failure to comply with applicable laws and regulations could expose MBIA Corp. to fines, the loss of its insurance licenses, and the inability to engage in certain business activity. In addition, future legislative, regulatory or judicial changes could adversely affect MBIA Corp. s ability to pursue its business, materially impacting our financial results. See Business Insurance Regulation in Part I, Item 1 for a description of current insurance regulations affecting MBIA Corp.

The Company has announced that it was in discussions with the SEC, the NYAG and the NYSID regarding potential settlements of their investigations into agreements entered into by MBIA Corp. in connection with the AHERF matter. In connection with the potential settlements with these regulators, the Company restated its financial statements for prior periods and accrued $75 million for the total amount the Company estimates, based on discussions to date, it will have to pay in connection with such settlements. To date, no settlements have been approved by the regulatory agencies. No assurance can be given that any settlements with the Company s regulators will be approved or that any settlement, if approved, will not have additional or different terms, which terms could have an adverse impact on the Company s business, prospects or financial condition. See Legal Proceedings in Part I, Item 3 for more information on the regulatory investigation.

Revenues Would Be Adversely Impacted Due to Decline in Realization of Installment Premiums

Due to the installment nature of a significant percentage of its premium income, MBIA Corp. has an embedded future revenue stream. The amount of installment premiums actually realized by MBIA Corp. could be reduced in the future due to factors such as early termination of insurance contracts or accelerated prepayments of underlying obligations. Such a reduction would result in lower revenues and would have an adverse effect on the Company s future financial position.

Adverse Results from Investment Management Services Activities Can Adversely Affect the Company s Financial Position

The Company s Investment Management Services businesses have grown as a proportion of its overall business (see Part I, Item 1. Business-Investment Management Services). Events that negatively affect the performance of the Investment Management Services businesses could have a negative effect on the overall performance of the Company, separate and distinct from the performance of the Company s financial guarantee business.

The Company s Investment Management Services businesses manage several asset-liability programs which enable the Company to earn a spread between the income earned on a portfolio of assets and the interest costs associated with the liabilities incurred to fund the purchase of such assets. These asset-liability programs are managed within a number of risk and liquidity parameters, but there can be no assurance that such parameters are adequate to prevent a decline in the value of the assets or a decline in investment income such that the programs will be unable to service outstanding liabilities. Any resulting loss could have an adverse impact on the Company s financial position.

Ability to Expand Investment Management Services Activities or Enter into Business Lines May Be Limited by Rating Agencies and/or Others

A rating agency has indicated that it will examine the non-core activities carried on by financial guaranty insurance company affiliates (such as the investment management and related services and sponsored MTN programs carried on by the Company s Investment Management Services businesses) and their impact on the overall credit profile of affiliated financial guarantors. In the event that a negative view of such activities exists, the Company may elect to delay or forego opportunities to grow its non-core business in the future and/or curtail its current investment management services operations.

Loss Reserves May Not Be Adequate to Cover Potential Losses

The financial guarantees issued by MBIA Corp. insure the financial performance of the obligations guaranteed over an extended period of time, in some cases over 30 years, under policies that MBIA Corp. has, in most circumstances, no right to cancel. As a result of the lack of statistical loss data due to the low level of losses in MBIA Corp. s financial guarantee business and in the financial guarantee industry in general, particularly in the structured asset-backed area, MBIA Corp. does not use traditional actuarial approaches to determine its loss reserves. Instead, an unallocated loss reserve is established in an amount deemed adequate to cover the expected levels of losses and loss adjustment expense on MBIA Corp. s overall portfolio. The size of the unallocated loss reserve is determined by a formula, the components of which are reviewed regularly. 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 losses in MBIA Corp. s insured portfolio will not

exceed its loss reserves. Losses from future defaults,

depending on their magnitude, could exceed loss reserves and therefore, have an adverse effect on the results of operations and financial condition of MBIA Corp. See Part I, Item 1. Business - Losses and Reserves; Remediation.

Unanticipated Catastrophic Events and Operational Risks May Adversely Impact MBIA Corp. s Insured Portfolio and Future Business

The Company s insurance operations underwrite and assess credit and other risks using internal models which are based on historical performance and default rates, as well as the Company s reasonable expectation of future performance. The Company manages its insurance and other exposures in an attempt to minimize the severity and impact of unexpected events. There can be no assurance, however, that the Company s internal models and portfolio management policies adequately assess and address the risk of unforeseen events, unexpectedly catastrophic events or the impact of risks with a severity significantly higher than those previously experienced, or that the assumptions which underlie the Company s internal models and policies are accurate. There can be no assurance that the Company will not incur material losses if such unforeseen, catastrophic or high severity events occur. In addition, even in the absence of unforeseen, catastrophic or high severity events, there can be no assurance that the Company s internal models, portfolio management policies and other internal systems and processes (or models, tools and services provided by third-parties) will be properly utilized or implemented in the normal operation of the Company s business. Any failure of such processes, models and systems and/or employee misconduct or fraud could have an adverse impact on the Company s business and financial condition.

Increased Rating Agency Capital Charges May Adversely Impact Future Business

Individual credits in MBIA Corp. s insured portfolio (including potential new credits) are assessed a rating agency capital charge based on a variety of factors including the nature of the credits, their underlying ratings and their expected and actual performance. In the event of an actual or perceived deterioration in creditworthiness, a reduction in the underlying rating or a change in the rating agency capital methodology, the Company may be required to hold more of its capital in reserve against credits in its insured portfolio, regardless of whether losses actually occur, or against potential new business. There can be no assurance that the Company s capital position will be adequate to meet such increased reserve requirements or that the Company will be able to secure additional capital, especially at a time of actual or perceived deterioration in creditworthiness of new or existing credits. Unless the Company was able to increase its amount of available capital, an increase in capital charges could reduce the amount of capital available to pay claims and support MBIA Corp. s Triple-A ratings and could have an adverse affect on MBIA Corp. s ability to write new business.

Potential Impact of General Economic and Geopolitical Conditions May Adversely Affect MBIA Corp. s Business Prospects and Insured Portfolio

Changes in general economic conditions can adversely impact the Company s business. Recessions, increases in corporate, municipal or consumer default rates, changes in interest rates, changes in law or regulation and other general economic and geopolitical conditions could adversely impact the Company s prospects for future business, as well as the performance of MBIA Corp. s insured portfolio and the Investment Portfolio.

General global unrest could disrupt the economy in this country and around the world and could have a direct material adverse impact on certain industries and on general economic activity. The Company has exposure in certain sectors that could suffer increased delinquencies and defaults as a direct result of these types of events. The Company s exposure to domestic and international airports and to domestic enhanced equipment trust certificate aircraft securitizations have experienced increased stress as a result of global events since 2001, including a downgrading of the ratings and the bankruptcy of some of the underlying issuers, and could experience further stress in the event of general global unrest in the future. Other exposures that depend on revenues from business and personal travel, such as bonds backed by hotel taxes and car rental fleet securitizations, have experienced or may experience increased levels of delinquencies and default. In addition, certain other sectors in which the Company has insured exposure, such as consumer loan securitizations (e.g., home equity, auto loan and credit card transactions), have experienced increased delinquencies and defaults in the underlying pools of loans and could experience further defaults in the event of future global unrest. To the extent that certain corporate sectors may be vulnerable to credit deterioration and increased defaults in the event of future global unrest, collateralized debt obligations backed by pools of corporate debt issuances in those stressed sectors could also be adversely impacted.

The Company s insurance operations underwrite exposures to the Company s reasonable expectation of future performance as well as at various stress levels estimating defaults and other conditions at levels higher than are reasonably expected to occur. There can be no assurance, however, that the Company will not incur material losses if the economic stress and increased defaults in certain sectors caused by change in economic conditions, default rates, global unrest, terrorism or similar events in the future is or will be more severe than the Company currently foresees and had assumed in underwriting its exposures.

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An Inability to Access Capital Could Adversely Affect Liquidity and Impact Ability to Write New Business

The Company s access to external sources of financing, as well as the cost of such financing, is dependent on various factors, including the long term debt ratings of the Company and the perceptions of the financial strength of MBIA Corp. The Company s debt ratings are influenced by numerous factors, either in absolute terms or relative to our peer group such as financial leverage, balance sheet strength, capital structure and earnings trends. If the Company cannot obtain adequate capital on favorable terms or at all, the Company s business, operating results and financial condition could be adversely affected.

MBIA Corp. has entered into credit facilities with third-party providers in order to supplement its capital position. When evaluating the Company s overall capital position, the rating agencies evaluate the financial strength of these providers, as well as their perceived willingness to fund these facilities if drawn. In the event that the ratings of these capital providers are reduced or withdrawn, the amount of capital credit the Company receives for these facilities would decline. There can be no assurance that the ratings of such providers will not decline in the future, that replacement providers will be available or, in the absence of a rating decline, that the rating agencies would not decrease the amount of capital credit they assign to the Company for such soft capital facilities. The inability to obtain adequate replacement capital on favorable terms or at all could have an adverse impact on the Company s business and financial condition.

Regulatory Regime and Changes to Accounting Rules May Adversely Impact Financial Results Irrespective of Business Operations

The Company applies fair value accounting for the portion of MBIA Corp. s business executed in credit derivative form as required by SFAS 133 and changes in fair value are recognized immediately in earnings. Therefore, any increases or decreases in the fair value of these credit derivatives will have an immediate corresponding impact on reported earnings. As changes in fair value can be caused by factors unrelated to the performance of the Company s business such as general market conditions and perceptions of credit risk, as well as events affecting particular insured credit default swap exposures, the application of fair value accounting may cause the Company s earnings to be more volatile than would be suggested by the actual performance of the Company s business operations. In addition, due to the complexity of fair value accounting and the application of SFAS 133, future amendments or interpretations of SFAS 133 may cause the Company to modify its accounting methodology in a manner which may have an adverse impact on the Company s financial results.

In addition, accounting standard and regulatory changes may require modifications to the Company s accounting methodology, both prospectively and for prior periods and such changes could have an adverse impact on the Company s financial results. As discussed in Part I, Item 1B. Unresolved Staff Comments below, the SEC and the FASB are considering the accounting methodology to be applied by financial guarantee industry participants for claims liability recognition, premium recognition, amortization of deferred policy acquisition costs and financial guarantee enhanced securities held for sale in guarantor investment portfolios. Until any final determination is reached, the Company intends to apply its existing methodology. There can be no certainty, however, that the SEC or the FASB will not require the Company to modify its current methodology, either on a going-forward basis or for prior periods. Any required modification of the Company s existing methodology, either with respect to these issues or other issues in the future, could have an impact on the Company s results of operations.

Item 1B. Unresolved Staff Comments

The Company s Investment Portfolio includes fixed income investments that were insured by MBIA Corp. at the time such obligations were issued (MBIA Insured Investments). As of December 31, 2005, MBIA Insured Investments, (excluding Conduit investments) amounted to $4.4 billion, or 14% of the Company s total Investment Portfolio. MBIA Insured Investments are accounted for as available-for-sale in the Investment Portfolio and recorded at fair value, which includes the value of the MBIA Corp. guarantee. Beginning in January 2005, several financial guarantee industry participants, including the Company, have received written comments from the SEC staff regarding the proper accounting treatment for financial guarantee enhanced securities held for sale in the investment portfolio of the financial guarantor who provided the enhancement for the portfolio security, or in the case of MBIA Corp., MBIA Insured Investments. Recent discussions with the SEC staff suggest that the SEC staff s tentative view of the appropriate accounting for MBIA Insured Investments is to extinguish a portion of the contingent guarantee obligation related to the amount acquired. The Company cannot predict how the SEC staff will resolve this issue and the resulting impact on the Company s consolidated financial statements. Until the issue is resolved, the Company intends to apply its existing methodology. There can be no certainty, however, that the SEC will not require the Company to modify its methodology, either on a going-forward basis or for prior periods. For more information on the accounting methodology applied to investments in the Company s Investment Portfolio, see Note 3: Significant Accounting Policies Investments in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries included in Part II, Item 8.

As a result of discussions in January and February 2005 between the SEC staff and several financial guarantee industry participants, including MBIA Corp., regarding differences in loss reserve recognition practices among these participants, the Company understood that the FASB staff

would consider whether additional guidance with respect to accounting for financial guarantee insurance should be provided. In June 2005, the FASB decided to add to its agenda a project to consider the accounting by

insurers for financial guarantee insurance. As part of this project the FASB will consider several aspects of the insurance accounting model for financial guarantee insurers, including claims liability recognition, premium recognition and the related amortization of deferred policy acquisition costs. The Company cannot currently assess how the FASB s and SEC staff s ultimate resolution of this issue will impact MBIA Corp. s loss reserving policy or the effect it might have on recognizing premium revenue and policy acquisition costs. When the FASB or the SEC reaches a conclusion on this issue, the Company and its financial guarantor peers may be required to change some aspects of its loss reserving policies and the potential changes could extend to premium and expense recognition. Until the issue is resolved, the Company intends to continue to apply its existing policy with respect to the establishment of both case basis and unallocated loss reserves and the recognition of premium revenue and policy acquisition costs. A further description of the Company s loss reserving policy is included in Note 3: Significant Accounting Policies in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries in Part II, Item 8.

Item 2. Properties

MBIA Corp. owns the 265,000 square foot office building on approximately 18 acres of property in Armonk, New York, in which the Company, MBIA Corp. and MBIA Asset Management have their headquarters. The Company has over the past several years added approximately 20 additional acres adjacent to its current headquarters in order to provide an ability to expand its headquarters as needed. MBIA Corp. also has offices with 39,900 square feet of rental space in New York, New York, San Francisco, California, Paris, France, Madrid, Spain, Sydney, Australia, London, England, Milan, Italy, and Tokyo, Japan. MuniServices has a total of 30,390 square feet of rental space in Washington, D.C., Detroit, Michigan, Philadelphia, Pennsylvania, Bensalem, Pennsylvania and five locations in California. Capital Asset rents 21,690 square feet for its offices in Pittsburgh, Pennsylvania, Palm Beach, Florida and Hingham, Massachusetts. MBIA Asset Management has 7,500 square feet of office space in Denver, Colorado. The Company believes that these facilities are adequate and suitable for its current needs.

Item 3. Legal Proceedings

In the normal course of operating its businesses, the Company may be involved in various legal proceedings. Various trusts that have been insured by MBIA Corp., and that own first and second mortgages have been named in lawsuits alleging that the originator of the mortgages, together with other trusts that are not insured and other entities that own first and second mortgages, violated state and federal truth in lending laws. In most of these cases the originators of the loans are no longer in business, and the plaintiffs are alleging that the current owners of the mortgages, including the MBIA insured trusts, are liable for the alleged violations of the originator as assignees of the mortgages. MBIA Corp. has not been named as a defendant in any of these lawsuits. The Company believes that the insured trusts will ultimately prevail in the litigation. We do not expect there to be any material losses in the trusts as a result of these lawsuits, but no assurances can be given as to the potential outcome of these actions.

In July 2002, MBIA Corp. filed suit against Royal Indemnity Company (Royal), in the United States District Court for the District of Delaware, to enforce insurance policies that Royal issued on certain vocational student loan transactions that MBIA Corp. insured. To date, claims in the amount of approximately $352 million have been made under the Royal policies with respect to loans that have defaulted. MBIA Corp. expects that there will be additional claims made under the policies with respect to student loans that may default in the future. Royal has filed an action seeking a declaration that it is not obligated to pay on its policies. If Royal does not honor its policies, MBIA Corp. will be required to make payment on the notes it insured, and will incur material losses under its policies. In October 2003, the court granted MBIA Corp. s motion for summary judgment and ordered Royal to pay all claims under its policies. Royal appealed the order, and pledged $389 million of investment grade collateral to MBIA Corp. to secure the entire amount of the judgment, with interest, and has agreed to post additional security for future claims and interest. The Federal District Court has ordered Royal to comply with the pledge agreement.

On October 3, 2005, the Court of Appeals for the Third Circuit upheld the decision of the United States District Court for the District of Delaware enforcing the Royal insurance policies and remanded the case to the District Court for a determination of whether the Royal policies cover all losses claimed under the policies. In particular, the Court of Appeals directed the District Court to consider whether the Royal policies cover losses resulting from the misappropriation rather than from defaults by students. MBIA Corp. believes that the Royal policies cover losses even if they result from misappropriations of student payments, but in any event it appears that all or substantially all of the claims made under the Royal policies relate to defaults by students rather than misappropriation of funds. Therefore, MBIA Corp. expects Royal to be required to pay all or substantially all of the claims made under its policies and to be reimbursed for any payments MBIA Corp. made under its policies. Royal has requested that the case be reheard *en banc*.

MBIA Corp. believes that it will prevail in the litigation with Royal and will have no ultimate loss on these policies, although there can be no assurance that MBIA Corp. will in fact prevail. If MBIA Corp. does not prevail in the litigation and Royal does not make payments on the Royal policies, MBIA Corp. expects to incur material losses under its policies. MBIA Corp. does not believe, however, that any such losses will have a

material adverse effect on its financial condition.

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In November 2004, the Company received identical document subpoenas from the SEC and the NYAG requesting information with respect to non-traditional or loss mitigation insurance products developed, offered or sold by the Company to third parties from January 1, 1998 to the present. While the subpoenas did not identify any specific transaction, subsequent conversations with the SEC and the NYAG revealed that the investigation included the arrangements entered into by MBIA Corp. in 1998 in connection with the bankruptcy of the Delaware Valley Obligated Group, an entity that is part of AHERF.

On March 9, 2005, the Company received a subpoena from the U.S. Attorney s Office for the Southern District of New York (U.S. Attorney) seeking information related to the agreements it entered into in connection with the AHERF loss. Thereafter, the Company has received additional subpoenas, substantively identical to each other, and additional informal requests, from the SEC and the NYAG for documents and other information.

On August 19, 2005, the Company received a Wells Notice from the SEC indicating that the staff of the SEC is considering recommending that the SEC bring a civil injunctive action against the Company alleging violations of federal securities laws arising from MBIA s action to retroactively reinsure losses it incurred from the AHERF bonds MBIA had guaranteed, including, but not limited to, its entering into excess of loss agreements and quota share agreements with three separate counterparties.

On November 8, 2005, the Company announced that it was in discussions with the SEC, the NYAG and the NYSID regarding potential settlements of their investigations into agreements entered into by MBIA Corp. in connection with the AHERF matter. In connection with the potential settlements, the Company announced that it was restating its financial statements to correct and restate its GAAP and statutory accounting for 1998 and subsequent years as discussed in Note 2: Restatement Of Consolidated Financial Statements in the Notes to Consolidated Financial Statements of MBIA Inc. and Subsidiaries in Part II, Item 8 and Restatement of Consolidated Financial Statements in Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7. In connection with the proposed settlements, the Company accrued $75 million for the total amount the Company estimates, based on discussions to date, it will have to pay in connection with any settlements.

The Company has been cooperating, and is continuing to cooperate fully with the investigations by the SEC, the NYAG, the NYSID and the U.S. Attorney. To date, no settlements have been approved by the regulatory agencies, and no assurance can be given that any settlements will be approved. Any settlements may have additional or different terms.

The Company has been named as a defendant in a consolidated private securities litigation suit: *In re MBIA Inc. Securities Litigation*; (Case No. 05 CV 03514(LLS); S.D.N.Y.) (filed October 3, 2005). Joseph W. Brown, the Company s Chairman and former Chief Executive Officer, Gary C. Dunton, the Company s Chief Executive Officer, Nicholas Ferreri, the Company s Chief Financial Officer, Neil G. Budnick, a Vice President of the Company and the Company s former Chief Financial Officer and Douglas C. Hamilton, the Company s Controller were also named as defendants in the suit, as were former Chairman and Chief Executive Officer David H. Elliot and former Executive Vice President, Chief Financial Officer and Treasurer Julliette S. Tehrani. The plaintiffs assert claims under Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), Rule 10b-5 promulgated thereunder, and Section 20(a) of the Exchange Act. The lead plaintiffs act as representatives for a class consisting of purchasers of the Company s stock during the period from August 5, 2003 to March 30, 2005 (the Class Period). The allegations contained in the lawsuit include, among other things, violations of the federal securities laws arising out of the Company s allegedly false and misleading statements about its financial condition and the nature of the arrangements entered into by MBIA Corp. in connection with the AHERF loss. The plaintiffs allege that, as a result of these misleading statements or omissions, the Company s stock traded at artificially inflated prices. These lawsuits seek unspecified compensatory damages in connection with purchases by members of the class of the Company s stock at such allegedly inflated prices during the Class Period. The Company does not expect the outcome of the private securities litigation to have a material adverse affect on its financial condition, although the outcome is uncertain and no assurance can be given that the Company will not suffer a loss.

Certain officers of the Company and certain members of the Company s Board of Directors have been named as defendants in a shareholder derivative action filed on behalf of the Company in the Supreme Court of New York, Westchester County on November 9, 2005: *Robert Purvis, Derivatively on Behalf of Nominal Defendant MBIA, Inc. v. Joseph W. Brown, Neil G. Budnick, C. Edward Chaplin, David C. Clapp, Clifford D. Corso, Gary C. Dunton, Claire L. Gaudiani, Daniel P. Kearney, Laurence H. Meyer, Debra J. Perry, John A. Rolls, and Ruth M. Whaley* (Case No. 20099-05). The plaintiff asserts claims for the benefit of the Company to redress injuries suffered by the Company as a result of alleged breaches of fiduciary duties by the named defendants in connection with the Company s accounting for certain transactions, including the AHERF loss. In addition, the plaintiff alleges that the officer defendants were unjustly enriched as a result of such alleged breach. The lawsuit seeks disgorgement to the Company of compensation granted to such officers, legal costs and unspecified equitable relief to remedy defendant s breaches of fiduciary duties.

There are no other material lawsuits pending or, to the knowledge of the Company, threatened, to which the Company or any of its subsidiaries is a party.

Item 4. Submission of Matters to a Vote of Security Holders

Not Applicable.

PART II

Item 5. Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company s common stock is listed on the New York Stock Exchange under the symbol MBI. As of March 1, 2006 there were 948 shareholders of record of the Company s common stock. The information concerning dividends on the Company s common stock is under Item 1. Business Insurance Regulation in this annual report.

The high and low stock prices and dividends with respect to the Company s common stock for the last two years are set forth below:

	2005			2004		
	Sales Price		Cash Dividends	Sales Price		Cash Dividends
Quarter Ended	**High**	**Low**	**Declared**	**High**	**Low**	**Declared**
March 31	$ 63.33	$ 52.10	$ 0.24	$ 67.34	$ 58.90	$ 0.20
June 30	61.35	49.07	0.28	64.90	54.30	0.24
September 30	63.23	54.75	0.28	59.14	52.55	0.24
December 31	64.00	54.15	0.28	65.21	53.43	0.24

The Company expects to continue its policy of paying regular dividends, although there is no assurance as to future dividends because they depend on future earnings, capital requirements, and financial condition.

From time to time, the Company repurchases shares of its common stock when, in the opinion of management, it is economically advantageous to do. In August 1999, the Company s Board of Directors authorized the repurchase of up to 11.25 million shares of the Company s common stock (after adjusting for the 2001 stock split). In July 2004, the Company completed the repurchase of all 11.25 million shares and received authorization from its Board of Directors to repurchase 1 million shares under a new repurchase program. On August 5, 2004, the Board of Directors authorized the repurchase of an additional 14 million shares of its common stock in connection with the new repurchase program. The Company will only repurchase shares of its common stock under the repurchase program when it feels that it is economically attractive to do so and in conformity with regulatory and rating agency guidelines.

The table below sets forth repurchases made by the Company in each month during the fourth quarter of 2005, all of which were purchased by the Company for settling awards under the Company s long-term incentive plans.

Month	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the Plan
October	1,707	$ 57.84	0	4,995,900
November	38,962	61.95	0	4,995,900
December	35,649	60.69	0	4,995,900

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Item 6. Selected Financial Data

Selected Financial and Statistical Data

MBIA Inc. and Subsidiaries

Dollars in millions except per share amounts	*2005*	*2004*	*2003*	*2002*	*2001*
GAAP Summary Income Statement Data:					
Insurance:					
Gross premiums written	**$ 985**	$ 1,117	$ 1,269	$ 952	$ 865
Premiums earned	**843**	850	773	618	547
Net investment income	**492**	474	438	433	413
Total insurance expenses	**294**	273	256	217	203
Insurance income	**1,056**	1,208	1,166	818	795
Investment management services income	**131**	48	55	34	38
Corporate loss	**(173)**	(84)	(59)	(64)	(63)
Income from continuing operations before income taxes	**1,016**	1,173	1,163	789	765
Net income	**711**	**843**	**825**	**585**	**570**
Basic EPS:					
Income from continuing operations	**5.31**	**5.92**	**5.74**	**3.99**	**3.82**
Net income	**5.30**	**5.94**	**5.75**	**3.99**	**3.84**
Diluted EPS:					
Income from continuing operations	**5.19**	**5.80**	**5.68**	**3.96**	**3.80**
Net income	**5.18**	**5.82**	**5.69**	**3.96**	**3.81**
GAAP Summary Balance Sheet Data:					
Fixed-maturity investments	**24,476**	20,411	17,090	15,154	13,674
Held-to-maturity investments	**5,765**	7,540	8,891		
Short-term investments	**1,678**	2,405	1,913	1,728	707
Other investments	**235**	262	357	213	135
Total assets	**34,561**	33,036	30,301	18,796	16,172
Deferred premium revenue	**3,185**	3,211	3,080	2,755	2,565
Loss and LAE reserves	**722**	749	712	638	595
Investment agreements	**10,806**	8,679	6,959	6,388	6,055
Commercial paper	**860**	2,599	2,640		
Medium-term notes	**7,542**	6,944	7,092	842	
Long-term debt	**1,210**	1,333	1,022	1,033	805
Shareholders equity	**6,592**	6,559	6,150	5,369	4,653
Book value per share	**49.17**	47.05	42.75	37.10	31.37
Dividends declared per common share	**1.120**	0.960	0.800	0.680	0.600
Financial Ratios:					
Loss and LAE ratio	**10.0%**	10.0%	10.0%	10.5%	11.1%
Underwriting expense ratio	**24.9**	22.2	23.2	24.5	26.0
Combined ratio	**34.9**	32.2	33.2	35.0	37.1
Net debt service outstanding [(1)]	**$ 889,019**	**$ 890,222**	**$ 835,774**	**$ 781,589**	**$ 722,408**
Net par amount outstanding [(1)]	**$ 585,003**	**$ 585,575**	**$ 541,026**	**$ 497,343**	**$ 452,409**

(1) Net of reinsurance and other reimbursement arrangements not accounted for as reinsurance.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations
FORWARD-LOOKING AND CAUTIONARY STATEMENTS

This annual report of MBIA Inc. (MBIA or the Company) includes statements that are not historical or current facts and are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words believe, anticipate, project, plan, expect, intend, will likely result, looking forward or will continue, and similar expressions identify forward-looking state These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. MBIA cautions readers not to place undue reliance on any such forward-looking statements, which speak only to their respective dates. The following are some of the factors that could affect financial performance or could cause actual results to differ materially from estimates contained in or underlying the Company s forward-looking statements:

- fluctuations in the economic, credit, interest rate or foreign currency environment in the United States (U.S.) and abroad;
- level of activity within the national and international credit markets;
- competitive conditions and pricing levels;
- legislative or regulatory developments;
- technological developments;
- changes in tax laws;
- the effects of mergers, acquisitions and divestitures; and
- uncertainties that have not been identified at this time.

The Company undertakes no obligation to publicly correct or update any forward-looking statement if it later becomes aware that such results are not likely to be achieved.

OVERVIEW

MBIA is a leading provider of financial guarantee products and specialized financial services. MBIA provides innovative and cost-effective products and services that meet the credit enhancement, financial and investment needs of its public- and private-sector clients worldwide. MBIA manages its activities primarily through three principal business operations: insurance, investment management services and municipal services. The Company s corporate operations include revenues and expenses that arise from general corporate activities and not from one of the Company s three principal business operations.

MBIA s insurance operations are principally conducted through MBIA Insurance Corporation and its subsidiaries (MBIA Corp.). MBIA Insurance Corporation has Triple-A financial strength ratings from Standard and Poor s Corporation (S&P), Moody s Investors Service, Inc. (Moody s), Fitch, Inc. and Rating and Investment Information, Inc. Additionally, MBIA Insurance Corporation s insurance subsidiaries have Triple-A financial strength ratings from at least S&P and Moody s. MBIA Corp. issues financial guarantees for municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, bonds backed by publicly or privately funded public-purpose projects, bonds issued by sovereign and sub-sovereign entities, obligations collateralized by diverse pools of corporate loans and credit default swaps and pools of corporate and asset-backed bonds, both in the new issue and secondary markets. The financial guarantees provide an unconditional and irrevocable guarantee of the payment of principal and interest on insured obligations when due.

MBIA s investment management services operations provide an array of products and services to the public, not-for-profit and corporate sectors. Such products and services are provided primarily through wholly owned subsidiaries of MBIA Asset Management, LLC and include cash management, discretionary asset management and fund administration services and investment agreement, medium-term note and commercial paper programs related to funding assets for third-party clients and for investment purposes.

MBIA s municipal services operations provide revenue enhancement services and products to public-sector clients nationwide, consisting of discovery, audit, collections/recovery and information services through MBIA MuniServices Company and its wholly owned subsidiaries. Additionally, the municipal services operations include Capital Asset Holdings GP, Inc. and certain affiliated entities (Capital Asset), a servicer of delinquent tax certificates.

The Company s results of operations for the years ended December 31, 2005, 2004 and 2003 are discussed in the Results of Operations section included herein.

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MBIA Inc. and Subsidiaries

Management s Discussion and Analysis

of Financial Condition and Results of Operations (Continued)

RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

On November 8, 2005, MBIA announced its decision to correct and restate its previously issued financial statements for 1998 and subsequent years in connection with potential settlements of investigations by the Securities and Exchange Commission (SEC) and the New York Attorney General s Office (NYAG) regarding agreements entered into by its subsidiary, MBIA Corp., in 1998. On November 12, 2005, MBIA filed with the SEC Amendment No. 1 on Form 10-K/A to its Form 10-K for the year ended December 31, 2004 to reflect the restatement of its financial statements as of and for the years ended December 31, 2004, 2003, 2002, 2001, 2000, 1999 and 1998.

In 1998, three reinsurers, Converium Reinsurance (North America) Inc. (Converium), AXA Re Finance S.A. (ARF) and Muenchener Rueckversicherungs-Gesellshaft (Munich Re) paid the Company $170 million under three separate agreements (the Excess-of-Loss Agreements) in connection with losses the Company incurred on $265 million of MBIA-insured bonds issued by the Alleghany Health, Education and Research Foundation (AHERF). The Excess-of-Loss Agreements were structured as three successive excess-of-loss facilities that aggregated to $170 million. Under the Excess-of-Loss Agreements, Converium paid the Company $70 million, and Munich Re and ARF each paid the Company $50 million.

In connection with the arrangements for the Excess-of-Loss Agreements, the Company entered into quota share agreements with Munich Re, ARF and Converium (each a Quota Share Agreement and, collectively, the Quota Share Agreements). Under the Quota Share Agreements, the Company agreed to cede to the three reinsurers new business written with an aggregate par sufficient to generate $297 million in gross premiums over a six year period ending October 1, 2004. Of the $297 million in premiums to be ceded under the Quota Share Agreements, the Company agreed to cede to Converium cash premiums equal to $102 million, to ARF adjusted gross premiums of $97 million and to Munich Re adjusted gross premiums of $98 million over this period.

On March 8, 2005, the Company announced its decision to restate its financial statements for 1998 and subsequent years to correct the accounting for the agreements with Converium and reflected this correction in the consolidated financial statements of its original Annual Report on Form 10-K for the year ended December 31, 2004. At that time, the Company believed that the accounting for the Excess of Loss Agreements and Quota Share Agreements with Munich Re and ARF was appropriate under Statement of Financial Accounting Standards (SFAS) 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts.

The restatement of the Company s financial statements for the Munich Re and ARF Excess-of-Loss and Quota Share Agreements, made in connection with the potential settlements, corrects and restates its accounting for these agreements because, taking into account developments in the regulatory investigations since March and further accounting analyses, they did not satisfy the risk transfer requirements for reinsurance accounting under SFAS 113. As a result, the Company restated its financial statements issued prior to September 30, 2005 to reflect the Excess-of-Loss and Quota Share Agreements with Munich Re and ARF under deposit accounting in accordance with Statement of Position (SOP) 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Risk instead of under reinsurance accounting. The Company also corrected and restated its 2004 statutory financial statements for the Munich Re and ARF Excess-of-Loss and Quota Share Agreements because they did not satisfy the requirements for reinsurance accounting under Regulation 108 of the New York State Insurance Department (NYSID). The restatements did not have a significant effect on the Company s financial position.

Additionally, in the third quarter of 2005, the Company completed a detailed review of its derivative instruments for which it applied shortcut method hedge accounting under SFAS 133, Accounting for Derivative Instruments and Hedging Activities , as amended. Shortcut method hedge accounting allows the assumption that the change in fair value of a hedged item exactly offsets the change in fair value of the related derivative. After completing its review, the Company determined that certain hedging relationships did not meet every technical aspect of shortcut method hedge accounting, although, such hedging relationships would have qualified for basic hedge accounting. Since the documentation that the Company prepared was designed to support shortcut method hedge accounting, it was not sufficient to support basic hedge accounting. As a result, the Company must account for these derivatives, from 2001 through September 30, 2005, as if they were not part of hedging relationships, which requires the change in fair value of these derivatives to be reflected in the Company s income statement without an offsetting change in fair value of the hedged items. The Company has restated its financial statements to correct the accounting for these derivatives for the year ended December 31, 2001 and subsequent periods through June 30, 2005. As of October 1, 2005, all of the subject hedging relationships

met the requirements for basic hedge accounting and have been recorded as such in the Company s financial statements for the year ended December 31, 2005.

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The following table presents the effects of the ARF, Munich Re and derivative accounting restatement on the consolidated financial statements of the Company for the three months ended March 31, 2005 and June 30, 2005. The effect of the Converium restatement was reflected in the previously issued consolidated financial statements of the Company for these periods.

	As of and For the Three Months Ended March 31, 2005		As of and For the Three Months Ended June 30, 2005	
In thousands except per share information	**Previously Reported**	**Restated**	**Previously Reported**	**Restated**
Consolidated Statement of Income Data:				
Ceded premiums	$ (35,688)	$ (32,126)	$ (33,641)	$ (31,622)
Net premiums written	246,931	250,493	215,324	217,343
Increase in deferred premium revenue	(40,693)	(39,648)	(6,391)	(3,958)
Scheduled premiums earned	169,873	173,760	177,207	180,902
Refunding premiums earned	36,365	37,085	31,726	32,483
Premiums earned	206,238	210,845	208,933	213,385
Net gains (losses) on derivative instruments and foreign exchange-insurance	(6,075)	(6,072)	4,119	4,002
Total insurance revenues	325,945	330,555	339,264	343,599
Losses and loss adjustment expenses	20,385	20,851	21,265	21,708
Amortization of deferred acquisition costs	16,293	16,657	16,506	16,858
Operating expenses	29,166	30,262	32,268	33,261
Total insurance expenses	65,844	67,770	70,039	71,827
Insurance income	260,101	262,785	269,225	271,772
Net gains (losses) on derivative instruments and foreign exchange-IMS	11,178	27,421	(3,439)	(27,395)
Investment management services income	36,812	53,055	15,372	(8,584)
Income from continuing operations before income taxes	277,706	296,633	261,312	239,903
Provision for income taxes	77,202	83,826	73,722	66,229
Income from continuing operations	200,504	212,807	187,590	173,674
Net income	$ 200,504	$ 212,807	$ 187,590	$ 173,674
Basic EPS:				
Income from continuing operations	$ 1.46	$ 1.55	$ 1.40	$ 1.30
Net income	$ 1.46	$ 1.55	$ 1.40	$ 1.30
Diluted EPS:				
Income from continuing operations	$ 1.43	$ 1.52	$ 1.37	$ 1.27
Net income	$ 1.43	$ 1.52	$ 1.37	$ 1.27
Consolidated Balance Sheet Data:				
Deferred acquisition costs	$ 371,932	$ 417,454	$ 383,006	$ 428,613
Prepaid reinsurance premiums	462,390	427,028	451,113	418,184
Reinsurance recoverable on unpaid losses	33,202	34,091	42,869	41,671
Derivative assets	270,648	270,485	252,637	252,544
Other assets	282,295	281,406	253,843	255,041
Total assets	33,756,665	33,766,662	34,784,595	34,797,180
Loss and loss adjustment expense reserves	755,563	778,064	667,570	690,801
Investment agreements	9,316,470	9,318,116	10,005,780	9,998,534

Deferred income taxes, net	573,849	563,551	661,184	654,888
Derivative liabilities	428,360	427,334	484,842	484,003
Other liabilities	381,426	397,724	396,596	412,019
Total liabilities	27,320,654	27,349,775	28,197,097	28,221,370
Retained earnings	5,377,327	5,361,923	5,527,063	5,497,743
Accumulated other comprehensive income	500,516	496,796	630,628	648,260
Total shareholders equity	$ 6,436,011	$ 6,416,887	$ 6,587,498	$ 6,575,810

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The restatement of the Company s financial statements did not have a material effect on its financial condition and MBIA does not expect the restatement to have any impact on its ratings or on the Triple-A ratings of MBIA Insurance Corporation. The following information presented in Management s Discussion and Analysis of Financial Condition and Results of Operations gives effect to the restatement.

CRITICAL ACCOUNTING ESTIMATES

The Company prepares its financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). The following accounting estimates are viewed by management to be critical because they require significant judgment on the part of management. Financial results could be materially different if alternate methodologies were used or if management modified its assumptions.

LOSSES AND LOSS ADJUSTMENT EXPENSES The financial guarantees issued by MBIA Corp. insure scheduled payments of principal and interest due on various types of financial obligations against a payment default on such payments by the issuers of the obligations. Loss and LAE reserves are established by the Company s Loss Reserve Committee, which is comprised of members of senior management, and require the use of judgment and estimates with respect to the occurrence, timing and amount of a loss on an insured obligation.

The Company establishes two types of loss and loss adjustment expense (LAE) reserves for non-derivative financial guarantees: an unallocated loss reserve and case basis reserves. The unallocated loss reserve is established with respect to the Company s entire insured portfolio. The Company s unallocated loss reserve represents the Company s estimate of losses that have or are probable to occur as a result of credit deterioration in the Company s insured portfolio but which have not yet been specifically identified and applied to specific insured obligations.

Each quarter the Company calculates its provision for the unallocated loss reserve as a fixed percent of scheduled net earned premium. Annually, the Loss Reserve Committee evaluates the appropriateness of this fixed percent loss factor. In performing this evaluation, the Loss Reserve Committee considers the composition of the Company s insured portfolio by municipal sector, structured asset class, remaining maturity and credit quality, along with the latest industry data, including historical default and recovery experience for the relevant sectors of the fixed-income market in order to determine if a trend is developing that indicates the loss factor should be increased or decreased. In addition, the Company considers its own historical loss activity and how those losses develop over time. The Loss Reserve Committee reviews the results of its annual evaluation over a period of several years to determine whether any long-term trends are developing. The Company s additions to specific case basis reserves in the years ended December 31, 2005 and 2004 exceeded the 12% loss factor currently used by the Company. The Loss Reserve Committee is continuing to monitor this trend and evaluate whether an adjustment to the Company s current loss factor is appropriate. However, if a catastrophic or very unusual loss occurred, the Loss Reserve Committee would consider taking an immediate charge through Losses and loss adjustment expenses and possibly also increasing the loss factor in order to maintain an adequate level of loss reserves. Since 2002, the Company calculated its provision for the unallocated loss reserve as 12% of scheduled net earned premium.

Significant changes to any variables on which the 12% loss factor is based, over an extended period of time, would likely result in an increase or decrease in the Company s loss factor with a corresponding increase or decrease in the amount of the Company s loss and loss adjustment expense provision. For example, as external and internal statistical data are applied to the various sectors of the Company s insured portfolio, a shift in business written toward sectors with high default rates would likely increase the loss factor, while a shift toward sectors with low default rates would likely decrease the loss factor. Additionally, increases in statistical default rates relative to the Company s insured portfolio and in the Company s actual loss experience or decreases in statistical recovery rates and in the Company s actual recovery experience would likely increase the Company s loss factor. Conversely, decreases in statistical default rates relative to the Company s insured portfolio and in the Company s actual loss experience or increases in statistical recovery rates and in the Company s actual recovery experience would likely decrease the Company s loss factor. During the years ended December 31, 2005, 2004 and 2003, the Company calculated its provision for the unallocated loss reserve of $84 million, $85 million and $77 million, respectively. This provision represents loss and loss adjustment expenses as reported on the Company s income statement.

The Company establishes specific reserves in an amount equal to the Company s estimate of identified or case basis reserves with respect to specific policies. A number of variables are taken into account in establishing specific case basis reserves for individual policies that depend primarily on the nature of the underlying insured obligation. These variables include the nature and 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 realized 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 Company does not believe that changes to these factors would materially change the amount of the Company s case basis loss reserves, with the exception of significant changes in salvage values of specific collateral. However, the Company does not believe that significant changes in salvage values of specific collateral are reasonably likely to occur.

MBIA Inc. and Subsidiaries

Management s Discussion and Analysis

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The Company s total loss reserves of $722 million represent a small fraction of its outstanding net debt service insured of $889 billion. However, management believes that these reserves are adequate to cover ultimate net losses. Given that the reserves are based on estimates, there can be no assurance that the ultimate liability will not exceed such estimates resulting in the Company recognizing additional loss and loss adjustment expense in earnings. While the underlying principles applied to loss reserving are consistent across the financial guarantee industry, differences exist with regard to the methodology and measurement of loss reserves. Alternate methods may produce different estimates than the method used by the Company. Additionally, the accounting for non-derivative financial guarantee loss reserves is possibly subject to change. See Note 3: Significant Accounting Policies in the Notes to Consolidated Financial Statements for a description of the Company s loss and loss adjustment expense accounting policy.

PREMIUM REVENUE RECOGNITION Upfront premiums are earned in proportion to the expiration of the related insured par while installment premiums are earned on a straight-line basis over each installment period, generally one year or less. Therefore, for transactions in which the premium is received upfront, premium earnings are greater in the earlier periods when there is a higher amount of par outstanding. The upfront premiums are apportioned to individual sinking fund payments of a bond issue according to an amortization schedule. After the premiums are allocated to each scheduled sinking fund payment, they are earned on a straight-line basis over the period of that sinking fund payment. Accordingly, deferred premium revenue represents the portion of premiums written that is applicable to the unexpired risk of insured bonds and notes. When an MBIA-insured issue is retired early, is called by the issuer, or is in substance paid in advance through a refunding accomplished by placing U.S. Government securities in escrow, the remaining deferred premium revenue is earned at that time since there is no longer risk to the Company.

The effect of the Company s upfront premium earnings policy is to recognize greater levels of upfront premiums in the earlier years of each policy insured, thus matching revenue recognition with exposure to the underlying risk. Recognizing premium revenue on a straight-line basis over the life of each policy without allocating premiums to the sinking fund payments would materially affect the Company s financial results. Premium earnings would be more evenly recorded as revenue throughout the period of risk than under the current method, but the Company does not believe that the straight-line method would appropriately match premiums earned to the Company s exposure to the underlying risk. Therefore, the Company believes its upfront premium earnings methodology is the most appropriate method to recognize its upfront premiums as revenue. The premium earnings methodology used by the Company is similar to that used throughout the financial guarantee industry.

VALUATION OF FINANCIAL INSTRUMENTS The fair market values of financial instruments held or issued by the Company are determined through the use of available market data and widely accepted valuation methods. Market data is retrieved from a variety of third-party data sources for input into the Company s valuation systems. Valuation systems are determined based on the characteristics of transactions and the availability of market data. The fair values of financial assets and liabilities are primarily calculated from quoted dealer market prices. However, dealer market prices may not be available for certain types of contracts that are infrequently purchased and sold. For these contracts, the Company may use alternate methods for determining fair values, such as dealer market quotes for similar contracts or cash flow modeling. Alternate valuation methods generally require management to exercise considerable judgment in the use of estimates and assumptions, and changes to certain factors may produce materially different values. In addition, actual market exchanges may occur at materially different amounts.

The Company s financial instruments categorized as assets are mainly comprised of investments in debt and equity instruments. The majority of the Company s debt and equity investments are accounted for in accordance with SFAS 115, Accounting for Certain Investments in Debt and Equity Securities. SFAS 115 requires that all debt instruments and certain equity instruments be classified in the Company s balance sheet according to their purpose and, depending on that classification, be carried at either amortized cost or fair market value. Quoted market prices are generally available for these investments. However, if a quoted market price is not available, a price is derived from internally developed models which use available market data. Equity investments outside the scope of SFAS 115 are accounted for under cost or equity method accounting principles. Other financial assets that require fair value reporting or disclosures within the Company s financial notes are valued based on underlying collateral or the Company s estimate of discounted cash flows.

MBIA regularly monitors its investments in which fair value is less than amortized cost in order to assess whether such a decline in value is other than temporary and, therefore, should be reflected as a realized loss in net income. Such an assessment requires the Company to determine the cause of the decline and whether the Company possesses both the ability and intent to hold the investment to maturity or until the value

recovers to an amount at least equal to amortized cost. Additionally, this assessment requires management to exercise judgment as to whether an investment is impaired based on market conditions and trends and the availability of relevant data. See "Note 13: Investment Income and Gains and Losses" in the Notes to Consolidated Financial Statements for further information regarding other than temporary losses recorded in net income.

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The Company s financial instruments categorized as liabilities primarily consist of obligations related to its asset/liability products, conduit medium-term note and conduit commercial paper programs, and debt issued for general corporate purposes. These liabilities are typically recorded at their face value adjusted for premiums or discounts. The fair values of such instruments are generally not reported within the Company s financial statements, but rather in the accompanying notes. However, financial liabilities that qualify as part of hedging arrangements under SFAS 133 are recorded at their fair values in the Company s balance sheet with respect to those risks being hedged. MBIA has instituted cash flow modeling techniques to estimate the value of its liabilities that qualify as hedged obligations under SFAS 133 based on current market data. Other financial liabilities that require fair value reporting or disclosures within the Company s notes to its financial statements are valued based on underlying collateral, the Company s estimate of discounted cash flows or quoted market values for similar transactions.

The Company s exposure to derivative instruments is created through contracts into which it directly enters and through third-party contracts it insures. The majority of MBIA s exposure to derivative instruments, measured by notional values, is related to certain synthetic collateralized debt obligations (CDOs) that it insures. These contracts meet the definition of a derivative under SFAS 133 but effectively represent an alternate form of financial guarantee execution. The fair values of the Company s derivative instruments are estimated using various valuation models that conform to industry standards. The Company utilizes both vendor-developed and proprietary models, based on the complexity of transactions. Dealer market quotes are typically obtained for regularly traded contracts and provide the best estimate of fair value for those contracts. However, when reliable dealer market quotes are not available, the Company uses a variety of market data relative to the type and structure of derivative contracts entered into by the Company. Several of the more significant types of market and contract data that influence the Company s valuation models include interest rates, credit quality ratings, credit spreads, default probabilities and diversity scores. The data is obtained from third-party sources and is reviewed for reasonableness and applicability to the Company s derivative portfolio. The fair value of the Company s derivative portfolio may be materially affected by changes in existing market data, the availability of new or improved market data, changes in specific contract data or enhancements to the Company s valuation models resulting from new market practices.

MBIA expects to hold all derivative instruments to their contractual maturity. Upon maturity of a contract, the unrealized value recorded in the Company s financial statements will be zero. However, in the unlikely event circumstances require the termination and settlement of a contract prior to maturity, any unrealized gain or loss will be realized.

The Company has dedicated resources to the development and ongoing review of its valuation models and has instituted procedures for the approval and control of data inputs. In addition, regular reviews are performed to ensure that the Company s valuation models are appropriate and produce values reflective of the current market environment. See Note 27: Fair Value of Financial Instruments in the Notes to Consolidated Financial Statements for additional information on the various types of instruments entered into by MBIA and a comparison of carrying values as reported in the Company s balance sheet to estimated fair values.

GOODWILL Under SFAS 142, Goodwill and Other Intangible Assets, goodwill and intangible assets with indefinite lives are no longer amortized but instead tested for impairment at least annually. The standard includes a two-step process aimed at determining the amount, if any, by which the carrying value of a reporting unit exceeds its fair value and should be charged as an expense through net income.

In performing its impairment test, the Company determined that the best measure of the fair value of the insurance reporting segment is its book value adjusted for the after-tax effects of net deferred premium revenue less deferred acquisition costs, the present value of installment premiums and a provision for losses to arrive at an adjusted book value. Adjusted book value is a common measure used by analysts to determine the value of financial guarantee companies.

In performing the impairment test for the investment management services operations, the fair values of the reporting segments were determined using a multiple of earnings before income tax, depreciation and amortization (EBITDA), as this is a common measure of fair value in the investment management industry. The multiple was determined based on a review of current industry valuation practices.

The Company performed its annual impairment testing of goodwill as of January 1, 2005 and January 1, 2006. On both dates, the fair values of the reporting segments exceeded their carrying values indicating that goodwill was not impaired. Alternate valuation methods would have likely produced different fair values. However, the Company believes that the valuation methods used provided the best estimates of fair value.

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RESULTS OF OPERATIONS

SUMMARY OF CONSOLIDATED RESULTS

The following table presents highlights of the Company s consolidated financial results for 2005, 2004 and 2003. Items listed under Other per share information (effect on net income) are items that management commonly identifies for the readers of its financial statements because they are a by-product of the Company s operations or due to general market conditions beyond the control of the Company.

In millions except per share amounts	2005	2004	2003
Revenues:			
Insurance	$ 1,350	$ 1,481	$ 1,423
Investment management services	910	538	412
Municipal services	25	27	27
Corporate	16	8	24
Gross revenues from continuing operations	2,301	2,054	1,886
Expenses:			
Insurance	295	273	256
Investment management services	780	491	357
Municipal services	22	26	26
Corporate	188	92	84
Gross expenses from continuing operations	1,285	882	723
Provision for income taxes	304	332	340
Income from continuing operations, net of tax	712	840	823
Income (loss) from discontinued operations, net of tax	(1)	3	2
Net income	$ 711	$ 843	$ 825
Net income per share information:*			
Net income	$ 5.18	$ 5.82	$ 5.69
Other per share information (effect on net income):			
Penalties and disgorgement	$ (0.52)		
Accelerated premium earned from refunded issues	$ 0.61	$ 0.59	$ 0.54
Net realized gains (losses)	$ (0.04)	$ 0.47	$ 0.36
Net gains (losses) on derivative instruments and foreign exchange	$ 0.18	$ (0.01)	$ 0.43
Income (loss) from discontinued operations	$ (0.01)	$ 0.02	$ 0.01

* All per share calculations are diluted.

Consolidated revenues from continuing operations increased 12% to $2.3 billion in 2005 from $2.1 billion in 2004. The growth in consolidated revenues was primarily due to a substantial increase in investment management services interest income resulting from growth in asset/liability products. Offsetting the increase in investment management services revenues was a decrease in insurance revenues resulting from a decline in gains on investment securities. Consolidated expenses from continuing operations increased 46% to $1.3 billion in 2005 from $882 million in 2004. This increase was principally due to an increase in investment management services interest expense, which was commensurate with the

increase in interest income, and estimated penalties and disgorgement related to the potential settlement of regulatory investigations of the Company. Net income for 2005 of $711 million was down 16% from $843 million for 2004. Net income per share was $5.18 for 2005 compared with $5.82 for 2004, an 11% decrease.

Consolidated revenues from continuing operations for 2004 were $2.1 billion compared with $1.9 billion for 2003, a 9% increase. The growth in consolidated revenues was primarily due to increases in insurance premium earnings and investment income, investment management services medium-term note program revenues and the full-year impact of the consolidation of conduit revenues. Consolidated expenses for 2004 were $882 million compared with $723 million for 2003, a 22% increase. This increase was primarily due to an increase in investment management services medium-term note program interest and operating expenses and the full year impact of the consolidation of conduit expenses. Net income for 2004 of $843 million was up 2% from $825 million recorded in 2003. Net income per share for 2004 was $5.82 compared with $5.69 for 2003, also a 2% increase.

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The Company s book value at December 31, 2005 was $49.17 per share, up 5% from $47.05 at December 31, 2004. The increase was principally driven by income from operations, which was somewhat offset by the effect of repurchasing shares into treasury stock at prices above the Company s book value per share. Book value per share has shown steady growth over the past three years with a three-year compound average growth rate of 10%.

INSURANCE OPERATIONS

The Company s insurance operations are principally comprised of the activities of MBIA Corp. MBIA Corp. issues financial guarantees for municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, bonds backed by publicly or privately funded public purpose projects, bonds issued by sovereign and sub-sovereign entities, obligations collateralized by diverse pools of corporate loans and credit default swaps and pools of corporate and asset-backed bonds, both in the new issue and secondary markets.

The municipal obligations that MBIA Corp. insures include tax-exempt and taxable indebtedness of states, counties, cities, utility districts and other political subdivisions, as well as airports, higher education and healthcare facilities and similar authorities and obligations issued by private entities that finance projects which serve a substantial public purpose. The asset-backed and structured finance obligations insured by MBIA Corp. typically consist of securities that are payable from or which are tied to the performance of a specified pool of assets that, in most cases, have a defined cash flow. Securities of this type include residential and commercial mortgages, a variety of consumer loans, corporate loans and bonds, trade and export receivables, aircraft, equipment and real property leases, and infrastructure projects.

Revenues from the Company s insurance operations decreased 9% to $1.35 billion in 2005 compared with $1.48 billion in 2004. The decline in insurance operations revenues was primarily the result of a decrease in net gains from investment securities and, to a lesser extent, a decrease in advisory fee income and net gains on derivative instruments. Net investment income increased 4%, partially offsetting the overall decline in revenues. Insurance expenses, which consist of loss and LAE, the amortization of deferred acquisition costs and operating costs, increased 8% to $295 million in 2005 compared with $273 million in 2004. Loss and LAE and the amortization of deferred acquisition costs remained relatively flat. Operating costs increased largely due to loss prevention costs, costs associated with the Company s Money Market Committed Preferred Custodial Trust securities (CPCT securities), consulting services and a decrease in the rate at which compensation and other costs are deferred as policy acquisition costs. Gross insurance expenses (expenses before ceding commission income and the deferral or amortization of acquisition costs) increased 3% in 2005 compared with 2004.

In 2004, revenues from insurance operations of $1.48 billion increased 4% compared with 2003. The growth in insurance operations revenues in 2004 was due to increases in earned premiums, net investment income and net realized gains offset by decreases in advisory fee income and net gains on derivative instruments. Insurance expenses increased 7% in 2004 compared with 2003. Loss and LAE and the amortization of deferred acquisition costs both increased in line with the increase in earned premiums. Operating expenses increased 3%, principally due to higher compensation costs, premiums related to the renewal of directors and officers liability insurance and loss prevention costs. Gross insurance expenses for 2004 increased 1% compared with 2003.

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The Company s gross premiums written (GPW), net premiums written (NPW) and net premiums earned for the last three years are presented in the following table:

In millions	2005	2004	2003	Percent Change 2005 vs. 2004	Percent Change 2004 vs. 2003
Gross premiums written:					
U.S.	$ 710	$ 737	$ 862	(4)%	(15)%
Non-U.S.	275	380	407	(28)%	(7)%
Total	$ 985	$ 1,117	$ 1,269	(12)%	(12)%
Net premiums written:					
U.S.	$ 658	$ 683	$ 765	(4)%	(11)%
Non-U.S.	200	275	310	(27)%	(11)%
Total	$ 858	$ 958	$ 1,075	(10)%	(11)%
Net premiums earned:					
U.S.	$ 620	$ 637	$ 615	(3)%	4%
Non-U.S.	223	213	158	5%	35%
Total	$ 843	$ 850	$ 773	(1)%	10%

GPW reflects premiums received and accrued for in the period and does not include the present value of future cash receipts expected from installment premium policies originated during the period. GPW was $985 million in 2005, down 12% from 2004.

NPW, which represents gross premiums written net of premiums ceded to reinsurers, decreased 10% to $858 million in 2005 from $958 million in 2004. The decline in 2005 was a result of the decline in GPW, slightly offset by a reduction in premiums ceded to reinsurers. Premiums ceded to reinsurers from all insurance operations were $127 million, $159 million and $194 million for 2005, 2004 and 2003, respectively. Reinsurance enables the Company to cede exposure and comply with its single risk and credit guidelines, although the Company continues to be primarily liable on the insurance policies it underwrites.

Net premiums earned include scheduled premium earnings as well as premium earnings from refunded issues. Net premiums earned in 2005 of $843 million decreased 1% over 2004 due to a 2% decrease in refunded premiums earned and a 1% decrease in scheduled premiums earned. The decrease in refunded premiums earned resulted from a modest slow down in refinancing activity in the municipal market from historically high levels.

In 2004, GPW decreased 12% compared with 2003, reflecting declines in both U.S and non-U.S. business. NPW decreased 11% compared with 2003, resulting from the decline in GPW, slightly offset by lower cession rates on U.S. business. The growth in net premiums earned in 2004 compared with 2003 reflects the increase in new business written in past years, increased refundings and a decline in the use of reinsurance.

MBIA evaluates the premium rates it charges for insurance guarantees through the use of internal and external rating agency quantitative models. These models assess the Company s premium rates and return on capital results on a risk adjusted basis. In addition, market research data is used to evaluate pricing levels across the financial guarantee industry for comparable risks. Although pricing has been acceptable in 2004 and 2005, the Company, along with the industry, experienced significant price increases over the period from 1998 through 2003. The Company s pricing levels indicate continued acceptable trends in overall portfolio profitability under all models, and the Company believes the pricing charged for its insurance products produces results that meet its long-term return on capital targets.

CREDIT QUALITY Financial guarantee companies use a variety of approaches to assess the underlying credit risk profile of their insured portfolios. 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. In evaluating credit risk, the Company obtains, when available, the underlying rating of the insured obligation before the benefit of its insurance policy from nationally recognized rating agencies (Moody s, S&P and Fitch, Inc.). All references to insured credit quality distributions contained herein reflect the underlying rating levels from these third-party sources. Other companies within the financial guarantee industry may report credit quality information based upon internal ratings that would not be comparable to MBIA s presentation.

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of Financial Condition and Results of Operations (Continued)

The credit quality of business insured during 2005 remained relatively high as 81% of total insured credits were rated A or above, before giving effect to MBIA s guarantee, compared to 76% in 2004 and 81% in 2003. At December 31, 2005, 81% of the Company s outstanding book of business was rated A or above before giving effect to MBIA s guarantee, up from 80% at December 31, 2004.

GLOBAL PUBLIC FINANCE MARKET MBIA s premium writings and premium earnings in both the new issue and secondary global public finance markets are shown in the following table:

Global Public Finance				**Percent Change**	
In millions	**2005**	**2004**	**2003**	**2005 vs. 2004**	**2004 vs. 2003**
Gross premiums written:					
U.S.	$ 450	$ 458	$ 570	(2)%	(20)%
Non-U.S.	119	208	263	(43)%	(21)%
Total	$ 569	$ 666	$ 833	(15)%	(20)%
Net premiums written:					
U.S.	$ 431	$ 439	$ 530	(2)%	(17)%
Non-U.S.	83	145	215	(43)%	(33)%
Total	$ 514	$ 584	$ 745	(12)%	(22)%
Net premiums earned:					
U.S.	$ 389	$ 400	$ 371	(3)%	8%
Non-U.S.	106	95	65	12%	46%
Total	$ 495	$ 495	$ 436	0%	14%

Global public finance GPW decreased 15% over 2004. This decrease reflects a drop in European business as significantly fewer transactions came to market during 2005, despite growth in the Latin American and Australian markets. U.S. GPW declined 2% over 2004. Although U.S. GPW declined slightly, it was positively impacted by steady flow business, particularly within the military housing and transportation sectors. NPW decreased 12% to $514 million in 2005 as a result of the decrease in GPW and a lower cession rate. The overall cession rate for business written during 2005 was 10% compared with 12% in 2004. The decrease in the overall cession rate was principally due to a decline in U.S. business ceded. Global public finance net premiums earned were $495 million in both 2005 and 2004. An increase in scheduled net premiums earned from non-U.S. business was offset by a decline in refunded premiums earned from U.S. business.

In 2004, global public finance GPW and NPW decreased 20% and 22%, respectively, over 2003. The decrease in GPW was primarily due to a significant decline in first quarter U.S. production and third quarter U.S. and non-U.S. production, which resulted from lower market issuance, increased competition and lower overall pricing. In 2004, the cession rate on total global public finance business written was 12%, which increased from an 11% cession rate in 2003. The increase in the 2004 cession rate resulted from an increase in non-U.S. business ceded. The greater decline in NPW compared with the decline in GPW was a result of the increase in cessions to reinsurers. Global public finance net premiums earned increased 14% over 2003. This growth reflects earnings generated from increased levels of U.S. and non-U.S. business written over the last several years and a 10% increase in refunded premiums earned.

The credit quality of global public finance business written by the Company in 2005 remained high. Insured credits rated A or above before the Company s guarantee represented 91% of global public finance business written in 2005, compared with 87% in 2004 and 88% in 2003. At December 31, 2005, 83% of the outstanding global public finance book of business was rated A or above before the Company s guarantee, up from 82% at December 31, 2004.

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GLOBAL STRUCTURED FINANCE MARKET MBIA s premium writings and premium earnings in both the new issue and secondary global structured finance markets are shown in the following table:

Global Structured Finance				**Percent Change**	
In millions	**2005**	**2004**	**2003**	**2005 vs. 2004**	**2004 vs. 2003**
Gross premiums written:					
U.S.	$ 260	$ 279	$ 292	(7)%	(4)%
Non-U.S.	156	172	144	(9)%	19%
Total	$ 416	$ 451	$ 436	(8)%	3%
Net premiums written:					
U.S.	$ 227	$ 244	$ 235	(7)%	4%
Non-U.S.	117	130	95	(10)%	37%
Total	$ 344	$ 374	$ 330	(8)%	13%
Net premiums earned:					
U.S.	$ 231	$ 237	$ 244	(3)%	(3)%
Non-U.S.	117	118	93	(1)%	27%
Total	$ 348	$ 355	$ 337	(2)%	5%

Global structured finance GPW decreased 8% in 2005 to $416 million from $451 million in 2004, resulting from decreases in U.S. and non-U.S. business written. The global structured finance sector continues to be adversely impacted by increased competition, tight spreads and greater investor demand for uninsured transactions. However, GPW was positively impacted by business from repeat issuers across all sectors. NPW in 2005 decreased 8% due to the decrease in GPW. The overall cession rate for business written during 2005 and 2004 was 17%. In 2005, global structured finance net premiums earned of $348 million were 2% below 2004. The decrease in net premiums earned resulted from the decline in business written and prepayments and maturities of insured issues.

In 2004, global structured finance GPW increased 3% to $451 million from $436 million in 2003, resulting from an increase in non-U.S. business written. Overall, the global structured finance sector was adversely impacted by tight spreads and greater investor demand for uninsured transactions. NPW for 2004 increased 13% due to the increase in GPW and lower cession rates on both U.S. and non-U.S. business written. The 2004 cession rate on total global structured finance business written was 17%, which declined from a 24% cession rate in 2003. In 2004, global structured finance net premiums earned of $355 million increased 5% over 2003. This increase was driven by higher levels of new non-U.S. business written over the last two years and a declining cession rate.

The credit quality of MBIA s global structured finance insured business written rated A or above, before giving effect to the Company s guarantee, was 69% in 2005, compared with 64% in 2004 and 71% in 2003. At December 31, 2005 and 2004, 77% of the outstanding global structured finance book of business was rated A or above before giving effect to the Company s guarantee.

INVESTMENT INCOME The Company s insurance-related net investment income and ending asset balances at amortized cost for the last three years are presented in the following table:

In millions	2005	2004	2003	Percent Change 2005 vs. 2004	Percent Change 2004 vs. 2003
Pre-tax income	$ 492	$ 474	$ 438	4%	8%
After-tax income	$ 392	$ 376	$ 348	4%	8%
Ending asset balances at amortized cost	$ 9,939	$ 9,201	$ 9,034	8%	2%

The Company s insurance-related net investment income, excluding net realized gains and losses, increased 4% to $492 million from $474 million in 2004. After-tax net investment income also increased 4% in 2005 as the proportion of taxable investments remained relatively consistent with 2004. Growth in investment income has been adversely impacted by the continued low interest rate environment, however, benefited from slightly higher average yields and an increase in average invested assets as a result of a reduction in dividends paid by MBIA Corp. to MBIA Inc. during 2005 as compared with 2004.

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In 2004, insurance-related net investment income, excluding net realized gains and losses, increased 8% to $474 million in 2004, up from $438 million in 2003. After-tax net investment income also increased 8% compared with 2003 as the proportion of taxable investments remained consistent from year to year. The increase in investment income for 2004 was principally the result of an increase in invested assets due to premium collections and reinvested interest. Since the fourth quarter of 2003, a portion of MBIA-administered conduit investment income has been reported as insurance-related net investment income. Excluding investment income related to MBIA-administered conduits, after-tax insurance-related investment income would have increased 6% from 2003.

ADVISORY FEES The Company collects advisory fees in connection with certain transactions. Depending upon the type of fee received and whether it is related to an insurance policy, the fee is either earned when it is due or deferred and earned over the life of the related transaction. Work, waiver and consent, termination, administrative and management fees, and expense reimbursements are earned when the related services are completed. Structuring fees are earned on a straight-line basis over the life of the related insurance policy and commitment fees are earned on a straight-line basis over the commitment period.

In 2005, advisory fee revenues decreased 32% over 2004 to $28 million. The decrease in advisory fees was primarily due to a decline in waiver and consent and commitment fees, as well as a decline in work fees reflecting fewer large complex transactions requiring advisory services. Partially offsetting the decrease in such fees was an increase in expense reimbursements associated with loss prevention efforts. In 2004, advisory fee revenues decreased 30% to $42 million, from $60 million in 2003. This decrease was primarily due to a decline in work fees, resulting from fewer large and complex transactions, and a decline in waiver and consent and structuring fees. Fees earned when due represented 72% of total advisory fee income in 2005, 63% in 2004 and 75% in 2003. Due to the transaction-specific nature inherent in advisory fees, fee revenues can vary significantly from year to year.

NET GAINS AND LOSSES Net realized losses in the insurance operations were $8 million in 2005, compared with net realized gains of $109 million and $48 million in 2004 and 2003, respectively. In 2005, net realized losses were primarily due to $19 million of impairment losses on receivables the Company recorded through salvage and subrogation rights it obtained as a result of claim payments it previously made on insured credits. Partially offsetting the impairment losses were net gains from sales of investment securities. The net realized gains in 2004 were largely due to a $77 million realized gain resulting from the sale of a common stock investment MBIA Corp. purchased in 2002 and $41 million resulting from the termination of certain transactions that were accounted for as deposits. The increase in 2004 was partially offset by an $11 million realized loss resulting from an other-than-temporary impairment of a fixed-maturity security.

Net losses on derivative instruments and foreign exchange in the insurance operations, which primarily represent changes in the market value of the Company s insured credit derivative portfolio, were $4 million in 2005 compared with net gains of $7 million and $104 million in 2004 and 2003, respectively. The 2005 net losses primarily resulted from the reversal of gains recorded in prior years on credit derivatives as transactions approach their maturity and that terminated in 2005, net of foreign currency gains. The 2004 and 2003 net gains were primarily due to an increase in the value of the Company s insured credit derivative portfolio, reflecting a tightening of credit spreads. Gains or losses on derivatives are largely driven by movements in credit spreads affecting the insurance operations insured portfolio of synthetic CDOs. However, credit spreads did not move significantly in 2005 and 2004 relative to 2003.

LOSSES AND LOSS ADJUSTMENT EXPENSES (LAE) The following table shows the case-specific, reinsurance recoverable and unallocated components of the Company s total loss and LAE reserves, as well as its loss provision and case basis activity, at the end of the last three years.

				Percent Change	
				2005 vs.	2004 vs.
In millions	**2005**	**2004**	**2003**	**2004**	**2003**

Case-specific:					
Gross	$ 513	$ 435	$ 387	18%	12%
Reinsurance recoverable on unpaid losses	59	35	61	69%	(44)%
Net case reserves	$ 454	$ 400	$ 326	14%	23%
Unallocated	209	314	325	(33)%	(3)%
Net loss and LAE reserves	$ 663	$ 714	$ 651	(7)%	10%
Losses and LAE	$ 84	$ 85	$ 77	(1)%	10%
Case basis activity	$ 189	$ 127	$ 60	49%	112%

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The Company recorded $84 million in loss and LAE in 2005, a slight decrease from 2004. The variance in loss and LAE corresponds to the slight decrease in scheduled net earned premium, as scheduled net earned premium is the base upon which the Company s 12% loss factor is applied. Likewise, the growth in loss and LAE in 2004 compared with 2003 is a direct result of growth in scheduled net earned premium during 2004. At December 31, 2005, the Company had $209 million in unallocated loss reserves, which represent the Company s estimate of losses associated with credit deterioration that has occurred in the Company s insured portfolio and are available for future case-specific activity. During 2004, the unallocated loss reserve was increased by reserves of $32 million related to an agreement with Asian Securitization & Infrastructure Assurance (Pte) Ltd (ASIA Ltd) whereby, as part of the agreement, the Company assumed ASIA Ltd s insurance obligations.

Total case basis activity transferred from the Company s unallocated loss reserve was $189 million in 2005, $127 million in 2004 and $60 million in 2003. During 2005, case basis activity primarily consisted of loss reserves for insured obligations within the aircraft enhanced equipment trust certificates (EETCs), CDO and manufactured housing sectors and within MBIA s guaranteed tax lien portfolios. Case basis activity during 2004 primarily consisted of loss reserves for insured obligations issued by Fort Worth Osteopathic Hospital, MBIA s guaranteed tax lien portfolios, AHERF, an older vintage CDO and a manufactured housing exposure. During 2003, case basis activity included reserves for MBIA s guaranteed tax lien portfolios, losses associated with the guarantee of an older vintage CDO and a Trenwick America Corp. debt obligation.

MBIA established a case loss reserve of $76 million in the fourth quarter of 2005 in connection with $686 million of net par exposure under four insured EETCs secured by 64 aircraft financed by Northwest Airlines. Northwest Airlines filed for bankruptcy protection in September 2005 and, subsequently, did not make scheduled payments on leases supporting outstanding senior debt for 31 aircraft in three of the four MBIA-insured EETCs. MBIA established the case loss reserve based on projected lower lease income related to these leases, the projected revenue from the potential redeployment of certain aircraft and estimated valuations for the aircraft subject to the defaulted leases. Currently, the leases related to the remaining 33 aircraft are performing according to the original contract terms. Temporary extensions are in place to allow Northwest Airlines to continue flying the non-compliant aircraft, with negotiations regarding the future of the aircraft underway at this time.

MBIA continues to closely monitor the manufactured housing sector, which has experienced continued stress during 2005 and 2004. MBIA ceased writing business in this sector, other than through certain CDO transactions, in 2000. At December 31, 2005, the Company had $33 million in case basis reserves, net of reinsurance, covering net insured par outstanding of $580 million on three credits within the manufactured housing sector. The Company had additional manufactured housing exposure of $1.8 billion in net insured par outstanding as of December 31, 2005, of which approximately 45% has been placed on the Company s Caution List-Medium and Caution List-High. An explanation of the Company s Classified List and Caution Lists is provided below.

The Company has significant exposures in its insured portfolio relating to regions impacted by hurricanes Katrina, Rita and Wilma. Insured credits in these regions encompass various types of sectors, including general obligation bonds, tax-backed, healthcare, transportation and higher education, among others. The Company is continuing its communication efforts with issuers, trustees and relevant state officials to evaluate the actual and potential impact that the hurricanes may have on its insured credits. Based on available information, the Company does not currently expect there to be material cases of prolonged nonpayment that would result in unreimbursed losses. As a result, during 2005, MBIA did not establish specific reserves for its exposure to the regions impacted by these hurricanes. To date, MBIA has paid $2 million in claim payments, for which it has been fully reimbursed.

MBIA s Insured Portfolio Management (IPM) Division is responsible for monitoring MBIA insured issues. The level and frequency of MBIA s monitoring of any insured issue depends on the type, size, rating and performance of the insured issue. If IPM identifies concerns with respect to the performance of an insured issue it may designate such insured issue as Caution List-Low, Caution List-Medium or Caution List-High. The designation of any insured issue as Caution List-Medium or Caution List-High is based on the nature and extent of these concerns and requires that an increased monitoring and, if needed, a remediation plan be implemented for the related insured issue.

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In the event MBIA determines that it must pay a claim or that a claim is probable and estimable with respect to an insured issue, it places the issue on its Classified List and establishes a case basis reserve for that insured issue. As of December 31, 2005, MBIA had 38 open case basis issues on its Classified List that had $454 million in aggregate case reserves, net of reinsurance. The Company does not establish any case basis reserves for issues that are listed as Caution List-Low, Caution List-Medium or Caution List-High until such issues are placed on the Company s Classified List.

Included in the Company s case basis reserves are both loss reserves for insured obligations for which a payment default has occurred and MBIA has already paid a claim and also for which a payment default has not yet occurred but a claim is probable and estimable in the future. At December 31, 2005, case basis reserves were comprised of the following:

Dollars in millions	Number of case basis issues	Loss Reserve	Par Outstanding
Gross of reinsurance:			
Issues with defaults	30	$ 379	$ 2,528
Issues without defaults	8	134	1,231
Total gross	38	$ 513	$ 3,759
Net of reinsurance:			
Issues with defaults	30	$ 354	$ 2,179
Issues without defaults	8	100	1,020
Total net	38	$ 454	$ 3,199

When MBIA becomes entitled to the underlying collateral of an insured credit under salvage and subrogation rights as a result of a claim payment, it records salvage and subrogation as an asset. Such amounts are included in the Company s balance sheet within Other assets. As of December 31, 2005 and 2004, the Company had salvage and subrogation of $143 million and $154 million, respectively. The decrease was principally due to $19 million of impairment losses in 2005 on receivables the Company recorded as a result of claim payments it previously made on insured credits.

As a result of discussions in January and February 2005 between the SEC staff and several financial guarantee industry participants, including MBIA, the Financial Accounting Standards Board (FASB) staff is considering whether additional guidance with respect to accounting for financial guarantee insurance should be provided. In June 2005, the FASB decided to add to its agenda a project to consider the accounting by insurers for financial guarantee insurance. As part of this project, the FASB is considering several aspects of the insurance accounting model for financial guarantee insurers, including claims liability recognition, premium recognition and the related amortization of deferred policy acquisition costs. When the FASB or the SEC reaches a conclusion on this issue, the Company and its financial guarantor peers may be required to change some aspects of its loss reserving policies and the potential changes could extend to premium and expense recognition. The Company cannot currently assess how the FASB and SEC staff s ultimate resolution of this issue will impact its loss reserving policy or the effect it might have on recognizing premium revenue and policy acquisition costs. Until the issue is resolved, the Company intends to continue to apply its existing policy with respect to the establishment of both case basis and unallocated loss reserves and the recognition of premium revenue and policy acquisition costs. A further description of the Company s loss reserving policy is included in Note 3: Significant Accounting Policies in the Notes to Consolidated Financial Statements.

RISK MANAGEMENT In an effort to mitigate losses, MBIA is regularly involved in the ongoing remediation of credits that may involve, among other things, waivers or renegotiations of financial covenants or triggers, waivers of contractual provisions, the granting of consents, and the taking of various other remedial actions. The nature of any remedial action is based on the type of the insured issue and the nature and scope of the event giving rise to the remediation. In most cases, as part of any such remedial activity, MBIA is able to improve its security position and to obtain concessions from the issuer of the insured bonds. From time to time, the issuer of an MBIA-insured obligation may, with the consent of MBIA, restructure the insured obligation by extending the term, increasing or decreasing the par amount or decreasing the related interest rate with MBIA insuring the restructured obligation. If, as the result of the restructuring, MBIA estimates that it will suffer an ultimate loss on the restructured obligation, MBIA will record a case basis loss reserve for the restructured obligation or, if it has already recorded a case basis loss reserve, it will re-evaluate the impact of the restructuring on the recorded reserve and adjust the amount of the reserve as appropriate.

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REINSURANCE Reinsurance enables the Company to cede exposure for purposes of increasing its capacity to write new business while complying with its single risk and credit guidelines. The rating agencies continuously review reinsurers providing coverage to the financial guarantee industry. When a reinsurer is downgraded, less capital credit is given to a financial guarantee provider under rating agency models. Over the past several years, most of MBIA s reinsurers have been downgraded and others remain under review. Any reduced capital credit associated with reinsurer downgrades has not and is not expected to have a material adverse effect on the Company. The Company generally retains the right to reassume the business ceded to reinsurers under certain circumstances, including rating downgrades of its reinsurers. The Company also remains liable on a primary basis for all reinsured risk, and although MBIA believes that its reinsurers remain capable of meeting their obligations, there can be no assurance of such in the future.

As of December 31, 2005, the aggregate amount of insured par ceded by MBIA to reinsurers under reinsurance agreements was $73.5 billion. Additionally, the Company has other reimbursement agreements not accounted for as reinsurance, primarily with a Single-A rated reinsurer, covering $7.2 billion of insured par. The following table displays the percentage ceded to and reinsurance recoverable from reinsurers by rating levels:

Reinsurers	Standard & Poor s Rating	Moody s Rating	Percentage of Total Par Ceded	Reinsurance Recoverable (in thousands)
Channel Reinsurance Ltd.	AAA	Aaa	45.19%	$ 4,546
Assured Guaranty Corp.	AAA	Aa1	17.73	23,947
Ram Reinsurance Company, Ltd.	AAA	Aa3	12.20	4,386
Ambac Assurance Corporation	AAA	Aaa	9.40	
Mitsui Sumitomo Insurance Company Ltd.	AA-	Aa3	6.36	2
Swiss Reinsurance Company, Zurich, Switzerland	AA	Aa2	2.81	
Radian Asset Assurance Inc.	AA	Aa3	1.61	7,838
Assured Guaranty Re Ltd.	AA	Aa2	0.82	
Sompo Japan Insurance Inc.	AA-	Aa3	0.81	2
Transatlantic Reinsurance Company	AA-	Aa3	0.59	1,620
Other [1]	A or above	A1 or above	2.40	16,347
Not Currently Rated			0.08	277
Total			100.00%	$ 58,965

[1] Several reinsurers within this category are not rated by Moody s.

While Channel Reinsurance Ltd. (Channel Re) continues to be a Triple-A rated reinsurer of MBIA, S&P has revised their outlook on Channel Re from stable to negative in 2005. MBIA does not expect S&P s revised outlook on Channel Re to have a material negative impact on the Company s financial condition or results of operations. Additionally, MBIA owned an equity interest of 17.4% and 11.4% in Channel Re and RAM Holdings Inc., the holding company of Ram Reinsurance Company, Ltd., respectively, at December 31, 2005.

POLICY ACQUISITION COSTS AND OPERATING EXPENSES Expenses that vary with and are primarily related to the production of the Company s insurance business (policy acquisition costs) are deferred and recognized over the period in which the related premiums are earned. If an insured bond issue is refunded and the related premium is earned early, the associated acquisition costs previously deferred are also

recognized early.

Annually, MBIA reviews its insurance-related expenses to determine if there have been any changes in its business or cost structure that would materially change the amount of costs accounted for as policy acquisition costs. If so, the Company conducts a policy acquisition cost study to determine the amount of insurance costs that relate to acquiring new insurance policies and that are deferrable under GAAP. MBIA completed its latest study in July 2005. The current policy acquisition cost study, which was effective beginning with the third quarter of 2005, resulted in a decrease of approximately $9.6 million in deferred policy acquisition costs for the year with a corresponding increase in insurance operating expenses. The change was principally driven by a reduction in the rate at which compensation costs associated with acquiring new insurance policies are deferred. The Company expects the quarterly change to be in the $5 million range going forward. However, policy acquisition costs and operating expenses will be influenced by the level of actual future expenses that qualify for deferral.

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MBIA will recognize a premium deficiency if the sum of the expected loss and loss adjustment expenses and unamortized policy acquisition costs exceed the related unearned premiums. If MBIA was to have a premium deficiency that is greater than unamortized acquisition costs, the unamortized acquisition costs would be reduced by a charge to expense and a liability would be established for any remaining deficiency. Although GAAP permits the inclusion of anticipated investment income when determining a premium deficiency, MBIA currently does not include this in making its determination.

The Company s insurance expenses, as well as its expense ratio, are shown in the following table:

				Percent Change	
				2005 vs.	2004 vs.
In millions	**2005**	**2004**	**2003**	**2004**	**2003**
Gross expenses	$ 266	$ 258	$ 257	3%	1%
Amortization of deferred acquisition costs	$ 67	$ 67	$ 60	0%	10%
Operating expenses	143	122	119	17%	3%
Total insurance operating expenses	$ 210	$ 189	$ 179	11%	5%
Expense ratio	24.9%	22.2%	23.2%		

In 2005, the amortization of deferred acquisition costs remained flat compared with 2004, in line with insurance premiums earned. The amortization of deferred acquisition costs increased 10% in 2004 compared with 2003 resulting from an increase in related premium earnings. At December 31, 2005 and 2004 there was an increase in the ratio of deferred expenses carried as assets on the balance sheet to deferred revenues carried as liabilities on the balance sheet plus the present value of future installment premiums. The increasing ratio in 2004 and 2005 reflects higher costs associated with acquiring new policies relative to the smaller growth in deferred premiums.

Operating expenses increased 17% to $143 million in 2005 from $122 million in 2004. This increase was largely due to loss prevention costs, costs associated with the Company s CPCT securities, consulting services and a decrease in the rate at which compensation costs are deferred as policy acquisition costs. In 2004, operating expenses increased 3% to $122 million from $119 million in 2003 largely due to higher compensation costs related to the expansion of the Company s global operations, premiums related to the renewal of directors and officers liability insurance and loss prevention costs.

Financial guarantee insurance companies use the expense ratio (expenses divided by net premiums earned) as a measure of expense management. The Company s 2005 expense ratio of 24.9% is higher than the 2004 ratio of 22.2% and the 2003 ratio of 23.2% as a result of the 17% increase in operating expenses.

VARIABLE INTEREST ENTITIES The Company provides structured funding and credit enhancement services to global finance clients through the use of certain MBIA-administered, bankruptcy-remote special purpose vehicles (SPVs) and through third-party SPVs. Third-party SPVs are used in a variety of structures guaranteed or managed by MBIA, whereby the Company has risks analogous to those of MBIA-administered SPVs. The Company has determined that such SPVs fall within the definition of a variable interest entity (VIE) under FASB Interpretation No. (FIN) 46(R), Consolidation of Variable Interest Entities (Revised). Under the provisions of FIN 46(R), MBIA must determine whether it has a variable interest in a VIE and if so, whether that variable interest would cause MBIA to be the primary beneficiary.

The primary beneficiary is the entity that will absorb the majority of the expected losses, receive the majority of the expected residual returns, or both, of the VIE and is required to consolidate the VIE.

In the third quarter of 2004, the Company began consolidating two VIEs established in connection with the Capital Asset Research Funding Series 1997A and Series 1998A tax lien securitizations to which the Company provided financial guarantees. The assets of these entities, which are principally reported within Other assets on MBIA s consolidated balance sheet, totaled $2.5 million at December 31, 2005 and $16.8 million at December 31, 2004. Liabilities of the securitizations substantially represented amounts due to MBIA, which were eliminated in consolidation. Additionally, the Company consolidates certain third-party VIEs as a result of financial guarantees provided by the insurance operations. Third-party VIEs assets and liabilities are primarily reported in Investments held-to-maturity and Variable interest entity floating rate notes, respectively, on the face of the Company s balance sheet. The assets and liabilities of these VIEs each totaled $1.3 billion at December 31, 2005 and $600.5 million at December 31, 2004. Consolidation of such VIEs does not increase MBIA s exposure above that already committed to in its insurance policies.

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INVESTMENT MANAGEMENT SERVICES

The Company s investment management services operations provide an array of products and services to the public, not-for-profit and corporate sectors. Such products and services are provided primarily through wholly owned subsidiaries of MBIA Asset Management, LLC (MBIA-AML) and include cash management, discretionary asset management and fund administration services and investment agreement, medium-term note and commercial paper programs related to funding assets for third-party clients and for investment purposes. The investment management services operations are comprised of three operating segments: asset/liability products, which include investment agreements and medium-term notes (MTNs) not related to the conduit programs; advisory services, which consist of third-party and related-party fee-based asset management; and conduit programs. During the third quarter of 2004, the Company completed the sale of the assets of 1838 Investment Advisors, LLC, which comprised the Company s equity advisory services segment. This segment has been reported as a discontinued operation in the Company s financial statements. See Note 16: Discontinued Operations in the Notes to Consolidated Financial Statements for additional information.

In 2005, investment management services revenues of $910 million increased 69% over 2004. Excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, revenues of $866 million increased 57% over 2004. The increase in revenues was primarily attributable to growth in the Company s asset/liability products segment and, to a lesser extent, higher yielding conduit segment assets. Advisory services revenues were also favorable compared to 2004 as a result of growth in managed assets. Total investment management services expenses in 2005 were $780 million, up 59% compared with 2004. This increase was primarily driven by higher interest expense from the growth in asset/liability products activity and higher yielding conduit liabilities, both of which were consistent with the growth in revenues.

In 2004, investment management services total revenues of $538 million increased 31% compared with 2003. Excluding net realized gains or losses and net gains or losses on derivative instruments and foreign exchange, 2004 total revenues increased $148 million, or 37%, compared with 2003 as a result of increased activity in asset/liability products and third-party management of CDO transactions in the advisory services segment. However, profitability in the pooled investment business declined compared with 2003 due to lower fees and an unfavorable geographic mix. Total investment management services expenses in 2004 were $491 million, up 37% compared with 2003 due to higher interest expense from increased asset/liability products activity, which was consistent with the growth in revenues.

Net realized gains from investment securities in the investment management services operations were $1 million in 2005 compared with net realized losses of $4 million in 2004 and net realized gains of $17 million in 2003. Net realized gains and losses in the investment management services operations were generated from the ongoing management of its investment portfolios.

Net gains on derivative instruments and foreign exchange from the investment management services operations in 2005 were $43 million compared with net losses of $10 million and $9 million in 2004 and 2003, respectively. The net gains in 2005 were primarily generated from an increase in U.S. dollar interest rates resulting in higher market values on pay fixed/receive floating U.S. dollar interest rate swaps associated with the asset/liability products and conduit programs. Such swaps economically hedge against interest rate movements but do not qualify for hedge accounting treatment under SFAS 133. Similarly, the net losses on derivative instruments and foreign exchange in 2004 and 2003 were largely due to movements in interest rates on interest rate swaps associated with the asset/liability products and conduit programs.

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Fixed-income ending assets under management as of December 31, 2005, which do not include conduit assets, were $44.2 billion, 13% above the 2004 year-end level and 29% above the 2003 year-end level. Conduit assets are held to their contractual maturities and are originated and managed differently from those held as available-for-sale by the Company or those managed for third parties. The following table summarizes the consolidated investment management services results and assets under management over the last three years:

				Percent Change	
				2005 vs.	2004 vs.
In millions	**2005**	**2004**	**2003**	**2004**	**2003**
Interest and fees	$ 866	$ 552	$ 404	57%	37%
Net realized gains (losses)	1	(4)	17	n/m	n/m
Net gains (losses) on derivative instruments and foreign exchange	43	(10)	(9)	n/m	(8)%
Total revenues	910	538	412	69%	31%
Interest expense	705	414	302	70%	37%
Operating expenses	75	77	55	(4)%	40%
Total expenses	780	491	357	59%	37%
Pre-tax income	$ 130	$ 47	$ 55	174%	(13)%
Ending assets under management:					
Fixed-income	$ 44,246	$ 39,129	$ 34,408	13%	14%

n/m Percentage change not meaningful.

The following provides a summary of each of the investment management services businesses by segment. See Note 15: Business Segments for a tabular presentation of the results of the investment management services segments.

Asset/liability products pre-tax income, excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, totaled $56.5 million in 2005, up 48% over 2004. At December 31, 2005, principal and accrued interest outstanding on investment agreement and medium-term note obligations and securities sold under agreements to repurchase totaled $15.7 billion compared to $12.5 billion at December 31, 2004. Assets supporting these agreements had market values of $15.9 billion and $12.6 billion at December 31, 2005 and December 31, 2004, respectively. These assets are comprised of high quality securities with an average credit quality rating of Double-A. In 2004, asset/liability products pre-tax income, excluding net realized losses and foreign currency and derivative losses, totaled $38.1 million compared with $31.3 million in 2003, an increase of 22%.

Advisory services pre-tax income, excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, totaled $19.6 million in 2005, up 19% over 2004. Third-party ending assets under management were $17.9 billion and $16.0 billion at December 31, 2005 and December 31, 2004, respectively. The market values of assets related to the Company s insurance and corporate investment portfolios managed by the investment management services operations at December 31, 2005 were $10.2 billion, slightly down from the balance at December 31, 2004 of $10.3 billion. In 2004, advisory services pre-tax income, excluding realized gains and losses from investment securities and gains and losses on derivative instruments and foreign exchange, totaled $16.5 million compared with $17.3 million in 2003, a 4% decrease.

Conduit program pre-tax income, excluding gains and losses on derivative instruments and foreign exchange, totaled $10.7 million in 2005 compared with $7.6 million in 2004 and $0.4 million in 2003. Certain of MBIA s consolidated subsidiaries have invested in MBIA s conduit debt obligations or have received compensation for services provided to MBIA s conduits. As such, MBIA has eliminated intercompany transactions with its conduits from its balance sheet and income statement. After the elimination of such intercompany assets and liabilities, conduit investments and conduit debt obligations were $4.5 billion and $4.2 billion, respectively, at December 31, 2005. The difference between the investments and debt obligations is primarily the result of the elimination of conduit debt owned by other MBIA subsidiaries. The effect of the elimination on the Company s consolidated balance sheet is a reduction of fixed-maturity investments, representing investments in conduit medium-term notes by other MBIA subsidiaries, with a corresponding reduction of conduit medium-term notes.

In October 2005, Moody s announced that it is undertaking a review of the non-core activities of financial guaranty insurance companies in order to assess the impact of such activities on the overall credit profile of financial guarantors. In its announcement,

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Moody s identified non-core activities as including investment management and related services and sponsored medium-term note programs. While Moody s acknowledged that well managed non-core activities can provide certain benefits, it asserted that such activities introduce distinct risks that may contribute to stress at financial guaranty insurance companies. Moody s also noted that significant growth in non-core activities could negatively impact the credit ratings assigned to affected financial guarantors if such growth occurred prior to publishing its findings. Moody s expects to publish a report highlighting its findings upon completion of its review. While MBIA has had discussions with Moody s with respect to its review, the Company cannot predict with certainty the outcome of the review or the effect the outcome will have on MBIA. However, MBIA does not anticipate that the outcome of the review will have a material impact on the Company s ability to grow its investment management services operations.

MUNICIPAL SERVICES

MBIA s municipal services operations are consolidated under MBIA MuniServices Company (MBIA MuniServices) and provide revenue enhancement services and products to public-sector clients nationwide, consisting of discovery, audit, collections/recovery and information (data) services. The municipal services operations also include Capital Asset, a servicer of delinquent tax certificates. MBIA currently insures an unconsolidated Capital Asset securitization, which matures in 2008 and has an outstanding balance of $117 million or $49 million net of existing loss reserves of $68 million. This securitization was structured through the sale by Capital Asset of tax liens to an off-balance sheet qualifying special purpose entity that was established in 1999 in connection with the securitization.

In 2005, the municipal services operations reported pre-tax income of $2.1 million, compared with pre-tax income of $1.6 million in 2004. Revenues decreased by 10% and expenses decreased by 13% due to a decline in the delinquent tax certificate portfolio serviced by Capital Asset as a result of tax certificate redemptions. In addition, revenue enhancement services margins improved in 2005 compared with 2004. Excluding gains and losses on investment securities and derivatives instruments, operating income was $2.1 million in 2005 compared to $1.9 million in 2004 and $1.0 million in 2003.

CORPORATE

The corporate operations consist of net investment income, net realized gains and losses on holding company investment assets, interest expense and corporate expenses. The corporate operations incurred a loss of $173 million, $84 million and $59 million for the years ended 2005, 2004 and 2003, respectively.

In 2005, net investment income increased 97% to $16.6 million, from $8.5 million in 2004. The increase was driven by substantially higher invested assets and a shift to longer term higher yielding investments. The increase in the invested assets resulted from additional debt issued by MBIA Inc. and dividends paid by MBIA Corp. to MBIA Inc. in the fourth quarter of 2004, somewhat offset by share repurchases of the Company s common stock during the first half of 2005. In 2004, net investment income decreased 6% to $8.5 million, from $9.0 million in 2003. The decrease resulted from the Company maintaining a short duration on holding company investments despite an average asset base growth of 35%.

Net realized losses from investment securities in the corporate operations were $1.0 million in 2005 and $0.5 million in 2004 compared with net realized gains of $15 million in 2003. Net realized gains and losses for all periods presented were generated from the ongoing management of the investment portfolios.

The corporate operations incurred interest expense of $91 million, $75 million and $68 million for the years ended 2005, 2004 and 2003, respectively. The increase in interest expense from year to year primarily resulted from the issuance of $350 million of debt, partially offset by the retirement of $50 million of debt, in the fourth quarter of 2004. Additionally, $100 million of debt was retired in the fourth quarter of 2005.

Corporate expenses were $97 million in 2005 compared with $18 million in 2004. The increase was principally due to a $75 million accrual of estimated penalties and disgorgement related to the potential settlement of regulatory investigations, as well as additional legal and consulting costs associated with the investigations. In 2004, corporate expenses increased 18% from 2003 principally due to costs associated with a

Singapore-based insurer in which the Company indirectly invested in and an increase in audit fees.

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TAXES

MBIA s tax policy is to optimize after-tax income by maintaining the appropriate mix of taxable and tax-exempt investments. In general, the effective tax rate fluctuates from time to time as the Company manages its investment portfolio on an after-tax total return basis. The effective tax rate for 2005, including tax related to discontinued operations, increased to 29.9% from 28.4% for 2004. The increase was primarily due to the accrual of regulatory penalties, which are not deductible for purposes of calculating the Company s Federal income taxes. The effective tax rate for 2004 of 28.4% decreased from 29.3% for 2003 as a result of foreign tax credits available from international operations.

On October 22, 2004, The American Jobs Creation Act of 2004 (the Act) was introduced and signed into law. The Act has a provision which allows for a special one-time dividends received deduction of 85% on the repatriation of certain foreign earnings to the U.S. parent with limitations. The Company has completed its evaluation of the repatriation provision and has determined this special one-time dividend will not be claimed.

CAPITAL RESOURCES

The Company carefully manages its capital resources to minimize its cost of capital while maintaining appropriate claims-paying resources to sustain its Triple-A claims-paying ratings. Capital resources are defined by the Company as total shareholders equity, long-term debt issued for general corporate purposes and various soft capital credit facilities. At December 31, 2005, total shareholders equity was $6.6 billion and total long-term debt was $1.2 billion. The Company uses debt financing to lower its overall cost of capital. MBIA maintains debt at levels it considers to be prudent based on its cash flow and total capital (shareholders equity plus long-term debt). The following table shows the Company s long-term debt and the ratio used to measure it:

	2005	**2004**	**2003**
Long-term debt (in millions)	$ 1,210	$ 1,333	$ 1,022
Long-term debt to total capital	16%	17%	14%

In August 1999, the Company announced that its board of directors had authorized the repurchase of 11.25 million shares of common stock of the Company, after adjusting for the 2001 stock split. The Company began the repurchase program in the fourth quarter of 1999. In July 2004, the Company completed the repurchase of all 11.25 million shares at an average price of $44.08 per share and received authorization from its board of directors to repurchase 1 million shares under a new repurchase program. On August 5, 2004, the Company s board of directors authorized the repurchase of an additional 14 million shares of common stock in connection with the new repurchase program. As of December 31, 2005, the Company had repurchased a total of 10.0 million shares under the current plan at an average price of $57.25 per share. A total of 5.9 million shares were repurchased in 2005 at an average price of $57.77 per share, all of which were repurchased in the first and second quarters of the year.

The Company has various soft capital credit facilities, such as lines of credit and equity-based facilities at its disposal, which further support its claims-paying resources. At December 31, 2005, MBIA Corp. maintained a $450 million limited recourse standby line of credit facility, reduced from $700 million at December 31, 2004, with a group of major Triple-A rated banks to provide funds for the payment of claims in excess of the greater of $500 million of cumulative claims, net of recoveries, or 5% of average annual debt service with respect to public finance transactions. The agreement is for a ten-year term, amended from a seven-year term, which expires in March 2015.

MBIA Corp. has access to $400 million of CPCT securities issued by eight trusts, which were created for the primary purpose of issuing CPCT securities and investing the proceeds in high quality commercial paper or short-term U.S. Government obligations. MBIA Corp. has a put option to sell to the trusts the perpetual preferred stock of MBIA Corp. If MBIA Corp. exercises its put option, the trusts will transfer the proceeds to MBIA Corp. in exchange for the preferred stock that will be held by the trusts. The trusts are vehicles for providing MBIA Corp. the opportunity to access new capital at its sole discretion through the exercise of the put options. The trusts are rated AA and Aa2 by S&P and Moody s,

respectively. To date, MBIA Corp. has not exercised its put options under any of these arrangements.

From time to time, MBIA accesses the capital markets to support the growth of its businesses. As such, MBIA filed a $500 million registration statement on Form S-3 with the SEC utilizing a shelf registration process. In November 2004, the Company completed its $350 million debt issuance of senior notes and currently has in effect a shelf registration with the SEC for $150 million. This shelf registration permits the Company to issue various debt and equity securities described in the prospectus filed as part of the registration statement.

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LIQUIDITY

Cash flow needs at the parent company level are primarily for dividends to its shareholders and interest payments on its debt. Liquidity and operating cash requirements of the Company are met by its cash flows generated from operations, which were more than adequate in 2005. Management of the Company believes that cash flows from operations will be sufficient to meet the Company s liquidity and operating cash requirements for the foreseeable future.

Cash requirements have historically been met by upstreaming dividend payments from MBIA Corp. to MBIA Inc. In 2005, the Company s operating cash flow from continuing operations totaled $781 million compared with $889 million in 2004 and $1.0 billion in 2003. The majority of net cash provided by operating activities is generated from premium writings and investment income in the Company s insurance operations.

Under New York State insurance law, without prior approval of the superintendent of the state insurance department, financial guarantee insurance companies can pay dividends from earned surplus subject to retaining a minimum capital requirement. In MBIA Corp. s case, regular dividends in any 12-month period cannot be greater than 10% of policyholders surplus as shown on MBIA Corp. s latest filed statutory financial statements. In 2005 and 2004, MBIA Corp. declared and paid regular dividends of $95 million and $372 million, respectively, to MBIA Inc. Additionally, MBIA Corp. declared and paid regular dividends of $280 million to MBIA Inc. in February 2006.

In addition to its regular dividends, in the fourth quarter of 2004 MBIA Corp. declared and paid a special dividend of $375 million to MBIA Inc., which was approved by the NYSID. MBIA Corp. s capital position, relative to its insured exposure, had improved substantially over the past several years as a result of improved premium rates and a higher quality insured portfolio, exceeding both the capital required by New York State insurance law and the rating agencies for purposes of maintaining its Triple-A ratings. The proceeds have been used primarily for share repurchases and general liquidity and other corporate purposes.

The Company has significant liquidity supporting its businesses. At the end of 2005, cash equivalents and short-term investments totaled $1.9 billion. If, for any reason, significant cash flow reductions occur in any of its businesses, MBIA has alternatives for meeting ongoing cash requirements. They include selling or pledging its fixed-income investments in its investment portfolio, tapping existing liquidity facilities and new borrowings.

As a part of MBIA s external borrowing capacity, it maintained two bank lines totaling $500 million as of December 31, 2004. These bank lines were maintained with a group of highly rated global banks and were comprised of a renewable $167 million facility with a term of 364 days and a $333 million facility with a five-year term maturing in April 2009. In April 2005, the $167 million facility expired on its stated expiration date and the $333 million facility was increased to $500 million and the term was extended one year to April 2010. During 2005, there was no balance outstanding under the facility.

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The available-for-sale investment portfolio provides a high degree of liquidity, since it is comprised of readily marketable high-quality fixed-income securities and short-term investments. At year-end 2005, the fair value of the consolidated available-for-sale investment portfolio was $26.4 billion, as shown in the following table:

In millions	2005	2004	Percent Change 2005 vs. 2004
Available-for-sale investments:			
Insurance operations:			
Amortized cost	$ 9,944	$ 9,205	8%
Unrealized net gain (loss)	310	531	(42)%
Fair value	$ 10,254	$ 9,736	5%
Investment management services operations:			
Amortized cost	$ 15,684	$ 12,209	28%
Unrealized net gain (loss)	286	398	(28)%
Fair value	$ 15,970	$ 12,607	27%
Corporate operations:			
Amortized cost	$ 166	$ 731	(77)%
Unrealized net gain (loss)	(1)	4	n/m
Fair value	$ 165	$ 735	(78)%
Total available-for-sale portfolio:			
Amortized cost	$ 25,794	$ 22,145	16%
Unrealized net gain (loss)	595	933	(36)%
Fair value	$ 26,389	$ 23,078	14%

n/m Percentage change not meaningful.

The increase in the amortized cost of insurance-related available-for-sale investments in 2005 was the result of positive cash flow from operations. The increase in the amortized cost of available-for-sale investments in the investment management services operations was the result of growth in the Company s asset/liability products program. Corporate investments decreased in 2005 compared with 2004 due to a decrease in dividends received from the insurance operations while share repurchase activity continued during the first half of 2005.

The fair value of the Company s investments is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Differences between fair value and amortized cost arise primarily as a result of changes in interest rates occurring after a fixed-income security is purchased, although other factors influence fair value, including credit-related actions, supply and demand forces and other market factors. When the Company holds its available-for-sale investments to maturity, unrealized gains or losses currently recorded in accumulated other comprehensive income in the shareholders equity section of the balance sheet will

decrease over time as the investments approach maturity. As a result, the Company expects to realize a value substantially equal to amortized cost. However, when investments are sold prior to maturity, the Company will realize any gains or losses in current net income. The Conduit portfolios are considered held-to-maturity, as the Company has the ability and intent to hold these investments to their contractual maturity. Therefore, these portfolios are reported at amortized cost and are not adjusted to reflect unrealized changes in fair value.

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The weighted-average credit quality of the Company s fixed-income portfolios has been maintained at Double-A since its inception. The quality distribution of the Company s fixed-maturity investment portfolios, excluding short-term investments, based on ratings from Moody s as of December 31, 2005 is presented in the following table. Alternate ratings sources, such as S&P, have been used for a small percentage of securities that are not rated by Moody s.

	Insurance		Investment Management Services		Investments Held-to-Maturity		Total	
In millions	Fair Value	% of Fixed-Income Investments	Fair Value	% of Fixed-Income Investments	Fair Value	% of Fixed-Income Investments	Fair Value	% of Fixed-Income Investments
Aaa	$ 6,454	70%	$ 9,366	62%	$ 4,456	78%	$ 20,276	67%
Aa	1,843	19%	2,902	19%	479	8%	5,224	17%
A	913	10%	2,873	19%	800	14%	4,586	16%
Baa	50	1%	71				121	
Not rated	5						5	
Total	$ 9,265	100%	$ 15,212	100%	$ 5,735	100%	$ 30,212	100%

MBIA s consolidated investment portfolio includes investments that are insured by MBIA Corp. (MBIA Insured Investments). At December 31, 2005, MBIA Insured Investments, excluding conduit investments, at fair value represented $4.4 billion or 14% of total investments. Conduit investments represented $4.5 billion or 14% of total investments. Without giving effect to the MBIA guarantee of the MBIA Insured Investments in the consolidated investment portfolio, as of December 31, 2005, based on the actual or estimated underlying ratings (i) the weighted average rating of the investment portfolio would be in the Aa range, (ii) the weighted average rating of just the MBIA Insured Investments in the investment portfolio would be in the A range and (iii) less than 1% of the investment portfolio would be rated below investment grade.

The underlying ratings of the MBIA Insured Investments as of December 31, 2005 are reflected in the following table. Amounts represent the fair value of such investments including the benefit of the MBIA guarantee. The ratings in the table below are the lower underlying rating assigned by S&P or Moody s when an underlying rating exists from either rating service, or when an external underlying rating is not available, the underlying rating is based on the Company s best estimate of the rating of such investment.

Underlying Ratings Scale In millions	Insurance Portfolio	Investment Management Services Portfolio	Held-to-Maturity Investment Portfolio	Total

Aaa	$ 10	$ 479	$ 214	$ 703
Aa	234	209	432	875
A	624	966	1,812	3,402
Baa	286	1,291	1,998	3,575
Below Investment Grade	107	155		262
Total	$ 1,261	$ 3,100	$ 4,456	$ 8,817

Typically, conduit programs involve the use of rating agencies in assessing the quality of asset purchases and in assigning ratings to the various programs funded through the conduits. All transactions currently funded in the conduits had an underlying rating of at least investment grade by Moody s and S&P prior to funding. The weighted average underlying rating for transactions currently funded in the conduits was A- by S&P and A3 by Moody s at the time such transactions were funded. MBIA estimates that the current weighted average underlying rating of all outstanding conduit transactions was A- by S&P and A3 by Moody s as of December 31, 2005.

The Company generates significant liquidity from its operations, as described above. Because of its risk management policies and procedures, diversification and reinsurance, the Company believes that the occurrence of an event that would significantly adversely affect liquidity is unlikely.

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CONTRACTUAL OBLIGATIONS

The following table summarizes the Company s contractual obligations as of December 31, 2005. For information on the Company s financial guarantee exposure see Note 21: Net Insurance In Force in the Notes to Consolidated Financial Statements.

	As of December 31, 2005				
		Less than			More than
In thousands	**Total**	**1 Year**	**1-3 Years**	**3-5 Years**	**5 Years**
Investment agreements	$ 11,496,336	$ 2,948,794	$ 2,286,956	$ 2,150,588	$ 4,109,998
Commercial paper	861,979	861,979			
Medium-term notes	8,636,276	2,167,872	2,497,416	1,071,372	2,899,616
Variable interest entity floating rate notes	1,280,160	120,405	75,772	60,537	1,023,446
Securities sold under agreements to repurchase	646,343	599,676	46,667		
Long-term debt	1,225,737	14,014	4,550		1,207,173
Gross insurance claim obligations	655,451	147,245	323,297	65,965	118,944
Total	$ 24,802,282	$ 6,859,985	$ 5,234,658	$ 3,348,462	$ 9,359,177

Investment agreements, commercial paper, medium-term notes, variable interest entity floating rate notes, securities sold under agreement to repurchase and long-term debt include accrued interest and exclude premiums or discounts and estimates of future interest payments. Gross insurance claim obligations represent the future value of payments MBIA expects to make, before estimated recoveries and reinsurance, under actual or probable insurance policy claims. The discounted value of such actual or estimated claims, after estimated recoveries, is reported as case basis reserves within loss and loss adjustment expense reserves on the Company s consolidated balance sheet.

MARKET RISK

In general, market risk relates to changes in the value of financial instruments that arise from adverse movements in factors such as interest rates, credit spreads, equity prices and foreign exchange rates. MBIA is exposed mainly to changes in interest rates that affect the fair value of its financial instruments, namely investment securities, investment agreement liabilities, debentures and certain derivative transactions. The Company s investment portfolio holdings are primarily U.S. dollar-denominated fixed-income securities including municipal bonds, U.S. Government bonds, mortgage-backed securities, collateralized mortgage obligations, corporate bonds and asset-backed securities. In periods of rising and/or volatile interest rates, profitability could be adversely affected should the Company have to liquidate these securities. Some mortgage-backed securities are subject to significant prepayment risk in periods of declining interest rates.

MBIA minimizes 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. In addition, the Company enters into various swap agreements that hedge the risk of loss due to interest rate and foreign currency volatility.

Interest rate sensitivity can be estimated by projecting a hypothetical instantaneous increase or decrease in interest rates. As of December 31, 2005, a hypothetical increase in interest rates of 100 and 300 basis points would have resulted in an after-tax decrease in the net fair value of the Company s financial instruments of approximately $322.2 million and $927.7 million, respectively. A decrease in interest rates of 100 and 300 basis points would have resulted in an after-tax increase in the net fair value of the Company s financial instruments of approximately $318.3 million and $952.2 million, respectively.

The effects of changes in investment grade corporate credit spreads on the fair value of the Company s credit derivative transactions will also impact earnings. These transactions primarily consist of synthetic structured credit derivatives guaranteed by MBIA Corp., as well as single name credit default swaps directly entered into by the investment management services operations as part of their asset management activities. Sensitivity to changes in credit spreads for these transactions can be estimated by projecting a hypothetical instantaneous shift in credit spreads. As of December 31, 2005, a hypothetical instantaneous increase in investment grade corporate credit spreads of 25, 50 and 75 basis points would have resulted in an after-tax decrease in the net fair value of the Company s credit derivatives of approximately $6.2 million, $19.5 million and $29.5 million, respectively. Conversely, a hypothetical instantaneous decrease in investment grade corporate credit spreads of 25, 50 and 75 basis points would have resulted in an after-tax increase in the net fair value of the Company s credit derivatives of approximately $3.2 million, $3.5 million and $3.3 million, respectively. Under SFAS 133, if such hypothetical shifts in credit spreads were to occur, the resulting change in the net fair value of the Company s credit derivatives would be recorded within the Company s income statement.

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Since the Company is able and primarily expects to hold its fixed-maturity securities and derivative transactions to maturity or until such time unrealized losses reverse, it does not expect to recognize any adverse impact to income or cash flows under the above scenarios.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Information concerning quantitative and qualitiative disclosures about market risk appears in Part II, item 7, Management s Discussion and Analysis of Financial Condition and Results of Operation under the heading Market Risk.

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Item 8. Financial Statements and Supplementary Data
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

MBIA Inc. and Subsidiaries

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of MBIA Inc.:

We have completed integrated audits of MBIA Inc. s 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements and Financial Statement Schedules

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of MBIA Inc. and its subsidiaries at December 31, 2005 and 2004 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a) (2), present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal Control over Financial Reporting

Also, in our opinion, management s assessment, included in Management s Report on Internal Control over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

New York, NY

March 8, 2006

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Consolidated Balance Sheets MBIA Inc. and Subsidiaries

In thousands except per share amounts	December 31, 2005	December 31, 2004
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair value (amortized cost $23,189,684 and $18,802,894)	$ 23,747,204	$ 19,679,905
Investments held-to-maturity, at amortized cost (fair value $5,734,335 and $7,535,787)	5,765,182	7,540,218
Investment agreement portfolio pledged as collateral, at fair value (amortized cost $712,054 and $713,704)	729,072	730,870
Short-term investments, at amortized cost (which approximates fair value)	1,678,281	2,405,192
Other investments	234,927	261,865
Total investments	32,154,666	30,618,050
Cash and cash equivalents	233,046	366,236
Accrued investment income	396,048	312,208
Deferred acquisition costs	427,111	406,035
Prepaid reinsurance premiums	407,614	434,968
Reinsurance recoverable on unpaid losses	58,965	34,610
Goodwill	79,406	79,406
Property and equipment, at cost (less accumulated depreciation of $121,165 and $108,848)	109,275	114,692
Receivable for investments sold	74,787	67,205
Derivative assets	326,867	288,564
Other assets	293,609	314,321
Total assets	**$ 34,561,394**	**$ 33,036,295**
Liabilities and Shareholders Equity		
Liabilities:		
Deferred premium revenue	$ 3,185,200	$ 3,211,181
Loss and loss adjustment expense reserves	721,502	748,869
Investment agreements	10,806,277	8,678,768
Commercial paper	859,997	2,598,655
Medium-term notes	7,542,416	6,943,840
Variable interest entity floating rate notes	1,280,160	600,505
Securities sold under agreements to repurchase	646,343	647,104
Short-term debt	58,745	58,745
Long-term debt	1,210,405	1,332,540
Deferred income taxes, net	569,536	599,627
Deferred fee revenue	20,379	26,780
Payable for investments purchased	83,369	94,609
Derivative liabilities	384,611	527,455
Other liabilities	600,810	408,820
Total liabilities	**27,969,750**	**26,477,498**
Shareholders Equity:		
Preferred stock, par value $1 per share; authorized shares 10,000,000; issued and outstanding none		
Common stock, par value $1 per share; authorized shares 400,000,000; issued shares 155,601,779 and 155,607,737	156,602	155,608
Additional paid-in capital	1,479,447	1,410,799
Retained earnings	5,747,171	5,187,484
Accumulated other comprehensive income, net of deferred income tax of $238,881 and $321,565	399,381	618,606
Unearned compensation restricted stock	(43,857)	(34,686)
Treasury stock, at cost 22,554,528 and 16,216,405 shares	(1,147,100)	(779,014)

Total shareholders equity		**6,591,644**		**6,558,797**
Total liabilities and shareholders equity	**$**	**34,561,394**	**$**	**33,036,295**

The accompanying notes are an integral part of the consolidated financial statements.

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Consolidated Statements of Income MBIA Inc. and Subsidiaries

In thousands except per share amounts	Years ended December 31 2005	2004	2003
Insurance			
Revenues:			
Gross premiums written	$ 984,908	$ 1,116,915	$ 1,268,808
Ceded premiums	(127,107)	(158,831)	(193,889)
Net premiums written	857,801	958,084	1,074,919
Increase in deferred premium revenue	(15,059)	(108,414)	(301,925)
Premiums earned (net of ceded premiums of $151,101, $146,537 and $192,647)	842,742	849,670	772,994
Net investment income	491,857	474,415	437,696
Advisory fees	28,235	41,539	59,719
Net realized gains (losses)	(8,075)	108,874	48,157
Net gains (losses) on derivative instruments and foreign exchange	(4,436)	6,627	104,030
Total insurance revenues	1,350,323	1,481,125	1,422,596
Expenses:			
Losses and loss adjustment	84,274	84,753	77,114
Amortization of deferred acquisition costs	66,577	66,412	60,491
Operating	143,378	122,309	118,584
Total insurance expenses	294,229	273,474	256,189
Insurance income	1,056,094	1,207,651	1,166,407
Investment management services			
Revenues	866,154	551,926	403,990
Net realized gains (losses)	1,384	(4,120)	17,135
Net gains (losses) on derivative instruments and foreign exchange	42,558	(9,670)	(8,995)
Total investment management services revenues	910,096	538,136	412,130
Interest expense	705,340	413,615	302,224
Expenses	74,194	76,912	55,005
Total investment management services expenses	779,534	490,527	357,229
Investment management services income	130,562	47,609	54,901
Municipal services			
Revenues	24,388	27,593	26,814
Net realized gains (losses)	(187)	(81)	139
Net gains (losses) on derivative instruments and foreign exchange	230	(279)	
Total municipal services revenues	24,431	27,233	26,953
Expenses	22,316	25,649	25,857
Municipal services income	2,115	1,584	1,096
Corporate			
Net investment income	16,646	8,446	9,000
Net realized gains (losses)	(989)	(467)	15,237
Interest expense	90,999	74,651	68,368

Corporate expenses	97,481	17,579	14,874
Corporate loss	(172,823)	(84,251)	(59,005)
Income from continuing operations before income taxes	1,015,948	1,172,593	1,163,399
Provision for income taxes	303,869	332,123	340,151
Income from continuing operations	712,079	840,470	823,248
Income (loss) from discontinued operations, net of tax	(1,093)	(602)	2,104
Gain on sale of discontinued operations, net of tax		3,178	
Income (loss) from discontinued operations	(1,093)	2,576	2,104
Net income	**$ 710,986**	**$ 843,046**	**$ 825,352**
Income from continuing operations per common share:			
Basic	**$ 5.31**	**$ 5.92**	**$ 5.74**
Diluted	**$ 5.19**	**$ 5.80**	**$ 5.68**
Net income per common share:			
Basic	**$ 5.30**	**$ 5.94**	**$ 5.75**
Diluted	**$ 5.18**	**$ 5.82**	**$ 5.69**
Weighted-average number of common shares outstanding:			
Basic	134,098,392	141,861,225	143,449,007
Diluted	137,220,731	144,799,513	144,980,396
Gross revenues from continuing operations	2,300,507	2,054,473	1,885,916
Gross expenses from continuing operations	1,284,559	881,880	722,517

The accompanying notes are an integral part of the consolidated financial statements.

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Consolidated Statements of Changes in Shareholders Equity MBIA Inc. and Subsidiaries

For the years ended December 31, 2005, 2004 and 2003

In thousands except per share amounts	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unallocated ESOP Shares	Unearned Compensation-Restricted Stock	Treasury Stock Shares	Treasury Stock Amount	Total Shareholders Equity
Balance, January 1, 2003	**152,555**	**$ 152,555**	**$ 1,239,313**	**$ 3,771,034**	**$ 541,320**	**$ (653)**	**$ (12,646)**	**(7,781)**	**$ (321,580)**	**$ 5,369,343**
Comprehensive income:										
Net income				825,352						825,352
Other comprehensive income:										
Change in unrealized appreciation of investments net of change in deferred income taxes of $34,698					64,886					64,886
Change in fair value of derivative instruments net of change in deferred income taxes of $7,127					13,235					13,235
Change in foreign currency translation net of change in deferred income taxes of $3,085					16,771					16,771
Other comprehensive income										94,892
Total comprehensive income										920,244
Capital issuance costs			(4,056)							(4,056)
Treasury shares acquired								(1,895)	(82,404)	(82,404)
Unallocated ESOP shares			(2)			653				651
Variable interest entity equity			46							46
Stock-based compensation	996	996	60,337				347			61,680
Dividends (declared per common share $0.800, paid per common share $0.770)				(115,212)						(115,212)
Balance, December 31, 2003	**153,551**	**153,551**	**1,295,638**	**4,481,174**	**636,212**		**(12,299)**	**(9,676)**	**(403,984)**	**6,150,292**
Comprehensive income:										
Net income				843,046						843,046
Other comprehensive loss:										
Change in unrealized appreciation of investments net of change in deferred income taxes of $(26,944)					(46,877)					(46,877)
Change in fair value of derivative instruments net of change in deferred income taxes of $4,055					7,532					7,532
Change in foreign currency translation net of change in deferred income taxes of $5,346					21,739					21,739
Other comprehensive loss										(17,606)
Total comprehensive income										825,440
Capital issuance costs			(2,353)							(2,353)

Treasury shares acquired							(6,540)	(375,030)	(375,030)
Stock-based compensation	2,057	2,057	117,514			(22,387)			97,184
Dividends (declared per common share $0.960, paid per common share $0.920)				(136,736)					(136,736)
Balance, December 31, 2004	**155,608**	**155,608**	**1,410,799**	**5,187,484**	**618,606**	**(34,686)**	**(16,216)**	**(779,014)**	**6,558,797**
Comprehensive income:									
Net income				710,986					710,986
Other comprehensive loss:									
Change in unrealized appreciation of investments net of change in deferred income taxes of $(109,413)					(228,453)				(228,453)
Change in fair value of derivative instruments net of change in deferred income taxes of $26,862					49,888				49,888
Change in foreign currency translation net of change in deferred income taxes of $(133)					(40,660)				(40,660)
Other comprehensive loss									(219,225)
Total comprehensive income									491,761
Treasury shares acquired							(6,387)	(369,715)	(369,715)
Stock-based compensation	994	994	68,648			(9,171)	48	1,629	62,100
Dividends (declared per common share $1.120, paid per common share $1.080)				(151,299)					(151,299)
Balance, December 31, 2005	**156,602**	**$ 156,602**	**$ 1,479,447**	**$ 5,747,171**	**$ 399,381**	**$ (43,857)**	**(22,555)**	**$ (1,147,100)**	**$ 6,591,644**

	2003	**2004**	**2005**
Disclosure of reclassification amount:			
Unrealized appreciation of investments arising during the period, net of taxes	$ 120,555	$ 19,320	$ (196,709)
Reclassification adjustment, net of taxes	(55,669)	(66,197)	(31,744)
Net unrealized appreciation, net of taxes	$ 64,886	$ (46,877)	$ (228,453)

The accompanying notes are an integral part of the consolidated financial statements.

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Consolidated Statements of Cash Flows MBIA Inc. and Subsidiaries

In thousands	Years ended December 31 2005	2004	2003
Cash flows from operating activities of continuing operations:			
Net income	$ 710,986	$ 843,046	$ 825,352
Loss (income) from discontinued operations, net of tax	1,093	602	(2,104)
Gain on sale of discontinued operations, net of tax		(3,178)	
Net income from continuing operations	712,079	840,470	823,248
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities of continuing operations:			
Increase in accrued investment income	(83,840)	(42,299)	(38,637)
Increase in deferred acquisition costs	(21,076)	(33,003)	(22,936)
Decrease (increase) in prepaid reinsurance premiums	27,354	(44,197)	(12,237)
(Decrease) increase in deferred premium revenue	(25,981)	143,544	296,668
(Decrease) increase in loss and loss adjustment expense reserves	(27,367)	37,038	73,598
(Increase) decrease in reinsurance recoverable on unpaid losses	(24,355)	26,792	(17,587)
Depreciation	12,317	13,904	11,483
Amortization of bond discount (premium), net	58,233	69,962	(96,868)
Amortization of medium-term notes and commercial paper (premium) discount, net	(18,244)	(20,536)	100,886
Net realized (gains) losses on sale of investments	7,867	(104,206)	(80,668)
Current income tax benefit	(7,998)	(33,779)	(2,397)
Deferred income tax provision	55,308	112,907	43,715
Net (gains) losses on derivative instruments and foreign exchange	(38,352)	3,322	(95,035)
Stock option compensation	19,421	16,701	26,428
Accrued interest payable	104,923	40,497	12,782
Penalties and disgorgement	75,000		
Other, net	(44,145)	(138,248)	3,528
Total adjustments to net income	69,065	48,399	202,723
Net cash provided by operating activities of continuing operations	781,144	888,869	1,025,971
Cash flows from investing activities of continuing operations:			
Purchase of fixed-maturity securities, net of payable for investments purchased	(15,792,509)	(25,367,369)	(26,187,781)
Sale of fixed-maturity securities, net of receivable for investments sold	11,569,513	20,687,363	22,390,745
Redemption of fixed-maturity securities, net of receivable for investments redeemed	428,175	877,070	1,597,511
Acquisition of conduits			1,134
Purchase of held-to-maturity investments	(1,530,911)	(1,442,684)	(1,465,209)
Redemptions of held-to-maturity investments	3,006,393	2,840,711	
Sale (purchase) of short-term investments	104,566	4,544	(104,638)
Sale (purchase) of other investments	33,912	74,419	(53,523)
Capital expenditures	(9,356)	(8,740)	(11,089)
Disposals of capital assets	1,650	2,255	1,016
Other	(340)		
Net cash used by investing activities of continuing operations	(2,188,907)	(2,332,431)	(3,831,834)
Cash flows from financing activities of continuing operations:			
Proceeds from issuance of investment agreements	7,591,807	6,007,451	4,364,322
Payments for drawdowns of investment agreements	(5,331,607)	(4,278,787)	(3,792,703)
Decrease in commerical paper	(1,739,438)	(39,329)	
Issuance of medium-term notes	3,343,531	3,186,567	2,840,770
Principal paydown of medium-term notes	(2,658,319)	(3,315,061)	(301,682)

Issuance of variable interest entity floating rate notes	678,611		
Securities sold under agreements to repurchase, net	(761)	141,221	(33,678)
Dividends paid	(147,247)	(132,072)	(110,999)
Net proceeds from issuance of short-term debt		1,408	57,337
Net proceeds from issuance of long-term debt		348,553	
Net repayment for retirement of long-term debt	(101,000)	(50,000)	
Capital issuance costs	(2,899)	(2,353)	(4,056)
Other borrowings and deposits	(9,957)	11,579	6,736
Purchase of treasury stock	(369,715)	(375,030)	(82,404)
Exercise of stock options	23,249	63,390	25,806
Net cash provided by financing activities of continuing operations	1,276,255	1,567,537	2,969,449
Discontinued operations (Revised - See Note 3):			
Net cash used by operating activities	(1,682)	(7,421)	(4,452)
Net cash provided by investing activities		22,138	56
Net increase (decrease) in cash and cash equivalents	(133,190)	138,692	159,190
Cash and cash equivalents - beginning of year	366,236	227,544	68,354
Cash and cash equivalents - end of year	$ 233,046	$ 366,236	$ 227,544
Supplemental cash flow disclosures:			
Income taxes paid	$ 254,344	$ 273,058	$ 293,695
Interest paid:			
Investment agreements	$ 352,202	$ 259,494	$ 245,632
Commercial paper	61,581	33,677	7,445
Medium-term notes	248,516	128,579	56,090
Variable interest entity floating rate notes	24,264	9,287	1,369
Securities sold under agreements to repurchase	20,060	11,783	15,597
Other borrowings and deposits	1,805	6,564	10,454
Long-term debt	87,047	70,970	70,024
Non cash items:			
Stock compensation	$ 19,421	$ 16,701	$ 26,428
Dividends declared but not paid	37,541	33,489	28,824

The accompanying notes are an integral part of the consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

NOTE 1: BUSINESS AND ORGANIZATION

MBIA Inc., together with its consolidated subsidiaries, (collectively, MBIA or the Company) is a leading provider of financial guarantee products and specialized financial services. MBIA provides innovative and cost-effective products and services that meet the credit enhancement, financial and investment needs of its public- and private-sector clients worldwide. MBIA manages its activities primarily through three principal business operations: insurance, investment management services and municipal services. The Company s corporate operations include revenues and expenses that arise from general corporate activities and not from one of the Company s three principal business operations.

MBIA s insurance operations are principally conducted through MBIA Insurance Corporation and its subsidiaries (MBIA Corp.) MBIA Insurance Corporation has Triple-A financial strength ratings from Standard and Poor s Corporation (S&P), Moody s Investors Service, Inc. (Moody s), Fitch, Inc. and Rating and Investment Information, Inc. Additionally, MBIA Insurance Corporation s insurance subsidiaries have Triple-A financial strength ratings from at least S&P and Moody s. MBIA Corp. issues financial guarantees for municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, bonds backed by publicly or privately funded public-purpose projects, bonds issued by sovereign and sub-sovereign entities, obligations collateralized by diverse pools of corporate loans and credit default swaps and pools of corporate and asset-backed bonds, both in the new issue and secondary markets. The financial guarantees provide an unconditional and irrevocable guarantee of the payment of principal and interest on insured obligations when due.

MBIA s investment management services operations provide an array of products and services to the public, not-for-profit and corporate sectors. Such products and services are provided primarily through wholly owned subsidiaries of MBIA Asset Management, LLC and include cash management, discretionary asset management and fund administration services and investment agreement, medium-term note and commercial paper programs related to funding assets for third-party clients and for investment purposes.

MBIA s municipal services operations provide revenue enhancement services and products to public-sector clients nationwide, consisting of discovery, audit, collections/recovery and information services through MBIA MuniServices Company and its wholly owned subsidiaries. Additionally, the municipal services operations include Capital Asset Holdings GP, Inc. and certain affiliated entities (collectively, Capital Asset), a servicer of delinquent tax certificates.

NOTE 2: RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

On November 8, 2005, MBIA announced its decision to correct and restate its previously issued financial statements for 1998 and subsequent years in connection with potential settlements of investigations by the Securities and Exchange Commission (SEC) and the New York Attorney General s Office (NYAG) regarding agreements entered into by its subsidiary, MBIA Insurance Corporation, in 1998. On November 12, 2005, MBIA filed with the SEC Amendment No. 1 on Form 10-K/A to its Form 10-K for the year ended December 31, 2004 to reflect the restatement of its financial statements as of and for the years ended December 31, 2004, 2003, 2002, 2001, 2000, 1999 and 1998.

In 1998, three reinsurers, Converium Reinsurance (North America) Inc. (Converium), AXA Re Finance S.A. (ARF) and Muenchener Rueckversicherungs-Gesellshaft (Munich Re) paid the Company $170 million under three separate agreements (the Excess-of-Loss Agreements) in connection with losses the Company incurred on $265 million of MBIA-insured bonds issued by the Alleghany Health, Education and Research Foundation (AHERF). The Excess-of-Loss Agreements were structured as three successive excess-of-loss facilities that aggregated to $170 million. Under the Excess-of-Loss Agreements, Converium paid the Company $70 million, and Munich Re and ARF each paid the Company $50 million.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

In connection with the arrangements for the Excess-of-Loss Agreements, the Company entered into quota share agreements with Munich Re, ARF and Converium (each a Quota Share Agreement and, collectively, the Quota Share Agreements). Under the Quota Share Agreements, the Company agreed to cede to the three reinsurers new business written with an aggregate par sufficient to generate $297 million in gross premiums over a six year period ending October 1, 2004. Of the $297 million in premiums to be ceded under the Quota Share Agreements, the Company agreed to cede to Converium cash premiums equal to $102 million, to ARF adjusted gross premiums of $97 million and to Munich Re adjusted gross premiums of $98 million over this period.

On March 8, 2005, the Company announced its decision to restate its financial statements for 1998 and subsequent years to correct the accounting for the agreements with Converium and reflected this correction in the consolidated financial statements of its original Annual Report on Form 10-K for the year ended December 31, 2004. At that time, the Company believed that the accounting for the Excess of Loss Agreements and Quota Share Agreements with Munich Re and ARF was appropriate under Statement of Financial Accounting Standards (SFAS) 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts.

The restatement of the Company s financial statements for the Munich Re and ARF Excess-of-Loss and Quota Share Agreements, made in connection with the potential settlements, corrects and restates its accounting for these agreements because, taking into account developments in the regulatory investigations since March and further accounting analyses, they did not satisfy the risk transfer requirements for reinsurance accounting under SFAS 113. As a result, the Company restated its financial statements issued prior to September 30, 2005 to reflect the Excess-of-Loss and Quota Share Agreements with Munich Re and ARF under deposit accounting in accordance with Statement of Position (SOP) 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Risk instead of under reinsurance accounting. The Company also corrected and restated its 2004 statutory financial statements for the Munich Re and ARF Excess-of-Loss and Quota Share Agreements because they did not satisfy the requirements for reinsurance accounting under Regulation 108 of the New York State Insurance Department (NYSID). The restatements did not have a significant effect on the Company s financial position.

Additionally, in the third quarter of 2005, the Company completed a detailed review of its derivative instruments for which it applied shortcut method hedge accounting under SFAS 133, Accounting for Derivative Instruments and Hedging Activities, as amended. Shortcut method hedge accounting allows the assumption that the change in fair value of a hedged item exactly offsets the change in fair value of the related derivative. After completing its review, the Company determined that certain hedging relationships did not meet every technical aspect of shortcut method hedge accounting, although, such hedging relationships would have qualified for basic hedge accounting. Since the documentation that the Company prepared was designed to support shortcut method hedge accounting, it was not sufficient to support basic hedge accounting. As a result, the Company must account for these derivatives, from 2001 through September 30, 2005, as if they were not part of hedging relationships, which requires the change in fair value of these derivatives to be reflected in the Company s income statement without an offsetting change in fair value of the hedged items. The Company has restated its financial statements to correct the accounting for these derivatives for the year ended December 31, 2001 and subsequent periods through June 30, 2005. As of October 1, 2005, all of the subject hedging relationships met the requirements for basic hedge accounting and have been recorded as such in the Company s financial statements for the year ended December 31, 2005.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

The following table presents the effects of the ARF, Munich Re and derivative accounting restatement on the unaudited consolidated financial statements of the Company for the three months ended March 31, 2005 and June 30, 2005. The effect of the Converium restatement was reflected in the previously issued consolidated financial statements of the Company for these periods.

	Unaudited		Unaudited	
	As of and For the Three Months Ended		As of and For the Three Months Ended	
	March 31, 2005		June 30, 2005	
In thousands except per share information	**Previously Reported**	**Restated**	**Previously Reported**	**Restated**
Consolidated Statement of Income Data:				
Ceded premiums	$ (35,688)	$ (32,126)	$ (33,641)	$ (31,622)
Net premiums written	246,931	250,493	215,324	217,343
Increase in deferred premium revenue	(40,693)	(39,648)	(6,391)	(3,958)
Scheduled premiums earned	169,873	173,760	177,207	180,902
Refunding premiums earned	36,365	37,085	31,726	32,483
Premiums earned	206,238	210,845	208,933	213,385
Net gains (losses) on derivative instruments and foreign exchange-insurance	(6,075)	(6,072)	4,119	4,002
Total insurance revenues	325,945	330,555	339,264	343,599
Losses and loss adjustment expenses	20,385	20,851	21,265	21,708
Amortization of deferred acquisition costs	16,293	16,657	16,506	16,858
Operating expenses	29,166	30,262	32,268	33,261
Total insurance expenses	65,844	67,770	70,039	71,827
Insurance income	260,101	262,785	269,225	271,772
Net gains (losses) on derivative instruments and foreign exchange-IMS	11,178	27,421	(3,439)	(27,395)
Investment management services income	36,812	53,055	15,372	(8,584)
Income from continuing operations before income taxes	277,706	296,633	261,312	239,903
Provision for income taxes	77,202	83,826	73,722	66,229
Income from continuing operations	200,504	212,807	187,590	173,674
Net income	$ 200,504	$ 212,807	$ 187,590	$ 173,674
Basic EPS:				
Income from continuing operations	$ 1.46	$ 1.55	$ 1.40	$ 1.30
Net income	$ 1.46	$ 1.55	$ 1.40	$ 1.30
Diluted EPS:				
Income from continuing operations	$ 1.43	$ 1.52	$ 1.37	$ 1.27
Net income	$ 1.43	$ 1.52	$ 1.37	$ 1.27
Consolidated Balance Sheet Data:				
Deferred acquisition costs	$ 371,932	$ 417,454	$ 383,006	$ 428,613
Prepaid reinsurance premiums	462,390	427,028	451,113	418,184
Reinsurance recoverable on unpaid losses	33,202	34,091	42,869	41,671
Derivative assets	270,648	270,485	252,637	252,544
Other assets	282,295	281,406	253,843	255,041
Total assets	33,756,665	33,766,662	34,784,595	34,797,180
Loss and loss adjustment expense reserves	755,563	778,064	667,570	690,801

Investment agreements	9,316,470	9,318,116	10,005,780	9,998,534
Deferred income taxes, net	573,849	563,551	661,184	654,888
Derivative liabilities	428,360	427,334	484,842	484,003
Other liabilities	381,426	397,724	396,596	412,019
Total liabilities	27,320,654	27,349,775	28,197,097	28,221,370
Retained earnings	5,377,327	5,361,923	5,527,063	5,497,743
Accumulated other comprehensive income	500,516	496,796	630,628	648,260
Total shareholders equity	$ 6,436,011	$ 6,416,887	$ 6,587,498	$ 6,575,810

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

The restatement of the Company s financial statements did not have a material effect on its financial condition and MBIA does not expect the restatement to have any impact on its ratings or on the Triple-A ratings of MBIA Insurance Corporation. Information presented in the Notes to Consolidated Financial Statements gives effect to the restatement, as applicable.

NOTE 3: SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. As additional information becomes available or actual amounts become determinable, the recorded estimates are revised and reflected in operating results. Actual results could differ from those estimates. The Company s significant accounting policies are as follows:

CONSOLIDATION The consolidated financial statements include the accounts of the Company, its subsidiaries and entities under its control for which the Company retains substantially all the risks and rewards. This includes variable interest entities (VIEs) consolidated under the requirements of Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 46(R), Consolidation of Variable Interest Entities. All significant intercompany balances have been eliminated. Certain amounts have been reclassified in prior years financial statements to conform to the current presentation. In addition, the Company has revised its 2004 and 2003 Consolidated Statements of Cash Flows to separately disclose the operating and investing portions of the cash flows attributable to discontinued operations. These amounts were previously reported on a combined basis.

INVESTMENTS The Company classifies its fixed-maturity investments as either available-for-sale or held-to-maturity, as defined by SFAS 115, Accounting for Certain Investments in Debt and Equity Securities. Available-for-sale investments are reported in the financial statements at fair value, with unrealized gains and losses, net of deferred taxes, reflected in accumulated other comprehensive income in shareholders equity. Bond discounts and premiums are amortized using the effective yield method over the remaining term of the securities. For pre-refunded bonds, the remaining term is determined based on the contractual refunding date. Investment income is recorded as earned. Realized gains or losses on the sale of investments are determined by specific identification and are included as a separate component of revenues.

Held-to-maturity investments consist mainly of debt securities, loans, lease receivables, trade receivables and floating rate notes. These investments are reported in the financial statements at amortized cost. Discounts and premiums are amortized using the straight-line method over the remaining term of the securities. Using an effective yield method to amortize discounts and premiums would not have produced materially different results. Investment income is recorded as earned.

Short-term investments are carried at amortized cost, which approximates fair value, and include all fixed-maturity securities with a remaining effective term to maturity of less than one year.

Other investments include the Company s interest in equity-oriented and equity method investments. The Company records its share of the unrealized gains and losses on equity-oriented investments, net of applicable deferred income taxes, in accumulated other comprehensive income in shareholders equity. The carrying amounts of equity method investments are initially recorded at cost and adjusted to recognize the Company s share of the profits or losses, net of any intercompany gains and losses, of the investees subsequent to the purchase date. Such profits and losses are recorded within net investment income in the accompanying Consolidated Statements of Income. Dividends are applied as a reduction of the carrying amount of equity method investments.

MBIA regularly monitors its investments in which fair value is less than amortized cost in order to assess whether such a decline in value is other than temporary and, therefore, should be reflected as a realized loss in net income. Such an assessment requires the Company to determine the cause of the decline and whether the Company possesses both the ability and intent to hold the investment to maturity or until the value recovers to an amount at least equal to amortized cost. This assessment requires management to exercise judgment as to whether an investment is impaired based on market conditions, trends and the availability of relevant data.

CASH AND CASH EQUIVALENTS Cash and cash equivalents include cash on hand and demand deposits with banks with original maturities of less than 90 days.

POLICY ACQUISITION COSTS Policy acquisition costs include those expenses that relate primarily to, and vary with, the acquisition of new insurance business. The Company periodically conducts a study to determine which operating costs have been incurred to acquire new insurance business and qualify for deferral. For business produced directly by MBIA Corp., such costs

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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include compensation of employees involved in underwriting and policy issuance functions, certain rating agency fees, state premium taxes and certain other underwriting expenses, reduced by ceding commission income on premiums ceded to reinsurers. Policy acquisition costs, net of ceding commissions, are deferred and amortized over the period in which the related premiums are earned.

MBIA will recognize a premium deficiency if the sum of expected loss and loss adjustment expenses and unamortized policy acquisition costs exceed the related unearned premiums. If MBIA were to have a premium deficiency that is greater than unamortized acquisition costs, the unamortized acquisition costs would be reduced by a charge to expense, and a liability (if necessary) would be established for any remaining deficiency. As of December 31, 2005, there have been no premium deficiencies. Although GAAP permits the inclusion of anticipated investment income when determining a premium deficiency, it is currently not being included in the Company s evaluation.

GOODWILL Goodwill represents the excess of the cost of acquiring a business enterprise over the fair value of the net assets acquired. Under SFAS 142, Goodwill and Other Intangible Assets, the Company tests the carry value of its goodwill for impairment at least annually. See Note 5 for an explanation of the Company s annual impairment test.

PROPERTY AND EQUIPMENT Property and equipment consists of land, buildings, leasehold improvements, furniture, fixtures and computer equipment and software. All property and equipment is recorded at cost and, except for land, is depreciated over the appropriate useful life of the asset using the straight-line method. Maintenance and repairs are charged to current earnings as incurred. The useful lives of each class of assets are as follows:

Buildings and site improvements	5-31 years
Leasehold improvements	4-10 years
Furniture and fixtures	8 years
Computer equipment and software	3-5 years

DERIVATIVES Under SFAS 133, all derivative instruments are recognized on the balance sheet at their fair value, and changes in fair value are recognized immediately in earnings unless the derivatives qualify as hedges. If the derivatives qualify as hedges, depending on the nature of the hedge, changes in the fair value of the derivatives are either offset against the change in fair value of assets, liabilities, or firm commitments through earnings, or are recognized in accumulated other comprehensive income until the hedged item is recognized in earnings. Any ineffective portion of a derivative s change in fair value is recognized immediately in earnings. If circumstances or events arise that require the termination and settlement of a derivative contract prior to maturity, any unrealized gain or loss will be recognized immediately in earnings. For qualifying fair value hedges, if the hedge relationship is terminated, the derivative fair value adjustment is reported as part of the basis of the hedged item and is amortized to earnings as a yield adjustment. For qualifying cash flow hedges, if the hedge relationship is terminated, the derivative fair value adjustment recorded in other comprehensive income is recognized in earnings at the time the hedged cash flows are recognized, consistent with the original hedge strategy. If the underlying hedged item of a hedge relationship ceases to exist, all changes in the fair value of the derivative are recognized in earnings each period until the derivative matures or terminates.

The nature of the Company s business activities require the management of various financial and market risks, including those related to changes in interest rates and foreign currency exchange rates. The Company uses derivative instruments to mitigate or eliminate certain of those risks. See Note 7 for a further discussion of the Company s use of derivatives and their impact on the Company s financial statements.

LOSSES AND LOSS ADJUSTMENT EXPENSES The financial guarantees issued by MBIA Corp. insure scheduled payments of principal and interest due on various types of financial obligations against a payment default on such payments by the issuers of the obligations. Loss and loss adjustment expense (LAE) reserves are established by the Company s Loss Reserve Committee, which is comprised of members of senior management, and require the use of judgment and estimates with respect to the occurrence, timing and amount of a loss on an insured obligation. As discussed below, the accounting for non-derivative financial guarantee loss reserves is possibly subject to change.

The Company establishes two types of loss and LAE reserves for non-derivative financial guarantees: an unallocated loss reserve and case basis reserves. The unallocated loss reserve is established on an undiscounted basis with respect to the Company s entire insured portfolio. The Company s unallocated loss reserve represents its estimate of losses that have or are probable to occur as a result of credit deterioration in the

Company s insured portfolio but which have not yet been specifically identified and applied to specific insured obligations. The unallocated loss reserve is increased on a quarterly basis using a formula that applies a loss factor to the Company s scheduled net earned premium for the respective quarter, both of which are defined and set forth below. This increase in the unallocated reserve is the Company s provision for loss and loss adjustment expenses as reported on the Company s income statement. Scheduled net earned premium represents quarterly premium earnings, net of reinsurance, from all policies in force less the portion of quarterly premium earnings that have been accelerated as a result of the refunding or defeasance of insured obligations. Total earned premium as reported on the Company s income statement includes both scheduled net earned premium and premium earnings that have been accelerated, net of reinsurance. Once a policy is originated, the amount of scheduled net earned

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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premium recorded in earnings will be included in the Company s calculation of its unallocated loss reserve. When an insured obligation is refunded, defeased or matures, the Company does not reverse the unallocated loss reserve previously generated from the scheduled net earned premium on such obligation as the Company s unallocated loss reserve is not specific to any individual obligation.

Each quarter, the Company calculates its provision for the unallocated loss reserve as a fixed percent of scheduled net earned premium. This amount is recorded as Losses and loss adjustment expense on the income statement. Annually, the Loss Reserve Committee evaluates the appropriateness of the fixed percent loss factor. In performing this evaluation, the Loss Reserve Committee considers the composition of the Company s insured portfolio by municipal sector, structured asset class, remaining maturity and credit quality, along with the latest industry data, including historical default and recovery experience for the relevant sectors of the fixed-income market in order to determine if a trend is developing that indicates the loss factor should be increased or decreased. In addition, the Company considers its own historical loss activity and how those losses develop over time. The Loss Reserve Committee reviews the results of its annual evaluation over several years to determine whether any long-term trends are developing. The Company s additions to specific case basis reserves in the years ended December 31, 2005 and 2004 exceeded the 12% loss factor currently used by the Company. The Loss Reserve Committee is continuing to monitor this trend and evaluate whether an adjustment to the Company s current loss factor is appropriate. During the years ended December 31, 2005, 2004 and 2003, the Company calculated its provision for the unallocated loss reserve as 12% of scheduled net earned premium.

When a case basis reserve is established, MBIA reclassifies the estimated amount from its unallocated loss reserve in an amount equal to the specific case basis loss reserve. Therefore, the amount of available unallocated loss reserve at the end of each period is reduced by the actual case basis reserves established in the same period. Such reclassification has no effect on the Company s income statement as the unallocated loss reserve and specific case basis reserves, gross of recoveries from reinsurers, are reported as liabilities within Loss and loss adjustment expense reserves on the Company s balance sheet. In the event that case basis reserves develop at a significantly faster or slower rate than anticipated by applying the loss factor to net scheduled earned premium, the Company will perform a qualitative evaluation with respect to the adequacy of the remaining unallocated loss reserve. In performing this evaluation, the Company considers the anticipated amounts of future transfers to existing case basis reserves, as well as the likeliness those policies for which case basis reserves have not been established will require case basis reserves at a faster or slower rate than initially expected.

If, after establishing case basis reserves for the period, the Company determines that the remaining unallocated loss reserve is not sufficient to cover its estimate of losses not yet specifically identified in its insured portfolio, additional unallocated loss reserves will be accrued at such time which, as a result, will reduce the Company s earnings for the period. Conversely, if the Company determines that the remaining unallocated loss reserve is in excess of the amount needed to cover its estimate of unidentified losses, the Company will reverse the excess at such time which, as a result, will increase the Company s earnings for the period. The Company has not made any such adjustment to its unallocated loss reserve during the periods presented in these financial statements.

MBIA establishes new case basis reserves with respect to a specific insurance policy when the Loss Reserve Committee determines that (i) a claim has been made or is probable in the future with respect to such policy based on specific credit events that have occurred and (ii) the amount of the ultimate loss that MBIA will incur under such policy can be reasonably estimated. The amount of the case basis reserve with respect to any policy is based on the net present value of the expected ultimate losses and loss adjustment expense payments that the Company expects to pay with respect to such policy, net of expected recoveries under salvage and subrogation rights. The amount of the expected loss, net of expected recoveries, is discounted based on a discount rate equal to the actual yield of the fixed-income portfolio held by the Company s insurance subsidiaries at the end of the preceding fiscal quarter. The Company believes this yield is an appropriate rate of return for present valuing its reserves as it reflects the rate of return on the assets supporting future claim payments by the Company. The discount rate used at December 31, 2005, 2004 and 2003 was 5.0%, 4.8% and 4.7%, respectively. When a case basis reserve is established for an insured obligation, the Company continues to record premium revenue until it believes that premiums will no longer be collected on that obligation.

Case basis reserves are established in the same manner for policies with respect to which an insured event (i.e., a payment default on the insured obligation) has already occurred and for those policies where the Company expects that an insured event will occur in the future based upon credit deterioration which has already occurred and has been identified. This reserving methodology is different from case basis reserves that are established by traditional property and casualty insurance companies, which determine case basis reserves only upon the occurrence of an insured event when reported. The Company does not establish case basis reserves for all payments due under an insured obligation but rather only those that the Company believes the issuer of the insured obligation will be unable to make. Case basis reserves cover the amount of principal and interest owed that the Company expects to pay on its insured obligations and the costs of settlement and other loss mitigation

expenses, net of expected recoveries. Expected recoveries reduce the amount of case basis reserves established by the Company. When MBIA becomes entitled to the underlying collateral of an insured

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credit under salvage and subrogation rights as a result of a claim payment, it records salvage and subrogation as an asset. Such amounts are included in the Company s balance sheet within Other assets.

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 realized 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.

Management believes that the Company s reserves are adequate to cover the ultimate net cost of claims. 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. See Note 23 for additional information regarding the Company s loss and LAE reserves.

The Company s loss reserving policy, described above, is based on guidance provided in SFAS 60, Accounting and Reporting by Insurance Enterprises, SFAS 5, Accounting for Contingencies and analogies to Emerging Issues Task Force (EITF) 85-20, Recognition of Fees for Guaranteeing a Loan. SFAS 60 requires that, for short-duration contracts, a liability for unpaid claim costs relating to insurance contracts, including estimates of costs relating to incurred but not reported claims, be accrued when insured events occur. Additionally, SFAS 5, requires that a loss be recognized where it is probable that one or more future events will occur confirming that a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated.

Although SFAS 60 provides guidance to insurance enterprises, the Company does not believe SFAS 60 comprehensively addresses the unique attributes of financial guarantee insurance contracts, as the standard was developed prior to the maturity of the financial guarantee industry. SFAS 60 provides guidance with respect to insurance contracts that are either short-duration or long-duration in nature. Financial guarantee contracts typically have attributes of both and, therefore, are difficult to classify as either. For instance, financial guarantee contracts are reported for regulatory purposes as property and liability insurance, normally considered short-duration, but have elements of long-duration contracts in that they are irrevocable and extend over a period that may be in excess of 30 years.

The Company believes its loss reserving policy reflects the requirements of applicable accounting literature, as well as the fact that financial guarantee losses occur over time as a result of credit deterioration, operational difficulties of the insured obligor or fraud, which may not be specifically detected when they occur but which can be generally estimated across a portfolio of insured obligations based on the credit quality and nature of the portfolio and historical default data. The Company does, however, recognize premium revenue and policy acquisition costs in a manner consistent with the guidance provided in SFAS 60 for short-duration contracts. If the Company and the rest of the financial guarantee industry were required to classify its insurance contracts as either short-duration or long-duration or if new specific guidance for financial guarantee insurance emerges, different methods of accounting could apply with respect to loss reserving and liability recognition, and possibly extend to premium revenue and policy acquisition cost recognition. Additionally, there are differences in the methodology and measurement of loss reserves followed by other financial guarantee companies.

As a result of discussions in January and February 2005 between the SEC staff and several financial guarantee industry participants, including MBIA, the FASB staff is considering whether additional guidance with respect to accounting for financial guarantee insurance should be provided. In June 2005, the FASB decided to add to its agenda a project to consider the accounting by insurers for financial guarantee insurance. As part of this project, the FASB is considering several aspects of the insurance accounting model for financial guarantee insurers, including claims liability recognition, premium recognition and the related amortization of deferred policy acquisition costs. When the FASB or the SEC reaches a conclusion on this issue, the Company and its financial guarantor peers may be required to change some aspects of their respective loss reserving policies and the potential changes could extend to premium and expense recognition. The Company cannot currently assess how the FASB and SEC staff s ultimate resolution of this issue will impact its loss reserving policy or the effect it might have on recognizing premium revenue and policy acquisition costs. Until the issue is resolved, the Company intends to continue to apply its existing policy with respect to the establishment of both case basis and unallocated loss reserves and the recognition of premium revenue and policy acquisition costs.

INVESTMENT AGREEMENTS, MEDIUM-TERM NOTES AND COMMERCIAL PAPER Investment agreements, medium-term notes and commercial paper are recorded on the balance sheet at the time such agreements are executed. The liabilities for investment agreements and medium-term notes are carried at their face value plus accrued interest. Interest expense is accrued at the contractual interest rate, adjusted for any premiums or discounts. Commercial paper is carried at face value adjusted for any discounts. Premiums and discounts related

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to investment agreements and medium-term notes are amortized on a constant yield basis. Discounts related to commercial paper are amortized on a straight-line basis, which approximates a constant yield to maturity.

SECURITIES BORROWED OR PURCHASED UNDER AGREEMENTS TO RESELL AND SECURITIES LOANED OR SOLD UNDER AGREEMENTS TO REPURCHASE Securities borrowed or purchased under agreements to resell and securities loaned or sold under agreements to repurchase are accounted for as collateralized transactions and are recorded at contract value plus accrued interest, subject to the provisions of SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. It is the Company s policy to take possession of securities borrowed or purchased under agreements to resell. Securities borrowed or loaned are primarily entered into to obtain securities that are repledged as part of MBIA s collateralized investment and repurchase agreement activity and are only transacted with high quality dealer firms.

PREMIUM REVENUE RECOGNITION Upfront premiums are earned in proportion to the expiration of the related insured par. Therefore, for transactions in which the premium is received upfront, premium earnings are greater in the earlier periods when there is a higher amount of par outstanding. The upfront premiums are apportioned to individual sinking fund payments of a bond issue according to an amortization schedule. After the premiums are allocated to each scheduled sinking fund payment, they are earned on a straight-line basis over the period of that sinking fund payment. Accordingly, deferred premium revenue represents the portion of premiums written that is applicable to the unexpired risk of insured bonds and notes. When an MBIA-insured issue is retired early, is called by the issuer, or is in substance paid in advance through a refunding accomplished by placing U.S. Government securities in escrow, the remaining deferred premium revenue is earned at that time since there is no longer risk to the Company. Installment premiums are earned on a straight-line basis over each installment period, generally one year or less.

Premiums ceded to reinsurers reduce the amount of earned premium the Company will recognize from its insurance policies. For both upfront and installment policies, ceded premium expense is recognized in earnings in proportion to and at the same time the related premium revenue is recognized. Ceding commission income is recognized in earnings at the time the related premium is recognized.

ADVISORY FEE REVENUE RECOGNITION The Company collects advisory fees in connection with certain transactions. Depending upon the type of fee received and whether it is related to an insurance policy, the fee is either earned when it is due or deferred and earned over the life of the related transaction. Work, waiver and consent, termination, administrative and management fees and expense reimbursements are earned when the related services are completed. Structuring fees are earned on a straight-line basis over the life of the related insurance policy and commitment fees are earned on a straight-line basis over the commitment period.

EMPLOYEE STOCK COMPENSATION The Company follows the fair value recognition provisions of SFAS 123, Accounting for Stock-Based Compensation. Under the modified prospective transition method selected by the Company under the provisions of SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure, compensation costs related to stock options are reflected in net income. See Notes 4 and 25 for further discussions regarding the methodology utilized in recognizing employee stock compensation expense.

INVESTMENT MANAGEMENT SERVICES OPERATIONS Investment management services (IMS) results are comprised of net investment income, fee income, expenses and gains and losses related to the Company s investment agreement, medium-term note and conduit programs and asset management advisory and administrative services. Fees related to asset management services are recognized in earnings as such services are performed.

MUNICIPAL SERVICES OPERATIONS Municipal services results are comprised of the net investment income, operating revenues, expenses and gains and losses of MBIA MuniServices Company and its subsidiaries. Operating revenues primarily consist of fees, which are recognized in earnings as the related services are performed.

CORPORATE Corporate results consist of net investment income, interest expense on MBIA Inc. debt and general corporate expenses. All legal and consulting costs associated with the investigations by the SEC, the NYAG and the NYSID are expensed as incurred.

GAINS AND LOSSES Net realized gains and losses are primarily generated from the sale of investments. Realized losses also include amounts resulting from the write-down of assets for which a decline in fair value below the Company s carry value is determined to be other than

temporary. Net gains and losses on derivative instruments and foreign exchange are the result of fair valuing the Company s derivative instruments and gains and losses resulting from revaluing transactions denominated in foreign currencies.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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FOREIGN CURRENCY TRANSLATION Assets and liabilities denominated in foreign currencies are translated at year-end exchange rates. Operating results are translated at average rates of exchange prevailing during the year. Unrealized gains or losses, net of deferred taxes, resulting from translation are included in accumulated other comprehensive income in shareholders equity. Gains and losses resulting from transactions in foreign currencies are recorded in current earnings.

INCOME TAXES Deferred income taxes are provided with respect to the temporary differences between the tax bases of assets and liabilities and the reported amounts in the financial statements that will result in deductible or taxable amounts in future years when the reported amounts of assets and liabilities are recovered or settled. Such temporary differences relate principally to premium revenue recognition, deferred acquisition costs, unrealized appreciation or depreciation of investments and derivatives, and MBIA Corp. s statutory contingency reserve.

The Internal Revenue Code permits companies writing financial guarantee insurance to deduct from taxable income amounts added to the statutory contingency reserve, subject to certain limitations. The tax benefits obtained from such deductions must be invested in non-interest-bearing U.S. Government tax and loss bonds. The Company records purchases of tax and loss bonds as payments of federal income taxes. The amounts deducted must be restored to taxable income when the contingency reserve is released, at which time the Company may present the tax and loss bonds for redemption to satisfy the additional tax liability.

NOTE 4: RECENT ACCOUNTING PRONOUNCEMENTS

In November 2005, the FASB issued FASB Staff Position (FSP) 115-1, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments, which nullifies certain requirements of EITF 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments and amends SFAS 115 and Accounting Principles Board Opinion (APB) 18, The Equity Method of Accounting for Investments in Common Stocks. FSP 115-1 outlines a three-step model to identify investment impairments in each reporting period. First, for each reporting period, individual securities are determined to be impaired if the fair value of a security is less than its cost. Second, impaired securities are evaluated as to whether the impairment is other than temporary based on existing applicable guidance. Lastly, if the impairment is other than temporary, an impairment loss is recognized in earnings equal to the difference between the investment s cost and fair value as of the reporting date. Under FSP 115-1, the disclosure requirements required by EITF 03-1 issued in December 2003 remain in effect. EITF 03-1 requires the Company to disclose certain information about unrealized losses on its investment portfolio that have not been recognized as other-than-temporary impairments. The requirements under FSP 115-1 are effective for reporting periods beginning after December 15, 2005. The Company believes that the adoption of FSP 115-1 will not have a material effect on the Company s financial position or results of operations. See Note 12 for disclosures required by EITF 03-1.

In December 2004, the FASB issued SFAS 123(R), Share-Based Payment. SFAS 123(R) is a revision of SFAS 123 and supersedes APB 25, Accounting for Stock Issued to Employees. SFAS 123(R) requires the Company to expense the fair value of employee stock options and other forms of stock-based compensation. In addition, SFAS 123(R) classifies share-based payment awards as either liability awards, which are remeasured at fair value at each balance sheet date, or equity awards, which are measured at fair value on the grant date and not subsequently remeasured. Generally, awards with cash-based settlement, repurchase features or that are settled at a fixed dollar amount are classified as liability awards, and changes in fair value will be reported in earnings. Awards with net-settlement features or that permit a cashless exercise with third-party brokers are classified as equity awards and changes in fair value are not reported in earnings. The requirements are effective for the Company as of January 1, 2006. The Company s long-term incentive plans include features which would result in both liability and equity awards. The Company adopted the fair value provisions of SFAS 123 effective January 1, 2002 and does not believe that the adoption of SFAS 123(R) for equity awards will have a material effect on the Company s financial position or results of operations. For liability awards, the Company currently remeasures these awards and does not believe that the adoption of SFAS 123(R) will have a material effect on the Company s financial position or results of operations.

In April 2003, the FASB issued SFAS 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS 133. SFAS 149 amends SFAS 133 for decisions made as part of the Derivatives Implementation Group process that effectively required amendments to SFAS 133, decisions made in connection with other FASB projects dealing with financial instruments and in connection with implementation issues raised in relation to the application of the definition of a derivative. SFAS 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Company s financial position and results of operations did not change as a result of the adoption of SFAS 149.

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In January 2003, the FASB issued FIN 46, which was revised in December 2003 as FIN 46(R), as an interpretation of Accounting Research Bulletin No. (ARB) 51, Consolidated Financial Statements. FIN 46(R) addresses consolidation of VIEs by business enterprises. An entity is considered a VIE subject to consolidation if the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support or if the equity investors lack one of three characteristics of a controlling financial interest. First, the equity investors lack the ability to make decisions about the entity s activities through voting rights or similar rights. Second, they do not bear the obligation to absorb the expected losses of the entity if they occur. Lastly, they do not claim the right to receive expected returns of the entity if they occur, which is the compensation for the risk of absorbing the expected losses. MBIA determined that FIN 46(R) applies to entities that it sponsors and, in certain cases, unaffiliated entities that it guarantees. See Note 6 for a further discussion on the impact of adoption of FIN 46(R) on the Company s financial statements.

NOTE 5: GOODWILL

Goodwill totaled $79.4 million as of December 31, 2005 and 2004, of which $76.9 million was within the insurance reporting segment and $2.5 million was within the investment management services reporting segments. As a result of the sale of the assets of 1838 Investment Advisors, LLC (1838) in May 2004, goodwill within the investment management services operations declined by $10.6 million during 2004.

The Company performed its annual impairment testing of goodwill as of January 1, 2005 and January 1, 2006. On both dates, the fair values of the insurance reporting segment and the investment management services reporting segment exceeded their carrying values indicating that goodwill was not impaired. In performing this evaluation, the Company determined that the best measure of the fair value of the insurance reporting segment was its book value adjusted for the after-tax effects of net deferred premium revenue less deferred acquisition costs, the present value of installment premiums and a provision for losses to arrive at adjusted book value. Adjusted book value is a common measure used by analysts to determine the value of financial guarantee companies. For the investment management services reporting segment, the fair value was determined using a multiple of earnings before income tax, depreciation and amortization (EBITDA), as this is a common measure of fair value in the investment management industry.

NOTE 6: VARIABLE INTEREST ENTITIES

The Company provides structured funding and credit enhancement services to global finance clients through the use of certain MBIA-administered, bankruptcy-remote special purpose vehicles (SPVs) and through third-party SPVs. The purpose of the MBIA-administered SPVs is to provide clients with an efficient source of funding, which may offer MBIA the opportunity to issue financial guarantee insurance policies. These SPVs purchase various types of financial instruments, such as debt securities, loans, lease receivables and trade receivables, and fund these purchases through the issuance of asset-backed short-term commercial paper or medium-term notes. The assets and liabilities within the medium-term note programs are managed primarily on a match-funded basis and may include the use of derivative hedges, such as interest rate and foreign currency swaps. By match-funding, the SPVs eliminate the risks associated with fluctuations in interest and foreign currency rates, indices and liquidity. Typically, programs involve the use of rating agencies in assessing the quality of asset purchases and in assigning ratings to the various programs. In general, asset purchases at the inception of a program are required to be investment grade by at least one major rating agency. The primary SPVs administered by MBIA are Triple-A One Funding Corporation (Triple-A), Meridian Funding Company, LLC (Meridian) and Polaris Funding Company, LLC (Polaris) (collectively, the Conduits). Third-party SPVs are used in a variety of structures guaranteed or managed by MBIA, whereby the Company has risks analogous to those of MBIA-administered SPVs. The Company has determined that such SPVs fall within the definition of a VIE under FIN 46(R).

Under the provisions of FIN 46(R), an entity is considered a VIE subject to consolidation if the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support or if the equity investors lack one of three characteristics of a controlling financial interest. First, the equity investors lack the ability to make decisions about the entity s activities through voting rights or similar rights. Second, they do not bear the obligation to absorb the expected losses of the entity if they occur. Lastly, they do not claim the right to receive expected returns of the entity if they occur, which is the compensation for the risk of absorbing the expected losses. A VIE is consolidated with its primary beneficiary, which is the entity that will absorb the majority of the expected losses, receive the majority of the expected residual returns, or both, of the VIE.

On September 30, 2003, prior to the applicable effective date of FIN 46(R), MBIA purchased the equity and acquired all controlling interests of the Conduits and began consolidating them in the financial statements of the Company. The Conduits fall within the scope of FIN 46(R) and continue to be consolidated by the Company. The conduit segment within the Company s investment management services operations is principally comprised of the activities of these entities. MBIA has included on its balance sheet the assets and liabilities of each Conduit, which consist primarily of various types of investments and medium-term

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notes and commercial paper, and has included in its income statement the operating revenues and expenses of the Conduits subsequent to their acquisition date. Certain of MBIA s consolidated subsidiaries have invested in Conduit debt obligations or have received compensation for services provided to the Conduits. As such, MBIA has eliminated intercompany transactions with the Conduits from its balance sheet and income statement. After the elimination of such intercompany assets and liabilities, Conduit total assets and liabilities were $4.6 billion and $4.4 billion, respectively, at December 31, 2005 and $7.0 billion and $6.7 billion, respectively, at December 31, 2004.

In 2004, the Company consolidated two VIEs established in connection with the securitization of Capital Asset tax liens. As a result of a clean-up call exercised for the Capital Asset Research Funding Series 1997A and Series 1998A tax lien securitizations, these securitizations no longer met the conditions of a qualifying special purpose entity under SFAS 140. MBIA holds a variable interest in these entities, which resulted from its insurance policies, and has determined that it is the primary beneficiary under FIN 46(R). MBIA has reported the assets of the securitizations, totaling $2.5 million and $16.8 million at December 31, 2005 and December 31, 2004, respectively, principally within Other assets on its consolidated balance sheet. Liabilities of the securitizations substantially represented amounts due to MBIA, which were eliminated in consolidation.

In addition to MBIA-administered SPVs, MBIA must determine whether it has variable interests in third-party VIEs and if so, whether those variable interests would cause MBIA to be the primary beneficiary and, therefore, consolidate such entities. Under FIN 46(R), MBIA s guarantee of the assets or liabilities of a VIE constitute a variable interest and require MBIA to assess whether it is the primary beneficiary. Consolidation of such VIEs does not increase MBIA s exposure above that already committed to in its insurance policies. The Company has consolidated third-party VIEs as a result of guarantees provided by its insurance operations. Third-party VIEs assets and liabilities are primarily reported in Investments held-to-maturity and Variable interest entity floating rate notes , respectively, on the face of the Company s balance sheet. The assets and liabilities of these VIEs each totaled $1.3 billion at December 31, 2005 and $600.5 million at December 31, 2004. Third-party VIEs creditors do not have recourse to the general assets of MBIA outside of the financial guarantee policy provided to the VIEs.

NOTE 7: DERIVATIVE INSTRUMENTS

MBIA enters into derivative transactions as an additional form of financial guarantee and for purposes of hedging risks associated with existing assets and liabilities and forecasted transactions. The Company accounts for derivative transactions in accordance with SFAS 133, as amended, which requires that all such transactions be recorded on the Company s balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings within Net gains (losses) on derivative instruments and foreign exchange or in shareholders equity within Accumulated other comprehensive income, depending on whether the derivative is designated as a hedge, and if so designated, the type of hedge.

INSURANCE The Company has entered into derivative transactions that it views as an extension of its core financial guarantee business but do not qualify for the financial guarantee scope exception under SFAS 133 and, therefore, must be stated at fair value. The insurance operations, which represent the majority of the Company s notional derivative exposure, have insured derivatives primarily consisting of structured pools of credit default swaps that the Company intends to hold for the entire term of the contract. The insurance operations have also provided guarantees on the value of certain structured closed-end funds, which meet the definition of a derivative under SFAS 133. The Company reduces risks embedded in its insured portfolio by entering into derivative transactions or other types of hedging arrangements. These arrangements may include reinsurance agreements and capital markets transactions in which the Company hedges a portion of the credit and market risk associated with its insured credit derivative portfolio. Premiums received on insured derivatives are recorded as part of premiums earned. Additionally, changes in fair values of derivative transactions within MBIA s insurance operations are recorded in current earnings.

INVESTMENT MANAGEMENT SERVICES The investment management services operations have entered into derivative transactions primarily consisting of interest rate, cross currency, credit default and total return swaps and principal protection guarantees. Interest rate swaps are entered into to hedge the risks associated with fluctuations in interest rates or fair values of certain contracts. Cross currency swaps are entered into to hedge the variability in cash flows resulting from fluctuations in foreign currency rates. Credit default swaps are entered into to hedge credit risk or to replicate investments in cash assets consistent with the Company s risk objectives and credit guidelines for its investment management business. The maximum amount of future payments the Company may be required to make under credit default swap contracts, should a full credit event occur on all of its outstanding contracts, is $1.6 billion. These credit default swaps reference credits with an average quality of AA-/Aa3 and have a maturity range of 1 5 years. In accordance with SFAS 133, the fair values of these credit default swaps at December 31, 2005 are recorded on the consolidated balance sheet as assets and liabilities, representing gross gains and losses, of $5.2 million

and $17 thousand, respectively. Total return swaps are entered into to enable the Company to earn returns on certain obligations without directly owning

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

the underlying obligations. The Company has also provided loss protection on certain MBIA-MISC managed municipal pools that invest in highly rated short-term fixed-income securities. Such protection is accounted for as a derivative under SFAS 133 and is included as part of the Company s principal protection guarantees.

Certain interest rate and cross currency swaps qualify as cash flow hedges and fair value hedges under SFAS 133. The cash flow hedges mitigate or offset fluctuations in cash flows arising from variable rate assets or liabilities. The unrealized gains and losses relating to the cash flow hedges are reported in accumulated other comprehensive income and will be reclassified into earnings as interest revenue and expense are recognized on the hedged assets and liabilities. The fair value hedges are used to protect against changes in the market value of the hedged assets or liabilities. The gains and losses relating to the fair value hedges are recorded directly in earnings. Cash flow and fair value hedges are hedging existing assets, liabilities or forecasted transactions. During 2005, the Company recorded gains of $.9 million (net of tax) and losses of $19 thousand (net of tax) in earnings within net gains (losses) on derivative instruments and foreign exchange due to the ineffectiveness of fair value and cash flow hedges, respectively.

The Conduits primarily enter into interest rate and cross currency swaps as economic hedges against interest rate and currency risks. The cross currency swaps qualify as fair value hedges of foreign currency risk under SFAS 133. During 2005, the Company recorded gains of $1.7 million (net of tax) in earnings due to the ineffectiveness of these hedges. The Company also recorded gains of $12.4 million (net of tax) on economic hedges that did not qualify for hedge accounting under SFAS 133.

Cash flow hedges related to the investment management services operations resulted in an aggregate net unrealized gain of $4.2 million (net of tax) in accumulated other comprehensive income at December 31, 2005. The aggregate net unrealized gain is composed of both positive and negative future cash flows. The Company expects that approximately $.8 million of unrealized gains (net of tax) will migrate from accumulated other comprehensive income into earnings during 2006 and the remaining amount over the term of the contracts.

MUNICIPAL SERVICES Capital Asset entered into an interest rate collar to economically hedge interest rate risk on a floating rate note. The change in the fair value of the collar is recorded each period in earnings, as the collar is not a qualifying hedge under SFAS 133.

CORPORATE The corporate operations has entered into a cross currency swap to hedge foreign exchange risks related to the issuance of certain MBIA long-term debt in accordance with the Company s risk management policies. The cross currency swap has been designated as a cash flow hedge and hedges the variability arising from currency exchange rate movements on the foreign denominated fixed rate debt. Changes in the fair value of the cross currency swap are recorded in accumulated other comprehensive income. As the debt is revalued at the spot exchange rate in accordance with SFAS 52, Foreign Currency Translation, an amount that will offset the related transaction gain or loss arising from the revaluation will migrate each period from accumulated other comprehensive income into earnings. This cash flow hedge was 100% effective during 2005.

The cross currency swap resulted in an aggregate unrealized gain of $1.8 million (net of tax) remaining in accumulated other comprehensive income at December 31, 2005. The Company expects that approximately $1.0 million of unrealized losses (net of tax) will migrate from accumulated other comprehensive income into earnings during 2006 and the remaining balance over the term of the contract.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

The notional values of the derivative instruments, net of reinsurance contracts where applicable, by business operations for the years ended December 31, 2005 and 2004 are as follows:

	Year ended December 31, 2005				
		Investment Management	Municipal		
In millions	**Insurance**	**Services**	**Services**	**Corporate**	**Total**
Credit default swaps	$ 77,112	$ 1,662	$	$	$ 78,774
Interest rate swaps		14,124			14,124
Principal protection guarantees	1,955	2,654			4,609
Currency swaps		3,894		133	4,027
Total return swaps	331	608			939
Credit linked notes	295	200			495
Interest rate caps/floors		450	4		454
All other		95			95
Total	$ 79,693	$ 23,687	$ 4	$ 133	$ 103,517

	Year ended December 31, 2004				
		Investment Management	Municipal		
In millions	**Insurance**	**Services**	**Services**	**Corporate**	**Total**
Credit default swaps	$ 80,093	$ 1,122	$	$	$ 81,215
Interest rate swaps		10,783			10,783
Principal protection guarantees	2,514	2,226			4,740
Currency swaps		3,476		154	3,630
Total return swaps	377	779			1,156
Credit linked notes	800	100			900
Interest rate caps/floors		450	6		456
All other		94			94
Total	$ 83,784	$ 19,030	$ 6	$ 154	$ 102,974

The Company manages counterparty credit risk on an individual counterparty basis through master netting agreements covering derivative transactions in the investment management services, municipal services and corporate operations. These agreements allow the Company to contractually net amounts due from a counterparty with those amounts due to such counterparty when certain triggering events occur. The Company only executes swaps under master netting agreements, which typically contain mutual credit downgrade provisions that generally provide the ability to require assignment or termination in the event either MBIA or the counterparty is downgraded below a specified credit rating. If the Company were to settle all transactions covered under netting agreements as of December 31, 2005, the amount required to be paid to counterparties would have been reduced by $173.4 million as a result of its contractual right to offset amounts due from such counterparties. The Company has chosen not to net receivables due from counterparties with payables due to counterparties in its balance sheet, but instead report these amounts on a gross basis as assets and liabilities.

In certain cases, the Company also manages credit risk through collateral agreements that give the Company the right to hold or the obligation to provide collateral when the current market value of certain derivative contracts exceeds an exposure threshold. Under these arrangements, the Company may receive or provide U.S. Treasury and other highly rated securities or cash to secure counterparties exposure to the Company or its exposure to counterparties, respectively. Such collateral is available to the holder to

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

pay for replacing the counterparty in the event that the counterparty defaults. As of December 31, 2005, no securities or cash were held or placed by the Company under these agreements.

FINANCIAL STATEMENT IMPACT As of December 31, 2005 and 2004, the Company held derivative assets of $326.9 million and $288.6 million, respectively, and derivative liabilities of $384.6 million and $527.5 million, respectively, which are shown separately on the consolidated balance sheets. The following tables display the amount of the derivative assets and liabilities by business operations for the years ended December 31, 2005 and 2004.

	Year ended December 31, 2005				
In millions	Insurance	Investment Management Services	Municipal Services	Corporate	Total
Derivative assets	$ 40.3	$ 250.2	$	$ 36.4	$ 326.9
Derivative liabilities	$ 32.1	$ 352.5	$	$	$ 384.6

	Year ended December 31, 2004				
In millions	Insurance	Investment Management Services	Municipal Services	Corporate	Total
Derivative assets	$ 39.8	$ 191.9	$	$ 56.9	$ 288.6
Derivative liabilities	$ 25.3	$ 501.9	$ 0.3	$	$ 527.5

The income statement impact for all derivative transactions for 2005 was an after-tax increase in net income of $77.9 million. The impact of all derivative transactions for 2004 and 2003 was an after-tax increase in net income of $32.1 million and $95.5 million, respectively. The income statement impact of derivative activity is broken down into revenues, net realized gains (losses), net gains (losses) on derivative instruments and foreign exchange and expenses. Interest and fee income, including premiums received on insured derivatives, and interest and fee expense on derivatives are recorded within revenues and expenses. For derivatives that have been designated as qualifying hedges, income and expense are recorded as an adjustment to those of the hedged items. The following tables display the impact described above on the 2005, 2004 and 2003 income statements by business operation of all derivative transactions.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

	Year ended December 31, 2005				
In millions	Insurance	Investment Management Services	Municipal Services	Corporate	Total
Revenues*	$ 73.2	$ 22.7	$	$	$ 95.9
Net realized gains (losses)		(4.5)			(4.5)
Net gains (losses) on derivative instruments and foreign exchange:					
Credit derivatives	(6.3)	(0.9)			(7.2)
Ineffectiveness on hedges		4.1			4.1
Economic hedges		41.3	0.2		41.5
Total revenues	66.9	62.7	0.2		129.8
Expenses*	(8.6)		(0.1)	(1.2)	(9.9)
Income (loss) before income taxes	58.3	62.7	0.1	(1.2)	119.9
Tax (provision) benefit	(20.4)	(22.0)		0.4	(42.0)
Net income (loss)	$ 37.9	$ 40.7	$ 0.1	$ (0.8)	$ 77.9

	Year ended December 31, 2004				
In millions	Insurance	Investment Management Services	Municipal Services	Corporate	Total
Revenues*	$ 68.9	$ (6.0)	$	$	$ 62.9
Net realized gains (losses)		(0.8)			(0.8)
Net gains (losses) on derivative instruments and foreign exchange:					
Credit derivatives	6.6	1.9			8.5
Ineffectiveness on hedges		(10.5)			(10.5)
Economic hedges		(1.1)	(0.3)		(1.4)
Total revenues	75.5	(16.5)	(0.3)		58.7
Expenses*	(8.0)		(0.2)	(1.2)	(9.4)
Income (loss) before income taxes	67.5	(16.5)	(0.5)	(1.2)	49.3
Tax (provision) benefit	(23.6)	5.8	0.2	0.4	(17.2)
Net income (loss)	$ 43.9	$ (10.7)	$ (0.3)	$ (0.8)	$ 32.1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

	Year ended December 31, 2003				
		Investment Management	Municipal		
In millions	Insurance	Services	Services	Corporate	Total
Revenues*	$ 51.0	$ 5.5	$	$ 0.8	$ 57.3
Net realized gains (losses)		0.7			0.7
Net gains (losses) on derivative instruments and foreign exchange:					
Credit derivatives	104.0	8.1			112.1
Ineffectiveness on hedges		(7.4)			(7.4)
Economic hedges		(9.7)			(9.7)
Total revenues	155.0	(2.8)		0.8	153.0
Expenses*	(6.0)				(6.0)
Income (loss) before income taxes	149.0	(2.8)		0.8	147.0
Tax (provision) benefit	(52.2)	1.0		(0.3)	(51.5)
Net income (loss)	$ 96.8	$ (1.8)	$	$ 0.5	$ 95.5

* Includes premiums earned, advisory fees and losses incurred in the insurance operations and interest income and expenses in the investment management services and corporate operations.

At December 31, 2005, the Company reported an accumulated unrealized gain of $6.0 million (net of tax) in other comprehensive income related to the fair value of the cash flow hedges compared to a $3.3 million unrealized gain (net of tax) at December 31, 2004. The change resulted from a $2.3 million after-tax unrealized gain in the fair value of the cash flow hedges and the transfer of $.5 million of after-tax net expense to earnings as a result of scheduled interest payments and receipts on the cash flow hedges. At December 31, 2005, the maximum term of derivative instruments that hedge forecasted transactions was approximately 13 years.

The fair value of the Company s derivative instruments is estimated using various valuation models that conform to industry standards. The Company utilizes both vendor-developed and proprietary models, based on the complexity of transactions. Dealer market quotes are typically obtained for regularly traded contracts and provide the best estimate of fair value. However, when reliable dealer market quotes are not available, the Company uses a variety of market and portfolio data relative to the type and structure of contracts. Several of the more significant types of data that influence the Company s valuation models include interest rates, credit quality ratings, credit spreads, default probabilities and diversity scores. This data is obtained from highly recognized sources and is reviewed for reasonableness and applicability to the Company s derivative portfolio.

The use of market data requires management to make assumptions on how the fair value of derivative instruments is affected by current market conditions. Therefore, results can significantly differ between models and due to changes in management assumptions. The Company has dedicated resources to the development and ongoing review of its valuation models and has instituted procedures for the approval and control of data inputs. In addition, regular reviews are performed to ensure that the Company s valuation models are appropriate and produce values reflective of the current market environment. In 2003, the Company added an additional third-party data source for generic credit spread information used by the Company in its valuation process to avoid undue reliance on any single data vendor, as well as to enhance its assessment of fair values. In 2004 and 2005, there were no significant changes to the valuation process.

NOTE 8: TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES

The Company enters into securities borrowing and lending contracts in connection with MBIA s collateralized investment and repurchase agreement activities and to invest short-term cash balances or provide liquidity to the Company s asset/liability programs. Such contracts are only

transacted with high quality dealer firms. It is the Company s policy to take possession of securities borrowed under these contracts.

The Company minimizes the credit risk of counterparties to transactions that might be unable to fulfill their contractual obligations by monitoring customer credit exposure and collateral value and requiring additional collateral to be deposited with the Company when deemed necessary.

SFAS 140 requires the Company to reclassify financial assets pledged as collateral under certain agreements and to report those assets at fair value as a separate line item on the balance sheet. At December 31, 2005 and 2004, the fair values of financial assets pledged as collateral under securities borrowing contracts were $729 million and $731 million, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

NOTE 9: EARNINGS PER SHARE

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share shows the dilutive effect of all stock options and other items outstanding during the period that could potentially result in the issuance of common stock. As of December 31, 2005, 2004 and 2003 there were 2,837,793, 2,294,297 and 5,606,205 stock options, respectively, that were not included in the diluted earnings per share calculation because they were antidilutive.

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2005, 2004 and 2003:

	Years ended December 31		
In thousands except per share amounts	**2005**	**2004**	**2003**
Income from continuing operations, net of tax	$ 712,079	$ 840,470	$ 823,248
Income (loss) from discontinued operations, net of tax	(1,093)	2,576	2,104
Net income	$ 710,986	$ 843,046	$ 825,352
Basic weighted-average shares	134,098,392	141,861,225	143,449,007
Effect of common stock equivalents	3,122,339	2,938,288	1,531,389
Diluted weighted-average shares	137,220,731	144,799,513	144,980,396
Basic EPS:			
Income from continuing operations	$ 5.31	$ 5.92	$ 5.74
Income (loss) from discontinued operations	(.01)	0.02	0.01
Net income	$ 5.30	$ 5.94	$ 5.75
Diluted EPS:			
Income from continuing operations	$ 5.19	$ 5.80	$ 5.68
Income (loss) from discontinued operations	(.01)	0.02	0.01
Net income	$ 5.18	$ 5.82	$ 5.69

NOTE 10: STATUTORY ACCOUNTING PRACTICES

The financial statements have been prepared on a GAAP basis, which differs in certain respects from the statutory accounting practices prescribed or permitted by the insurance regulatory authorities. Statutory accounting practices differ from GAAP in the following respects:

upfront premiums are earned on a basis proportionate to the scheduled periodic maturity of principal and payment of interest (debt service) to the original total principal and interest insured as opposed to earning in proportion to the expiration of the related risk;

acquisition costs are charged to operations as incurred rather than deferred and amortized as the related premiums are earned;

fixed-maturity investments are generally reported at amortized cost rather than fair value;

a contingency reserve is computed on the basis of statutory requirements, and reserves for losses and LAE are established at present value for specific insured issues that are identified as currently or likely to be in default. Under GAAP, reserves are established based on the Company s reasonable estimate of the identified and unallocated losses and LAE on the insured obligations it has written;

changes in net deferred income taxes are recognized as a separate component of gains and losses in surplus. Under GAAP, changes in the Company s net deferred income tax balances are recognized in net income;

the Internal Revenue Service permits financial guarantee insurance companies a deduction for increases to the statutory contingency reserve resulting in the purchase of tax and loss bonds equal to the tax benefit derived. Tax and loss bonds purchased are recorded as admitted assets and credited to surplus. Contingency reserves are not permitted under GAAP;

the acquisitions of MBIA Corp. and MBIA Illinois were recorded at statutory book value. Therefore, no goodwill was recorded. Under GAAP, goodwill represents the excess of the cost of acquisitions over the fair value of the net assets acquired;

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MBIA Inc. and Subsidiaries

derivative assets and liabilities exclude insurance guarantees, while under GAAP, guarantees that do not qualify for the financial guarantee scope exception under SFAS 133 are recorded at fair value; and

certain assets designated as non-admitted assets are charged directly against surplus but are reflected as assets under GAAP. Consolidated net income of MBIA Corp. determined in accordance with statutory accounting practices for the years ended December 31, 2005, 2004 and 2003 was $633.0 million, $768.5 million and $669.2 million, respectively.

The following is a reconciliation of consolidated shareholders equity presented on a GAAP basis for the Company and its consolidated subsidiaries to statutory capital and surplus for MBIA Corp. and its subsidiaries:

	As of December 31			
In thousands	**2005**	**2004**		
Company s GAAP shareholders equity	$ 6,591,644	$ 6,558,797		
Non-insurance segment assets and liabilities, net	303,525	225,804		
Premium revenue recognition	(730,541)	(670,765)		
Deferral of acquisition costs	(427,111)	(406,035)		
Investments, including unrealized gains	(443,776)	(894,834)		
Contingency reserve	(2,768,992)	(2,705,147)		
Unallocated loss and LAE reserves	344,755	2,439		
Current portion of long-term debt	303			303
Total current liabilities	57,258	105,657	8,222	171,137
Long-term debt	167,328			167,328
Long-term portion of deferred revenue, net	2,198	1,173(g)		3,371
Long-term portion of equipment financing obligations	3,518			3,518
Other long-term liabilities	3,516	(352) (h)	620(h)	3,784
Total liabilities	233,818	106,478	8,842	349,138
Common stock subject to conditional redemption		14,595(i)		14,595
Stockholders equity (deficit):				
Common stock	74	(1) (i)		73
Additional paid-in capital	730,178	(14,540) (a)(i)		715,638
Accumulated other comprehensive loss	(53)			(53)
Accumulated deficit	(668,917)	(93,741)	(8,773)	(771,431)

	61,282	(108,282)	(8,773)	(55,773)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	60,371	(108,282)	(8,773)	(56,684)
	$ 294,189	$ 12,791	$ 69	$ 307,049

Refer to the explanation of adjustments on the next page.

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $13,271 related to the change to the sell-through revenue recognition method (deferred royalties $9,680; deferred cost of products sold $3,591); to reclassify Organon cost sharing receivable balance to co-promotion liability $(461). Current quarter adjustments include $786 related to the change to the sell-through revenue recognition method (deferred royalties $(100); deferred cost of products sold $886); to reclassify Organon cost-sharing receivable balance to co-promotion liability $461; to correct prepaid clinical trial expense $(192);.

(c) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(d) To expense the payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene in March 2004.

(e) Cumulative effect of prior period adjustments includes $(643) related to the change to the sell-through revenue recognition method (product cost $(1,599); royalties $956); to reclassify Organon cost-sharing receivable balance to co-promotion liability $(461); to correct accruals for bonus expense $270 and property tax expense $(277); to reclassify Seragen acquisition liability from other long-term liabilities $2,700; to accrue interest for the Seragen acquisition liability $739. Current quarter adjustments include $(2,055) related to the change to the sell-through revenue recognition method (product cost - $(1,563); royalties $(492)); to reclassify Organon cost-sharing receivable balance to co-promotion liability $461; to reclassify from other long term liabilities the payment of a portion of the Seragen acquisition liability $(600).

(f) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(g) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(h) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,348; to reclassify the Seragen acquisition liability to accrued liabilities $(2,700). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $20; to reclassify to accrued liabilities the payment of a portion of the Seragen acquisition liability $600.

(i) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1), additional paid in capital $(14,594).

(j) To reclassify portions of inventory not expected to be used within one year to long-term.

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended March 31, 2004		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 34,136	$ (9,197)(a)(b)	$ 24,939
Collaborative research and development and other revenues	2,476		2,476
Total revenues	36,612	(9,197)	27,415
Operating costs and expenses:			
Cost of products sold	8,823	(1,278) (c)	7,545
Research and development	16,852	665(b)(d)(e)	17,517
Selling, general and administrative	14,472	233(b)(d)(f)	14,705
Co-promotion	6,731		6,731
Total operating costs and expenses	46,878	(380)	46,498
Loss from operations	(10,266)	(8,817)	(19,083)
Other income (expense):			
Interest income	231		231
Interest expense	(3,091)	44(b)	(3,047)
Other, net	(13)	16(g)	3
Total other expense, net	(2,873)	60	(2,813)
Loss before income taxes	(13,139)	(8,757)	(21,896)
Income tax expense		(16) (g)	(16)
Net loss	$ (13,139)	$ (8,773)	$ (21,912)
Basic and diluted per share amounts:			
Net loss	$ (0.18)		$ (0.30)

Weighted average number of common shares	73,299,281	73,299,281

Refer to the explanation of adjustments on the next page.

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(9,245).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(886); royalties $(392).

(d) To reclassify $742 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(e) To expense $1,120 payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene in March 2004; to reflect patent expense in the proper accounting period $238.

(f) To reflect legal expense in the proper accounting period $(373).

(g) To reclassify income taxes related to international operations $16.

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	June 30, 2004			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 41,920			$ 41,920
Short-term investments	43,958			43,958
Accounts receivable, net	17,936	$ (113) (a)	$ (49) (a)	17,774
Current portion of inventories, net	11,752	(3,986) (a)(j)	(49) (a)(j)	7,717
Other current assets	3,245	13,824(a)(b)	(601) (a)(b)	16,468
Total current assets	118,811	9,725	(699)	127,837
Restricted investments	1,656			1,656
Long-term portion of inventories, net		4,083(j)	167(j)	4,250
Property and equipment, net	23,910			23,910
Acquired technology and product rights, net	132,520	260(a)(c)		132,780
Other assets	8,420	(1,208) (a)(d)		7,212
	$ 285,317	$ 12,860	$ (532)	$ 297,645
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 20,225	$ 1(a)	$	$ 20,226
Accrued liabilities	36,108	66(a)(e)	(364) (a)(e)	35,810
Current portion of deferred revenue, net	2,381	113,812(f)	7,661(f)	123,854
Current portion of equipment financing obligations	2,453			2,453
Current portion of long-term debt	303			303
Total current liabilities	61,470	113,879	7,297	182,646
Long-term debt	167,256			167,256
Long-term portion of deferred revenue, net	2,120	1,173(g)		3,293
Long-term portion of equipment financing obligations	3,547			3,547
Other long-term liabilities	2,925	268(h)	20(h)	3,213

Total liabilities	237,318	115,320	7,317	359,955
Common stock subject to conditional redemption		14,595(i)		14,595
Stockholders equity (deficit):				
Common stock	74	(1)(i)		73
Additional paid-in capital	732,096	(14,540) (a)(i)		717,556
Accumulated other comprehensive loss	(127)			(127)
Accumulated deficit	(683,133)	(102,514)	(7,849)	(793,496)
	48,910	(117,055)	(7,849)	(75,994)
Treasury stock	(911)			(911)
Total stockholders equity (deficit):	47,999	(117,055)	(7,849)	(76,905)
	$ 285,317	$ 12,860	$ (532)	$ 297,645

Refer to the explanation of adjustments on the next page.

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $14,057 related to the change to the sell-through revenue recognition method (deferred royalties $9,580; deferred cost of products sold $4,477). Current quarter adjustments include $(781) related to the change to the sell-through revenue recognition method (deferred royalties $(876); deferred cost of products sold $95).

(c) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(d) To expense the effect of The Salk Institute payment to buy-out the Company s royalty obligation on lasofoxifene $(1,120).

(e) Cumulative effect of prior period adjustments includes $(2,698) related to the change to the sell-through revenue recognition method (product cost $(3,162); royalties $464); to correct property tax expense $(260); to reclassify Seragen acquisition liability from other long-term liabilities $2,100; accrual of interest on the Seragen acquisition liability $739. Current quarter adjustments include $(358) related to the change to the sell-through revenue recognition method (product cost $510; royalties $(868)).

(f) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(g) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(h) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,368; to reclassify the Seragen acquisition liability to accrued liabilities $(2,100). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $20.

(i) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595)   common stock $(1), additional paid-in capital $(14,594).

(j) To reclassify portion of inventory not expected to be used within one year to long-term.

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended June 30, 2004		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 37,485	$ (8,186) (a)(b)	$ 29,299
Collaborative research and development and other revenues	2,975		2,975
Total revenues	40,460	(8,186)	32,274
Operating costs and expenses:			
Cost of products sold	9,926	(208) (c)	9,718
Research and development	18,174	(1,608) (b)(d)	16,566
Selling, general and administrative	16,625	1,491(b)(d)	18,116
Co-promotion	7,000		7,000
Total operating costs and expenses	51,725	(325)	51,400
Loss from operations	(11,265)	(7,861)	(19,126)
Other income (expense):			
Interest income	208		208
Interest expense	(3,140)	12(b)	(3,128)
Other, net	(19)	18(e)	(1)
Total other expense, net	(2,951)	30	(2,921)
Loss before income taxes	(14,216)	(7,831)	(22,047)
Income tax expense		(18) (e)	(18)
Net loss	$ (14,216)	$ (7,849)	$ (22,065)
Basic and diluted per share amounts:			
Net loss	$ (0.19)		$ (0.30)

Weighted average number of common shares	73,754,146	73,754,146

Refer to the explanation of adjustments on the next page.

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(8,097).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product sales $(214); royalties $6.

(d) To reclassify $1,454 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(e) To reclassify income taxes related to international operations $18.

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	September 30, 2004			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 46,020			$ 46,020
Short-term investments	34,387			34,387
Accounts receivable, net	30,583	$ (162) (a)	$ 36(a)	30,457
Current portion of inventories, net	11,355	(4,035)(b)(l)	66(a)(l)	7,386
Other current assets	2,985	13,223(a)(c)	2,729(a)(c)	18,937
Total current assets	125,330	9,026	2,831	137,187
Restricted investments	1,656			1,656
Long-term portion of inventories, net		4,250(l)	(45)(l)	4,205
Property and equipment, net	23,844			23,844
Acquired technology and product rights, net	129,852	260(a)(d)		130,112
Other assets	7,977	(1,208)(a)(e)		6,769
	$ 288,659	$ 12,328	$ 2,786	$ 303,773
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 16,719	$ 1(a)	$ 68(a)	$ 16,788
Accrued liabilities	49,527	(298)(a)(f)	(3,308) (a)(f)	45,921
Current portion of deferred revenue, net	2,352	121,473(g)	17,720(g)	141,545
Current portion of equipment financing obligations	2,617			2,617
Current portion of long-term debt	314			314
Total current liabilities	71,529	121,176	14,480	207,185
Long-term debt	167,171			167,171
Long-term portion of deferred revenue, net	2,043	1,173(h)		3,216
Long-term portion of equipment financing obligations	4,087			4,087
Other long-term liabilities	2,870	288(i)	15(i)	3,173

Total liabilities	247,700	122,637	14,495	384,832
Common stock subject to conditional redemption		14,595(j)	(2,250) (k)	12,345
Stockholders equity (deficit):				
Common stock	74	(1)(j)		73
Additional paid-in capital	731,841	(14,540)(a)(j)	2,250(k)	719,551
Accumulated other comprehensive loss	(123)			(123)
Accumulated deficit	(689,922)	(110,363)	(11,709)	(811,994)
	41,870	(124,904)	(9,459)	(92,493)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	40,959	(124,904)	(9,459)	(93,404)
	$ 288,659	$ 12,328	$ 2,786	$ 303,773

Refer to the explanation of adjustments on the next page.

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EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) To reverse replacement reserve.

(c) Cumulative effect of prior period adjustments includes $13,276 related to the change to the sell-through revenue recognition method (deferred royalties $8,704; deferred cost of products sold $4,572). Current quarter adjustments include $2,654 related to the change to the sell-through revenue recognition method (deferred royalties $2,486; deferred cost of products sold $168).

(d) To correct accumulated amortization expense related to ONTAK acquired technology - $357.

(e) To expense the payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene $(1,120).

(f) Cumulative effect of prior period adjustments includes $(3,056) related to the change to the sell-through revenue recognition method (product cost $(2,652); royalties - $(404)); to correct bonus expense $(201); to reclassify Seragen acquisition liability from other long-term liabilities $2,100; to accrue interest on Seragen acquisition liability $739. Current quarter adjustments include $(3,349) related to the change to the sell-through revenue recognition method (product cost $(4,806); royalties $1,457).

(g) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(h) To reflect the deferral of a portion of the sale of royalty rights to Royalty Pharma.

(i) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,388; to reclassify the Seragen acquisition liability to accrued liabilities $(2,100). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis- $15.

(j) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1), additional paid-in capital $(14,594).

(k) To reflect Pfizer s redemption of shares in connection with the achievement of a milestone in accordance with the Pfizer settlement agreement.

(l) To reclassify portion of inventory not expected to be used with one year to long-term.

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended September 30, 2004		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 44,726	$ (12,792)(a)(b)	$ 31,934
Sale of royalty rights, net		67(c)	67
Collaborative research and development and other revenues	4,771		4,771
Total revenues	49,497	(12,725)	36,772
Operating costs and expenses:			
Cost of products sold	11,011	(1,192)(d)	9,819
Research and development	17,980	(1,233)(b)(e)	16,747
Selling, general and administrative	15,890	1,421(b)(e)	17,311
Co-promotion	8,501		8,501
Total operating costs and expenses	53,382	(1,004)	52,378
Loss from operations	(3,885)	(11,721)	(15,606)
Other income (expense):			
Interest income	255		255
Interest expense	(2,919)	(226)(b)(f)	(3,145)
Other, net	(240)	241(b)(f)(g)	1
Total other expense, net	(2,904)	15	(2,889)
Loss before income taxes	(6,789)	(11,706)	(18,495)
Income tax expense		(3)(g)	(3)
Net loss	$ (6,789)	$ (11,709)	$ (18,498)
Basic and diluted per share amounts:			
Net loss	$ (0.09)		$ (0.25)

Weighted average number of common shares	73,845,613	73,845,613

Refer to the explanation of adjustments on the next page.

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EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(12,842).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the recognition of revenue previously deferred in regard to the sale of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(163), royalties $(1,029).

(e) To reclassify $1,221 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(f) To reclassify $238 of interest and factoring expenses incurred under a factoring arrangement from other, net to interest expense.

(g) To reclassify income taxes related to international operations $3.

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	March 31, 2003			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 12,979			$ 12,979
Short-term investments	21,004			21,004
Accounts receivable, net	17,086	$ 247(a)	$ 13(a)	17,346
Inventories, net	5,395	150(a)	(18)(a)	5,527
Other current assets	6,547	7,665(a)(b)	(280)(a)(b)	13,932
Total current assets	63,011	8,062	(285)	70,788
Restricted investments	10,741			10,741
Property and equipment, net	9,229			9,229
Acquired technology and product rights, net	145,862	260(a)(c)		146,122
Other assets	12,333	3,958(a)(d)	(3,958)(a)(d)	12,333
	$ 241,176	$ 12,280	$ (4,243)	$ 249,213
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 13,441	$ 913(a)(e)	$ (314)(a)(e)	$ 14,040
Accrued liabilities	17,640	(2,182)(a)(f)	3,386(a)(f)	18,844
Current portion of deferred revenue, net	4,637	43,926(g)	7,594(g)	56,157
Current portion of equipment financing obligations	2,105	253(h)	15(h)	2,373
Total current liabilities	37,823	42,910	10,681	91,414
Long-term debt	155,250			155,250
Long-term portion of deferred revenue, net	2,709	581(i)		3,290
Long-term portion of equipment financing obligations	3,707	(253)(h)	(15)(h)	3,439
Other long-term liabilities	3,664	(463)(j)	32(j)	3,233

Total liabilities	203,153	42,775	10,698	256,626
Common stock subject to conditional redemption/repurchase		34,595(k)	(20,000)(l)	14,595
Stockholders equity (deficit):				
Common stock	70	(3)(k)	2(l)	69
Additional paid-in capital	677,561	(30,355)(a)(k)	15,865(l)	663,071
Accumulated other comprehensive loss	(61)			(61)
Accumulated deficit	(638,636)	(34,732)	(10,808)	(684,176)
	38,934	(65,090)	5,059	(21,097)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	38,023	(65,090)	5,059	(22,008)
	$ 241,176	$ 12,280	$ (4,243)	$ 249,213

Refer to the explanation of adjustments on the next page.

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EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $7,603 related to the change to the sell-through revenue recognition method (deferred royalties $4,215; deferred cost of products sold $3,388). Current quarter adjustments include $118 related to the change to the sell-through revenue recognition method (deferred royalties $98; deferred cost of products sold $20); to correct prepaid clinical trial expense $(352).

(c) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(d) To record the capitalization of the X-Ceptor Purchase Right in October 1999 $3,990; to write-off the X-Ceptor Purchase Right in March 2003, which was previously recognized for the period from 1999 to June 2002 $(3,990).

(e) To correct clinical trial expense cumulative effect of prior period adjustments $918; current quarter adjustments $(367).

(f) Cumulative effect of prior period adjustments include $(1,089) related to the change to the sell-through revenue recognition method (product cost $(1,491); royalties $402); to correct accruals for bonus expense $694, and property tax expense $(316); to reclassify Seragen acquisition liability from other long-term liabilities $2,700; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $(4,133). Current quarter adjustments include $(444) related to the change to the sell-through revenue recognition method (product cost $(126); royalties $(318)) ; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $4,133.

(g) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(h) To reclassify equipment lease obligations from long-term to current obligations.

(i) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(j) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for annual rent increases amortized over the lease term on a straight line basis $2,237; to reclassify the Seragen acquisition liability to accrued liabilities - $(2,700). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $32.

(k) In accordance with EITF D-98, to reclassify from equity the Company s issuance of common stock to Pfizer common stock $(1); additional paid in capital $(14,594); Elan shares common stock $(2); additional paid in capital $(19,998); reclassification of the Elan shares from accrued liabilities to additional paid-in capital $4,133.

(l) To reflect the repurchase and retirement of the Elan shares in February 2003 $20,000 common stock $2; additional paid-in capital $19,998; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $(4,133).

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended March 31, 2003		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 18,928	$ (7,455)(a)(b)	$ 11,473
Collaborative research and development and other revenues	4,195		4,195
Total revenues	23,123	(7,455)	15,668
Operating costs and expenses:			
Cost of products sold	6,620	(418)(c)	6,202
Research and development	16,640	(91)(b)	16,549
Selling, general and administrative	12,426	(74)(b)	12,352
Total operating costs and expenses	35,686	(583)	35,103
Loss from operations	(12,563)	(6,872)	(19,435)
Other income (expense):			
Interest income	243		243
Interest expense	(2,682)	(26)(b)	(2,708)
Other, net	(5,318)	(3,895)(b)(d)(e)	(9,213)
Total other expense, net	(7,757)	(3,921)	(11,678)
Loss before income taxes	(20,320)	(10,793)	(31,113)
Income tax expense		(15)(e)	(15)
Net loss	$ (20,320)	$ (10,808)	$ (31,128)
Basic and diluted per share amounts:			
Net loss	$ (0.29)		$ (0.44)
Weighted average number of common shares	70,238,438		70,238,438

Refer to the explanation of adjustments on the next page.

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(7,468).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(3); royalties $(415).

(d) To reflect the write off of the X-Ceptor Purchase Right in March 2003 $3,990.

(e) To reclassify income taxes related to international operations $15.

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	June 30, 2003			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 24,248			$ 24,248
Short-term investments	17,595			17,595
Accounts receivable, net	7,689	$ 260(a)	$ (221) (a)	7,728
Inventories, net	4,806	132(a)	93(a)	5,031
Other current assets	2,635	7,385(a)(b)	1,390(a)(b)	11,410
Total current assets	56,973	7,777	1,262	66,012
Restricted investments	6,204			6,204
Property and equipment, net	8,843			8,843
Acquired technology and product rights, net	143,194	260(a)(c)		143,454
Other assets	11,718			11,718
	$ 226,932	$ 8,037	$ 1,262	$ 236,231
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 10,819	$ 599(a)(d)	$ (185)(a)	$ 11,233
Accrued liabilities	18,319	1,204(a)(e)	(26)(a)(e)	19,497
Current portion of deferred revenue, net	4,126	51,520(f)	13,400(f)	69,046
Current portion of equipment financing obligations	1,890	268(g)	224(g)	2,382
Total current liabilities	35,154	53,591	13,413	102,158
Long-term debt	155,250			155,250
Long-term portion of deferred revenue, net	2,430	581(h)		3,011
Long-term portion of equipment financing obligations	3,403	(268)(g)	(224)(g)	2,911
Other long-term liabilities	3,638	(431)(i)	32(i)	3,239

Total liabilities	199,875	53,473	13,221	266,569
Common stock subject to conditional redemption		14,595(j)		14,595
Stockholders equity (deficit):				
Common stock	70	(1)(j)		69
Additional paid-in capital	678,577	(14,490)(a)(j)		664,087
Accumulated other comprehensive loss	(46)			(46)
Accumulated deficit	(650,633)	(45,540)	(11,959)	(708,132)
	27,968	(60,031)	(11,959)	(44,022)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	27,057	(60,031)	(11,959)	(44,933)
	$ 226,932	$ 8,037	$ 1,262	$ 236,231

Refer to the explanation of adjustments on the next page.

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EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $7,721 related to the change to the sell-through revenue recognition method (deferred royalties $4,313; deferred cost of products sold $3,408); to correct prepaid clinical trial expense $(290). Current quarter adjustments include $1,416 related to the change to the sell-through revenue recognition method (deferred royalties $1,818; deferred cost of products sold $(402)).

(c) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(d) To correct clinical trial expense $551.

(e) Cumulative effect of prior period adjustments includes $(1,533) related to the change to the sell-through revenue recognition method (product cost $(1,617); royalties $84); to correct accruals for bonus expense $588, property tax expense $(361), and legal, trademark and patent expense -$(240); to reclassify Seragen acquisition liability from long-term to current $2,700. Current quarter adjustments includes $(105) related to the change to the sell-through revenue recognition method (product cost $(565); royalties $460).

(f) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(g) To reclassify equipment financing obligations from long-term to current obligations.

(h) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(i) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,269; to reclassify the Seragen acquisition liability to accrued liabilities $(2,700). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $32.

(j) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1); additional paid in capital $(14,594).

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended June 30, 2003		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 25,187	$ (13,016)(a)(b)	$ 12,171
Collaborative research and development and other revenues	3,939		3,939
Total revenues	29,126	(13,016)	16,110
Operating costs and expenses:			
Cost of products sold	7,766	(921)(c)	6,845
Research and development	16,859	(215)(b)(d)(e)	16,644
Selling, general and administrative	13,571	(2)(b)(d)	13,569
Total operating costs and expenses	38,196	(1,138)	37,058
Loss from operations	(9,070)	(11,878)	(20,948)
Other income (expense):			
Interest income	140		140
Interest expense	(2,688)	(81)(b)	(2,769)
Other, net	(379)	16(f)	(363)
Total other expense, net	(2,927)	(65)	(2,992)
Loss before income taxes	(11,997)	(11,943)	(23,940)
Income tax expense		(16)(f)	(16)
Net loss	$ (11,997)	$ (11,959)	$ (23,956)
Basic and diluted per share amounts:			
Net loss	$ (0.17)		$ (0.35)
Weighted average number of common shares	69,275,323		69,275,323

Refer to the explanation of adjustments on the next page.

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EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(12,835).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $437; royalties $(1,358).

(d) To reclassify $9 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(e) To correct clinical trial expense $(331).

(f) To reclassify income taxes related to international operations $16.

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	September 30, 2003			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 73,002			$ 73,002
Short-term investments	13,744			13,744
Accounts receivable, net	9,923	$ 39(a)	$ (42)(a)	9,920
Current portion of inventories, net	6,005	225(a)	(798)(a)(k)	5,432
Other current assets	3,188	8,775(a)(b)	1,684(a)(b)	13,647
Total current assets	105,862	9,039	844	115,745
Restricted investments	6,203			6,203
Long-term portion of inventories, net			679(k)	679
Property and equipment, net	9,072			9,072
Acquired technology and product rights, net	140,526	260(a)(c)		140,786
Other assets	11,134			11,134
	$ 272,797	$ 9,299	$ 1,523	$ 283,619
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 17,261	$ 414(a)(d)	$ (141)(a)	$ 17,534
Accrued liabilities	23,228	1,178(a)(e)	(829)(a)(e)	23,577
Current portion of deferred revenue, net	3,502	64,920(f)	14,092(f)	82,514
Current portion of equipment financing obligations	2,299	492(g)	(492)(g)	2,299
Total current liabilities	46,290	67,004	12,630	125,924
Long-term debt	155,250			155,250
Long-term portion of deferred revenue, net	2,352	581(h)		2,933
Long-term portion of equipment financing obligations	2,682	(492)(g)	492(g)	2,682
Other long-term liabilities	3,627	(399)(i)	27(i)	3,255

Total liabilities	210,201	66,694	13,149	290,044
Common stock subject to conditional redemption		14,595(j)		14,595
Stockholders equity (deficit):				
Common stock	73	(1)(j)		72
Additional paid-in capital	725,244	(14,490)(a)(j)		710,754
Accumulated other comprehensive loss	(90)			(90)
Accumulated deficit	(661,720)	(57,499)	(11,626)	(730,845)
	63,507	(71,990)	(11,626)	(20,109)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	62,596	(71,990)	(11,626)	(21,020)
	$ 272,797	$ 9,299	$ 1,523	$ 283,619

Refer to the explanation of adjustments on the next page.

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EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $9,137 related to the change to the sell-through revenue recognition method (deferred royalties $6,131; deferred cost of products sold $3,006); to correct prepaid clinical trial expense $(234). Current quarter adjustments include $1,501 related to the change to the sell-through revenue recognition method (deferred royalties $1,525; deferred cost of products sold $(24)).

(c) To correct accumulated amortization expense related to ONTAK acquired technology - $357.

(d) To correct clinical trial expense $276.

(e) Cumulative effect of prior period adjustments includes $(1,638) related to the change to the sell-through revenue recognition method (product cost $(2,182); royalties $544); to correct accruals for bonus expense $482, and property tax expense -$(340); to reclassify Seragen acquisition liability from long-term to current $2,700. Current quarter adjustments include $(903) related to the change to the sell-through revenue recognition method (product cost $(881); royalties $(22)).

(f) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(g) To reclassify equipment financing obligations from long-term to current obligations.

(h) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(i) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,301; to reclassify the Seragen acquisition liability to accrued liabilities $(2,700). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $27.

(j) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1), additional paid in capital $(14,594).

(k) To reclassify portion of inventory not expected to be used within one year to long-term.

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended September 30, 2003		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 28,123	$(13,363)(a)(b)	$ 14,760
Sale of royalty rights, net		35(c)	35
Collaborative research and development and other revenues	3,160		3,160
Total revenues	31,283	(13,328)	17,955
Operating costs and expenses:			
Cost of products sold	8,565	(1,524) (d)	7,041
Research and development	17,696	(261) (b)(e)(f)	17,435
Selling, general and administrative	13,216	26(b)(e)	13,242
Total operating costs and expenses	39,477	(1,759)	37,718
Loss from operations	(8,194)	(11,569)	(19,763)
Other income (expense):			
Interest income	136		136
Interest expense	(2,653)	(170) (b)	(2,823)
Other, net	(376)	122(b)(g)	(254)
Total other expense, net	(2,893)	(48)	(2,941)
Loss before income taxes	(11,087)	(11,617)	(22,704)
Income tax expense		(9) (g)	(9)
Net loss	$ (11,087)	$(11,626)	$ (22,713)
Basic and diluted per share amounts:			
Net loss	$ (0.16)		$ (0.32)

Weighted average number of common shares	70,100,280	70,100,280

Refer to the explanation of adjustments on the next page.

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EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(13,376).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the recognition of revenue previously deferred in regard to the sales of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $23, royalties $(1,547).

(e) To reclassify $20 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(f) To correct clinical trial expense $(281).

(g) To reclassify income taxes related to international operations $9.

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LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended December 31, 2003		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 42,394	$(25,474) (a)(b)	$ 16,920
Sale of royalty rights, net	12,500	(749) (c)	11,751
Collaborative research and development and other revenues	2,714		2,714
Total revenues	57,608	(26,223)	31,385
Operating costs and expenses:			
Cost of products sold	8,667	(2,198) (d)	6,469
Research and development	16,484	(434) (b)(e)	16,050
Selling, general and administrative	12,448	929(b)(f)(g)	13,377
Co-promotion	9,360		9,360
Total operating costs and expenses	46,959	(1,703)	45,256
Income (loss) from operations	10,649	(24,520)	(13,871)
Other income (expense):			
Interest income	264		264
Interest expense	(2,947)	105(b)	(2,842)
Other, net	(19)	(185) (b)(h)	(204)
Total other expense, net	(2,702)	(80)	(2,782)
Income (loss) before income taxes and cumulative effect of a change in accounting principle	7,947	(24,600)	(16,653)
Income tax expense		(16) (h)	(16)
Income (loss) before cumulative effect of a change in accounting principle	7,947	(24,616)	(16,669)
Cumulative effect of changing method of accounting for variable interest entity	(2,005)		(2,005)
Net income (loss)	$ 5,942	$(24,616)	$ (18,674)
Basic per share amounts:			
	$ 0.11		$ (0.23)

Income (loss) before cumulative effect of a change in accounting principle				
Cumulative effect of changing method of accounting for variable interest entity		(0.03)		(0.03)
Net income (loss)	$	0.08	$	(0.26)
Weighted average number of common shares for basic net income (loss) per share		73,098,427		73,098,427
Diluted per share amounts:				
Income (loss) before cumulative effect of a change in accounting principle	$	0.10	$	(0.23)
Cumulative effect of changing method of accounting for variable interest entity		(0.02)		(0.03)
Net income (loss)	$	0.08	$	(0.26)
Weighted average number of common shares for diluted net income (loss) per share		99,684,427		73,098,427

Refer to the explanation of adjustments on the next page.

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EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(25,508).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(608), royalties $(1,590).

(e) To reclassify $26 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense; to correct patent expense $(233).

(f) To reflect accrual of interest on Seragen acquisition liability $739.

(g) To reflect legal expense in the proper accounting period $308.

(h) To reclassify income taxes related to international operations $16.

3. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosure of contingent assets and contingent liabilities, at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The Company s critical accounting policies are those that are both most important to the Company s financial condition and results of operations and require the most difficult, subjective or complex judgments on the part of management in their application, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Because of the uncertainty of factors surrounding the estimates or judgments used in the preparation of the consolidated financial statements, actual results may materially vary from these estimates.

Cash, Cash Equivalents and Short-term Investments

Cash and cash equivalents consist of cash and highly liquid securities with maturities at the date of acquisition of three months or less. Non-restricted equity and debt security investments with a maturity of more than three months are considered short-term investments and have been classified by management as available-for-sale. Such investments are carried at fair value, with unrealized gains and losses included as a separate component of stockholders equity. The Company determines cost based on the specific identification method.

Restricted Investments

Restricted investments consist of the following (in thousands):

	December 31,	
	2004	**2003**
Current:		
U.S. government securities	$	$ 9,204
Non-current:		
Exelixis, Inc. common stock	$ 722	$
Certificates of deposit	1,656	1,656
	$ 2,378	$ 1,656

The U.S. government securities were required to be held with a trustee to pay semi-annual interest payments due in 2004 on the 6% Convertible Subordinated Notes issued in November 2002. These securities have been classified by management as held-to-maturity and are accounted for at amortized cost (See Note 10).

The Exelixis, Inc. common stock, which was acquired in connection with Exelixis acquisition of Ligand s X-Ceptor Therapeutics, Inc. common stock, is subject to certain trading restrictions and accordingly, has been classified as a restricted investment (see Note 16).

The certificates of deposit are held with a financial institution as collateral under equipment financing and third-party service provider arrangements. These certificates have been classified by management as held-to-maturity and are accounted for at amortized cost (See Note 12).

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash equivalents, investments and accounts receivable.

The Company invests its excess cash principally in United States government debt securities, investment grade corporate debt securities and certificates of deposit. The Company has established guidelines relative to diversification and maturities that maintain safety and liquidity. These guidelines are periodically reviewed and modified to take

advantage of trends in yields and interest rates. The Company has not experienced any significant losses on its cash equivalents, short-term investments or restricted investments.

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Trade accounts receivable represent the Company s most significant credit risk. The Company extends credit on an uncollateralized basis primarily to wholesale drug distributors throughout the United States. Prior to entering into sales agreements with new customers, and on an ongoing basis for existing customers, the Company performs credit evaluations. To date, the Company has not experienced significant losses on customer accounts.

As more fully discussed in Note 6, the Company sells certain of its accounts receivable under a non-recourse factoring arrangement with a finance company. The Company can transfer funds in any amount up to a specified percentage of the net amount due from the Company s trade customers at the time of the sale to the finance company, with the remaining funds available upon collection or write-off of the trade receivable. As of December 31, 2004, the gross amount due from the finance company was $6.1 million, all of which had been collected as of January 31, 2005.

Inventories, net

Inventories, net are stated at the lower of cost or market value. Cost is determined using the first-in-first-out method. Inventories, net consist of the following (in thousands):

	December 31,	
	2004	2003
		(Restated)
Raw materials	$ 1,855	$ 314
Work-in-process	2,302	5,567
Finished goods	8,642	3,776
Less: inventory reserves	(1,027)	(1,177)
	11,772	8,480
Less: current portion	(7,155)	(5,634)
Long-term portion of inventories, net	$ 4,617	$ 2,846

See Note 12, Commitments and Contingencies Manufacturing and Supply Agreements.

Property and Equipment

Property and equipment is stated at cost and consists of the following (in thousands):

	December 31,	
	2004	2003
Land	$ 5,176	$ 5,124
Equipment, building, and leasehold improvements	59,568	56,563
Less accumulated depreciation and amortization	(41,097)	(38,186)
	$ 23,647	$ 23,501

Depreciation of equipment and building is computed using the straight-line method over the estimated useful lives of the assets which range from three to thirty years. Assets acquired pursuant to capital lease arrangements and leasehold improvements are amortized using the straight-line method over their estimated useful lives or their related lease term, whichever is shorter.

Cumulative Effect of Accounting Change

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, an interpretation of ARB No. 51, which was subsequently revised in December 2003 (FIN 46(R)). FIN 46(R) requires the consolidation of certain variable interest entities (VIEs) by the primary beneficiary of the entity if the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or if the equity investors lack the characteristics of a controlling financial interest.

Ligand implemented FIN 46(R) effective December 31, 2003, and consolidated the entity from which it leased one of its two corporate headquarter buildings as of that date, as it determined that the entity was a VIE, as defined by FIN 46(R), and that the Company would absorb a majority of its expected losses, if any, as defined by FIN 46(R). Accordingly, Ligand consolidated assets, which consist of land, the building, and related tenant improvements, with a total carrying value of $13.6 million, net of accumulated depreciation. Additionally, the Company consolidated the entity s debt of $12.5 million and non-controlling interest of $0.6 million. All such assets and liabilities are included in the accompanying consolidated balance sheet at December 31, 2003. The non-controlling interest is included in Other long-term liabilities. In connection with the implementation of FIN 46(R), the Company also recorded a $2.0 million charge ($0.03 per share) as a cumulative effect of the accounting change on December 31, 2003. Due to the structure of

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the operating agreement for the entity, the entity s depreciation and interest expense were not allocated to the non-controlling interest. The entity s creditors and holder of its beneficial interest only had recourse against the assets of the VIE, not the general credit of Ligand. See also Note 12, Commitments and Contingencies, for a discussion of all the Company s leases. In April 2004, the Company exercised its right to acquire the portion of Nexus that it did not own. The acquisition resulted in Ligand s assumption of the existing loan against the property and payment to Nexus other shareholder of approximately $0.6 million.

Acquired Technology and Product Rights

In accordance with SFAS No. 142, *Goodwill and Other Intangibles,* the Company amortizes intangible assets with finite lives in a manner that reflects the pattern in which the economic benefits of the assets are consumed or otherwise used up. If that pattern cannot be reliably determined, the assets are amortized using the straight-line method.

Acquired technology and product rights represent payments related to the Company s acquisition of ONTAK (see Note 9) and license rights for AVINZA (see Note 7). Because the Company cannot reliably determine the pattern in which the economic benefits of the acquired technology and products rights are realized, acquired technology and product rights are amortized on a straight-line basis over 15 years, which approximated the remaining patent life at the time the assets were acquired and otherwise represents the period estimated to be benefited. Specifically, the Company is amortizing its ONTAK asset through June 2014 which is approximate to the expiration date of its U.S. patent of December 2014. The AVINZA asset is being amortized through November 2017, the expiration of its U.S. patent. Acquired technology and product rights consist of the following (in thousands):

	December 31,	
	2004	**2003**
		(Restated)
AVINZA	$ 114,437	$ 114,437
Less accumulated amortization	(16,096)	(8,467)
	98,341	105,970
ONTAK	45,312	45,312
Less accumulated amortization	(16,210)	(13,165)
	29,102	32,147
	$ 127,443	$ 138,117

Amortization of acquired technology and product rights for the years ended December 31, 2004, 2003 and 2002 was $10.7 million, $10.7 million and $3.9 million, respectively. Estimated annual amortization for these assets for each of the years in the period from 2005 to 2009 is $10.7 million and $73.9 million, thereafter.

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment annually or whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value for the Company s long-lived assets is determined using the expected cash flows discounted at a rate commensurate with the risk involved.

Based on its impairment assessment completed in the fourth quarter of 2004, the Company believes the future cash flows to be received from its long-lived assets will exceed the assets carrying value, and accordingly has not recognized any impairment losses through December 31, 2004. Ligand s impairment assessment could be impacted by various factors including a more than insignificant disruption of supply, new competing products or technologies that could result in a significant decrease in the demand for or the pricing of its products, regulatory actions that require the Company to restrict or cease promotion of the products, a product recall to address regulatory issues, and/or patent claims by third parties.

Fair Value of Financial Instruments

The carrying amount of cash, cash equivalents, short-term investments, accounts receivable, restricted investments, accounts payable and accrued liabilities at December 31, 2004 and 2003 are considered to be a reasonable estimate of their fair values due to the short-term nature of those instruments. As of December 31, 2004 and 2003, the carrying amount of equipment financing obligations represents a reasonable estimate of their fair value due to their interest rates approximating current market rates.

The carrying value and estimated fair value of the Company s long-term debt at December 31, 2004 and 2003 is as follows (in thousands):

	December 31, 2004		December 31, 2003	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
6% Convertible Subordinated Notes (Note 10)	$ 155,250	$ 308,948	$ 155,250	$ 387,931
Note payable to bank	12,159	12,808	12,453	13,261

Estimated fair value amounts have been determined using available market information.

Revenue Recognition

The Company generates revenue from product sales, collaborative research and development arrangements, and other activities such as distribution agreements, royalties, and sales of technology rights. Payments received under such arrangements may include non-refundable fees at the inception of the contract for technology rights under collaborative arrangements or product rights under distribution agreements, fully burdened funding for services performed during the research phase of collaborative arrangements, milestone payments for specific achievements designated in the collaborative or distribution agreements, royalties on sales of products resulting from collaborative arrangements, and payments for the supply of products under distribution agreements.

The Company recognizes revenue in accordance with SAB 104 and SFAS 48. SAB 104 states that revenue should not be recognized until it is realized or realizable and earned. Revenue is realized or realizable and earned when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the seller s price to the buyer is fixed and determinable; and (4) collectibility is reasonably assured. SFAS 48 states that revenue from sales transactions where the buyer has the right to return the product shall be recognized at the time of sale only if (1) the seller s price to the buyer is substantially fixed or determinable at the date of sale, (2) the buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product, (3) the buyer s obligation to the seller would not be changed in the event of theft or physical destruction or damage of the product, (4) the buyer acquiring the product for resale has economic substance apart from that provided by the seller, (5) the seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer, and (6) the amount of future returns can be reasonably estimated.

Product sales

The Company has determined that domestic shipments made to wholesalers for AVINZA, ONTAK, Targretin capsules and Targretin gel do not meet the revenue recognition criteria of SFAS 48 and SAB 104 at the time of shipment, and therefore such shipments are accounted for using the sell-through method. Under the sell-through method, the Company does not recognize revenue upon shipment of product to the wholesaler. For these product sales, the Company invoices the wholesaler, records deferred revenue at gross invoice sales price less estimated cash discounts and for ONTAK, end-customer returns, and classifies the inventory held by the wholesaler as deferred cost of goods sold within other current assets. At that point, the Company makes an estimate of units that may be returned and records a reserve for those units against the deferred cost of goods sold account. The Company recognizes revenue when such inventory is sold through (as defined hereafter), on a first-in first-out (FIFO) basis. Sell through for ONTAK, Targretin capsules and Targretin gel are considered to be at the point of out movement from the wholesaler to the wholesaler s customer. Sell through for AVINZA is considered to be at the prescription level or at the point of patient consumption for channels with no prescription requirements.

A summary of the revenue recognition policy used for each product and the expiration of the underlying patents for each product is as follows:

	Method	Revenue Recognition Event	Patent Expiration
AVINZA	Sell-through	Prescriptions	November 2017
ONTAK	Sell-through	Wholesaler out-movement	December 2014
Targretin capsules	Sell-through	Wholesaler out-movement	October 2016
Targretin gel	Sell-through	Wholesaler out-movement	October 2016
Panretin	Sell-in	Shipment to wholesaler	August 2016
International	Sell-in	Shipment to international distributor	February 2011 through April 2013

For the years ended December 31, 2004, 2003 and 2002, net product sales recognized under the sell-through method represented 96%, 94%, and 95%, respectively, and net product sales under the sell-in method represented 4%, 6%, and 5%, respectively.

Additionally under the sell-through method, royalties paid based on unit shipments to wholesalers are deferred and recognized as royalty expense as those units are sold through and recognized as revenue. Royalties paid to technology partners are deferred as the Company has the right to offset royalties paid for product that are later returned against subsequent royalty obligations. Royalties for which the Company does not have the ability to offset (for example, at the end of the contracted royalty period) are expensed in the period the royalty obligation becomes due. During the fourth quarter of 2004, the Company recorded a charge to royalty expense in the amount of $3.0 million for deferred royalties at the end of the contracted period for which the Company did not have offset rights.

The Company estimates sell-through based upon (1) analysis of third-party information, including information obtained from certain wholesalers with respect to their inventory levels and sell-through to customers, and third-party market research data, and (2) the Company s internal product movement information. To assess the reasonableness of third-party demand (i.e. sell-through) information, the Company prepares separate demand reconciliations based on inventory in the distribution channel. Differences identified through these reconciliations outside an acceptable range will be recognized as an adjustment to the third-party reported demand in the period those differences are identified. This adjustment mechanism is designed to identify and correct for any material variances between reported and actual demand over time and other potential anomalies such as inventory shrinkage at wholesalers. The Company s estimates are subject to the inherent limitations of estimates that rely on third-party data, as certain third-party information is itself in the form of estimates. The Company s sales and revenue recognition under the sell-through method reflect the Company s estimates of actual product sold through the channel.

The Company uses information from external sources to estimate its gross product sales under the sell-through revenue recognition method and significant gross to net sales adjustments. Such estimates include product information with respect to prescriptions, wholesaler out-movement and inventory levels, and retail pharmacy stocking levels, and the Company s own internal information. The Company receives information from IMS Health, a supplier of market research to the pharmaceutical industry, which it uses to estimate sell-through demand for its products and retail pharmacy inventory levels. The Company also receives wholesaler out-movement and inventory information from its wholesaler customers that is used to support and validate its demand-based, sell-through revenue recognition estimates. Additionally, the Company uses wholesaler provided out-movement information to estimate ONTAK sell-through revenue as this data is not available from IMS. The inventory information received from wholesalers is a product of their record-keeping process and their internal contacts surrounding such processes.

The Company recognizes revenue for Panretin upon shipment to wholesalers as its wholesaler customers only stock minimal amounts of Panretin, if any. As such, wholesaler orders are considered to approximate end-customer demand for the product. Revenues from sales of Panretin are net of allowances for rebates, chargebacks and discounts. For international shipments of the Company s product, revenue is recognized upon shipment to its third-party international distributors.

Sale of Royalty Rights

Revenue from the sale of royalty rights represents the sale to third parties of rights for and exercise of options to acquire future royalties the Company may earn from the sale of products in development with its collaborative

partners. If the Company has no continuing involvement in the research, development or marketing of these products, sales of royalty rights are recognized as revenue in the period the transaction is consummated or the options are exercised or expire. If the Company has significant continuing involvement in the research, development or marketing of the product, proceeds for the sale of royalty rights are accounted for as a financing in accordance with EITF 88-18: *Sales of Future Royalties* (See Note 11).

Collaborative Research and Development and Other Revenues

Collaborative research and development and other revenues are recognized as services are performed consistent with the performance requirements of the contract. Non-refundable contract fees for which no further performance obligation exists and where the Company has no continuing involvement are recognized upon the earlier of when payment is received or collection is assured. Revenue from non-refundable contract fees where Ligand has continuing involvement through research and development collaborations or other contractual obligations is recognized ratably over the development period or the period for which Ligand continues to have a performance obligation. Revenue from performance milestones is recognized upon the achievement of the milestones as specified in the respective agreement. Payments received in advance of performance or delivery are recorded as deferred revenue and subsequently recognized over the period of performance or upon delivery.

The composition of collaborative research and development and other revenues is as follows (in thousands):

	Year Ended December 31,		
	2004	2003 (Restated)	2002 (Restated)
Collaborative research and development	$ 7,843	$ 10,887	$ 18,268
Development milestones	3,681	2,807	5,060
Other	311	314	515
	$ 11,835	$ 14,008	$ 23,843

Net Product Sales

The Company s net product sales represent total product sales less allowances for rebates, chargebacks, discounts, and promotions and losses to be incurred on returns from wholesalers resulting from increases in the selling price of the Company s products. In addition, the Company incurs certain distributor service agreement fees related to the management of its product by wholesalers. These fees have been recorded within net revenues. For ONTAK, the Company also has established reserves for returns from end customers (i.e. other than wholesalers) after sell-through revenue recognition has occurred.

The composition of net product sales by product is as follows (in thousands):

	Year Ended December 31,		
	2004	2003 (Restated)	2002 (Restated)
AVINZA	$ 69,470	$ 16,482	$ 1,114
ONTAK	32,200	24,108	17,706
Targretin capsules	15,105	11,556	8,563
Other	3,560	3,178	2,943
	$ 120,335	$ 55,324	$ 30,326

Deferred Revenue, Net

Under the sell-through revenue recognition method, the Company does not recognize revenue upon shipment of product to the wholesaler. For these shipments, the Company invoices the wholesaler, records deferred revenue at gross invoice sales price, and classifies the inventory held by the wholesaler (and subsequently held by retail pharmacies as in the case of AVINZA) as deferred cost of goods sold within other current assets. Deferred revenue is presented net of deferred cash and other discounts. Other deferred revenue reflects certain collaborative research and development payments and the sale of certain royalty rights.

The composition of deferred revenue, net is as follows (in thousands):

	December 31, 2004	December 31, 2003 (Restated)
Deferred product revenue	$ 153,632	$ 105,839
Other deferred revenue	5,574	6,228
Deferred discounts	(2,166)	(2,900)
Deferred revenue, net	$ 157,040	$ 109,167
Current, net	$ 152,528	$ 105,719
Long-term, net	$ 4,512	$ 3,448

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Deferred product revenue, net (1)		
Current	$ 151,466	$ 102,939
Long-term	$	$
Other deferred revenue		
Current	$ 1,062	$ 2,780
Long-term	$ 4,512	$ 3,448

(1) Deferred product revenue does not include other gross to net revenue adjustments made when the Company reports net product sales. Such adjustments include Medicaid rebates, managed health care rebates, and government chargebacks, which are included in accrued liabilities in the accompanying consolidated financial statements.

Allowance for Return Losses

Product sales are net of adjustments for losses resulting from price increases the Company may experience on product returns from its wholesaler customers. The Company s policy for returns allows customers, primarily wholesale distributors, to return its oncology products three months prior to and six months after expiration. For ONTAK, customers are generally allowed to return product in exchange for replacement ONTAK vials. The Company s policy for returns of AVINZA allows customers to return the product six months prior to and six months after expiration. Upon an announced price increase, typically in the quarter prior to when a price increase becomes effective, the Company revalues its estimate of deferred product revenue to be returned to recognize the potential higher credit a wholesaler may take upon product return determined as the difference between the new price and the previous price used to value the allowance.

ONTAK End-Customer Returns

Under the sell-through method of revenue recognition, the estimate of product returns from the wholesalers does not result in a gross to net sales adjustment since the shipment of product to the wholesalers does not result in revenue recognition. For ONTAK, revenue is recognized when product is shipped from wholesalers to end-customers, primarily hospitals and clinics that have the capability to administer the product to patients. These customers have the right to return expired product to the wholesaler who in turn can return the product to the Company. In accordance with SFAS 48, the Company records a return provision upon sell-through of ONTAK by establishing a reserve in an amount equal to the estimate of sales recorded but for which the related products are expected to be returned by the end customer. Estimates of the sales return accrual are based on historical experience.

Medicaid rebates

The Company s products are subject to state government-managed Medicaid programs whereby discounts and rebates are provided to participating state governments. Medicaid rebates are accounted for by establishing an accrual in an amount equal to the Company s estimate of Medicaid rebate claims attributable to sales recognized in that period. The estimate of the Medicaid rebates accrual is determined primarily based on historical experience regarding Medicaid rebates, as well as current and historical prescription activity provided by external sources, current contract prices and any expected contract changes. The Company additionally considers any legal interpretations of the applicable laws related to Medicaid and qualifying federal and state government programs and any new information regarding changes in the Medicaid programs regulations and guidelines that would impact the amount of the rebates. The Company adjusts the accrual periodically throughout each period to reflect actual experience, expected changes in future prescription volumes and any changes in business circumstances or trends.

Government chargebacks

The Company s products are subject to certain programs with federal government entities and other parties whereby pricing on products is extended below wholesaler list price to participating entities. These entities purchase products through wholesalers at the lower vendor price, and the wholesalers charge the difference between their acquisition cost and the lower vendor price back to the Company. Chargebacks are accounted for by establishing an accrual in an amount equal to the estimate of chargeback claims. The Company determines estimates of the chargebacks primarily based on historical experience regarding chargebacks and current contract prices under the vendor programs. The Company considers vendor payments and claim processing time lags and adjusts the accrual periodically throughout each period to reflect actual experience and any changes in business circumstances or trends.

Managed health care rebates and other contract discounts

The Company offers rebates and discounts to managed health care organizations and to other contract counterparties such as hospitals and group purchasing organizations in the U.S. Managed health care rebates and other contract discounts are accounted for by establishing an accrual in an amount equal to the estimate of managed health care rebates and other contract discounts. Estimates of the managed health care rebates and other contract discounts accruals are determined primarily based on historical experience regarding these rebates and discounts and current contract prices. The Company also considers the current and historical prescription activity provided by external sources, current contract prices and any expected contract changes and adjusts the accrual periodically throughout each period to reflect actual experience and any changes in business circumstances or trends.

Costs and Expenses

Cost of products sold includes manufacturing costs, amortization of acquired technology and product rights, and royalty expenses associated with the Company s commercial products. Research and development costs are expensed as incurred. Amounts paid for products or to buy-out product royalty obligations for which a new drug application has been filed with the FDA are capitalized. Research and development expenses were $65.2 million, $66.7 million and $59.1 million in 2004, 2003 and 2002, respectively, of which approximately 88%, 84% and 75% were sponsored by Ligand, and the remainder of which was funded pursuant to collaborative research and development arrangements.

Advertising Expenses

Advertising expenses, including advertising incurred through the Company s AVINZA co-promotion arrangement with Organon, are expensed as incurred.

Debt Issuance Costs

The costs related to the issuance of debt are capitalized and amortized to interest expense using the effective interest method over the lives of the related debt.

Income Taxes

The Company recognizes liabilities or assets for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes (SFAS 109). These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. SFAS 109 requires that a valuation allowance be established when management determines that it is more likely than not that all or a portion of a deferred tax asset will not be realized. The Company evaluates the realizability of its net deferred tax assets on a quarterly basis and valuation allowances are provided, as necessary. During this evaluation, the Company reviews its forecasts of income in conjunction with other positive and negative evidence surrounding the realizability of its deferred tax assets to determine if a valuation allowance is required. Adjustments to the valuation allowance will increase or decrease the Company s income tax provision or benefit.

Loss Per Share

Net loss per share is computed using the weighted average number of common shares outstanding. Basic and diluted net loss per share amounts are equivalent for the periods presented as the inclusion of potential common shares in the number of shares used for the diluted computation would be anti-dilutive. Potential common shares, the shares that would be issued upon the conversion of convertible notes and the exercise of outstanding warrants and stock options, were 32.4 million, 32.3 million and 31.9 million at December 31, 2004, 2003 and 2002, respectively.

Accounting for Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees,* and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation.*

Pro forma information regarding net loss and loss per share is required by SFAS No. 123*, Accounting for Stock-based Compensation*, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The estimated weighted average fair value at grant date for the options granted during 2004, 2003 and 2002 was $9.46, $6.41 and $7.92 per option, respectively. The fair value for these options was estimated at the dates of grant using the Black-Scholes option valuation model with the following weighted-average assumptions:

	2004	2003	2002
Risk free interest rates	3.61%	3.25%	2.80%
Dividend yields			
Volatility	74%	74%	77%
Weighted average expected life	5 years	5 years	5 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

In accordance with SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure,* the following table summarizes the Company s results on a pro forma basis as if it had recorded compensation expense based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed under SFAS No. 123, *Accounting for Stock-Based Compensation*, for 2004, 2003 and 2002 (in thousands, except for net loss per share information):

	Year Ended December 31,		
	2004	2003 (Restated)	2002 (Restated)
Net loss, as reported	$ (45,141)	$ (96,471)	$ (52,257)
Stock-based employee compensation expense included in reported net loss	89	565	49
Less total stock-based compensation expense determined under fair value based method for all awards	(7,674)	(6,797)	(6,434)
Net loss pro forma	$ (52,726)	$ (102,703)	$ (58,642)
Net loss per share, as reported	$ (0.61)	$ (1.36)	$ (0.76)
Net loss per share pro forma	$ (0.72)	$ (1.45)	$ (0.85)

On January 31, 2005, Ligand accelerated the vesting of certain unvested and out-of-the-money stock options previously awarded to the executive officers and other employees under the Company s 1992 and 2002 stock option plans which had an exercise price greater than $10.41, the closing price of the Company s stock on that date. Options to purchase approximately 1.3 million shares of common stock (of which approximately 450,000 shares were subject to options held by the executive officers) were accelerated. Options held by non-employee directors were not accelerated.

Holders of incentive stock options (ISOs) within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, were given the election to decline the acceleration of their options if such acceleration would have the effect of changing the status of such option for federal income tax purposes from an ISO to a non-qualified stock option. In addition, the executive officers plus other members of senior management agreed that they will not sell any shares acquired through the exercise of an accelerated option prior to the date on which the exercise would have been permitted under the option s original vesting terms. This agreement does not apply to a) shares sold in order to pay applicable taxes resulting from the exercise of an accelerated option or b) upon the officer s retirement or other termination of employment.

The purpose of the acceleration was to eliminate any future compensation expense the Company would have otherwise recognized in its income statement with respect to these options upon the implementation of the Financial

Accounting Standard Board (FASB) statement Share-Based Payment (FAS 123R).

Comprehensive (Loss) Income

Comprehensive loss represents net loss adjusted for the change during the periods presented in unrealized gains and losses on available-for-sale securities less reclassification adjustments for realized gains or losses included in net loss, as well as foreign currency translation adjustments. The accumulated unrealized gains or losses and cumulative foreign currency translation adjustments are reported as accumulated other comprehensive income (loss) as a separate component of stockholders equity (deficit).

Segment Reporting

The Company currently operates in a single operating segment. The Company generates revenue from various sources that result primarily from its underlying research and development activities. In addition, financial results are prepared and reviewed by management as a single operating segment. The Company continually evaluates the benefits of operating in distinct segments and will report accordingly when such distinction is made.

Guarantees and Indemnifications.

The Company accounts for and discloses guarantees in accordance with FASB Interpretation No. 45 (FIN 45), *Guarantor s Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57 and 107 and rescission of FIN 34*. The following is a summary of the Company s agreements that the Company has determined are within the scope of FIN 45:

Under its bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer s or director s serving in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. However, the Company has a directors and officers liability insurance policy that limits its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of December 31, 2004 and 2003.

The Company may enter into indemnification provisions under its agreements with other companies in its ordinary course of business, typically with business partners, suppliers, contractors, customers and landlords. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for direct losses suffered or incurred by the indemnified party as a result of the Company s activities or, in some cases, as a result of the indemnified party s activities under the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2004 and 2003.

Reclassifications

Certain balances in the prior period consolidated financial statements have been reclassified to conform with current period presentation.

4. Investments

The following table summarizes the various investment categories at December 31, 2004 and 2003 (in thousands):

	Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
December 31, 2004				
U.S. government securities	$ 12,463	$ ¾	$ (29)	$ 12,434
Corporate obligations	4,234	1	(11)	4,224
	16,697	1	(40)	16,658
Certificates of deposit restricted	1,656	¾	¾	1,656
Total debt securities	18,353	1	(40)	18,314
Equity securities	3,186	338	¾	3,524
Equity securities restricted	722	¾	¾	722
	$ 22,261	$ 339	$ (40)	$ 22,560

December 31, 2003							
U.S. government securities	$ 14,265	$	8	$	(1)	$	14,272
Corporate obligations	16,518		11		(1)		16,528
	30,783		19		(2)		30,800
U.S. government securities restricted	9,204		¾		¾		9,204
Certificates of deposit restricted	1,656		¾		¾		1,656
	$ 41,643	$	19	$	(2)	$	41,660

There were no material realized gains or losses on sales of available-for-sale securities for the years ended December 31, 2004, 2003 and 2002.

The amortized cost and estimated fair value of debt security investments at December 31, 2004, by contractual maturity, are shown below (in thousands). Expected maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

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	December 31, 2004	
	Cost	Estimated fair value
Due in one year or less	$ 10,439	$ 10,418
Due after one year through three years	7,914	7,896
	$ 18,353	$ 18,314

5. Other Balance Sheet Details

Accounts receivable consist of the following (in thousands):

	December 31,	
	2004	2003
		(Restated)
Trade accounts receivable	$ 25,860	$ 5,809
Due from finance company	6,084	14,034
Less discounts and allowances	(1,097)	(942)
	$ 30,847	$ 18,901

Other current assets consist of the following (in thousands):

	December 31,	
	2004	2003
		(Restated)
Deferred royalty cost	$ 9,363	$ 9,680
Deferred cost of products sold	4,784	3,590
Prepaid insurance	1,024	1,036
Prepaid other	2,102	1,278
Other	440	777
	$ 17,713	$ 16,361

Other assets consist of the following (in thousands):

	December 31,	
	2004	2003
		(Restated)
Prepaid royalty buyout, net	$ 2,584	$ 2,856
Debt issue costs, net	3,231	4,205
Investments	¾	203
Other	359	732
	$ 6,174	$ 7,996

Accrued liabilities consist of the following (in thousands):

	December 31,	
	2004	2003 (Restated)
Allowances for loss on returns, rebates, chargebacks, other discounts, ONTAK end-customer and Panretin product returns	$ 16,151	$ 9,196
Co-promotion	7,845	8,899
Distribution services	3,693	¾
Compensation	4,324	4,129
Royalties	5,134	4,297
Seragen purchase liability	2,838	3,439
Interest	1,164	1,164
Other	2,759	1,543
	$ 43,908	$ 32,667

The following summarizes the activity in the accrued liability accounts related to allowances for loss on returns, rebates, chargebacks, other discounts, ONTAK end-customer and Panretin returns (in thousands):

	Year Ended December 31,		
	2004	2003 (Restated)	2002 (Restated)
Balance beginning of year	$ 9,196	$ 3,952	$ 3,190
Provision for ONTAK end-customer and Panretin returns	3,015	1,547	2,886
Returns	(2,492)	(1,308)	(2,986)
Net change ONTAK end-customer and Panretin returns	523	239	(100)
Provision for losses on returns due to changes in prices	5,018	4,229	2,265
Charges	(3,025)	(856)	(1,802)
Net change losses on returns	1,993	3,373	463
Provision for Medicaid rebates	14,430	2,724	511
Payments	(11,074)	(1,239)	(445)
Net change Medicaid rebates	3,356	1,485	66
Provision for chargebacks	3,962	2,184	936
Payments	(3,684)	(2,123)	(958)
Net change chargebacks	278	61	(22)
Provision for managed care rebates and other contract discounts	5,773	852	34
Payments	(4,455)	(457)	(3)
Net change managed care rebates and other contract discounts	1,318	395	31
Provision for other discounts	6,495	9,035	2,091
Payments	(7,008)	(9,344)	(1,767)
Net change other discounts	(513)	(309)	324
Balance end of year	$ 16,151	$ 9,196	$ 3,952

6. Accounts Receivable Factoring Arrangement

During 2003, the Company entered into a one-year accounts receivable factoring arrangement under which eligible accounts receivable are sold without recourse to a finance company. The agreement was renewed for a one-year period in the second quarter of 2004 and again in the second quarter of 2005 through December 2007. Commissions on factored receivables are paid to the finance company based on the gross receivables sold, subject to a minimum

annual commission. Additionally, the Company pays interest on the net outstanding balance of the uncollected factored accounts receivable at an interest rate equal to the JPMorgan Chase Bank prime rate. The Company continues to service the factored receivables. The servicing expenses for 2004 and 2003 and the servicing liability at December 31, 2004 and 2003 were not material. There were no material gains or losses on the sale of such receivables. The Company accounts for the sale of receivables under this arrangement in accordance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*.

The agreement requires the Company to provide its consolidated financial statements to the finance company within 120 days after year-end. Because the Company was unable to complete its restated consolidated financial statements within 120 days, it was in default of this requirement. A waiver of this financial reporting covenant has been granted through December 31, 2005.

As of December 31, 2004 and 2003, the Company had received cash of $17.2 million and $27.5 million, respectively, under the factoring arrangement for the sale of trade receivables that were outstanding as of that date. The gross amount due from the finance company at December 31, 2004 and 2003 was $6.1 million and $14.0 million, respectively.

7. Strategic Alliance with Elan Corporation

The Company and Elan Corporation, plc (Elan) have been parties to a number of agreements that provided financing to the Company and a license to Elan s product AVINZA. Significant provisions are as follows:

Financing Arrangement

From 1998 through 2000, the Company issued Elan through a series of separate transactions, $110.0 million in zero coupon convertible senior notes (the Notes). Through 2001, Elan had subsequently converted $40.0 million of the Notes into shares of the Company s common stock. In December 2001, Elan agreed to convert $50.0 million of the Notes plus accrued interest of $11.8 million into 4,406,010 shares of Ligand common stock. The conversion occurred in February 2002 subsequent to regulatory approval.

In March 2002, Elan agreed to convert the remaining Notes totaling $20.0 million of zero coupon convertible senior notes and $4.7 million of accrued interest into 1,766,916 shares of Ligand common stock. In connection with the conversion, Ligand provided Elan with a $2.0 million conversion incentive through the issuance of 102,151 shares of common stock. The cost of the conversion incentive is recorded as debt conversion expense in the accompanying consolidated statement of operations.

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The financing arrangement with Elan contained certain rights of first refusal upon the subsequent issuance of securities. In accordance with such rights and as a result of other equity issuances by the Company, the Company granted 91,406 warrants to Elan in 1999. Elan subsequently exercised the warrants in connection with the March 2002 conversion of the Notes.

License and Supply Agreement

In 1998, Elan also agreed to exclusively license and supply to the Company in the United States and Canada its proprietary product AVINZA, a form of morphine for chronic, moderate-to-severe pain. In November 2002, the Company and Elan agreed to amend the terms of the AVINZA license and supply agreement. Under the terms of the amendment, Ligand paid Elan $100.0 million in return for a reduction in Elan s product supply price on sales of AVINZA by Ligand, rights to sublicense and obtain a co-promotion partner in its territories, and rights to qualify and purchase AVINZA from a second manufacturing source. Elan s adjusted royalty and supply price of AVINZA is approximately 10% of the product s net sales, compared to approximately 30-35% in the prior agreement. Ligand committed to annually purchase a minimum of 40 batches of AVINZA from Elan through 2005, estimated at approximately $9.2 million per year. In addition, Elan agreed to forego its option to co-promote AVINZA in the United States and Canada. The amount paid to Elan and related transaction costs were capitalized as acquired product rights.

The total amount paid to Elan for AVINZA purchases and royalties in 2004 and 2003 was $15.4 and $6.3 million, respectively. The purchases in 2003 represent 20 batches of product. Elan was unable to obtain a sufficient quota of morphine from the Drug Enforcement Agency and was therefore only able to supply Ligand with 20 batches prior to December 31, 2003. The remaining batches were subsequently shipped to Ligand in 2004. Ligand met its minimum purchase commitment for 2004.

Repurchase of Elan Shares

In connection with the November 2002 restructuring of the AVINZA license agreement, the Company also agreed to repurchase approximately 2.2 million Ligand common shares held by an affiliate of Elan for $9.00 a share. The difference between the $9.00 per share purchase price and the public price of the shares ($7.14 per share) at the time the agreement was signed, approximately $4.1 million, was treated as an additional component of the price paid for the reduced AVINZA royalty rate under the restructured license and supply agreement and, accordingly, is capitalized as acquired technology and product rights. The shares were purchased and retired in February 2003. In accordance with Emerging Issue Task Force Topic D-98, Classification and Measurement of Redeemable Securities (EITF D-98), the Elan shares with a carrying value totaling $20.0 million were reclassified in November 2002 to common stock subject to conditional redemption/repurchase, since the Company was obligated as of that date to repurchase the shares.

In addition, Elan agreed to a 6-month lock-up period on 11.8 million of its remaining 12.2 million Ligand shares. Ligand agreed to changes to Elan s registration rights to facilitate an orderly distribution of its shares after the lock-up period. In May and July 2003, Elan disclosed that it had sold the remaining 12.2 million Ligand shares to unrelated third parties. In July 2003, Ligand filed a resale registration statement on behalf of the unrelated third parties, registering the resale of the shares they had acquired from Elan.

Distribution Agreement

In February 2001, the Company and Elan entered into a distribution agreement providing for the distribution of certain of the Company s products in various European and other international territories for a term of ten years. In 2001, the Company received a $1.5 million up-front fee at contract inception, which is deferred and amortized over the life of the distribution agreement, and $4.5 million in milestone payments upon the subsequent submission of European Union (EU) applications for MAA and grants of MAAs for certain of the products subject to the distribution agreement. The Company may receive additional payments as products are submitted and approved in the territories. In February 2004, Elan and Medeus Pharma Limited (now Zeneus) announced that Medeus had acquired Elan s European sales and marketing business, and that the acquisition included the marketing and distribution rights to certain of the Company s products in Europe.

8. AVINZA Co-Promotion

In February 2003, Ligand and Organon Pharmaceuticals USA Inc. (Organon) announced that they had entered into an agreement for the co-promotion of AVINZA. Under the terms of the agreement, Organon committed to a specified minimum number of primary and secondary product calls delivered to certain high prescribing physicians and hospitals beginning in March 2003. Organon s compensation is structured as a percentage of net sales based on Ligand s standard accounting principles and generally accepted accounting principles (GAAP), which pays Organon for their efforts and also provides Organon an economic incentive for performance and results. In exchange, Ligand pays Organon a percentage of AVINZA net sales based on the following schedule:

Annual Net Sales of AVINZA	% of Incremental Net Sales Paid to Organon by Ligand
$0-35 million (2003 only)	0% (2003 only)
$0-150 million	30%
$150-300 million	40%
$300-425 million	50%
> $425 million	45%

Through the announcement of the restatement, Ligand calculated and paid Organon s compensation according to its prior application of GAAP and its prior standard accounting principles. The restatement corrects the recognition of revenue for transactions involving AVINZA that did not satisfy all of the conditions for revenue recognition contained in SFAS 48 and SAB 104. Shipments made to wholesalers for AVINZA did not meet the revenue recognition criteria under GAAP and such transactions were restated using the sell-through method as opposed to the sell-in method previously used.

Under the sell-through method used in the restatement and to be used on a going-forward basis, Ligand does not recognize revenue upon shipment of AVINZA to the wholesaler. As a result, Ligand believes it has overpaid Organon under the terms of the agreement by approximately $18.6 million through December 31, 2004. Ligand has notified Organon regarding the overpayment and its intention to apply such overpayment to future amounts due under the co-promotion agreement calculated under GAAP and its standard accounting principles. Organon has expressed its disagreement with this position and Ligand is currently in discussions with Organon. While the discussions continue, the payments made and under discussion are currently reflected in Ligand s 2004 and 2003 consolidated financial statements as co-promotion expense, $9.2 million in 2004 and $9.4 million in 2003, respectively. Therefore, the consolidated financial statements included herein do not recognize the overpayment pending resolution of the matter. Until this matter is resolved, Ligand will continue to account for co-promotion expense based on net sales determined using the sell-in method.

Additionally, Ligand and Organon agreed to equally share all costs for AVINZA advertising and promotion, medical affairs and clinical trials. Each company is responsible for its own sales force costs and other expenses. The initial term of the co-promotion agreement is ten years. Organon has the option any time prior to the end of year five to extend the agreement to 2017 by making a $75.0 million payment to Ligand. Either party may terminate the agreement in the event that net sales of AVINZA during 2007 are less than a specified level. Further, either party may terminate the agreement upon material breach of the other party, including a failure of the other party to meet at least 95% of its minimum sales calls obligations, or to use its commercially reasonable efforts to market and promote AVINZA in accordance with the mutually agreed marketing plan, which includes the number, targeting and frequency of sales calls. For 2003, the Company was required to pay Organon 30% of net AVINZA sales in excess of $35.0 million. Co-promotion expense for 2004 and 2003 was $30.1 million and $9.4 million, respectively.

9. Seragen

In 1998, the Company completed a merger with Seragen. Under the terms of the merger agreement, Ligand paid merger consideration of $31.7 million at closing and $34.1 million in 1999 subsequent to final FDA approval of ONTAK. Pending resolution of final contingencies and in accordance with the terms of the merger agreement, the Company has withheld $2.1 million and $2.8 million as of December 31, 2004 and 2003, respectively (recorded in accrued liabilities), from payments made to certain Seragen stakeholders (See Note 12).

In connection with the Seragen merger, the Company acquired substantially all the assets of Marathon Biopharmaceuticals, LLC (Marathon), which provided manufacturing services to Seragen. In 2000, Ligand sold the contract manufacturing assets of Marathon and in connection with the sale, entered into a three-year supply and development agreement with the acquirer for the manufacture of ONTAK. Purchases under the agreement amounted to $3.0 million, $4.6 million and $1.8 million in 2004, 2003 and 2002, respectively. In 2003, the Company entered into a new five-year agreement with Cambrex Bio Science Hopkinton, Inc., the successor of Marathon, for the

continued manufacturing of ONTAK.

10. Long-term Debt

Long-term debt consists of the following (in thousands):

	December 31, 2004	December 31, 2003
6% Convertible Subordinated Notes	$ 155,250	$ 155,250
Note payable to bank	12,159	12,453
	167,409	167,703
Less current portion	(320)	(295)
Long-term debt	$ 167,089	$ 167,408

6% Convertible Subordinated Notes

In November 2002, the Company completed a private offering of 6% Convertible Subordinated Notes in the aggregate principal amount of $155.3 million, receiving net proceeds of $150.1 million. The notes pay interest semi-annually at a rate of 6% and mature on November 16, 2007. Holders may convert the notes into shares of common stock at any time prior to maturity at a conversion rate of 161.9905 shares per $1,000 principal amount of notes. Total shares of common stock that would be issued if all notes were converted is 25,149,025. Of the net proceeds, $18.0 million was invested in U.S. government securities and placed with a trustee to pay the first four scheduled interest payments. These first four interest payments were made in 2003 and 2004 for $9.1 million and $9.3 million, respectively. On or after November 22, 2005, the Company has the option to redeem the notes, in whole or in part, at specified redemption prices ranging from 102.4% to 101.2% of the outstanding principal amount plus accrued and unpaid interest. Upon a change in control, holders of the notes can require the Company to repurchase the notes. The Company paid approximately $5.2 million in debt issuance costs that are being amortized using the interest method.

Note Payable to Bank

In December 2003, Ligand implemented the provisions of FIN 46(R), *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51* (see Note 2, Significant Accounting Policies Cumulative Effect of Accounting Change). In connection with the implementation of FIN 46(R), the Company consolidated the entity, Nexus, from which it leased one of its corporate headquarter buildings, including assets of $13.6 million and a note payable to bank (the Note) of $12.5 million. Ligand subsequently acquired the portion of Nexus it did not previously own in April 2004. As of December 31, 2004, the Note has a net book value of $12.2 million. The Note carries an interest rate of 7.15% and requires periodic principal and interest payments through July 2008. The Note is secured by a lien on the subject building (including the land and tenant improvements associated with that building). Payments due on the Note during each of the years subsequent to December 31, 2004, through maturity, are $0.3 million for 2005, $0.3 million for 2006, $0.4 million for 2007, and $11.1 million for 2008.

Convertible Subordinated Debentures

In June 2002, the Company redeemed $50.0 million in face value of 7.5% convertible subordinated debentures due January 2003. The remaining $1.6 million of accretion to face value at the time of redemption was charged to interest expense. Amortization of debt discount for 2002, using the interest method, was $1.1 million.

11. Royalty Agreements

The Company has royalty obligations under various technology license agreements. During 2004, royalties to individual licensors were accrued ranging from 0.5% to 20.0% of net sales. Royalty expense for the years ended December 31, 2004, 2003 and 2002 was $15.5 million, $8.2 million and $5.6 million, respectively.

Sale of Royalty Rights

Revenue from the sale of royalty rights represents the sale to third parties of rights and options to acquire future royalties we may earn from the sale of products in development with our collaborative partners. If we have no continuing involvement in the research or development of these products, sales of royalty rights are recognized as revenue in the period the transaction is consummated or the options are exercised or expire.

In March 2002, we entered into an agreement with Royalty Pharma AG (Royalty Pharma) to sell a portion of our rights to future royalties from the net sales of three selective estrogen receptor modulator (SERM) products now in late stage development with two of our collaborative partners, Pfizer and Wyeth. The agreement provided for the initial sale of rights to 0.25% of such product net sales for $6.0 million and options to acquire up to an additional 1.00% of net sales for $50.0 million. Of the initial $6.0 million sale of rights, $0.2 million was attributed to the fair market value of the options and recorded as deferred revenue. The deferred revenue was recognized upon exercise or expiration of the options.

In July and December of 2002, the agreement was amended to replace the existing options with new options providing for the rights to acquire an additional 1.3125% of net sales for $63.8 million. Royalty Pharma exercised each of the three available 2002 options, as amended, acquiring rights to 0.4375% of net sales for $12.3 million. The fair value estimated for the amended options, $0.2 million, was recorded as deferred revenue.

In October 2003, the existing royalty agreement was amended and Royalty Pharma exercised an option for $12.5 million in exchange for 0.7% of potential future sales of the three SERM products for 10 years. Under the revised agreement, Royalty Pharma had three additional options to purchase up to 1.3% of such product net sales for $39.0 million.

In November 2004, Royalty Pharma agreed to purchase an additional 1.625% royalty on future sales of the SERM products for $32.5 million and cancel its remaining two options. Payments from the royalty purchase are non-refundable.

Under the underlying royalty agreements, both Pfizer and Wyeth have the right to offset a portion of any future royalty payments owed to the Company to the extent of previous milestone payments. Accordingly, the Company deferred a portion of the revenue associated with each tranche of royalty right sold, including rights acquired upon the exercise-of-options, equal to the pro-rata share of the potential royalty offset. Such amounts associated with the offset rights against future royalty payments will be recognized as revenue upon receipt of future royalties from the respective partners.

Sale of royalty rights recognized in 2004, 2003 and 2002 amounted to $31.3 million, $11.8 million, and $17.6 million, respectively, net of the deferral of offset rights of $1.4 million, $0.6 million and $0.6 million, respectively, and the recognition in 2004 and 2003 of $0.2 million and $0.1 million, respectively, of option value deferred in previous periods.

Sale of Interest in Targretin Capsules Net Sales

In December 2002, Ligand entered into an agreement to sell Royalty Pharma a 1% interest in net sales of Targretin capsules for $1.0 million starting in January 2003. The $1.0 million is being accounted for as a financing arrangement in accordance with Emerging Issues Task Force (EITF) Issue No. 88-18, Sales of Future Revenues, due to the Company s continuing involvement with Targretin capsules.

Buy Out of Salk Royalty Obligation

In March 2004, the Company paid The Salk Institute (Salk) $1.1 million in connection with the Company s exercise of an option to buy out milestone payments, other payment-sharing obligations and royalty payments due on future sales of lasofoxifene, a product under development by Pfizer. This payment was recognized as a development expense for the year ended December 31, 2004 because Pfizer had not yet filed its NDA at the time of the Company s exercise.

Restructuring of ONTAK Royalty

In November 2004, Ligand and Eli Lilly and Company (Lilly) agreed to amend their ONTAK royalty agreement to add options in 2005 that if exercised would restructure Ligand s royalty obligations on net sales of ONTAK. Under the revised agreement, Ligand and Lilly each obtained two options. Ligand s options, exercisable in January 2005 and April 2005, provide for the buy down of a portion of the Company s ONTAK royalty obligation on net sales in the United States for total consideration of $33.0 million. Lilly also had two options exercisable in July 2005 and October 2005 to trigger the same royalty buy-downs for total consideration of up to $37.0 million dependent on whether Ligand has exercised one or both of its options.

Ligand s first option, providing for a one-time payment of $20.0 million to Lilly in exchange for the elimination of Ligand s ONTAK royalty obligations in 2005 and a reduced reverse-tiered royalty scale on ONTAK sales in the U.S. thereafter, was exercised in January 2005. The second option which provides for a one-time payment of $13.0 million to Lilly in exchange for the elimination of royalties on ONTAK net sales in the U.S. in 2006 and a reduced reverse-tiered royalty thereafter was exercised in April 2005. Additionally, beginning in 2007 and throughout the remaining ONTAK patent life (2014), Ligand will pay no royalties to Lilly on U.S. sales up to $38.0 million. Thereafter, Ligand would pay royalties to Lilly at a rate of 20% on net U.S. sales between $38.0 million and $50.0 million; at a rate of 15% on net U.S. sales between $50.0 million and $72.0 million; and at a rate of 10% on net U.S. sales in excess of $72.0 million. The option payments totaling $33.0 million will be capitalized and amortized over the remaining ONTAK patent life of approximately 10 years, which represents the period estimated to be benefited, using the greater of the straight-line method or the expense determined based on the tiered royalty schedule set forth above. In accordance with SFAS No. 142, *Goodwill and Other Intangibles,* the Company amortizes intangible assets with finite lives in a manner that reflects the pattern in which the economic benefits of the assets are consumed or otherwise used up. If that pattern cannot be reliably determined, the assets are amortized using the

straight-line method.

12. Commitments and Contingencies

Equipment Financing

The Company has entered into capital lease and equipment note payable agreements that require monthly payments through December 2008 including interest ranging from 4.73% to 10.66%. The carrying value of equipment under these agreements at December 31, 2004 and 2003 was $9.5 million and $6.5 million, respectively. At December 31, 2004 and 2003, related accumulated amortization was $4.3 million and $3.3 million, respectively. The underlying equipment is used as collateral under the equipment notes payable.

Certain of the equipment financing agreements contain provisions that require the Company to fund standby letters of credit equal to the balance financed under the arrangement in the event unrestricted cash levels fall below specified amounts.

Property Leases

As of December 31, 2003, the Company leased one of its corporate office buildings from Nexus Equity VI LLC (Nexus), a limited liability company in which Ligand held a 1% ownership interest. No Ligand officer or employee had any financial interest with regard to this lease arrangement or with Nexus. The lease agreement provided for increases in annual rent of 4% and terminated in 2014. In addition, Ligand had the option to either purchase the portion of Nexus that it did not own, purchase the property from the lessor at a purchase price equal to the outstanding debt on the property plus a calculated return on the investment made by Nexus other shareholder, sell the property to a third party, or renew the lease arrangement.

This specific type of operating lease is commonly referred to as a synthetic lease . Prior to the issuance of FIN 46(R), synthetic leases represented a form of off-balance sheet financing under which they were treated as an operating lease for financial reporting purposes and as a financing lease for tax purposes. Under FIN 46(R), a synthetic lease is evaluated to determine i) if it qualifies as a VIE and if so, ii) the primary beneficiary required to consolidate the VIE.

Under FIN 46(R), Ligand determined that Nexus qualified as a VIE, and that Ligand was the primary beneficiary of the VIE, as the Company would absorb the majority of the entity s expected losses, if any, as defined by FIN 46(R). In accordance with FIN 46(R), the Company consolidated Nexus as of December 31, 2003. See Note 3, Significant Accounting Policies Cumulative Effect of Accounting Change section for information on the impact of the Company s adoption of FIN 46(R).

The maximum exposure to loss on the synthetic lease was indemnification for various losses, costs and expenses incurred by Nexus as a result of Ligand s use of the premises or the environmental condition of the property to the extent it exceeded the limit of insurance held by the Company. Any such additional losses, costs or expenses were contingent upon the existence of certain conditions and were not quantifiable as of December 31, 2003.

In April 2004, the Company exercised its right to acquire the portion of Nexus that it did not own. The acquisition resulted in Ligand s assumption of the existing loan against the property and payment to Nexus other shareholder of approximately $0.6 million.

The Company leases its other office and research facilities under operating lease arrangements with varying terms through July 2015. The agreements provide for increases in annual rents based on changes in the Consumer Price Index or fixed percentage increases ranging from 3% to 7%. The Company recognizes rent expense on a straight-line basis. Deferred rent at December 31, 2004 and 2003 was $2.4 million and $2.3 million, respectively.

Total rent expense under all office leases for 2004, 2003 and 2002 was $1.9 million, $3.5 million and $3.4 million, respectively.

At December 31, 2004 annual minimum payments due under the Company s office, equipment and vehicle lease obligations are as follows (in thousands):

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	Obligations under capital leases and equipment notes payable		Operating leases	
2005	$	2,980	$	2,939
2006		2,176		2,397
2007		1,508		1,780
2008		701		1,833
2009		¾		1,888
Thereafter		¾		11,627
Total minimum lease payments		7,365	$	22,464
Less amounts representing interest		(758)		
Present value of minimum lease payments		6,607		
Less current portion		(2,604)		
	$	4,003		

Product Liability

The Company s business exposes it to potential product liability risks. The Company s products also may need to be recalled to address regulatory issues. A successful product liability claim or series of claims brought against the Company could result in payment of significant amounts of money and divert management s attention from running the business. Some of the compounds the Company is investigating may be harmful to humans. For example, retinoids as a class are known to contain compounds which can cause birth defects. The Company may not be able to maintain insurance on acceptable terms, or the insurance may not provide adequate protection in the case of a product liability claim. To the extent that product liability insurance, if available, does not cover potential claims, the Company would be required to self-insure the risks associated with such claims. The Company believes that it carries reasonably adequate insurance for product liability claims.

Distribution Service Agreements

In 2004, the Company entered into one-year fee-for-service agreements (or distribution service agreements) for each of its products, with the majority of its wholesaler customers. These agreements were subsequently renewed in 2005 for an additional one-year period. In exchange for a set fee, the wholesalers agreed to provide the Company with certain information regarding product stocking and out-movement; agreed to maintain inventory quantities within specified minimum and maximum levels; inventory handling, stocking and management services; and certain other services surrounding the administration of returns and chargebacks. The amount of minimum payments due under the distribution service agreements for 2005, including agreements that were subsequently renewed, is approximately $11.9 million.

For the years ended December 31, 2004, 2003, and 2002 shipments to three wholesale distributors each accounted for more than 10% of total shipments and in the aggregate 77%, 82%, and 92% of total shipments, respectively.

Employment Agreements

The Company has employment agreements with its Chief Executive Officer, Chief Scientific Officer and Chief Financial Officer which include severance provisions and change in control severance arrangements with each of its executive officers except its Chief Executive Officer, David E. Robinson. Mr. Robinson s agreement automatically renews every three years unless terminated and provides for minimum salary, as adjusted, and incentive bonuses paid upon attainment of specified management goals and severance provisions in the event of termination under specified conditions, including change of control. The change in control severance agreements provide for severance payments

in the event that employment is involuntarily terminated in connection with a change in control of the Company.

Consultant Agreements

The Company has various arrangements with consultants with terms ranging from one to three years.

Manufacturing and Supply Agreements

The Company has limited approved manufacturers for its products and, for certain product components or manufacturing stages, it has only one supplier. Any problems with such manufacturing operations or capacity could reduce sales of the Company s products as could any licensing or other contract disputes with these suppliers.

As of December 31, 2004, Elan was the Company s only approved supplier of AVINZA, its largest product. In March 2004, Ligand entered into a five-year manufacturing and packaging agreement with Cardinal Health PTS, LLC (Cardinal) under which Cardinal will manufacture AVINZA at its Winchester, Kentucky facility. In August 2005, the FDA approved the production of AVINZA at the Cardinal facility. Under the terms of the agreement, Ligand committed to certain minimum annual purchases ranging from approximately $1.6 million to $2.3 million.

In 2005, the Company completed a multi-year process of transferring its filling and finishing of ONTAK from Lilly to Hollister-Stier. In anticipation of this transfer, the Company used Lilly to fill and finish, in 2003, a higher than normal number of ONTAK lots each of which required a forward dating determination. If commercial and clinical usage of these lots does not approximate the estimated pattern of usage as determined for purposes of dating, the Company could be required to write-off the value of one or more of these lots. As of December 31, 2004, the carrying amount of ONTAK finished goods inventory was approximately $4.2 million.

Litigation

Seragen, Inc., our subsidiary, and Ligand, were named parties to Sergio M. Oliver, et al. v. Boston University, et al., a putative shareholder class action filed on December 17, 1998 in the Court of Chancery in the State of Delaware in and for New Castle County, C.A. No. 16570NC, by Sergio M. Oliver and others against Boston University and others, including Seragen, its subsidiary Seragen Technology, Inc. and former officers and directors of Seragen. The complaint, as amended, alleged that Ligand aided and abetted purported breaches of fiduciary duty by the Seragen related defendants in connection with the acquisition of Seragen by Ligand and made certain misrepresentations in related proxy materials and seeks compensatory and punitive damages of an unspecified amount. On July 25, 2000, the Delaware Chancery Court granted in part and denied in part defendants motions to dismiss. Seragen, Ligand, Seragen Technology, Inc. and our acquisition subsidiary, Knight Acquisition Corporation, were dismissed from the action. Claims of breach of fiduciary duty remain against the remaining defendants, including the former officers and directors of Seragen. The hearing on the plaintiffs motion for class certification took place on February 26, 2001. The court certified a class consisting of shareholders as of the date of the acquisition and on the date of the proxy sent to ratify an earlier business unit sale by Seragen. On January 20, 2005, the Delaware Chancery Court granted in part and denied in part the defendants motion for summary judgment. The Court denied plaintiffs motion for summary judgment in its entirety. Trial was scheduled for February 7, 2005. Prior to trial, several of the Seragen director-defendants reached a settlement with the plaintiffs. The trial in this action then went forward as to the remaining defendants and concluded on February 18, 2005. The timing of a decision by the Court and the outcome are unknown. While Ligand and its subsidiary Seragen have been dismissed from the action, such dismissal is subject to a possible subsequent appeal upon any judgment in the action against the remaining parties, as well as possible indemnification obligations with respect to certain defendants.

On December 11, 2001, a lawsuit was filed in the United States District Court for the District of Massachusetts against Ligand by the Trustees of Boston University and other former stakeholders of Seragen. The suit was subsequently transferred to federal district court in Delaware. The complaint alleges breach of contract, breach of the implied covenants of good faith and fair dealing and unfair and deceptive trade practices based on, among other things, allegations that Ligand wrongfully withheld approximately $2.1 million in consideration due the plaintiffs under the Seragen acquisition agreement. This amount had been previously accrued for in the Company s consolidated financial statements in 1998. The complaint seeks payment of the withheld consideration and treble damages. Ligand filed a motion to dismiss the unfair and deceptive trade practices claim. The Court subsequently granted Ligand s motion to dismiss the unfair and deceptive trade practices claim (i.e. the treble damages claim), in April 2003. In November 2003, the Court granted Boston University s motion for summary judgment, and entered judgment for Boston University. In January 2004, the district court issued an amended judgment awarding interest of approximately $0.7 million to the plaintiffs in addition to the approximately $2.1 million withheld. In view of the judgment, the Company recorded a charge of $0.7 million to Selling, general and administrative expense in the fourth quarter of 2003. The Company continues to believe that the plaintiff s claims are without merit and has appealed the judgment in this case as well as the award of interest and the calculation of damages. The appeal has been fully briefed and was argued in June 2005 and the parties are awaiting the court s decision. The likelihood of success on appeal is unknown.

Beginning in August 2004, several purported class action stockholder lawsuits were filed in the United States District Court for the Southern District of California against the Company and certain of its directors and officers. The actions were brought on behalf of purchasers of the Company s common stock during several time periods, the longest of which runs from July 28, 2003 through August 2, 2004. The complaints generally allege that the Company violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission by making false and misleading statements, or concealing information about the Company s business, forecasts and financial performance, in particular statements and information related to drug development issues and AVINZA inventory levels. These lawsuits have been consolidated and lead plaintiffs appointed. A consolidated complaint was filed by the plaintiffs on March 2005. On September 27, 2005, the court granted the Company s motion to dismiss the consolidated complaint, with leave for plaintiffs to file an amended complaint within 30 days. No trial date has been set.

Beginning on or about August 13, 2004, several derivative actions were filed on behalf of the Company by individual stockholders in the Superior Court of California. The complaints name the Company s directors and certain of its officers as defendants and name the Company as a nominal defendant. The complaints are based on the same facts and circumstances as the purported class actions discussed in the previous paragraph and generally allege breach of fiduciary duties, abuse of control, waste and mismanagement, insider trading and unjust enrichment. These actions are in discovery. The court has set a trial date of May 26, 2006.

In October 2005, a shareholder derivative action was filed on behalf of the Company in the United States District Court for the Southern District of California. The complaint names the Company s directors and certain of its officers as defendants and the Company as a nominal defendant. The action was brought by an individual stockholder. The complaint generally alleges that the defendants falsified Ligand s publicly reported financial results throughout 2002 and 2003 and the first three quarters of 2004 by improperly recognizing revenue on product sales. The complaint generally alleges breach of fiduciary duty by all defendants and requests disgorgement, e.g., under Section 304 of the Sarbanes-Oxley Act of 2002. No trial date has been set.

The Company believes that all of the above actions are without merit and intends to vigorously defend against each of such lawsuits. Due to the uncertainty of the ultimate outcome of these matters, the impact on future financial results is not subject to reasonable estimates.

In October 2005, a lawsuit was filed in the Court of Chancery in the State of Delaware by Third Point Offshore Fund, Ltd. requesting the Court to order Ligand to hold an annual meeting for the election of directors within 60 days of an order by the Court. Ligand s annual meeting has been delayed as a result of the previously announced restatement. The complaint requested the Court to set a time and place and record date for such annual meeting and establish the quorum for such meeting as the shares present at the meeting, notwithstanding any relevant provisions of Ligand s certificate of incorporation or bylaws. The complaint also sought payment of plaintiff s costs and attorney s fees. Ligand agreed on November 11, 2005 to settle this lawsuit and schedule the annual meeting for January 31, 2006. The record date will be set by the Board of Directors and will be between December 5 and December 15, 2005. No special quorum requirement will be established and each party will be responsible for its own costs and fees. Third Point has indicated that it will solicit proxies to elect at least three directors at the annual meeting.

In connection with the restatement, the SEC instituted a formal investigation concerning the Company s consolidated financial statements. These matters were previously the subject of an informal SEC inquiry.

In addition, the Company is subject to various lawsuits and claims with respect to matters arising out of the normal course of business. Due to the uncertainty of the ultimate outcome of these matters, the impact on future financial results is not subject to reasonable estimates.

13. Common Stock Subject to Conditional Redemption Pfizer Settlement Agreement

In April 1996, the Company and Pfizer entered into a settlement agreement with respect to a lawsuit filed in December 1994 by the Company against Pfizer. In connection with a collaborative research agreement the Company entered into with Pfizer in 1991, Pfizer purchased shares of the Company s common stock. Under the terms of the settlement agreement, at the option of either the Company or Pfizer, milestone and royalty payments owed to the Company can be satisfied by Pfizer by transferring to the Company shares of the Company s common stock at the exchange ratio of $12.375 per share. In accordance with EITF D-98, the remaining common stock issued and outstanding to Pfizer following the settlement was reclassified as common stock subject to conditional redemption (between liabilities and equity) since Pfizer has the option to settle with Company s shares milestone and royalties payments owed to the Company and such option is not within the Company s control.

In the third quarter of 2004, Ligand earned a development milestone of approximately $2.0 million from Pfizer, in connection with Pfizer s filing with the FDA of a new drug application for lasofoxifene. The milestone is recorded as Other revenue in the accompanying Consolidated Statement of Operations. Pfizer elected to pay the milestone in stock and subsequently tendered 181,818 shares to the Company. Ligand retired the tendered shares in September 2004. The difference between the fair value of the shares tendered and the carrying value of such shares based on the exchange ratio, approximately $0.3 million, was credited to additional paid-in capital. At December 31, 2004, the remaining shares of the Company s Common Stock that could be redeemed totaled approximately 998,000, which are reflected at the exchange ratio price of $12.375 for a total of $12.3 million.

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14. Stockholders Equity (Deficit)

Stock Issuances

At its annual meeting of stockholders held on June 11, 2004, the Company s stockholders approved an increase in the authorized number of shares of Common Stock from 130,000,000 to 200,000,000.

Shares of common stock issued under the Company s stock option/stock issuance plans during the years ended December 31, 2004, 2003 and 2002 were 582,176; 344,957; and 346,187, respectively.

Shares of common stock issued under the Company s employee stock purchase plan during the years ended December 31, 2004, 2003 and 2002 were 101,895; 136,301; and 89,592, respectively.

In September 2003, the Company raised proceeds of $45.0 million net of offering costs of $2.0 million, in a private placement of 3,483,593 shares of its common stock.

In 2002, the Company raised proceeds of $66.1 million net of offering costs of $3.2 million, in a private placement of 4,252,500 shares of its common stock.

Issuance of Shares to Elan

In 2002, the Company issued Elan 6,366,483 shares of common stock in connection with the conversion of the principal and interest of certain zero coupon convertible senior notes, as described in Note 7.

In 2002, the Company also issued Elan 302,554 shares of common stock in settlement of a $5.0 million milestone resulting from the FDA approval of AVINZA.

Repurchase of Elan Shares

As more fully described in Note 7, in February 2003, Ligand purchased and retired approximately 2.2 million Ligand common shares held by an affiliate of Elan.

Warrants

During 2004, warrants to purchase 201,200 shares of common stock were exercised. At December 31, 2004, there were outstanding warrants to purchase 748,800 shares of the Company s common stock. The warrants have an exercise price of $10.00 per share and expire on October 6, 2006.

Stock Plans

In May 2002, the Company s stockholders approved the 2002 Stock Option/Stock Issuance Plan (the 2002 Option Plan) which is the successor to the Company s 1992 Stock Option/Stock Issuance Plan (the 1992 Plan). The 2002 Option Plan provides for the issuance of options to purchase 1,305,000 shares of the Company s common stock including options for approximately 550,000 shares of common stock that remained available for issuance under the 1992 Plan. At the time the 2002 Option Plan became effective, there were approximately 6,855,000 shares reserved for issuance including shares that had been reserved for and were subject to outstanding options under the 1992 Plan. The options granted generally have 10-year terms and vest over four years of continued employment. The Company also has an employee stock purchase plan (the 2002 Employee Stock Purchase Plan) that provides for the sale of up to 540,000 shares of the Company s common stock to employees.

In each of June 2004 and 2003, the Company s stockholders approved amendments to the 2002 Option Plan increasing the authorized number of shares of common stock available for issuance by 750,000 shares. Additionally, in June 2003, the Company s stockholders approved an amendment to the 2002 Employee Stock Purchase Plan increasing the authorized number of shares of common stock available for purchase by 400,000 shares.

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Following is a summary of the Company s stock option plan activity and related information:

	Shares	Weighted average exercise price	Options exercisable at year end	Weighted average exercise price
Balance at January 1, 2002	5,398,366	$ 11.27		
Granted	1,345,072	12.34		
Exercised	(346,187)	9.20		
Canceled	(737,006)	11.34		
Balance at December 31, 2002	5,660,245	11.64	3,720,719	$ 11.41
Granted	1,414,228	10.20		
Exercised	(345,374)	10.31		
Canceled	(565,577)	12.88		
Balance at December 31, 2003	6,163,522	11.27	4,014,009	$ 11.35
Granted	1,430,639	14.93		
Exercised	(581,759)	9.59		
Canceled	(298,333)	13.16		
Balance at December 31, 2004	6,714,069	$ 12.11	4,320,643	$ 11.68

Following is a further breakdown of the options outstanding as of December 31, 2004:

	Options Outstanding			Options exercisable	
Range of exercise prices	Options outstanding	Weighted average remaining life in years	Weighted average exercise price	Number exercisable	Weighted average exercise price
$ 1.82 - $9.25	1,463,458	6.89	$ 7.59	853,119	$ 7.26
9.31 - 11.25	1,367,029	5.80	10.17	1,018,264	10.20
11.38 - 13.25	1,402,170	4.72	12.29	1,208,295	12.29
13.31 - 15.63	1,468,562	7.07	14.46	755,857	14.37
16.06 - 20.70	1,012,850	7.77	17.62	485,108	16.86
	6,714,069	6.39	$ 12.11	4,320,643	$ 11.68

As more fully discussed under Note 3, Accounting for Stock Based Compensation , in January 2005 the Company accelerated certain unvested and out-of-the-money stock options previously awarded to the executive officers and other employees under the Company s 1992 and 2002 stock option plans which had an exercise price greater than $10.41, the closing price on the date of acceleration.

At December 31, 2004, 452,577 and 203,955 shares were available under the 2002 Option Plan and the 2002 Employee Stock Purchase Plan, respectively, for future grants of stock options or sale of stock.

Preferred Stock

The Company has authorized 5,000,000 shares of preferred stock, of which 1,600,000 are designated Series A Participating Preferred Stock (the Preferred Stock). The Board of Directors of Ligand has the authority to issue the Preferred Stock in one or more series and to fix the designation, powers, preferences, rights, qualifications, limitations and restrictions of the shares of each such series, including the dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption (including sinking fund provisions), liquidation preferences and the number of shares constituting any such series, without any further vote or action by the stockholders. The rights and preferences of Preferred Stock may in all respects be superior and prior to the rights of the common stock. The issuance of the Preferred Stock could decrease the amount of earnings and assets available for distribution to holders of common stock or adversely affect the rights and powers, including voting rights, of the holders of the common stock and could have the effect of delaying, deferring or preventing a change in control of Ligand. As of December 31, 2004 and 2003 there are no preferred shares issued or outstanding.

Shareholder Rights Plan

The Company has a preferred shareholder rights plan (the Shareholder Rights Plan), which provides for a dividend distribution of one preferred share purchase right (a Right) on each outstanding share of the Company s common stock. Each Right entitles stockholders to buy 1/1000th of a share of Ligand Series A Participating Preferred Stock at an exercise price of $100, subject to adjustment. In September 2002, the Board amended the Rights Plan, reducing from 20% to 10% the trigger percentage of

outstanding shares which, if acquired, would permit the rights to be exercised. Generally, the Rights become exercisable following the tenth day after a person or group announces an acquisition of 10% or more of the common stock, or announces commencement of a tender offer, the consummation of which would result in ownership by the person or group of 10% or more of the common stock. The Company will be entitled to redeem the Rights at $0.01 per Right at any time on or before the earlier of the tenth day following acquisition by a person or group of 10% or more of the common stock and September 13, 2006. In March 2004 the Board of Directors approved an amendment to the Plan to remove an exception which had allowed Elan to own up to 25% of the Company s common stock without triggering the Rights.

15. Collaborative Research and Development Agreements

The Company is party to various research and development collaborations with large pharmaceutical companies including Abbott Laboratories, Eli Lilly and Company (Lilly), GlaxoSmithKline, Organon Company, Pfizer, Inc., TAP Pharmaceutical Products Inc., and Wyeth (formerly American Home Products). These arrangements generally provide for the license of certain technologies and a collaborative research period ranging from one to five years. Drugs resulting from these collaborations are then developed, manufactured and marketed by the corporate partners. The arrangements may provide for the Company to receive revenue from the transfer of technology rights at contract inception, collaborative research revenue during the research phase, milestone revenue for compounds moving through clinical development, and royalty revenue from the sale of drugs developed through the collaborative efforts.

The following are details regarding significant collaborative arrangements that were in the research phase during the years ended December 31, 2004, 2003 and 2002.

TAP

On June 22, 2001, the Company entered into a research and development collaboration with TAP Pharmaceutical Products Inc. (TAP) to focus on the discovery and development of selective androgen receptor modulators (SARMs). SARMs contribute to the prevention and treatment of certain diseases, including hypogonadism, male and female sexual dysfunction, male and female osteoporosis, frailty, and hormone therapy. Under the agreement, TAP provided funding for a minimum of 12 to 19 Ligand scientists over the initial term of the contract, which concluded in June 2004. TAP had the option to extend the initial term by up to two additional years. In December 2003, the companies announced the first extension of the collaboration through June 2005. In December 2004, the companies announced the second and final extension of the collaboration through June 2006.

Collaborative research revenues recognized under the agreement for the years ended December 31, 2004, 2003 and 2002 were $3.8 million, $5.2 million and $6.3 million, respectively. Research expenses incurred by the Company in support of the TAP collaboration for the years ended December 31, 2004, 2003 and 2002 were $2.9 million, $4.4 million and $6.1 million, respectively. The agreement further provides for milestones moving through the development stage and royalties ranging from 6.0% to 12.0% on annual net sales of drugs resulting from the collaboration. Net milestone revenue of $0.8 million was earned in 2004.

Eli Lilly & Company

On November 25, 1997, the Company entered into a research and development collaboration with Lilly for the discovery and development of products based on Ligand s Intracellular Receptor technology. Under the agreement, Lilly provided funding for a minimum of 31 to 40 Ligand scientists over the research term of the contract. The initial five year research term concluded in November 2002. Lilly had the option to extend the initial term by up to three additional years. In April 2002, the companies announced the first extension of the collaboration through November 2003. In May 2003, the companies announced the second and final extension of the collaboration through November 2004.

Collaborative research revenues recognized under the agreement for the years ended December 31, 2004, 2003 and 2002 were $4.0 million, $5.7 million and $11.6 million, respectively. Research expenses incurred by the Company in support of the Lilly collaboration for the years ended December 31, 2004, 2003 and 2002 were $3.6 million, $5.2 million and $8.3 million, respectively. The agreement further provides for milestones moving through the development stage and royalties ranging from 5.0% to 12.0% on annual net sales of drugs resulting from the collaboration. Net milestone revenue of $1.1 million and $2.4 million were earned in 2003 and 2002, respectively.

Organon

On February 11, 2000, the Company entered into a research and development collaboration with Organon to focus on small molecule compounds with potential effects for the treatment and prevention of gynecological diseases mediated through the progesterone receptor. Under the agreement, Organon provided funding for 8 Ligand scientists during the two year research phase, which was completed in February 2002. Collaborative research revenues recognized and expenses incurred under the agreement for the year ended December 31, 2002 were $0.3 million and $0.5 million, respectively. The agreement further provides for milestones moving through the development stage and royalties ranging from 2.5% to 7.0% on annual net sales of drugs resulting from the collaboration.

16. X-Ceptor Therapeutics, Inc.

In June 1999, Ligand became a minority equity investor in a new private corporation, X-Ceptor Therapeutics, Inc. (X-Ceptor). Ligand invested $6.0 million in X-Ceptor through the acquisition of convertible preferred stock.

Ligand maintained the right to acquire all, but not less than all, of the outstanding X-Ceptor stock at June 30, 2002 or upon the cash balance of X-Ceptor falling below a pre-determined amount, or to extend that right by 12 months by providing additional funding of $5.0 million. In April 2002, Ligand informed X-Ceptor that it was extending its purchase right. The $5.0 million paid to X-Ceptor in July 2002 was carried as an asset until March 2003, when Ligand informed X-Ceptor that it would not exercise the purchase right. The $5.0 million purchase right was written-off in March 2003 and is included in Other, net expense in the accompanying consolidated statement of operations.

As part of the original transaction entered into in June 1999, X-Ceptor granted to Ligand the right to acquire all of the outstanding stock of X-Ceptor (the Purchase Right). In October 1999, the Company issued warrants to X-Ceptor investors, founders and certain employees to purchase 950,000 shares of Ligand common stock with an exercise price of $10.00 per share and an expiration date of October 6, 2006. The fair value of the warrants on the date of issuance was $4.20 per warrant or $4.0 million. The warrant issue was deemed to be consideration for the Purchase Right and accordingly was recorded as an other asset. This asset was written off to Other, net expense in the quarter ended March 31, 2003, the period the Company determined that the Purchase Right would not be exercised.

On September 29, 2004, Ligand announced that the Company had agreed to vote its shares in favor of the proposed acquisition of X-Ceptor by Exelixis Inc. (Exelixis). Exelixis acquisition of X-Ceptor was subsequently completed on October 18, 2004 and in connection therewith, Ligand received 618,165 shares of Exelixis common stock. The shares received by Ligand have certain trading restrictions for which a resale registration statement has been filed. Additionally, approximately 21% of the shares were placed in escrow for up to one year to satisfy indemnification and other obligations. Shares of Exelixis which can be sold within one year are classified as available for sale. These shares are carried at fair value, with unrealized gains and losses included as a separate component of stockholder s equity (deficit). The unrealized gain on these shares as of December 31, 2004 is $0.3 million. Shares of Exelixis which have trading restrictions greater than one year are classified as restricted investments and carried at cost. Ligand recorded a net gain on the transaction in October 2004 of $3.7 million, based on the fair market value of the consideration received which is included in Other income (expense) in the accompanying statement of operations.

Ligand accounted for its investment in X-Ceptor using the equity method of accounting. Ligand s interest in X-Ceptor losses for the years ended December 31, 2003 and 2002 was $1.0 million and $1.1 million, respectively, which are included in Other income (expense) in the Consolidated Statement of Operations. The Company accounts for its investment in Exelixis as an available-for-sale security (See Note 3 *Restricted Investments*).

17. Income Taxes

At December 31, 2004, the Company has both federal and state net operating loss carryforwards of approximately $530.2 million and $94.1 million, respectively, which will begin expiring in 2005. The difference between the federal and California tax loss carryforwards is primarily due to the capitalization of research and development expenses for California income tax purposes and the 50% to 60% limitation on losses incurred prior to 2004 in California. The Company has $25.0 million of federal research and development credits carryforwards which will expire beginning in 2005 and $13.7 million of California research and development credits that have no expiration date.

Pursuant to Internal Revenue Code Sections 382 and 383, use of a portion of net operating loss and credit carryforwards will be limited because of cumulative changes in ownership of more than 50% that occurred within three periods during 1989, 1992, and 1996. In addition, use of Glycomed s and Seragen s preacquisition tax net operating and credit carryforwards will also be limited

because the acquisitions by the Company represent changes in ownership of more than 50%. Such tax net operating loss and credit carryforwards have been reduced, including the related deferred tax assets. In addition, it is possible that the Company has had subsequent changes in ownership since 1996 that could further limit its net operating loss and credit carryforwards generated during that period. The Company has not determined whether any such cumulative ownership change has occurred and if so, the extent of any resulting carryforward limitations. The Company s research and development credits pertain to federal and California jurisdictions. These jurisdictions require that the Company create minimum documentation and support, such as done via a Research & Development Credit Study. In the absence of sufficient documentation and support these government jurisdictions may disallow some or all of the credits. Although the Company has not performed a formal study, the Company believes that it maintains sufficient documentation to support the benefitting of the credits in the consolidated financial statements. Prior to utilizing a significant portion of the credits to reduce taxes payable, the Company will review its documentation and support to determine if a formal study is necessary.
The components of the income tax provision were as follows (in thousands):

	December 31,		
	2004	2003 (Restated)	2002 (Restated)
Current Provision:			
Federal	$ 81	$	$
State	98		
Foreign	54	56	44
	233	56	44
Deferred Provision:			
Federal			
State			
	$ 233	$ 56	$ 44

Significant components of the Company s deferred tax assets and liabilities as of December 31, 2004 and 2003 are shown below. A valuation allowance has been recognized to fully offset the net deferred tax assets as of December 31, 2004 and 2003 as realization of such assets is uncertain.

	December 31,	
	2004	2003 (Restated)
	(in thousands)	
Deferred liabilities:		
Purchased intangible assets	$ (8,667)	$ (9,795)
Total deferred tax liabilities	(8,667)	(9,795)
Deferred assets:		
Net operating loss carryforwards	$ 185,247	$ 185,501

Research and development credit carryforwards	34,070	31,478
Capitalized research and development	7,012	9,402
Fixed assets and intangibles	6,220	6,675
Accrued expenses	37,183	22,995
Deferred revenue	24,961	20,455
Other	199	224
	294,892	276,730
Valuation allowance for deferred tax assets	(286,225)	(266,935)
Net deferred tax asset	$	$

As of December 31, 2004, approximately $6.8 million of the valuation allowance for deferred tax assets related to benefits of stock option deductions which, when recognized, will be allocated directly to paid-in capital.

A reconciliation of income tax expense (benefit) to the amount computed by applying the statutory federal income tax rate to the net loss is summarized as follows (in thousands):

		December 31,	
	2004	2003 (Restated)	2002 (Restated)
Amounts computed at statutory federal rate	$ (15,341)	$ (32,027)	$ (17,752)
State taxes net of federal benefit	(385)	(6,635)	(1,315)
Effect of foreign operations	54	226	44
Meals & entertainment	171	321	247
Federal research and development credits	(1,253)	(376)	(1,224)
Non-controlling interest		1,013	367
Nexus LLC acquisition	(1,159)		
Return to provision adjustments			1,949
Change in valuation allowance	18,144	37,378	17,063
Other	2	156	665
	$ 233	$ 56	$ 44

18. New Accounting Pronouncements

In March 2004, the Financial Accounting Standards Board (FASB) approved the consensus reached on the Emerging Issues Task Force (EITF) Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.* EITF 03-1 provides guidance for identifying impaired investments and new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however the disclosure requirements remain effective for annual periods ending after June 15, 2004. The Company does not believe the impact of adopting EITF 03-1 will be significant to its overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R replaced SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and superseded Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). In March 2005, the U.S. Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 (SAB 107), which expresses views of the SEC staff regarding the interaction between SFAS 123R and certain SEC rules and regulations, and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. SFAS 123R will require compensation cost related to share-based payment transactions to be recognized in the financial statements. SFAS 123R required public companies to apply SFAS 123R in the first interim or annual reporting period beginning after June 15, 2005. In April 2005, the SEC approved a new rule that delays the effective date, requiring public companies to apply SFAS 123R in their next fiscal year, instead of the next interim reporting period, beginning after June 15, 2005. As permitted by SFAS 123, the Company elected to follow the guidance of APB 25, which allowed companies to use the intrinsic value method of accounting to value their share-based payment transactions with employees. SFAS 123R requires measurement of the cost of share-based payment transactions to employees at the fair value of the award on the grant date and recognition of expense over the requisite service or vesting period. SFAS 123R requires implementation using a modified version of prospective application, under which compensation expense of the unvested portion of previously granted awards and all new awards will be recognized on or after the date of adoption. SFAS 123R also allows companies to adopt SFAS 123R by restating previously issued statements, basing the amounts on the expense previously calculated and reported in their pro forma footnote disclosures required under SFAS 123. The Company will adopt SFAS 123R in the first interim period of fiscal 2006 and is currently evaluating the impact that the adoption of SFAS 123R will have on its results of operations and financial position.

In November 2004, the FASB issued SFAS No. 151, *Inventory Pricing* (SFAS 151). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). This statement requires that those items be

recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The impact of the adoption of SFAS No. 151 is not expected to have a material impact on the Company s consolidated statements of operations or consolidated balance sheets.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, to address the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for nonmonetary exchanges that do not have commercial substance. This statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The impact of the adoption of SFAS No. 153 is not expected to have a material impact on the Company s consolidated statements of operations or consolidated balance sheets.

In May 2005, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 requires retrospective application to prior-period financial statements of changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

19. Summary of Unaudited Quarterly Financial Information

The following is a summary of the unaudited quarterly results of operations for the years ended December 31, 2004 and 2003 (in thousands, except per share amounts).

	Quarter ended			
	March 31 (Restated)	**June 30 (Restated)**	**September 30 (Restated)**	**December 31**
2004				
Product sales	$ 24,939	$ 29,299	$ 31,934	$ 34,163
Sale of royalty rights, net	¾	¾	67	31,275
Collaborative research and development and other revenues	2,476	2,975	4,771	1,613
Total revenues	27,415	32,274	36,772	67,051
Cost of products sold	7,545	9,718	9,819	12,722
Research and development costs	17,517	16,566	16,747	14,374
Selling, general and administrative	14,705	18,116	17,311	15,666
Co-promotion	6,731	7,000	8,501	7,845
Total operating costs and expenses	46,498	51,400	52,378	50,607
Other (expense) income, net	(2,813)	(2,921)	(2,889)	1,086
Income tax expense	16	18	3	196
Net (loss)/ income	$ (21,192)	$ (22,065)	$ (18,498)	$ 17,334
Basic net (loss)/income per share	$ (0.30)	$ (0.30)	$ (0.25)	$ 0.23
Diluted net (loss)/income per share	$ (0.30)	$ (0.30)	$ (0.25)	$ 0.20
Weighted average number of common shares for basic net (loss)/income per share	73,299	73,754	73,846	73,861
Weighted average number of common shares for diluted net (loss)/income per share	73,299	73,754	73,846	99,450

	Quarter ended			
	March 31 (Restated)	**June 30 (Restated)**	**September 30 (Restated)**	**December 31 (Restated)**
2003				
Product sales	$ 11,473	$ 12,171	$ 14,760	$ 16,920
Sale of royalty rights, net	¾	¾	35	11,751
Collaborative research and development and other revenues	4,195	3,939	3,160	2,714
Total revenues	15,668	16,110	17,955	31,385
Cost of products sold	6,202	6,845	7,041	6,469
Research and development costs	16,549	16,644	17,435	16,050
Selling, general and administrative	12,352	13,569	13,242	13,377
Co-promotion	¾	¾	¾	9,360

Total operating costs and expenses	35,103	37,058	37,718	45,256
Other expense, net	11,678	2,992	2,941	2,782
Income tax expense	15	16	9	16
Cumulative effect of accounting change	¾	¾	¾	(2,005)
Net loss	$ (31,128)	$ (23,956)	$ (22,713)	$ (18,674)
Basic and diluted net loss per share:				
Loss before cumulative effect of a change in accounting principle	$ (0.44)	$ (0.35)	$ (0.32)	$ (0.23)
Cumulative effect of changing method of accounting for variable interest entity				(0.03)
Basic and diluted net loss per share	$ (0.44)	$ (0.35)	$ (0.32)	$ (0.26)
Weighted average number of common shares, for basic and diluted net loss per share	70,238	69,275	70,100	73,098

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20. Subsequent Events

NASDAQ Delisting

The Company s common stock was delisted from the NASDAQ National Market on September 7, 2005. Unless and until the Company s common stock is relisted on NASDAQ, its common stock is expected to be quoted on the Pink Sheets. The quotation of the Company s common stock on the Pink Sheets may reduce the price of the common stock and the levels of liquidity available to the Company s stockholders. In addition, the quotation of the Company s common stock on the Pink Sheets may materially adversely affect the Company s access to the capital markets, and the limited liquidity and reduced price of its common stock could materially adversely affect the Company s ability to raise capital through alternative financing sources on terms acceptable to the Company or at all. Stocks that are quoted on the Pink Sheets are no longer eligible for margin loans, and a company quoted on the Pink Sheets cannot avail itself of federal preemption of state securities or blue sky laws, which adds substantial compliance costs to securities issuances, including pursuant to employee option plans, stock purchase plans and private or public offerings of securities. The Company s delisting from the NASDAQ National Market and quotation on the Pink Sheets may also result in other negative implications, including the potential loss of confidence by suppliers, customers and employees, the loss of institutional investor interest and fewer business development opportunities.

Settlement of Patent Interference

In March 2005, Ligand announced that it reached a settlement agreement in a recent patent interference action initiated by Ligand against two patents owned by The Burnham Institute and SRI International, but exclusively licensed to Ligand. The Company believes the settlement strengthens its intellectual property position for bexarotene, the active ingredient in the Targretin products. The settlement also reduces the royalty rate on those products while extending the royalty payment term to SRI/Burnham.

Under the agreement, Burnham will have a research-only sublicense to conduct basic research under the assigned patents and Ligand will have an option on the resulting products and technology. In addition, Burnham and SRI agreed to accept a reduction in the royalty rate paid to them in the future on U.S. sales of Targretin under an earlier agreement. The aggregate royalty rate owed to both SRI and Burnham by Ligand will be reduced from 4% to 3% of net sales and the term of the royalty payments extended from 2012 to 2016. If the patent issued on the pending Ligand patent application is extended beyond 2016, the royalty rate would be reduced to 2% and paid for the term of the longest Ligand patent covering bexarotene.

Targretin Capsules

In March 2005, the Company announced that the final data analysis for Targretin Capsules in NSCLC showed that the trials did not meet their endpoints of improved overall survival and projected two year survival. The Company is continuing to analyze the data and apply it to the continued development of Targretin Capsules in NSCLC.

Pfizer Collaboration Lasofoxifene

In August 2004, Pfizer submitted an NDA to the FDA for lasofoxifene for the prevention of osteoporosis in postmenopausal women. In September 2005, Pfizer announced the receipt of a non-approvable letter from the FDA for the prevention of osteoporosis. Lasofoxifene is a product that resulted from the Company s collaboration with Pfizer and upon which the Company will receive royalties if the product is approved by the FDA and subsequently marketed by Pfizer. In December 2004, Pfizer filed a supplemental NDA for the use of lasofoxifene for the treatment of vaginal atrophy which remains pending at the FDA. As a result of the supplemental lasofoxifene NDA filing, the Company exercised an option in January 2005 to pay The Salk Institute $1.12 million to buy out royalty payments due on future sales of the product in this additional indication. Lasofoxifene is also being developed by Pfizer for the treatment of osteoporosis.

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PART II
INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution

The following table sets forth the fees and expenses, other than underwriting discounts and commissions, payable in connection with the registration of the common stock hereunder. All amounts are estimates except the SEC registration fee.

Item		Amount to be paid
SEC Registration Fee		10,104
Legal Fees and Expenses		50,000
Accounting Fees and Expenses		50,000
Printing and Edgarization Expenses		25,000
Transfer Agent and Registrar Fees		5,000
Miscellaneous Expenses		4,996
Total	$	145,100

Item 14. Indemnification of Directors and Officers

Section 145 of the Delaware General Corporation Law permits a corporation to include in its charter documents, and in agreements between the corporation and its directors and officers, provisions expanding the scope of indemnification beyond that specifically provided by the current law.

Our amended and restated certificate of incorporation provides for the indemnification of directors to the fullest extent permissible under Delaware law.

Our bylaws provide for the indemnification of officers, directors and third parties acting on our behalf if this person acted in good faith and in a manner reasonably believed to be in and not opposed to our best interest, and, with respect to any criminal action or proceeding, the indemnified party had no reason to believe his or her conduct was unlawful.

We have entered into indemnification agreements with our directors and executive officers, in addition to indemnification provided for in our charter documents, and we intend to enter into indemnification agreements with any new directors and executive officers in the future.

We have purchased and intend to maintain insurance on behalf of any person who is or was a director or officer against any loss arising from any claim asserted against him or her and incurred by him or her in that capacity, subject to certain exclusions and limits of the amount of coverage.

Item 15. Recent Sales of Unregistered Securities

For the three years ended December 31, 2005, we have sold the following unregistered securities:

(1) On September 11, 2003, we issued 3,483,593 shares of our common stock in an unregistered transaction to selected institutional and accredited investors, including several current Ligand investors, for aggregate consideration of approximately $47 million. In connection with the issuance of the shares, we paid $2.0 million in cash compensation to the placement agents. We subsequently registered the resale of all of these shares on a Form S-3 registration statement (No. 333-109172), filed on September 26, 2003, as amended October 8, 2003, and declared effective on October 8, 2003. The shares were issued under a claim of exemption under Regulation D promulgated by the SEC or, alternatively, under Section 4(2) of the Securities Act. This transaction did not involve a public offering. Appropriate legends were affixed to the stock certificates, as applicable, issued in such

transactions. We believe each transferee had adequate access to information about us to make an informed investment decision and each transferee is an accredited investor within the meaning of Rule 501 of Regulation D.

(2) In April, May and December, 2005, an aggregate of, approximately 34,000 shares of our common stock were issued to a director, a consultant and former employee of the Company in connection with certain option exercises under the Company s 2002 stock option plan. We received approximately $187,000 from the option exercises. The 2002 option plan was registered by Ligand on a Form S-8. However, due to a delay in our periodic report filings, the Form S-8 was not current at the time the shares were issued. Each of the recipients that was issued shares under the 2002 stock option plan is an accredited investor in accordance with Rule 501 of Regulation D.

There were no underwriters employed in connection with any of the transactions set forth in this Item 15.

Item 16. Exhibits and Financial Statement Schedules

(a) Exhibits

Exhibit Number	Description
2.1(1)	Agreement and Plan of Reorganization dated May 11, 1998, by and among the Company, Knight Acquisition Corp. and Seragen, Inc. (Filed as Exhibit 2.1).
2.2 (1)	Option and Asset Purchase Agreement, dated May 11, 1998, by and among the Company, Marathon Biopharmaceuticals, LLC, 520 Commonwealth Avenue Real Estate Corp. and 660 Corporation. (Filed as Exhibit 10.3).
2.3 (19)	Asset Purchase Agreement among CoPharma, Inc., Marathon Biopharmaceuticals, Inc., Seragen, Inc. and the Company dated January 7, 2000. (The schedules referenced in this agreement have not been included because they are either disclosed in such agreement or do not contain information which is material to an investment decision (with certain confidential portions omitted). The Company agrees to furnish a copy of such schedules to the Commission upon request).
2.5 (1)	Form of Certificate of Merger for acquisition of Seragen, Inc. (Filed as Exhibit 2.2).
3.1 (1)	Amended and Restated Certificate of Incorporation of the Company. (Filed as Exhibit 3.2).
3.2 (1)	Bylaws of the Company, as amended. (Filed as Exhibit 3.3).
3.3 (2)	Amended Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Company.
3.5 (31)	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Company dated June 14, 2000.
3.6 (3)	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Company dated September 30, 2004.
3.7 (52)	Amendment to the Bylaws of the Company dated November 8, 2005. (Filed as Exhibit 3.1).
4.1 (4)	Specimen stock certificate for shares of Common Stock of the Company.
4.2 (16)	Preferred Shares Rights Agreement, dated as of September 13, 1996, by and between the Company and Wells Fargo Bank, N.A. (Filed as Exhibit 10.1).
4.3 (13)	Amendment to Preferred Shares Rights Agreement, dated as of November 9, 1998, between the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent. (Filed as Exhibit 99.1).
4.4 (17)	Second Amendment to the Preferred Shares Rights Agreement, dated as of December 23, 1998, between the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent (Filed as Exhibit 1).

4.7 (37)	Fourth Amendment to the Preferred Shares Rights Agreement and Certification of Compliance with Section 27 Thereof, dated as of October 3, 2002, between the Company and Mellon Investor Services LLC, as Rights Agent.
4.9 (38)	Indenture dated November 26, 2002, between Ligand Pharmaceuticals Incorporated and J.P. Morgan Trust Company, National Association, as trustee, with respect to the 6% convertible subordinated notes due 2007. (Filed as Exhibit 4.3).
4.10 (38)	Form of 6% Convertible Subordinated Note due 2007. (Filed as Exhibit 4.4).

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Exhibit Number	Description
4.11 (38)	Pledge Agreement dated November 26, 2002, between Ligand Pharmaceuticals Incorporated and J.P. Morgan Trust Company, National Association. (Filed as Exhibit 4.5).
4.12 (38)	Control Agreement dated November 26, 2002, among Ligand Pharmaceuticals Incorporated, J.P. Morgan Trust Company, National Association and JP Morgan Chase Bank. (Filed as Exhibit 4.6).
4.13 (5)	Amended and Restated Preferred Shares Rights Agreement dated as of March 20, 2004, which includes as Exhibit A the Form of Rights Certificate and as Exhibit B the Summary of Rights.
4.14 (50)	Form of First Amendment to the Amended and Restated Preferred Shares Rights Agreement effective December 8, 2005 between the Company and Mellon Investor Services LLC. (Filed as Exhibit 10.1).
5.1*	Opinion of Latham & Watkins LLP.
10.1 (49)	Second Amendment to Non-Qualified Deferred Compensation Plan.
10.2 (49)	Letter Agreement by and between the Company and Tod G. Mertes dated as of December 8, 2005.
10.3 (4)	Form of Stock Issuance Agreement.
10.30 (4)	Form of Proprietary Information and Inventions Agreement.
10.31 (4)	Agreement, dated March 9, 1992, between the Company and Baylor College of Medicine (with certain confidential portions omitted).
10.33 (4)	License Agreement, dated November 14, 1991, between the Company and Rockefeller University (with certain confidential portions omitted).
10.34 (4)	License Agreement and Bailment, dated July 22, 1991, between the Company and the Regents of the University of California (with certain confidential portions omitted).
10.35 (4)	Agreement, dated May 1, 1991, between the Company and Pfizer Inc (with certain confidential portions omitted).
10.36 (4)	License Agreement, dated July 3, 1990, between the Company and the Brigham and Woman s Hospital, Inc. (with certain confidential portions omitted).
10.38 (4)	License Agreement, dated January 5, 1990, between the Company and the University of North Carolina at Chapel Hill (with certain confidential portions omitted).
10.41 (4)	License Agreement, dated October 1, 1989, between the Company and Institute Pasteur (with certain confidential portions omitted).

10.43 (4)	License Agreement, dated June 23, 1989, between the Company and La Jolla Cancer Research Foundation (with certain confidential portions omitted).
10.44 (4)	License Agreement, dated October 20, 1988, between the Company and the Salk Institute for Biological Studies, as amended by Amendment to License Agreement dated September 15, 1989, Second Amendment to License Agreement, dated December 1, 1989 and Third Amendment to License Agreement dated October 20, 1990 (with certain confidential portions omitted).
10.46 (4)	Form of Indemnification Agreement between the Company and each of its directors.
10.47 (4)	Form of Indemnification Agreement between the Company and each of its officers.
10.58 (4)	Stock Purchase Agreement, dated September 9, 1992, between the Company and Glaxo, Inc.

Exhibit Number	Description
10.59 (4)	Research and Development Agreement, dated September 9, 1992, between the Company and Glaxo, Inc. (with certain confidential portions omitted).
10.60 (4)	Stock Transfer Agreement, dated September 30, 1992, between the Company and the Rockefeller University.
10.61 (4)	Stock Transfer Agreement, dated September 30, 1992, between the Company and New York University.
10.62 (4)	License Agreement, dated September 30, 1992, between the Company and the Rockefeller University (with certain confidential portions omitted).
10.67 (4)	Letter Agreement, dated September 11, 1992, between the Company and Mr. Paul Maier.
10.73 (21)	Supplementary Agreement, dated October 1, 1993, between the Company and Pfizer, Inc. to Agreement, dated May 1, 1991.
10.78 (23)	Research, Development and License Agreement, dated July 6, 1994, between the Company and Abbott Laboratories (with certain confidential portions omitted). (Filed as Exhibit 10.75).
10.82 (23)	Research, Development and License Agreement, dated September 2, 1994, between the Company and American Home Products Corporation, as represented by its Wyeth-Ayerst Research Division (with certain confidential portions omitted). (Filed as Exhibit 10.77).
10.83 (23)	Option Agreement, dated September 2, 1994, between the Company and American Home Products Corporation, as represented by its Wyeth-Ayerst Research Division (with certain confidential portions omitted). (Filed as Exhibit 10.80).
10.93 (6)	Indemnity Agreement, dated June 3, 1995, between the Company, Allergan, Inc. and Allergan Ligand Retinoid Therapeutics, Inc.
10.97 (6)	Research, Development and License Agreement, dated December 29, 1994, between SmithKline Beecham Corporation and the Company (with certain confidential portions omitted).
10.98 (6)	Stock and Note Purchase Agreement, dated February 2, 1995, between SmithKline Beecham Corporation, S.R. One, Limited and the Company (with certain confidential portions omitted).
10.140 (28)	Promissory Notes, General Security Agreements and a Credit Terms and Conditions letter dated March 31, 1995, between the Company and Imperial Bank (Filed as Exhibit 10.101).
10.146 (24)	

	Amendment to Research and Development Agreement, dated January 16, 1996, between the Company and American Home Products Corporation, as amended.
10.148 (24)	Lease, dated July 6, 1994, between the Company and Chevron/Nexus partnership, First Amendment to lease dated July 6, 1994.
10.149 (25)	Successor Employment Agreement, signed May 1, 1996, between the Company and David E. Robinson.
10.150 (7)	Master Lease Agreement, signed May 30, 1996, between the Company and USL Capital Corporation.
10.151 (25)	Settlement Agreement and Mutual Release of all Claims, signed April 20, 1996, between the Company and Pfizer, Inc. (with certain confidential portions omitted).
10.152 (25)	Letter Amendment to Abbott Agreement, dated March 14, 1996, between the Company and Abbott Laboratories (with certain confidential portions omitted).

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Exhibit Number	Description
10.153 (26)	Letter Agreement, dated August 8, 1996, between the Company and Dr. Andres Negro-Vilar.
10.155 (7)	Letter Agreement, dated November 4, 1996, between the Company and William Pettit.
10.157 (7)	Master Lease Agreement, signed February 13, 1997, between the Company and Lease Management Services.
10.158 (7)	Lease, dated March 7, 1997, between the Company and Nexus Equity VI LLC.
10.161 (29)	Settlement Agreement, License and Mutual General Release between Ligand Pharmaceuticals and SRI/LJCRF, dated August 23, 1995 (with certain confidential portions omitted).
10.163 (30)	Extension of Master Lease Agreement between Lease Management Services and Ligand Pharmaceuticals dated July 29, 1997.
10.164 (27)	Third Amendment to Agreement, dated September 2, 1997, between the Company and American Home Products Corporation.
10.165 (8)	Amended and Restated Technology Cross License Agreement, dated September 24, 1997, among the Company, Allergan, Inc. and Allergan Ligand Retinoid Therapeutics, Inc.
10.167 (8)	Development and License Agreement, dated November 25, 1997, between the Company and Eli Lilly and Company (with certain confidential portions omitted).
10.168 (8)	Collaboration Agreement, dated November 25, 1997, among the Company, Eli Lilly and Company, and Allergan Ligand Retinoid Therapeutics, Inc. (with certain confidential portions omitted).
10.169 (8)	Option and Wholesale Purchase Agreement, dated November 25, 1997, between the Company and Eli Lilly and Company (with certain confidential portions omitted).
10.171 (8)	First Amendment to Option and Wholesale Purchase Agreement dated February 23, 1998, between the Company and Eli Lilly and Company (with certain confidential portions omitted).
10.172 (8)	Second Amendment to Option and Wholesale Purchase Agreement, dated March 16, 1998, between the Company and Eli Lilly and Company (with certain confidential portions omitted).
10.176 (10)	Secured Promissory Note, dated March 7, 1997, in the face amount of $3,650,000, payable to the Company by Nexus Equity VI LLC. (Filed as Exhibit 10.1).
10.177 (10)	Amended memorandum of Lease effective March 7, 1997, between the Company and Nexus Equity VI LLC. (Filed as Exhibit 10.2).

10.178 (10)	First Amendment to Lease, dated March 7, 1997, between the Company and Nexus Equity VI LLC. (Filed as Exhibit 10.3).
10.179 (10)	First Amendment to Secured Promissory Note, date March 7, 1997, payable to the Nexus Equity VI LLC. (Filed as Exhibit 10.4).
10.184 (11)	Letter agreement, dated May 11, 1998, by and among the Company, Eli Lilly and Company and Seragen, Inc. (Filed as Exhibit 99.6).
10.185 (1)	Amendment No. 3 to Option and Wholesale Purchase Agreement, dated May 11, 1998, by and between Eli Lilly and Company and the Company. (Filed as Exhibit 10.6).
10.186 (1)	Agreement, dated May 11, 1998, by and among Eli Lilly and Company, the Company and Seragen, Inc. (Filed as Exhibit 10.7).
10.188 (11)	Settlement Agreement, dated May 1, 1998, by and among Seragen, Inc., Seragen

Exhibit Number	Description
	Biopharmaceuticals Ltd./Seragen Biopharmaceutique Ltee, Sofinov Societe Financiere D Innovation Inc., Societe Innovatech Du Grand Montreal, MDS Health Ventures Inc., Canadian Medical Discoveries Fund Inc., Royal Bank Capital Corporation and Health Care and Biotechnology Venture Fund (Filed as Exhibit 99.2).
10.189 (11)	Accord and Satisfaction Agreement, dated May 11, 1998, by and among Seragen, Inc., Seragen Technology, Inc., Trustees of Boston University, Seragen LLC, Marathon Biopharmaceuticals, LLC, United States Surgical Corporation, Leon C. Hirsch, Turi Josefsen, Gerald S.J. and Loretta P. Cassidy, Reed R. Prior, Jean C. Nichols, Elizabeth C. Chen, Robert W. Crane, Shoreline Pacific Institutional Finance, Lehman Brothers Inc., 520 Commonwealth Avenue Real Estate Corp. and 660 Corporation (Filed as Exhibit 99.4).
10.191 (10)	Letter of Agreement dated September 28, 1998 among the Company, Elan Corporation, plc and Elan International Services, Ltd. (with certain confidential portions omitted), (Filed as Exhibit 10.5).
10.198 (14)	Stock Purchase Agreement by and between the Company and Warner-Lambert Company dated September 1, 1999 (with certain confidential portions omitted). (Filed as Exhibit 10.2).
10.200 (14)	Nonexclusive Sublicense Agreement, effective September 8, 1999, by and among Seragen, Inc., Hoffmann-La Roche Inc. and F. Hoffmann-La Roche Ltd. (with certain confidential portions omitted). (Filed as Exhibit 10.4).
10.203 (14)	License Agreement effective June 30, 1999 by and between the Company and X-Ceptor Therapeutics, Inc. (with certain confidential portions omitted). (Filed as Exhibit 10.7).
10.218 (18)	Royalty Stream Purchase Agreement dated as of December 31, 1999 among Seragen, Inc., the Company, Pharmaceutical Partners, L.L.C., Bioventure Investments, Kft, and Pharmaceutical Royalties, LLC. (with certain confidential portions omitted).
10.220 (19)	Research, Development and License Agreement by and between Organon Company and Ligand Pharmaceuticals Incorporated dated February 11, 2000 (with certain confidential portions omitted).
10.224 (20)	Research, Development and License Agreement by and between Bristol Myers Squibb Company and Ligand Pharmaceuticals Incorporated dated May 19, 2000 (with certain confidential portions omitted).
10.230 (31)	Amended and Restated Registration Rights Agreement, dated as of June 29, 2000 among the Company and certain of its investors.
10.231 (2)	Marketing and Distribution Agreement with Ferrer Internacional S.A. to market and distribute Ligand Pharmaceuticals Incorporated products in Spain, Portugal and Greece. (Filed as Exhibit 10.3).

10.232 (2)	Marketing and Distribution Agreement with Ferrer Internacional S.A. to market and distribute Ligand Pharmaceuticals Incorporated products in Central and South America. (Filed as Exhibit 10.4).
10.233 (32)	Second Amendment to the Research, Development and License Agreement, dated as of September 2, 1994, between the Company and American Home Products Corporation (with certain confidential portions omitted).
10.234 (32)	Fourth Amendment to the Research, Development and License Agreement, dated as of September 2, 1994, between the Company and American Home Products Corporation (with certain confidential portions omitted).
10.235 (32)	Distributorship Agreement, dated February 29, 2001, between the Company and Elan Pharma International Limited (with certain confidential portions omitted).

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Exhibit Number	Description
10.238 (33)	Letter Agreement, dated May 17, 2001, between the Company and Gian Aliprandi.
10.239 (33)	Research, Development and License Agreement by and between the Company and TAP Pharmaceutical Products Inc. dated June 22, 2001 (with certain confidential portions omitted).
10.240 (34)	Letter Agreement, dated December 13, 2001, between the Company and Warner R. Broaddus, Esq.
10.242 (34)	First Addendum to Amended and Restated Registration Rights Agreement dated June 29, 2000, effective as of December 20, 2001.
10.244 (35)	Second Addendum to Amended and Restated Registration Rights Agreement dated June 29, 2000, effective as of March 28, 2002.
10.245 (35)	Purchase Agreement, dated March 6, 2002, between the Company and Pharmaceutical Royalties International (Cayman) Ltd.
10.246 (36)	Amended and Restated License Agreement Between The Salk Institute for Biological Studies and the Company (with certain confidential portions omitted).
10.247 (37)	Amendment Number 1 to Purchase Agreement, dated July 29, 2002, between the Company and Pharmaceutical Royalties International (Cayman) Ltd.
10.250 (40)	Amended and Restated License and Supply Agreement, dated December 6, 2002, between the Company, Elan Corporation, plc and Elan Management Limited (with certain confidential portions omitted).
10.252 (40)	Amendment Number 1 to Amended and Restated Registration Rights Agreement, dated November 12, 2002, between the Company and Elan Corporation plc and Elan International Services, Ltd.
10.253 (40)	Second Amendment to Purchase Agreement, dated December 19, 2002, between the Company and Pharmaceuticals Royalties International (Cayman) Ltd.
10.254 (40)	Amendment Number 3 to Purchase Agreement, dated December 30, 2002, between the Company and Pharmaceuticals Royalties International (Cayman) Ltd. (with certain confidential portions omitted).
10.255 (40)	Purchase Agreement, dated December 30, 2002, between the Company and Pharmaceuticals Royalties International (Cayman) Ltd. (with certain confidential portions omitted).
10.256 (41)	Co-Promotion Agreement, dated January 1, 2003, by and between the Company and Organon Pharmaceuticals USA Inc. (with certain confidential portions omitted).
10.257 (42)	

	Letter Agreement, dated June 26, 2002, between the Company and James J. L Italien, Ph.D.
10.258 (42)	Letter Agreement, dated May 20, 2003, between the Company and Tod G. Mertes.
10.259 (42)	Amendment No. 2 to Amended and Restated Registration Rights Agreement, dated June 25, 2003.
10.261 (43)	Letter Agreement, dated July 1, 2003, between the Company and Paul V. Maier.
10.262 (43)	Letter Agreement, dated July 1, 2003, between the Company and Ronald C. Eld.
10.263 (43)	Separation Agreement and General Release, effective July 10, 2003, between the Company and Thomas H. Silberg (with certain confidential portions omitted).

Exhibit Number	Description
10.264 (44)	Option Agreement Between Investors Trust & Custodial Services (Ireland) Ltd., as Trustee for Royalty Pharma, Royalty Pharma Finance Trust and the Company, dated October 1, 2003 (with certain confidential portions omitted).
10.265 (44)	Amendment to Purchase Agreement Between Royalty Pharma Finance Trust and the Company, dated October 1, 2003 (with certain confidential portions omitted).
10.266 (44)	Manufacture and Supply Agreement between Seragen and Cambrex Bio Science Hopkinton, Inc., dated October 11, 2003 (with certain confidential portions omitted).
10.267*	2002 Stock Incentive Plan (as amended and restated).
10.268 (44)	2002 Employee Stock Purchase Plan, dated July 1, 2002 (as amended through June 30, 2003).
10.269 (44)	Form of Stock Option Agreement.
10.270 (44)	Form of Employee Stock Purchase Plan Stock Purchase Agreement.
10.271 (44)	Form of Automatic Stock Option Agreement.
10.272 (44)	Form of Director Fee Stock Option Agreement.
10.273 (45)	Letter Agreement, dated as of February 26, 2004, between the Company and Martin Meglasson.
10.274 (45)	Adoption Agreement for Smith Barney Inc. Execchoice (R) Nonqualified Deferred Compensation Plan.
10.275 (45)	Commercial Supply Agreement, dated February 27, 2004, between Seragen Incorporated and Holister-Stier Laboratories LLC (with certain confidential portions omitted).
10.276 (45)	Manufacturing and Packaging Agreement, dated February 13, 2004 between Cardinal Health PTS, LLC and the Company (with certain confidential portions omitted).
10.277 (45)	Letter Agreement, dated July 1, 2003 between the Company and William A. Pettit.
10.278 (46)	Letter Agreement, dated as of October 1, 2004, between the Company and Eric S. Groves
10.279 (46)	Form of Distribution, Storage, Data and Inventory Management Services Agreement.
10.280 (46)	Amendment Number 1 to the Option Agreement between Investors Trust & Custodial Services (Ireland) Ltd., solely in its capacity as Trustee for Royalty Pharma, Royalty Pharma Finance Trust and Ligand Pharmaceuticals Incorporated dated November 5, 2004.

10.281 (46)	Amendment to Agreement among Ligand Pharmaceuticals Incorporated, Seragen, Inc. and Eli Lilly and Company dated November 8, 2004.
10.282 (46)	Amendment to Purchase Agreement between Royalty Pharma Finance Trust, Ligand Pharmaceuticals Incorporated & Investors Trust and Custodial Services (Ireland) Ltd., solely in its capacity as Trustee of Royalty Pharma dated November 5, 2004.
10.283 (47)	Form of Management Lockup Agreement.
10.284 (47)	Letter Agreement, dated March 11, 2005, between the Company and Andres Negro Vilar.
10.285 (47)	Confidential Interference Settlement Agreement dated March 11, 2005, by and between the Company, SRI International and The Burnham Institute.
10.286 (48)	Letter Agreement dated as of July 28, 2005 between the Company and Taylor J. Crouch.

Exhibit Number	Description
10.287 *	Amended and Restated Research, Development and License Agreement dated as of December 1, 2005 between the Company and Wyeth (formerly American Home Products Corporation).
10.288 (51)	Settlement Agreement dated as of December 2, 2005 by and among Ligand Pharmaceuticals Incorporated and Third Point LLC, Third Point Offshore Fund, Ltd., Third Point Partners LP, Third Point Ultra Ltd., Lyxor/Third Point Fund Ltd., and Third Point Partners Qualified LP. (Filed as Exhibit 10.1).
10.289*	Form of Stock Issuance Agreement for non-employee directors.
10.290*	Form of Amended and Restated Director Fee Stock Option Agreement for 2005 award to Alexander Cross.
10.291*	Form of Amended and Restated Director Fee Stock Option Agreement for 2005 award to Henry Blissenbach, John Groom, Irving Johnson, John Kozarich, Daniel Loeb, Carl Peck, Jeffrey Perry, Brigette Roberts and Michael Rocca.
10.292	Termination and Return of Rights Agreement between Ligand Pharmaceuticals Incorporated and Organon USA Inc.
21.1	Subsidiaries of Registrant (See Business).
23.1	Consent of BDO Seidman, LLP.
23.2*	Consent of Latham & Watkins LLP (included in Exhibit 5.1).
24.1	Power of Attorney (See page II-15).

Confidential treatment has been requested for portions of this exhibit. These portions have been omitted from the Registration Statement and submitted separately to the Securities and Exchange Commission.

* Previously filed.

(1) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company s Registration Statement on Form S-4 (No. 333-58823) filed on July 9, 1998.

(2) This exhibit was previously filed as part of and is hereby incorporated by reference to same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended March 31, 1999.

(3) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended September 30, 2004.

(4) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Registration Statement on Form S-1 (No. 33-47257) filed on April 16, 1992 as amended.

(5) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Form 8-A 12G/A, filed on April 6, 2004.

(6) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Registration Statement on Form S-1/S-3 (No. 33-87598 and 33-87600) filed on December 20, 1994, as amended.

(7) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the period ended December 31, 1996.

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(8) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the period ended December 31, 1997.

(10) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended September 30, 1998.

(11) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Current Report on Form 8-K of Seragen, Inc. filed on May 15, 1998.

(12) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the period ended December 31, 1998.

(13) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Registration Statement on Form 8-A/A Amendment No. 1 (No. 0-20720) filed on November 10, 1998.

(14) This exhibit was previously filed as part of and is hereby incorporated by reference to the numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended September 30, 1999.

(15) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Schedule 13D of Elan Corporation, plc, filed on January 6, 1999, as amended.

(16) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company s Registration Statement on Form S-3 (No. 333-12603) filed on September 25, 1996, as amended.

(17) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Registration Statement on Form 8-A/A Amendment No. 2 (No. 0-20720) filed on December 24, 1998.

(18) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the period ended December 31, 1999.

(19) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended March 31, 2000.

(20) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2000.

(21) This exhibit was previously filed as part of, and are hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the year ended December 31, 1993.

(23) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended September 30, 1994.

(24) This exhibit was previously filed, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the year ended December 31, 1995.

(25)

This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly report on Form 10-Q for the period ended June 30, 1996.

(26) This exhibit was previously filed as part of, and is hereby incorporated by reference at the same numbered exhibit filed with the Company s Quarterly report on Form 10-Q for the period ended September 30, 1996.

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(28) This exhibit was previously filed as part of, and are hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly report on Form 10-Q for the period ended September 30, 1995.

(29) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended March 31, 1997.

(30) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended June 30, 1997.

(31) This exhibit was previously filed as part of, and are hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2000.

(32) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended March 31, 2001.

(33) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2001.

(34) This exhibit was previously filed as part of, and are hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2001.

(35) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended March 31, 2002.

(36) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2002.

(37) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended September 30, 2002.

(38) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company s Registration Statement on Form S-3 (No. 333-102483) filed on January 13, 2003, as amended.

(40) This exhibit was previously filed as part of, and are hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2002.

(41) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended March 31, 2003.

(42) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2003.

(43) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended September 30, 2003.

(44) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

(45) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended March 31, 2004.

(46) This exhibit was previously filed as part of, and are hereby incorporated by reference to the same numbered exhibit filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

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(47) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended March 31, 2005.

(48) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Quarterly Report on Form 10-Q for the period ended September 30, 2005.

(49) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company s Current Report on Form 8-K filed on December 14, 2005.

(50) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company s Current Report on Form 8-K filed on December 13, 2005.

(51) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company s Current Report on Form 8-K filed on December 5, 2005.

(52) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company s Current Report on Form 8-K filed on November 14, 2005.

(b) Financial Statement Schedules

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the consolidated financial statements or notes thereto.

Schedule II Valuation and Qualifying Accounts (in thousands)

	Balance at Beginning of Period	**Charges**	**Deductions**	**Balance at End of Period**
December 31, 2004:				
Allowance for doubtful accounts and cash discounts	$ 942	$ 4,612	$4,457	$ 1,097
Reserve for inventory valuation	1,177	1,179	1,329	1,027
Valuation allowance on deferred tax assets	266,935	19,290		286,225
December 31, 2003 (Restated):				
Allowance for doubtful accounts and cash discounts	$ 233	$ 1,928	$1,219	$ 942
Reserve for inventory valuation	1,438	426	687	1,177
Valuation allowance on deferred tax assets	229,162	37,773		266,935
December 31, 2002 (Restated):				
Allowance for doubtful accounts and cash discounts	$ 560	$ 1,155	$1,482	$ 233
Reserve for inventory valuation	1,726	293	581	1,438
Valuation allowance on deferred tax assets	211,212	17,950		229,162

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Item 17. Undertakings

The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act;

(ii) To reflect in the prospectus any facts or event arising after the effective date of the registration statement (or in the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20% change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

Insofar as indemnification by the Registrant for liabilities arising under the Securities Act of 1933, as amended, may be permitted to our directors, officers and controlling persons of the Registrant, we have been advised that in the opinion of the Securities and Exchange Commission, this indemnification is against public policy as expressed in the Securities Act of 1933, as amended, and is, therefore, unenforceable. In the event that a claim for indemnification against these liabilities (other than the payment by the Registrant of expenses incurred or paid by any of our directors, officers or controlling persons in the successful defense of any action, suit or proceeding) is asserted by a director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question of whether this indemnification is against public policy as expressed in the Securities Act of 1933, as amended, and will be governed by the final adjudication of this issue.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, as amended, Ligand Pharmaceuticals Incorporated has duly caused this Registration Statement on Form S-1/A to be signed on its behalf by the undersigned, thereunto duly authorized, in San Diego, California on the 10th day of February, 2006.

LIGAND PHARMACEUTICALS INCORPORATED

By: /s/ DAVID E. ROBINSON
David E. Robinson
President and Chief Executive Officer

POWER OF ATTORNEY

Pursuant to the requirements of the Securities Act of 1933, as amended, this Registration Statement on Form S-1/A has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ DAVID E. ROBINSON David E. Robinson	Chairman of the Board, President, Chief Executive Officer and Director (Principal Executive Officer)	February 10, 2006
/s/ PAUL V. MAIER Paul V. Maier	Senior Vice President, Chief Financial Officer (Principal Financial and Accounting Officer)	February 10, 2006
* Henry F. Blissenbach	Director	
* Alexander D. Cross	Director	
* John Groom	Director	
* Irving S. Johnson	Director	
* John W. Kozarich	Director	
* Daniel S. Loeb	Director	
*	Director	

Carl C. Peck	
*	Director
Jeffrey R. Perry	
*	Director
Brigette Roberts	
*	Director
Michael A. Rocca	

* By: /s/ DAVID E. ROBINSON	* By: /s/ PAUL V. MAIER
David E. Robinson Attorney-in-Fact	Paul V. Maier Attorney-in-Fact

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