MBIA INC
Form DEF 14A
March 28, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
SCHEDULE 14A
Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant [X]
Filed by a Party other than the Registrant [_]
Check the appropriate box:

[_] Preliminary Proxy Statement
[_] CONFIDENTIAL, FOR USE OF THE COMMISSION ONLY (AS PERMITTED BY RULE 14A-6(E)(2))
[X] Definitive Proxy Statement
[_] Definitive Additional Materials
[_] Soliciting Material Pursuant to (S) 240.14a-11(c) or (S) 240.14a-12

MBIA INC.

(Name of Registrant as Specified In Its Charter)

NOT APPLICABLE

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

[X] No fee required.
[_] Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.
(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(4) Proposed maximum aggregate value of transaction:

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(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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MBIA Inc.

113 King Street

Armonk, NY 10504
914 273-4545

Joseph W. Brown

Chairman

[LOGO] MBIA

April 3, 2002

Dear Owners:

I am pleased to invite you to the annual meeting of MBIA shareholders on Thursday, May 9, 2002. The meeting will be held at our offices located at 113 King Street, Armonk, New York, at 10:00 a.m.

Our formal agenda for this year's meeting is to vote on the election of directors, to approve the Company's Annual and Long-Term Incentive Plan, to approve the Restricted Stock Plan for Non-Employee Directors, to approve the Amended and Restated Deferred Compensation Plan for Non-Employee Directors and to ratify the selection of independent auditors for 2002. After the formal agenda is completed, Gary Dunton and I will report to you on the highlights of 2001 and discuss the outlook for our business in 2002. We will also answer any questions you may have.

Whether or not you plan to attend the meeting, your vote on these matters is important to us. Please complete, sign and return the enclosed proxy card in the envelope provided. Alternatively, you can vote your proxy by telephone or through the Internet by following the instructions on the enclosed proxy card.

We appreciate your continued support on these matters and look forward to seeing you at the meeting.

Very truly yours,
/s/ Joseph W. Brown
Joseph W. Brown
Chairman

MBIA INC.

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Dear Shareholders:

We will hold the annual meeting of MBIA Inc. shareholders at the Company's offices located at 113 King Street, Armonk, New York, on Thursday, May 9, 2002 at 10:00 a.m., New York time in order:

1: To elect nine directors for a term of one year, expiring at the 2003 Annual Meeting;

2: To approve the Company's Annual and Long-Term Incentive Plan for purposes of Section 162(m) of the Internal Revenue Code;

3: To approve the Amended and Restated Deferred Compensation and Stock Ownership Plan for Non-Employee Directors;

4: To approve the Restricted Stock Plan for Non-Employee Directors;

5: To ratify the selection of PricewaterhouseCoopers LLP, certified public accountants, as independent auditors for the Company for the year 2002;

6: To transact any other business as may properly come before the meeting.

These items are more fully described in the following pages. You may vote your shares either in person at the meeting or by mailing in the completed proxy card, provided you were a shareholder of record at the close of business on March 21, 2002. You may also vote your shares if you were a shareholder of record at the close of business on March 21, 2002 by telephone or through the Internet by following the instructions on the enclosed proxy card.

Shareholders are reminded that shares cannot be voted unless the signed proxy card is returned, or other arrangements have been made to have the shares represented at the meeting, or unless they vote their shares by telephone or Internet as described on the Proxy Card.

Sincerely,

/s/ Richard L. Weill

Richard L. Weill
Secretary

113 King Street
Armonk, New York 10504
April 3, 2002

MBIA INC.

PROXY STATEMENT

Purpose of the Proxy. This proxy statement and the enclosed proxy card are being mailed to you on or about April 3, 2002 because MBIA's Board of Directors is soliciting your vote at the 2002 annual meeting of shareholders. MBIA's Annual Report for the year 2001 is included in this package as well, and together this material should give you enough information to allow you to make an informed vote.

How it Works. If you owned MBIA stock at the close of business on March 21, 2002, you are entitled to vote. On that date, there were 148,166,601 shares of MBIA common stock outstanding, which is our only class of voting stock. You have one vote for each share of MBIA common stock you own.

Please fill in your proxy card and send it to us before the date of our annual meeting or vote by telephone or over the Internet. If you do not specify how your proxy is to be voted, it will be voted as recommended by the Board of Directors. You can revoke your proxy at any time before the annual meeting if, for example, you would like to vote in person at the meeting.

If you abstain from voting, or if your shares are held in the name of your broker and your broker does not vote on any of the proposals, your proxy will be counted simply to calculate the number of shares represented at the meeting. It will not be counted as a vote on any proposal.

Directors are elected by a plurality of the votes cast. To ratify the independent auditors, a majority of shares voting is required.

Proposal 1:

ELECTION OF DIRECTORS

All of MBIA's directors are elected at each annual shareholders' meeting for a one-year term. Shareholders will elect nine directors at the 2002 meeting to serve a term expiring at the 2003 annual meeting.

Following is information about each nominee, including biographical data for at least the last five years. Should one or more of these nominees become unavailable to accept nomination or election as Director (an event not now anticipated), all proxies received will be voted for such other persons as the Board may recommend, unless the Board reduces the number of directors.

Joseph W. Brown............. Mr. Brown joined the Company as Chief Executive Officer in January 1999 and became Chairman of the Company in May 1999. Prior to that he was Chairman of the Board of Talegen Holdings, Inc. from 1992 through 1998. Prior to joining Talegen, Mr. Brown had been with Fireman's Fund Insurance Companies as President and Chief Executive Officer. Mr. Brown has served as a director of the Company since 1990 and previously served as a director from December of 1986 through May of 1989. Mr. Brown also serves as a director of Oxford Health Plans, Inc. and Safeco Corporation. Age 53.

David C. Clapp.............. Mr. Clapp retired as a General Partner of Goldman, Sachs & Co. in 1994. From 1990 until late 1994, he was Partner-in-charge of the Municipal Bond Department at Goldman, Sachs & Co. (investment bank). Mr. Clapp is a member of the Boards of the Hazelden Foundation, Kent School, Scenic Hudson Inc. and Bard College. He is past Chairman of the Municipal Securities Rulemaking Board, Chairman Emeritus of the Board of Trustees of the Museum of the

City of New York and Chair of the New York Arthritis Foundation. Mr. Clapp has served as director of the Company since 1994. Age 64.

Gary C. Dunton.............. Mr. Dunton, who joined MBIA in early 1998, is President and Chief Operating Officer of the Company. Prior to joining MBIA, he was President of the Family and Business Insurance Group, USF&G Insurance, with which he had been associated since 1992. Prior to joining USF&G, he was responsible for Aetna Life & Casualty Standard Commercial Lines business. Mr. Dunton was on the Company's board from 1996 until early 1998. Mr. Dunton currently serves as a director of OfficeTiger.com, an on-line support services company. Age 47.

Claire L. Gaudiani..........	Dr. Gaudiani is a Visiting Scholar at the Yale Law School. From 1988 until June 2001, Dr. Gaudiani was President of Connecticut College. Dr. Gaudiani has also been President and CEO of the New London Development Corporation since 1997 and continues in that capacity. She also serves as a director of The Henry Luce Foundation Inc. She has been a director of the Company since being elected at the 1992 Annual Meeting. Age 57.
William H. Gray, III........	Mr. Gray is President and Chief Executive Officer of the United Negro College Fund, Inc. Mr. Gray has served as Special Advisor to the President on Haiti, Majority Whip and Budget Chairman for the U.S. House of Representatives, a faculty member at several colleges, and has been pastor of the 5,000-member Bright Hope Baptist Church in Philadelphia for 25 years. He serves as a director of J.P. Morgan Chase & Co., Pfizer, Dell Computers Corporation, Prudential Financial, Viacom, Rockwell International Corporation, Electronic Data Systems Incorporated and EZGov.com. Mr. Gray has been a director of the Company since 1992. Age 60.
Freda S. Johnson............	Ms. Johnson is President of Government Finance Associates, Inc. (municipal finance advisory company), a firm which she has been associated with since late 1990. She served as Executive Vice President and Executive Director of the Public Finance Department of Moody's Investors Service, Inc. from 1979 to 1990. Ms. Johnson is a past member of the National Association of State Auditors, Comptrollers and Treasurers' National Advisory Board on State and Local Government Secondary Market Disclosure and a past member of the corporate advisory board of Queens College. She is also a past director of the National Association of Independent Public Finance Advisors and was a member of the Municipal Securities Rulemaking Board's MSIL Committee on Dissemination of Disclosure Information. Ms. Johnson has served on the Company's Board of Directors since 1990. Age 55.
Daniel P. Kearney...........	Mr. Kearney, currently a financial consultant, retired as Executive Vice President of Aetna Inc. (insurance company) in February 1998. Prior to joining Aetna in 1991, he served as President and Chief Executive Officer of the Resolution Trust Corporation Oversight Board from 1989 to 1991. From 1988 to 1989, Mr. Kearney was a principal at Aldrich, Eastman & Waltch, Inc., a pension fund

advisor. Mr. Kearney was a managing director at Salomon Brothers Inc. (investment bank) in charge of the mortgage finance and real estate finance

departments from 1977 to 1988. He serves as a director of Fiserv, Inc., MGIC Investors Corporation and Great Lakes REIT. Mr. Kearney has served on the Company's Board of Directors since being elected at the 1992 Annual Meeting. Age 62.

James A. Lebenthal......... Mr. Lebenthal is Chairman Emeritus of Lebenthal & Co., Inc., a broker-dealer of municipal bonds. He also acts as consultant to The Advest Group Inc., which acquired Lebenthal & Co. in 2001. He served as Chairman from 1978 through 2001 and as President from 1986 to 1988 and April to June of 1995. He serves on the Board of Directors of the Museum of the City of New York. Mr. Lebenthal has been a director of the Company since August of 1988. Age 73.

John A. Rolls.............. Mr. Rolls has been President and Chief Executive Officer of Thermion Systems International since 1996. From 1992 until 1996, he was President and Chief Executive Officer of Deutsche Bank North America. Prior to joining Deutsche Bank in 1992, he served as Executive Vice President and Chief Financial Officer of United Technologies from 1986 to 1992. He is a director of Bowater, Inc., Fuel Cell Energy, Inc. and VivaScan Corporation. Mr. Rolls joined the Company's Board in 1995. Age 60.

The Board has set a policy that no person aged 70 years or older can be nominated a director. The Board has waived this policy with respect to Mr. Lebenthal, however, and granted him a final one year extension.

The Board is currently engaged in a search for two to three new Directors. If suitable candidates are found before the next annual shareholders meeting, the Board plans to elect them to the Board in accordance with its power under the Company's by-laws to fill interim vacancies on the Board.

After serving the Company and its predecessor in various capacities for almost 30 years, including as Chairman and Chief Executive Officer from 1992 until 1999 and as a director since 1988, David H. Elliott is not standing for re-election as a Director. The Chairman and the entire Board of Directors wish to express their profound gratitude to Mr. Elliott for his many years of dedicated leadership and his significant contribution to the Company's success.

The Board of Directors recommends unanimously that you vote FOR this proposal to re-elect these nine directors.

THE BOARD OF DIRECTORS AND ITS COMMITTEES

The Board of Directors supervises the overall affairs of the Company. To assist it in carrying out these responsibilities, the Board has delegated authority to six Committees, described below. The Board of Directors met five times during 2001. Except for one Board meeting and one Committee meeting that one director did not attend during 2001, all directors standing for re-election attended all of the Board meetings and meetings of Committees on which they served.

Board Committees

The Executive Committee, which at year-end consisted of Messrs. Brown (chairperson), Kearney and Rolls, did not meet in 2001. The Executive Committee

is authorized to exercise powers of the Board during intervals between Board meetings, subject to limitations set forth in the by-laws of the Company.

The Finance Committee, which at year-end consisted of Messrs. Clapp, Dunton, Elliott and Rolls (chairperson), met twice during 2001. This Committee approves and monitors the Company's investment policies, activities and portfolio holdings, and reviews investment performance and asset allocation.

The Risk Oversight Committee, which at year-end consisted of Messrs. Clapp, Dunton, Elliott and Kearney (chairperson) met two times during 2001. This Committee monitors the underwriting process to ensure compliance with guidelines, and reviews proposed changes to underwriting policy and guidelines. It also reviews proposals to develop new product lines which are outside the scope of existing businesses.

The Compensation and Organization Committee, which at year-end consisted of Mr. Clapp (chairperson), Ms. Gaudiani, Messrs. Kearney and Rolls, met twice during 2001. This Committee reviews and approves overall policy with respect to compensation matters. Every year, the Committee reviews the performance of the Chairman and makes recommendations to the Board on the Chairman's compensation. The Committee approves senior officer compensation and reviews significant organizational changes and executive succession planning.

The Audit Committee, which at year-end consisted of Mr. Gray, Ms. Johnson (chairperson), Messrs. Lebenthal and Rolls, met five times during 2001. It reviews the Company's annual and quarterly financial statements, reviews the reports of the Company's independent auditor and the performance of those auditors. The Committee also reviews the qualification of the Company's Internal Audit Department.

The Committee on Directors, which at year-end consisted of Ms. Gaudiani, Mr. Gray (chairperson) and Ms. Johnson, met once during 2001. This Committee makes recommendations to the Board on Director nominees and on the size and composition of the Board. It also recommends guidelines and criteria for the selection of nominees. In 2001 the Committee on Directors and the Board of Directors adopted the "MBIA Inc. Corporate Governance Practices". The Corporate Governance Practices establish corporate governance guidelines and principles with respect to the role of the board of directors, meetings of the board of directors, board structure and commitees of the board. The MBIA Inc. Corporate Governance Practices are available on the MBIA web site.

Director's Compensation

Outside Directors. The Company paid Directors who are not executive officers a fee of $30,000 for their services in 2001, plus an additional $2,000 for attendance at each Board and Committee meeting. The Company also paid Committee chairs an additional $1,000 per meeting for each meeting they chair. The Company has a Deferred Compensation and Stock Ownership Plan for non-employee directors, in which directors can defer all or a portion of their fees, and receive payment either in cash or in shares of common stock. As of year-end, seven of the eight non-employee directors elected to participate in this plan. In addition to the annual cash fee, the Company also granted non-employee directors an award of restricted stock with a value of $50,000 under the Restricted Stock Plan for Directors described below.

In January 2002, in order to maintain the competitiveness of compensation payable to outside directors and to be able to attract and retain qualified outside directors, the Board of Directors approved certain changes in the

compensation paid to outside directors. Under the new plan, the annual and per meeting fees will remain the same, but directors will receive an annual grant of restricted stock with a value of $50,000 at the time of grant, in lieu of the award of stock units of $30,000 that had been granted for 2000. The award of restricted stock under the new plan was made effective with respect to 2001 and subsequent years. In addition, new directors will receive a one time grant of restricted stock with a value of $75,000 at the time of grant. The terms of the restricted stock granted to directors are described in more detail below under Proposal 4.

In January 2002, the Board of Directors approved (i) the Amended and Restated Deferred Compensation and Stock Ownership Plan for Non-Employee Directors and (ii) the Restricted Stock Plan for Non-Employee Directors, which are described in more detail under Proposal 3 and Proposal 4 below, respectively.

Executive Officer Directors. Mr. Brown and Mr. Dunton, who are also executive officers of the Company, do not receive compensation for their services as directors.

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REPORT OF THE COMPENSATION AND ORGANIZATION COMMITTEE ON EXECUTIVE COMPENSATION

To: The MBIA Inc. Board of Directors
From: The Compensation and Organization Committee:
Mr. David C. Clapp, Chairperson
Ms. Claire L. Gaudiani
Mr. Daniel P. Kearney
Mr. John A. Rolls

MBIA's Compensation and Organization Committee (the "Committee") is made up of four members of the Board of Directors who are not current or former employees of the Company, and are not eligible to participate in any of the programs that it administers.

This report on Executive Compensation by the Committee contains the following topics:

1. Role of the Compensation and Organization Committee
2. Guiding Principles of Compensation
3. 2001 Performance Factors
4. Elements of the Compensation Program
5. Compensation of the Chief Executive Officer
6. Stock Ownership Guidelines
7. Loans and Stock Activity
8. Tax Deductibility of Executive Compensation

1. Role of the Compensation and Organization Committee

We set the overall compensation principles of the Company and evaluate the Company's entire compensation program at least once a year. As part of our specific responsibilities (i) we review and approve the recommendations of the Chief Executive Officer (the "CEO") for the aggregate level of compensation to be paid to all employees of the Company, (ii) we review the recommendations of the CEO for the individual compensation levels for members of the senior leadership team, which includes the Company's Executive Policy Committee and

certain other officers ("Senior Officers") and (iii) we establish and recommend to the Board the compensation level of the CEO. The Board approves the CEO's and Senior Officers' compensation levels.

2. Guiding Principles of Compensation

The fundamental goal of MBIA's compensation program is to attract, motivate and retain a highly skilled team of executives and employees who will deliver superior performance that builds shareholder value. The Company's compensation program is significantly linked to shareholder interests as our emphasis is on pay for performance, with individual, operational and corporate performance rewarded on a short-term and long-term basis. Specifically, the principles that guide our compensation program include:

- Pay for Performance: an employee's compensation should reflect his or her individual performance and achievement of agreed upon short-term and long-term individual goals, the performance of the employee's unit and the achievement by the unit of its goals, and the performance of the Company as a whole and the achievement by the Company of its goals.

- Pay Competitively: compensation should be competitive with organizations with comparable business profiles and similar financial performance.

- Increase Variable Compensation and Long-Term Incentives: an employee's variable pay and long-term incentives increases as a percentage of overall compensation as the employees overall compensation and responsibility increases.

- Align Employee and Shareholder Interests: as employees and executives assume greater seniority and responsibility, their compensation should include more long-term incentives that encourage superior performance that builds long-term value for the Company and its shareholders, thereby aligning their interests with the interest of both the Company and its shareholders.

3. 2001 Performance Factors

The Committee reviewed the long-term financial and operational objectives of the Company and the specific objectives set in the Company's 2001 Business Plan at the beginning of 2001. The Committee noted the strong overall results of the Company and concluded that overall the Company met or exceeded almost all of the goals established in the 2001 Business Plan, including operating earnings per share, operating return on equity and growth in adjusted book value. The Committee also reviewed the results for each of the Company's businesses. The Company's insurance operations met or exceeded all of the financial and operational goals for 2001, including, but not limited to, total adjusted direct premiums written, returns on business written, credit quality of business written and statutory expense ratio. These goals were met while maintaining overall pricing discipline. The Company's asset management businesses had increases in assets under management and operating income as compared to 2000, although not fully meeting the objectives of the 2001 Plan. The municipal services business incurred a small operating loss for 2001, as compared to a small operating income set as an objective in the 2001 Plan.

4. Elements of the Compensation Program

The three components of MBIA's compensation program are:

- Annual Fixed Compensation (Salary)
- Annual Variable Compensation (Bonus)
- Long-term Incentives (Stock Options, Restricted Stock Awards and Adjusted Book Value Awards)

.. Fixed Compensation (Salary)

We base our recommendations on salaries and salary increases for the CEO and the Senior Officers on the job content of each position, competitive salaries for comparable positions, the executive's experience and the actual performance of each executive. The Company also grants cost of living salary increases from time to time as it deems necessary to remain competitive. For 2002, Mr. Brown, the CEO, recommended, and the Committee and Board agreed, that salaries of only three of the eleven Senior Officers should be increased, to reflect individual responsibility and to maintain market competitiveness.

.. Variable Compensation (Bonus)

The annual bonus component of incentive compensation is designed to align our Senior Officers' compensation with the short-term (annual) performance of the Company. Actual bonus grants can range from 0% to 200% of salary, depending on a Senior Officer's position and performance. The CEO can receive up to 200% of his salary as a performance-based bonus.

A Senior Officer's annual bonus is based on the Company's performance in certain areas, including return on equity, change in earnings per share, change in adjusted book value per share, relative performance to peer group companies, expense management, success in achieving the business plan and strategic goals set for each division, employee development, and the individual Senior Officer's personal contribution to the achievement of the Company's goals and of the individual's specific goals. The weight and effect of any of these factors on the compensation of each Senior Officer varies depending on the individual officer's job responsibility.

Based on strong Company results in 2001 as described under "2001 Performance Factors" above, Mr. Brown recommended, and the Committee and Board agreed, that the aggregate bonus pool for Senior Officers be set at approximately 90% (compared to 82.5% for 2000) of the maximum bonus payable based on the bonus range established at the beginning of the year. The individual bonuses paid to each of the Senior Officers were recommended by Mr. Brown and approved by the Committee and the Board.

Form of Bonus Payment. Bonuses for Senior Officers are paid in a combination of cash and restricted stock. The percentage of the bonus payable in the form of restricted stock ranges from 40% to 100%. The actual percentage mix is based on the Senior Officer's title and job position. The CEO and the President receive 100% of their bonus in restricted stock.

The actual number of shares of restricted stock granted to a Senior Officer is determined by dividing the portion of the annual bonus to be paid in the form of restricted stock by 75% of the closing price of the Company's stock on the date of grant. The restricted stock vests in full four years after the grant, and is subject to accelerated vesting under certain conditions, including termination of employment without cause, death or disability or a change of control of the Company.

Sizing the Bonus Pools. Mr. Brown recommended to the Committee the aggregate size of the Company's bonus pools for each of the insurance units, the investment management units and the municipal services unit, excluding from these pools the bonuses paid to the CEO and the Senior Officers.

The size of the pool for each of these units is based both on the Company's overall performance and on each unit's performance. Mr. Brown and the Committee considered the following factors in establishing the bonus pool for each unit: return on equity, absolute return as measured by IRR on new business, growth in reported earnings, growth in adjusted book value per share, the relative performance of peer group companies and the unit's achievement of its annual goals.

In 2001, the Committee approved an aggregate bonus pool for the Company's insurance business funded at 90% (compared to 85% in 2000) of the maximum bonus payable to each employee based on the ranges established at the beginning of the year. The bonus pools for other business units were increased or decreased based on the performance of these units during the year. The aggregate amount of bonuses paid to all employees for 2001 was approximately $41.2 million compared to approximately $40.5 million for 2000.

.. Long-Term Incentives

The Company's Long-Term Incentive Plan (the "Plan") provides participants with an incentive linked to both multiple-year financial performance and shareholder value. The Plan authorizes both the annual granting of stock options as well as the payment of compensation in the form of cash or stock that is paid at the end of a multi-year cycle based on the Company attaining certain performance goals. Individual long-term incentive awards are based on a percentage target of total annual cash (salary plus bonus) compensation as well as an individual's level of responsibility. Awards under the Plan are typically granted to employees who have a title of Vice-President or higher, up to and including CEO.

Long-term incentive awards are divided between a grant of stock options and a deferred target payment of cash or Company stock that is tied to the achievement of a specified level of growth in modified book value per share ("MBV") of the Company's stock. In order to more closely align the pay-out of the long-term incentive award with the Company's long-term objective of increasing ROE, the Committee adopted MBV as a new performance measure to replace the previously used measure of adjusted book value (ABV). In addition, the Committee believes that MBV will be easier for employees to understand and follow thereby better linking employees' efforts to the Company's results. MBV is computed by taking the Company's GAAP book value and adjusting it to eliminate unrealized gains and losses on investments and derivatives; unearned compensation pertaining to restricted stock awards; dividends declared during the award period; and interest on dividends paid during the award period. In general, long-term incentive awards are split 50/50 between stock options and MBV awards.

At the recommendation of Mr. Brown, the Committee decided to apply the new MBV measure retroactively starting with the long-term incentive awards that were made to employees in December 2000 and to Senior Officers in January 2001. The Committee decided not to apply the new MBV measure to the long-term incentive awards made in 1999, which will continue to be based on the achievement of ABV targets.

Stock Options. Stock options give employees the right to purchase shares of the Company's common stock at the closing price on the date of the grant. Except for the options granted to the CEO and the President, each option vests over four or five years, and is subject to accelerated vesting upon a change of control of the Company. All options expire ten years from the date of the grant. On February 7, 2002, a total of 1,161,500 options were awarded to employees with respect to 2001, excluding the options granted to Mr. Brown (which are described below).

MBV Awards. An MBV award has a target pay out amount and is payable in cash or shares of Company stock three years after the grant date. In order to receive the 2001 MBV target award, MBV must grow at a compound annual rate of 13.5%. The actual amount of MBV pay out ranges between 75% and 200% of the target award, depending on the compound annual growth in MBV. Under the 2001 award, MBV must grow at least 8% in order to receive any award and 18% in order to receive the maximum award of 200% of target MBV award.

The Committee also reviewed the performance criteria for the payment of the adjusted book value award made in December 1998, which is being paid in the first quarter of 2002, and covers the period from 1999 through 2001. Based on such criteria, the Committee approved an award of 85% of the target pay out.

5. Compensation of the Chief Executive Officer

.. Performance Requirements

The CEO's salary and bonus are based on a number of factors related to the Company's and the CEO's performance including return on equity; change in earnings per share; change in adjusted book value per share; internal returns on insurance business written during the year; relative performance to peer group companies; the achievement of the Company's business plan goals and the CEO's achievement of his specific goals. In determining Mr. Brown's compensation, the Committee gave 70% weight to the achievement of the Company's financial goals and 30% weight to the achievement of other elements of the Company's business plan and of his own personal goals.

.. Salary, Bonus and Long-Term Incentive Award

Salary. Mr. Brown's salary is fixed at $750,000 for five years until January 1, 2004.

Bonus. The Committee noted the successful financial results for 2001 and the positive performance of the Company during the year, all as described under "2001 Performance Factors" above, and Mr. Brown's significant role in the achievement of the results. At the specific request of Mr. Brown, however, the Committee acceded to Mr. Brown's wishes that his bonus and long-term incentive awards not be increased over the previous year's level of 66% of the maximum target amounts. The Committee recommended and the Board approved for Mr. Brown a bonus of 26,001 shares of restricted stock. As set forth in his employment agreement, Mr. Brown's annual bonus is paid entirely in restricted common stock of the Company.

Under the restrictions applicable to the shares, Mr. Brown cannot sell or pledge the stock until the first day after a consecutive ten-day period that ends on or before February 6, 2007 and during which the stock has traded at $70 or above on each day of the ten day period. If this price target has not been met on or before February 7, 2007, all of the stock is forfeited.

Long-Term Incentive Award. The Committee also recommended a long-term incentive award for Mr. Brown comprised of an option grant of 375,000 shares and an MBV award with a target pay out of $1,552,871, such long-term incentive award being identical to the previous year.

The exercise price for Mr. Brown's options is $52.81, the closing price of the Company's stock on February 7, 2002, the date of the grant. Mr. Brown's options will vest immediately (but not before February 7, 2005) on the first day after a period of ten consecutive trading days during which the Company's common

stock has traded at least at $70 on each day. In addition, the options will vest in full on February 7, 2011, subject to Mr. Brown's continued employment with the Company through such dates, even if the trading requirement set forth above has not been met.

The pay out of Mr. Brown's MBV award is contingent both on the Company's stock trading at $70 or above for ten consecutive trading days at some point between February 7, 2002 and December 31, 2006, and on actual growth in MBV as described above. If the Company's stock does not trade at $70 or above for ten consecutive trading days at any point during this period, Mr. Brown will not receive this award regardless of whether the MBV pay out target is met.

The restrictions on the restricted stock are terminated and the vesting of the stock options and the pay out of the MBV award are accelerated immediately upon the occurrence of certain events including the termination of Mr. Brown's employment without cause, Mr. Brown's death or disability or a change of control of the Company.

The Committee also reviewed and approved the payment of a 1998 adjusted book value award to Mr. Brown of $1,685,000.

6. Stock Ownership Guidelines

The Board has adopted stock ownership guidelines to help increase senior management stock ownership and more closely align senior management's interests with those of shareholders.

Under these guidelines, the CEO is encouraged to own Company stock with a value equal to approximately five times his annual salary, and the other Senior Officers are encouraged to own Company stock with a value of approximately three or four times their annual salary, depending on their job and title. This includes stock owned in retirement plans and also the value of restricted stock. The CEO and the other Senior Officers either currently own or are expected within five years of becoming Senior Officers to own sufficient stock to comply with the stock ownership guidelines.

7. Loans and Stock Activity

The Company does not have any program in place to provide loans to Senior Officers of the Company. No senior officer has an outstanding loan with the Company.

To the knowledge of the Company, all stock or stock option activity by Senior Officers and Directors required to be disclosed has been reported to the SEC in the month following such activity. All exercise and sale of stock options by senior officers during 2001 related to 10-year options with less than three years to expiration.

8. Tax Deductibility of Executive Compensation

Based on currently prevailing authority, including proposed Treasury

regulations issued in December 1995, and in consultation with outside tax and legal experts, the Committee has determined that it is unlikely that the Company would pay any amounts of executive compensation in 2001 or 2002 that would result in the loss of a federal income tax deduction under Section 162(m) of the Internal Revenue Code of 1986, as amended.

Date: March 21, 2002

This report of the Compensation and Organization Committee shall not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the Company specifically incorporates this information by reference, and shall not otherwise be deemed filed under such Acts.

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MBIA INC.

I. SUMMARY COMPENSATION TABLE

		Annual Compensation			Long-Term Award	
Name & Principal Position	Year	Salary ($)	Bonus ($)(a)	Other Annual Compensation ($)	Restricted Stock Awards ($)(b)	S U
Joseph W. Brown..................................	2001	750,000	0	0	1,373,111	
Chairman and Chief Executive Officer	2000	750,000	0	0	1,373,077	
	1999	738,942	0	0	0	1
Gary C. Dunton...................................	2001	600,000	0	0	1,500,000	
President	2000	600,000	0	0	1,373,077	
	1999	568,750	0	0	960,000	
Richard L. Weill.................................	2001	525,000	330,000	0	675,000	
Vice President	2000	525,000	300,000	0	617,885	
	1999	531,200	0	0	735,000	
John B. Caouette.................................	2001	525,000	330,000	0	0	
Vice President	2000	525,000	300,000	0	0	
	1999	512,500	0	0	735,000	
Neil G. Budnick..................................	2001	525,000	330,000	0	675,000	
Vice President and Chief Financial Officer	2000	525,000	300,000	0	617,885	
	1999	512,500	220,500	0	441,000	

(a) The 2001 amounts were paid on March 1, 2002 for the 2001 performance year. The 2000 amounts were paid on January 11, 2001 for the 2000 performance year. See footnote (b) regarding the payment of bonuses in the form of restricted stock.

(b) These amounts represent the value of the restricted stock that was granted as part of the annual bonus. With respect to 2001, these amounts were awarded to Messrs. Brown, Dunton, Weill and Budnick on February 7, 2002 for the 2001 performance year and paid in 26,001, 28,404, 12,782 and 12,782 shares of restricted stock, respectively. The shares were valued at the closing price on the date of the awards for all years. Dividends are paid

on all restricted stock at the same rate payable to all common shareholders and thus are not reflected in the amounts reported. Aggregate holdings, net of employee deferrals to the Company's 401(k) plan, as of February 7, 2002 are as follows:

	Number of Shares	Value ($)
Joseph W. Brown	53,667	2,591,742
Gary C. Dunton	90,840	3,922,708
Richard L. Weill	55,150	2,290,997
John B. Caouette	28,736	1,013,228
Neil G. Budnick	41,608	1,793,720

(c) On February 7, 2002, Messrs. Brown, Dunton, Weill, Caouette and Budnick were awarded 375,000, 200,000, 55,000, 75,000 and 75,000 stock options, respectively, with respect to the 2001 performance year. The 2001 options were granted on January 11, 2001 for the 2000 performance year. There were no options granted to the executive officers in 2000. In 2000, the Company changed its date for awarding bonuses and long-term incentive awards from the fourth quarter of the year to the first quarter of the following year. All shares have been adjusted for the 3 for 2 stock split effective April 20, 2001.

(d) On March 1, 2002, Messrs. Brown, Dunton, Weill, Caouette and Budnick received distributions of the 1998 ABV award in the following amounts, which represents 85% of the target payout: $1,685,000, $1,000,000, $561,850, $549,950 and $527,850, respectively.

(e) Consists of (i) contributions to the Company's money purchase pension plan and 401(k) plan and supplemental benefit plans, (ii) premiums paid on behalf of such employees under a split-dollar life insurance policy, (iii) premiums paid on behalf of such employees under a supplemental disability insurance policy, and (iv) in the case of Mr. Caouette, a portion of the annual bonus awarded to Mr. Caouette in a deferred stock award (in lieu of restricted stock) of 12,782 shares that will vest and be

distributed on February 7, 2006. Such amounts were paid or contributed in 2002 for the 2001 performance year were as follows:

	Contributions to pension & 401k plans	Premiums for Split-dollar Life policy	Premiums for Supplemental Disability policy	Deferred Stock Award
Joseph W. Brown.	266,975	128,511	0	0
Gary C. Dunton..	258,750	29,602	20,956	0
Richard L. Weill	204,188	44,564	21,369	0
John B. Caouette	204,188	71,767	32,603	675,000
Neil G. Budnick.	204,188	24,277	11,698	0

MBIA INC.

II. OPTION GRANTS IN 2001

Individual Grants

Name	Number of Securities Underlying Options Granted(a)(d)	Percent of Total Options Granted to Employees in 2001(b)	Exercise Price Per Share ($/Sh)	Expiration Date	Grant Date Present Value ($)(c)
Joseph W. Brown.	375,000	30%	44.6250	Jan 11, 2011	5,790,625
Gary C. Dunton..	112,500	9%	44.6250	Jan 11, 2011	1,737,188
Richard L. Weill	54,000	4%	44.6250	Jan 11, 2011	833,850
John B. Caouette	54,000	4%	44.6250	Jan 11, 2011	833,850
Neil G. Budnick.	54,000	4%	44.6250	Jan 11, 2011	833,850

(a) These options were granted on January 11, 2001 for the 2000 performance year. They have a ten-year term and vest as follows: year 1-0%; year 2-40%; year 3-60%; year 4-80%; year 5-100% (subject to certain acceleration provisions if there occurs a change in control of the Company or upon the death, disability or retirement of the employee). With respect to Mr. Brown's award, no vesting in years 1 to 3; if at any time during years 1 to 9 the stock has traded at $70 per share for ten consecutive trading days (the "Trading Target"), the options would immediately vest in full but no sooner than the third anniversary date; if the Trading Target is not met in years 1 to 9, then the options would vest in full on the ninth anniversary date. All shares and share prices have been adjusted for the 3 for 2 stock split effective April 20, 2001.

(b) Percentages are based on the total number of options granted to all employees in 2001 (1,265,374). If the options issued to all employees in December 2000 for the 2000 performance year (880,407) were included, the percentages would be as follows: Mr. Brown 17%, Mr. Dunton 5%, Mr. Weill 3%, Mr. Caouette 3% and Mr. Budnick 3%.

(c) The fair value is based upon the Black-Scholes option valuation model. Black-Scholes is a mathematical model used to estimate the theoretical price an individual would pay for a traded option. The actual value an executive may realize will depend on the excess of the stock price over the exercise price. There is no assurance the value realized will be at or near the value estimated by Black-Scholes. The fair value of each option is $15.4417 based on the following assumptions : (i) an exercise price of $44.625, (ii) an option term of 6.19 years, (iii) a future dividend yield of 1.225%, (iv) a risk-free interest rate of 4.925% and (v) an estimated stock price volatility of 0.3010.

(d) The following table shows stock options granted to Messrs. Brown, Dunton, Weill, Caouette and Budnick on February 7, 2002 with respect to the 2001 performance year:

Number of Securities Underlying	Percent of Total Options Granted to Employees in 2002	Exercise Price	Grant Date

Name	Options Granted	as of February 7, 2002	Per Share ($/Sh)	Expiration Date	Present Value ($)
Joseph W. Brown.	375,000	24%	52.8100	Feb 7, 2012	6,842,813
Gary C. Dunton..	200,000	13%	52.8100	Feb 7, 2012	3,649,500
Richard L. Weill	55,000	4%	52.8100	Feb 7, 2012	1,003,613
John B. Caouette	75,000	5%	52.8100	Feb 7, 2012	1,368,563
Neil G. Budnick.	75,000	5%	52.8100	Feb 7, 2012	1,368,563

These options have the same vesting terms as described in footnote (a) above. The options granted to Messrs. Brown and Dunton have substantially the same vesting terms as the options granted to Mr. Brown on January 11, 2001 described in footnote (a) above, except that the expiration date is February 7, 2012. The fair value of each option estimated by the Black-Scholes option valuation model is $18.2475 based on the following assumptions: (i) an exercise price of $52.81, (ii) an option term of 6.26 years, (iii) a future dividend yield of 1.14%, (iv) a risk-free interest rate of 4.835% and (v) an estimated stock price volatility of 0.2954.

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III. AGGREGATED OPTION EXERCISES IN 2001 AND 2001 YEAR-END OPTION VALUES (a)

Name	Number of Shares Acquired upon Exercise(b)	Value Realized($)(c)	Number of securities Underlying Options at December 31, 2001		Value of Unexercised In-the Money Options at December 31, 2001($)(d)	
			Exercisable	Unexercisable	Exercisable	Unexercisabl
Joseph W. Brown.	0	$ 0	0	1,821,000	$ 0	$18,620,523
Gary C. Dunton..	0	0	103,662	518,493	1,572,019	5,352,906
Richard L. Weill	27,000	947,131	249,786	103,719	6,884,705	1,409,607
John B. Caouette	52,500	1,802,010	159,354	259,452	3,083,956	2,821,761
Neil G. Budnick.	18,000	509,400	95,982	326,658	2,126,055	3,272,626

(a) Does not include options granted on February 7, 2002 for the 2001 performance year. All shares have been adjusted for the 3 for 2 stock split effective April 20, 2001.
(b) All of these options had expiration dates no later than three years from the date of exercise.
(c) The "Value Realized" is equal to the fair market value on the date of exercise, less the exercise price, multiplied by the number of shares acquired.
(d) These values are based on $53.63 per share, the fair market value of the shares underlying the options on December 31, 2001, less the exercise price, times the number of options.

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IV. LONG-TERM INCENTIVE PLAN -- AWARDS IN LAST FISCAL YEAR (a)(b)

Name	Performance Period Until Payout	Threshold	Target	Maximum
Joseph W. Brown.	Three years	0	$1,552,871	$3,105,742
Gary C. Dunton..	Three years	0	1,552,871	3,105,742
Richard L. Weill	Three years	0	869,608	1,739,216
John B. Caouette	Three years	0	869,608	1,739,216
Neil G. Budnick.	Three years	0	869,608	1,739,216

(a) The awards were made on January 11, 2001 for the 2000 performance year, with the payout, if any, occurring in early 2004. The target award is based on a projected 13.5% growth in the modified book value per share of the Company's stock, subject to the threshold level which requires 8% growth and the maximum level which requires 18% growth. With respect to Mr. Brown's award, unless the stock has traded at $70 per share for ten consecutive trading days during the period between January 11, 2001 and December 31, 2005, he will receive no award regardless of the growth in modified book value per share of the Company's stock. These awards were initially based on the growth in "adjusted book value" per share, but were changed on February 7, 2002 to be based on the growth in "modified book value" per share. The calculation of modified book value is described in the Report of the Compensation and Organization Committee on Executive Compensation.

(b) The following table sets forth the long-term incentive awards made to Messrs. Brown, Dunton, Weill, Caouette and Budnick on February 7, 2002 with respect to the 2001 performance year with the payout, if any, occurring in early 2005:

Name	Performance Period Until Payout	Threshold	Target	Maximum
Joseph W. Brown.	Three years	0	$1,552,871	$3,105,742
Gary C. Dunton..	Three years	0	1,750,000	3,500,000
Richard L. Weill	Three years	0	900,000	1,800,000
John B. Caouette	Three years	0	900,000	1,800,000
Neil G. Budnick.	Three years	0	900,000	1,800,000

With respect to Mr. Brown's award, unless the stock has traded at $70 per share for ten consective trading days during the period between February 7, 2002 and December 31, 2006, he will receive no award regardless of the growth in modified book value per share of the Company's stock.

MBIA INC.

V. EQUITY COMPENSATION PLAN INFORMATION TABLE

(a)	(b)	
Number of securities to be issued upon exercise of	Weighted-average exercise price of	Num remainin iss co

Plan Category	outstanding options, warrants and rights	outstanding options, warrants and rights	(excludi
Equity compensation plans approved by security holders....................................	9,756,222	$41.432	
Equity compensation plans not approved by security holders............................	--	--	
Total....................................	9,756,222	$41.432	

(a) Includes 3,825,765 shares from the Company's 1996 Incentive Plan that will be superceded upon the approval of the 2002 Annual and Long-Term Incentive Plan described under Proposal 2 herein. Upon approval of the 2002 Annual and Long-Term Incentive Plan, the total number of securities remaining available for issuance under equity compensation plans will be 5,420,742.

Total Return data and graph for 2001 Proxy Statement

[CHART]

Total Return
MBIA Inc. vs. S&P 500 Index vs.
S&P Financial Index

	1996	1997	1998	1999	2000	2001
MBIA Inc. Common Stock	100	133.75	132.81	108.57	154.50	169.57
S&P Index	100	133.35	171.46	207.54	188.65	166.24
S&P Financial Index	100	152.58	199.66	255.02	313.18	293.52

Proposal 2:

APPROVE THE MBIA INC. ANNUAL AND LONG-TERM INCENTIVE PLAN FOR PURPOSES OF SECTION 162(m) OF THE INTERNAL REVENUE CODE

Introduction

At the 1995 annual meeting of shareholders of the Company (the "Shareholders"), the Shareholders approved the MBIA 1996 Incentive Plan (the "1996 Incentive Plan") to allow for the payment of performance based compensation to certain executive officers of the Company that would be exempt from the deduction limitation contained in Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"). The 1996 Incentive Plan established certain performance criteria (the "Performance Criteria") for the payment of Performance Based Compensation.

The 1996 Plan covered performance based compensation through December 31, 2000. Pursuant to the powers granted to the Board of Directors under Section 7(a) of the 1996 Incentive Plan, the Board of Directors extended the 1996 Incentive Plan until December 31, 2001 to cover compensation payable in respect of 2001.

In order to continue its policy of providing the Company's key employees the opportunity to earn competitive levels of incentive compensation based primarily on the performance of the Company, the Board of Directors has amended and restated the 1996 Incentive Plan, and adopted it effective as of January 1, 2002, subject to the approval of the Company's shareholders. The amended and restated 1996 Incentive Plan is now called the MBIA Inc. Annual and Long-Term Incentive Plan (the "2002 Incentive Plan"). The 2002 Incentive Plan has been designed to enable the Company to make awards to executive officers that would be exempt from the limitations contained in such Section 162(m). The Company is seeking shareholder approval of the extension of the 1996 Incentive Plan, and the amendment and restatement thereof, effective January 1, 2002, in the form of the 2002 Incentive Plan.

Description of 2002 Incentive Plan

The principal features of the 2002 Incentive Plan are summarized below. The description below is subject to the terms of the 2002 Incentive Plan, which is contained in its entirety as Exhibit A hereto.

Eligibility. The 2002 Incentive Plan authorizes the Compensation and Organization Committee of the Board of Directors (the "Committee") to award incentive compensation to officers and other key employees of the Company and its subsidiaries, including all of the Company's executive officers. The number of eligible participants in the 2002 Incentive Plan will vary from year to year at the discretion of the Committee.

Incentive Awards. The 2002 Incentive Plan has two component parts, a long-term program and a short-term program. The long-term program authorizes the payment of an incentive award at the end of a multi-year cycle selected by the Committee based upon attaining performance targets relating to corporate, divisional, unit or individual objectives established by the Committee. The short-term program authorizes the payment of annual bonuses based upon the attainment of performance targets also related to corporate, divisional, unit or individual objectives established by the Committee.

Performance Criteria. The Committee will establish the performance objectives that must be attained in order for the Company to pay bonuses under the 2002 Incentive Plan. The Company believes that various factors influence its overall performance and that different key employees have a direct impact on different aspects of its business. Further, the Company believes that, to be effective, any incentive plan must provide the Committee latitude to make awards that reward performance measured against a wide array of performance objectives.

Accordingly, unless the Committee determines at the time of grant not to qualify the award as performance based compensation under Section 162(m), the performance objectives for awards made under

the 2002 Incentive Plan will be based upon one or more of the following criteria: (i) consolidated earnings before income taxes; (ii) earnings per share; (iii) book value or modified book value per share; (iv) return on shareholders equity; (v) adjusted gross premium and adjusted direct premium (vi) risk adjusted return on allocated capital; (vii) the net present value of projected net income after cost of capital; (viii) the credit quality and performance of the insured portfolios of the company's insurance subsidiaries; (ix) the amount of assets under management of the company's investment management businesses; (x) the relative performance of peer group companies;

(xi) expense management; (xii) return on investment; (xiii) improvements in capital structure; and (xiv) profitability of an identifiable business unit or product.

Form of Payment. The Committee will determine whether an award under the 2002 Incentive Plan is payable in cash, in shares of Common Stock or in any combination thereof. The Committee will have the right to impose whatever conditions it deems appropriate with respect to the award of shares of Common Stock, including conditioning the vesting of such shares on the performance of additional service.

The maximum number of shares available for issuance under the 2002 Incentive Plan will be 1,500,000 shares.

Payment of Awards. If any of the performance criteria established by the Committee with respect to a particular award is satisfied for the relevant performance period, the Committee may authorize payment to the participant of (i) an annual bonus in an amount not to exceed $3,000,000 or (ii) a long-term award in an amount or in value not to exceed $5,000,000. The Committee has the discretion to pay amounts which are less than these maximum amounts payable under the 2002 Incentive Plan. A participant who is not an employee of the Company or one of its subsidiaries on the last day of the performance period for which the award is payable may receive a pro-rated award, based on the full period of performance, unless the Committee determines that the participant will not receive such an award.

Administration. The Committee will at all times be comprised of at least two directors each of whom is an "outside director" for purposes of Section 162(m). The Committee will administer and interpret the 2002 Incentive Plan. With respect to any award to an executive officer intended to qualify for the performance based compensation exception to Section 162(m), the 2002 Incentive Plan will be interpreted in a manner which is consistent with the requirements of Section 162(m).

Subject to the express provisions of the 2002 Incentive Plan, the Committee will have the authority to select the officers and employees eligible to participate in the 2002 Incentive Plan, to establish the performance objectives for each performance period, and to reduce the amount that may be paid to any participant from the maximum amount otherwise payable pursuant to the 2002 Incentive Plan. Prior to making any payment with respect to any performance award made under the 2002 Incentive Plan, the Committee will be required to certify (i) that the performance objectives have been attained and (ii) the amount payable to such executive officer.

Amendment and Termination. The Board or the Committee may at any time amend, terminate or suspend the 2002 Incentive Plan, without shareholder approval, except if shareholder approval is required for payments that are made under the 2002 Incentive Plan to qualify for treatment as performance based compensation under Section 162(m). The 2002 Incentive Plan will not be effective with respect to calendar years ending after December 31, 2006, unless otherwise extended by action of the Board.

Federal Income Tax Consequences. Payments made under the 2002 Incentive Plan will be taxable to the recipients thereof when paid and the Company or the subsidiary of the Company which employs or employed the recipient will generally be entitled to a Federal income tax deduction in the calendar year for which the amount is paid.

VOTE NECESSARY TO APPROVE THE MBIA INC. ANNUAL AND LONG-TERM INCENTIVE PLAN

The approval of the 2002 Incentive Plan requires the affirmative vote of a

majority of all shares of Common Stock of the Company in person or represented by proxy and entitled to vote at the Annual Meeting

of Shareholders. Abstention from voting on the proposal will have the same effect as voting against the proposal. Broker non-votes will have no effect on the outcome. If the 2002 Incentive Plan is not approved by the stockholders, no further awards will be made under the 2002 Incentive Plan.

The Board of Directors unanimously recommends a vote FOR approval of the 2002 Incentive Plan.

Proposal 3:

APPROVAL OF AMENDED AND RESTATED DEFERRED COMPENSATION AND STOCK OWNERSHIP PLAN FOR NON-EMPLOYEE DIRECTORS OF MBIA INC.

The Board of Directors has adopted and is recommending approval of the Amended and Restated Deferred Compensation and Stock Ownership Plan for Non-Employee Directors (the "Amended Plan"). The Company's existing Deferred Compensation and Stock Ownership Plan for Non-Employee Directors (the "Current Plan") was approved by shareholders in 1993. The Amended Plan amends the exchange and distribution provisions governing the deferral of Director retainers and fees as set forth in the Current Plan.

The Current Plan and the Amended Plan each provide that an eligible director may elect to be paid the retainer and annual fee compensation paid annually to directors either in cash on a quarterly basis with no deferral of income, or to defer receipt of all or a portion of such compensation until a time following termination of such director's service on the Board. A director electing to defer compensation may choose to allocate deferred amounts to either a hypothetical investment account (the "Investment Account"), or a hypothetical share account (the "Share Account"), which have been set up to credit such deferred payments.

Amounts allocated to the Investment Account are credited to a hypothetical money market account earning hypothetical interest based on the Lehman Brothers Government/Corporate Bond Index. Amounts allocated to the Director's Share Account are converted into units with each such unit representing the right to receive a share of common stock at the time or times distributions commence under the Plan. Dividends are paid as stock units each quarter.

Under the Current Plan, distributions of amounts credited under the Share Account may be made in shares of common stock or, at the election of the participating director, in cash. The Amended Plan would eliminate this election and would require that Share Account distributions be made in shares of common stock. Under the Current Plan, an eligible director may elect to transfer amounts previously allocated (together with accrued earnings), between the Investment Account and the Share Account. The Amended Plan would eliminate the ability to transfer account balances between the Accounts. This change is expected to promote additional long-term share ownership by directors.

The maximum number of shares available for issuance under the Amended Plan will be 100,000 shares.

The description of the Amended Plan above is subject to the terms of the Amended Plan, which is contained in its entirety as Exhibit B hereto.

VOTE NECESSARY TO APPROVE THE AMENDED AND RESTATED DEFERRED

COMPENSATION AND STOCK OWNERSHIP PLAN FOR
NON-EMPLOYEE DIRECTORS

To be approved, this proposal requires the affirmative vote of the holders of a majority of the shares of Common Stock present in person or represented by proxy at the Annual Meeting and entitled to vote thereon. Abstentions from voting on this proposal will have the effect of votes against this proposal. Broker non-votes will have no effect on the outcome of this proposal. If this proposal is not approved, the shares of common stock issued to Directors pursuant to the Amended Plan may not be eligible for listing on the New York Stock Exchange (NYSE) under the current NYSE rules (unless the shares issued will be treasury shares).

The Board of Directors unanimously recommends that shareholders vote FOR the approval of the Amended Plan.

Proposal 4:

ADOPTION OF THE MBIA INC. RESTRICTED STOCK PLAN
FOR NON-EMPLOYEE DIRECTORS

Introduction

The Board of Directors has adopted and is recommending approval of the MBIA Restricted Stock Plan for Non-Employee Directors (the "Restricted Stock Plan"). The Restricted Stock Plan will permit stock-based compensation to be paid to directors in shares of restricted stock and provides that up to 100,000 shares of the Company's common stock will be made available for restricted stock awards to non-employee directors.

Pursuant to the Restricted Stock Plan, from now on annual stock grants will be awarded to non-employee directors in the form of restricted stock of the Company, rather than as stock units. For the current year, 2002, the Board of Directors has approved an increase in the value of the annual stock grant to directors from $30,000 to $50,000, to be paid in the form of restricted shares. In addition, the Board of Directors has approved an increase in the value of the one-time restricted stock grant to new directors from $60,000 to $75,000.

The Board of Directors believes that the increase in total compensation for directors will allow the Company to keep pace with Director market total compensation and to align annual pay with Directors' contributions. Moreover, the issuance of restricted shares is consistent with stock grants given to MBIA executives, is a common marketplace practice and closely aligns Directors' interests with shareholder interests.

The principal features of the Restricted Stock Plan are summarized below. The description below is subject to the terms of the Restricted Stock Plan, which is contained in its entirety as Exhibit C hereto.

Restricted Stock Plan

Eligibility and Administration. The Compensation and Organization Committee of the Board of Directors will have the discretionary authority to determine the Directors to whom restricted stock will be granted and the terms and conditions of such restricted stock, including the number of shares of restricted stock to be granted, the time or times at which the restricted stock will vest, whether any restriction shall be modified or waived after date of grant, and the rights of a participant with respect to the restricted stock

following the participant's service as director.

Restricted Stock Awards. Shares granted to Directors under the Restricted Stock Plan will be subject to restrictions on transferability. The restriction period applicable to a restricted stock award will lapse and the shares of restricted stock will become freely transferable on the earlier of: i) the death or disability of a participating director, (ii) a change of control in the Company as defined in the Restricted Stock Plan, (iii) the Company's failure to nominate a participating director for re-election, (iv) the failure of the shareholders to elect a participant director at any shareholders meeting, or (v) the tenth anniversary of the date of the restricted stock grant. If a participating director leaves the Board for any reason other than the foregoing at any time prior to the date when the restriction period lapses, all unvested shares will revert back to the Company.

Voting Rights; Dividends. During the restricted period, a participating director may vote the restricted shares and receive dividends.

Termination. Prior Stock Plan. The Board may amend, modify, suspend or terminate the Restricted Stock Plan, provided that no such action will alter or impair a participant director's rights under any previously granted restricted stock award. The 1996 Directors Stock Unit Plan, which granted phantom share units to directors, will be preserved and the units currently outstanding under that Plan will remain as phantom shares, but no new grants will be made under that program.

VOTE NECESSARY TO APPROVE THE RESTRICTED STOCK PLAN
FOR NON-EMPLOYEE DIRECTORS

To be approved, this proposal requires the affirmative vote of the holders of a majority of the shares of Common Stock present in person or represented by proxy at the Annual Meeting and entitled to vote thereon. Abstentions from voting on this proposal will have the effect of votes against this proposal. Broker non-votes will have no effect on the outcome of this proposal. If this proposal is not approved, the shares of restricted common stock issued to Directors pursuant to the Restricted Stock Plan may not be eligible for listing on the New York Stock Exchange under the current NYSE rules (unless the shares issued will be treasury shares).

The Board of Directors unanimously recommends that shareholders vote FOR the approval of the the Restricted Stock Plan.

REPORT OF THE AUDIT COMMITTEE

To: The MBIA Inc. Board of Directors
From: The Audit Committee:
Ms. Freda S. Johnson, Chairwoman
Mr. William H. Gray, III
Mr. James A. Lebenthal
Mr. John A. Rolls

The Audit Committee is composed of four outside Directors who are not employees or officers of the Company. In the business judgement of the Board,

these Directors are free of any relationship that would interfere with their independent judgment as members of this Committee. In the first quarter of 2002, the Audit committee evaluated its existing charter in light of recent developments and changing market practices with respect to the role of the Audit Committee and decided to adopt a new charter. The Committee adopted a revised Audit Committee Charter on March 21, 2002. A copy of the new Audit Committee Charter is attached to this Proxy Statement as Exhibit D.

This report of the Audit Committee covers the following topics:

1. Respective Roles of the Audit Committee, Company Management and the Independent Auditors

2. 2001 Activities

3. Limitations of the Audit Committee

1. Respective Roles of the Audit Committee, Company Management and the Independent Auditors

Our Committee is responsible for providing oversight of the Company's financial statements and results, the audit process and internal controls. We also recommend to the Board of Directors the selection of the Company's outside auditors, and we review the auditors' procedures that ensure their independence with respect to the services performed for the Company.

Company management is responsible for the preparation, presentation and integrity of the Company's financial statements, for the Company's accounting and financial reporting principles and for the Company's internal controls and procedures. These internal controls and procedures are designed to assure compliance with accounting standards and applicable laws and regulations.

The independent auditors, PricewaterhouseCoopers LLP (PwC), are responsible for performing an independent audit of and expressing an opinion with respect to the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America.

2. 2001 Activities

In performing our oversight role this year, we have:

- considered and discussed the audited financial statements with management and the independent auditors;

- discussed and reviewed all communication with the auditors, as required by Statement on Auditing Standards No. 61, "Communications with Audit Committees." We have received a letter from the auditors as required by Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees." In connection with this requirement, PwC has not provided to the Company any information technology consulting services relating to financial information systems design and implementation; and

- considered whether the provision of other non-audit services by the auditors is compatible with maintaining their independence.

Based on the reviews and discussions we describe in this Report, and subject to the limitations on the role and responsibilities of the Audit Committee referred to below and in the Charter, we recommended to the Board of Directors

that the Company's audited financial statements be included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

3. Limitations of the Audit Committee

As members of the Audit Committee, we are not professionally engaged in, nor experts in the practice of, auditing or accounting. Nor are we experts with respect to determining auditor independence. We rely on the information provided to us and on the representations made by management and the independent auditors. Therefore, we do not assure that the audit of the Company's financial statements has been carried out in accordance with generally accepted auditing standards, that the financial statements are presented in accordance with generally accepted accounting principles or that PwC is in fact "independent". Furthermore, we cannot provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or internal controls designed to assure compliance with accounting standards and applicable laws and regulations.

Date: March 21, 2001

This report of the Audit Committee shall not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the Company specifically incorporates this information by reference, and shall not otherwise be deemed filed under such Acts.

AUDIT FEES

The Company paid PwC $613,000 for professional services rendered for the audit of the Company's annual financial statements for the year ended December 31, 2001 and for reviews of the Company's quarterly financial statements included in the Company's quarterly reports on Form 10-Q for 2001.

OTHER FEES

PwC did not provide the Company with any information technology services relating to financial systems design and implementation for 2001.

The Company paid PwC $1,596,000 for other services rendered to the Company and its subsidiaries in 2001. A breakdown of these activities and their related fees are as follows: $640,000 for tax related services; $585,000 for subsidiary audit work and other attest services; $192,000 for review of new business transactions; $91,000 for review and advice with respect to new accounting standards; $84,000 for special audit work; and, $4,000 for other advisory services.

Proposal 5:

SELECTION OF INDEPENDENT AUDITORS

Since its founding in 1986, MBIA has used PwC as its independent auditor. From 1974 to 1986, PwC served the same role for MBIA's predecessor organization, the Municipal Bond Insurance Association. During 2001, PwC examined the accounts of the Company and its subsidiaries and also provided tax advice and other services to the Company in connection with its Securities and Exchange Commission filings.

Upon recommendation of the Audit Committee, the Board has appointed PwC as the independent auditors of the Company for 2002, subject to shareholder approval.

We expect that one or more representatives of PwC will be available at the Annual Meeting to make a statement, if desired, and to answer questions from those shareholders present.

The Board of Directors recommends unanimously that you vote FOR this proposal to hire PricewaterhouseCoopers LLP as independent auditors for the Company.

OTHER MATTERS/SHAREHOLDER PROPOSALS

The Board knows of no other business to be brought before the meeting other than what is set forth above. If other matters are introduced at the meeting, the individuals named as proxies on the enclosed proxy card are also authorized to vote upon such matters using their own discretion. Under the terms of the Company's by-laws, shareholders who intend to present an item of business at the 2003 annual meeting must provide notice of such business to the Company's secretary no later than November 15, 2002.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

The table below contains certain information about the only beneficial owners known to the Company as of March 21, 2002 of more than 5% of the outstanding shares of Common Stock.

Name and Address of Beneficial Owner	Shares of Common Stock Beneficially Owned	Percent of Class
Wellington Management Company LLP (1) 75 State Street.................... Boston, MA 02109...................	16,157,657	10.9%
FMR Corp. (2)....................... 82 Devonshire Street................ Boston, MA 02109...................	9,349,764	6.3%

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(1) This information as to the beneficial ownership of shares of Common Stock is based on the January 10, 2002 Schedule 13G filed by Wellington Management Company LLP with the Securities and Exchange Commission ("SEC"). Such filing indicates that Wellington does not have sole voting power nor sole dispositive power with respect to any of these shares.

(2) This information as to the beneficial ownership of shares of Common Stock is based on the February 14, 2002 Schedule 13G filed by FMR Corp. with the SEC. Such filing indicates that FMR has sole voting power with respect to 497,974 of these shares and sole dispositive power with respect to 9,349,764 of these shares.

SECURITY OWNERSHIP OF DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth, as of March 21, 2002, the beneficial ownership of shares of Common Stock of each Director, each Senior Officer named in the Summary Compensation Table above, and all Directors and Executive Officers of the Company, as a group.

Name	Shares of Common Stock Beneficially Owned	Shares Acquirable Upon Exercise of Options (2)	Total Shares Beneficially Owned (3)
Directors			
Joseph W. Brown (1) (4)	537,169	--	537,169
David C. Clapp (4).....	17,248	--	17,248
Gary C. Dunton (1).....	118,597	118,662	237,259
David H. Elliott (4)...	111,295	363,090	474,385

Name	Shares of Common Stock Beneficially Owned	Shares Acquirable Upon Exercise of Options (2)	To Sh Benef Owne
Claire L. Gaudiani (4).............................	13,230	--	1
William H. Gray, III (4)...........................	6,437	--	
Freda S. Johnson (4)...............................	23,077	--	2
Daniel P. Kearney (4)..............................	19,125	--	
James A. Lebenthal (4).............................	21,495	--	2
John A. Rolls (4)..................................	31,472	--	3
Executive Officers (1)			
Richard L. Weill...................................	125,921	235,386	36
John B. Caouette...................................	117,567	139,354	25
Neil G. Budnick....................................	55,982	94,482	15
All of the above and other Executive Officers Members as a group.......................................	1,321,646	1,154,021	2,47

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(1) This number includes shares held by the Executive Officers under the Company's exempt 401(k) Plan and includes restricted shares and stock units awarded annually to certain of the Executive Officers.

(2) This column indicates the number of shares that are presently exercisable or will become exercisable on or before May 15, 2002 under the Company's stock option program.

(3) The percentage of shares of Common Stock beneficially owned by all Directors and Executive Officers as a group is 1.7% of the shares of Common Stock outstanding.

(4) This number includes (a) Common Stock equivalent deferral units held under the Company's Deferred Compensation and Stock Ownership Plan for Non-Employee Directors, (b) Common Stock units awarded under the restricted stock compensation plan and (c) restricted stock awarded under the Restricted Stock Plan for Non-Employee Directors. (See the discussion of these plans under "The Board of Directors and its Committees").

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Ownership of and transactions in the Company's stock by Executive Officers and Directors of the Company are required to be reported to the Securities and Exchange Commission in accordance with Section 16 of the Securities Exchange Act of 1934. To the Company's knowledge all such required filings were made on a timely basis.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Empire State Municipal Exempt Trusts, Guaranteed Series

MBIA Corp. insures municipal bonds held by certain of the Guaranteed Series of Empire State Municipal Exempt Trusts. One of the co-sponsors of the Guaranteed Series of Empire State Municipal Exempt Trusts is Lebenthal & Co., Inc., the emeritus chairman of which is James A. Lebenthal, a director of the Company. The Company believes the terms of the insurance policies and the premiums charged are no less favorable to MBIA Corp. than the terms and premium levels for other similar unit investment trusts.

Retirement Agreement with David H. Elliott

Upon the retirement of Mr. David H. Elliott, the Company's former Chairman and CEO, from the Company in May 1999, the Company entered into a retirement agreement with Mr. Elliott under which Mr. Elliott agreed to provide the Company with consulting services for two years following his retirement. The Company agreed to pay Mr. Elliott for his consulting services for each of 1999 and 2000 (i) an amount equal to his annual base salary as in effect on January 1, 1999 and (ii) a cash performance bonus in an amount

determined by the Compensation and Organization Committee, but (subject to the applicable performance criteria being satisfied) not less than the bonus that was paid to him for 1998. For 2000, Mr. Elliott was paid $700,000 for his consulting services pursuant to the retirement agreement. In addition, for 2000, the Committee granted Mr. Elliott a bonus of $1,300,000. For 2001, Mr. Elliott was paid $266,000 for his consulting services pursuant to the retirement agreement.

VOTING BY TELEPHONE OR VIA THE INTERNET

The Company has arranged to allow you to vote your shares of Common Stock by telephone or via the Internet. You may also vote your shares by mail. Please see the proxy card or voting instructions form accompanying this Proxy Statement for specific instructions on how to cast your vote by any of these methods.

In order to vote your shares by telephone or via the Internet, your vote must be received by 4:00 p.m., New York City time, on May 8, 2002. Submitting your vote by telephone or via the Internet will not affect your right to vote in person should you decide to attend the Annual Meeting.

The telephone and Internet voting procedures are designed to authenticate shareholders' identities, to allow shareholders to give their voting instructions and to confirm that shareholders' instructions have been recorded properly. We have been advised that the Internet voting procedures that have been made available to you are consistent with the requirements of applicable law. If you decide to vote your shares via the Internet, there may be costs associated with electronic access, such as usage charges from Internet access providers and telephone companies, that you will have to bear.

MISCELLANEOUS

The cost to prepare and mail these proxy materials will be borne by the Company. Proxies may be solicited by mail, in person or by telephone or telegraph by directors, officers and regular employees of the Company without

extra compensation and at the Company's expense. The Company will also ask bankers and brokers to solicit proxies from their customers and will reimburse them for reasonable expenses. In addition, the Company has engaged MacKenzie Partners of New York to assist in soliciting proxies for a fee of approximately $6,000 plus reasonable out-of-pocket expenses.

A copy of the Company's Annual Report on Form 10-K to the Securities and Exchange Commission is available on the Company's web site at www.mbia.com or by writing to the Corporate Communications Department, MBIA Inc., 113 King Street, Armonk, New York 10504.

By order of the Board of Directors,

/s/ Richard L. Weill

Richard L. Weill
Secretary

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Exhibit A

MBIA INC.

ANNUAL AND LONG-TERM INCENTIVE PLAN
(Effective as of January 1, 2002)

1. Purpose.

The purposes of the Plan are to enable the Company and its Subsidiaries to attract, retain, motivate and reward the best qualified executive officers and key employees by providing them with the opportunity to earn competitive compensation directly linked to the Company's performance. The Plan was originally adopted as January 1, 1996 and has been amended and restated as of January 1, 2002.

2. Definitions.

Unless the context requires otherwise; the following words as used in the Plan shall have the meanings ascribed to each below, it being understood that masculine, feminine and neuter pronouns are used interchangeably and that each comprehends the others.

(a) "Board" shall mean the Board of Directors of the Company.

(b) "Committee" shall mean the Compensation and Organization Committee of the Board (or such other committee of the Board that the Board shall designate from time to time) consisting of two or more directors each of whom is an "outside director" within the meaning of Section 162(m).

(c) "Company" shall mean MBIA Inc.

(d) "Covered Employee" shall have the meaning set forth in Section 162(m).

(e) "Participant" shall mean (i) each executive officer of the Company and (ii) each other employee of the Company or a Subsidiary whom the Committee designates as a participant under the Plan.

(f) "Performance Period" shall mean each calendar year or multi-year cycle as determined by the Committee.

(g) "Plan" shall mean the MBIA Inc. Annual and Long-Term Incentive Plan, as set forth herein and as may hereafter be amended from time to time.

(h) "Section 162(m)" shall mean Section 162(m) of the Internal Revenue Code of 1986, as amended, and any regulations promulgated thereunder.

(i) "Subsidiary" shall mean any corporation in which the Company owns, directly or indirectly, stock representing more than 50% of the voting power of all classes of stock entitled to vote.

3. Administration.

The Committee shall administer and interpret the Plan, provided that, in no event, shall the Plan be interpreted in a manner which would cause any award intended to be qualified as performance based compensation under Section 162(m) to fail to so qualify. The Committee shall establish the performance objectives for any calendar year in accordance with Section 4 and certify whether such performance objectives have been obtained. Any determination made by the Committee under the Plan shall be final and conclusive. The Committee may employ such legal counsel, consultants and agents (including counsel or agents who are employees of the Company or a Subsidiary) as it may deem desirable for the administration of the Plan and may rely upon any opinion received from any such counsel or consultant or agent and any computation received from such consultant or agent. All expenses incurred in the administration of the Plan, including, without limitation, for the engagement of any counsel, consultant or agent, shall be paid by the Company. No member or former member of the Board or the Committee shall be liable for any act, omission, interpretation, construction or determination made in connection with the Plan other than as a result of such individual's willful misconduct.

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4. Bonuses.

(a) Performance Criteria. Within 90 days after each Performance Period begins (or such other date as may be required or permitted under Section 162(m)), the Committee shall establish the performance objective or objectives that must be satisfied in order for a Participant to receive a bonus and other long term incentive awards for such Performance Period. Unless the Committee determines at the time of grant not to qualify the award as performance-based compensation under Section 162(m), any such performance objectives will be based upon the relative or comparative achievement of one or more of the following criteria, as determined by the Committee for the Performance Period: (i) consolidated earnings before income taxes; (ii) earnings per share; (iii) book value or adjusted book value per share; (iv) return on shareholders equity; (v) adjusted gross premium and adjusted direct premium (vi) risk adjusted return on allocated capital; (vi) the net present value of projected net income after cost of capital ;(vii) the credit quality and performance of the insured portfolios of the company's insurance subsidiaries; (viii) the amount of assets under management of the company's investment management businesses; (ix) the relative performance of peer group companies; (x) expense management; (xi) return on investment; (xii) improvements in capital structure; (xiii) profitability of an identifiable business unit or product.

(b) Maximum Amount Payable. If the Committee certifies in writing that any of the performance objectives established for the relevant Performance Period under Section 4(a) has been satisfied, each Participant who is employed by the Company or one of its Subsidiaries on the last day of the Performance Period for which the bonus is payable shall be entitled to receive (i) an annual bonus in an amount not to exceed $3,000,000 and/or (ii) a long-term award in an

amount not to exceed $5,000,000. If a Participant's employment terminates for any reason (including, without limitation, his death, disability or retirement under the terms of any retirement plan maintained by the Company or a Subsidiary) prior to the last day of the Performance Period for which the bonus is payable, the maximum bonus payable to such Participant under the preceding sentence shall be multiplied by a fraction, the numerator of which is the number of days that have elapsed during the Performance Period in which the termination occurs prior to and including the date of the Participant's termination of employment and the denominator of which is the total number of days in the Performance Period.

(c) Negative Discretion. Notwithstanding anything else contained in Section 4(b) to the contrary, the Committee shall have the right, in its absolute discretion, (i) to reduce or eliminate the amount otherwise payable to any Participant under Section 4(b) based on individual performance or any other factors that the Committee, in its discretion, shall deem appropriate and (ii) to establish rules or procedures that have the effect of limiting the amount payable to each Participant to an amount that is less than the maximum amount otherwise authorized under Section 4(b).

(d) Affirmative Discretion. Notwithstanding any other provision in the Plan to the contrary, (i) the Committee shall have the right, in its discretion, to pay a bonus to any Participant who is not a Covered Employee for the year in which the amount paid would ordinarily be deductible by the Company for federal income tax purposes in an amount up to the maximum bonus payable under Section 4(b), based on individual performance or any other criteria that the Committee deems appropriate and (ii) in connection with the hiring any person who is or becomes a Covered Employee, the Committee may provide for a minimum bonus amount in any Performance Period, regardless of whether performance objectives are attained.

5. Payment.

Except as otherwise provided hereunder, payment of any bonus amount determined under Section 4 shall be made to each Participant as soon as practicable after the Committee certifies that one or more of the applicable performance objectives have been attained (or, in the case of any bonus payable under the provisions of Section 4(d), after the Committee determines the amount of any such bonus).

6. Form of Payment.

The Committee shall determine whether any bonus payable under the Plan is payable in cash, in shares of Common Stock or in any combination thereof. The Committee shall have the right to impose whatever

conditions it deems appropriate with respect to the award of shares of Common Stock, including conditioning the vesting of such shares on the performance of additional service. The maximum number of shares available for issuance under the Plan shall be 1,500,000.

7. General Provisions.

(a) Effectiveness of the Plan. As amended and restated, the Plan shall be effective with respect to calendar years beginning on or after January 1, 2002 and ending on or before December 31, 2006, unless the term hereof is extended by action of the Board.

(b) Amendment and Termination. Notwithstanding Section 6(a), the Board or the Committee may at any time amend, suspend, discontinue or terminate the Plan; provided; however, that no such action shall be effective without approval by the shareholders of the Company to the extent necessary to continue to qualify the amounts payable hereunder to Covered Employees as performance-based compensation under Section 162(m).

(c) Designation of Beneficiary. Each Participant may designate a beneficiary or beneficiaries (which beneficiary may be an entity other than a natural person) to receive any payments which may be made following the Participant's death. Such designation may be changed or canceled at any time without the consent of any such beneficiary. Any such designation, change or cancellation must be made in a form approved by the Committee and shall not be effective until received by the Committee. If no beneficiary has been named, or the designated beneficiary or beneficiaries shall have predeceased the Participant, the beneficiary shall be the Participant's spouse or, if no spouse survives the Participant, the Participant's estate. If a Participant designates more than one beneficiary, the rights of such beneficiaries shall be payable in equal shares, unless the Participant has designated otherwise.

(d) No Right of Continued Employment. Nothing in this Plan shall be construed as conferring upon any Participant any right to continue in the employment of the Company or any of its Subsidiaries.

(e) No Limitation on Corporate Actions. Nothing contained in the Plan shall be construed to prevent the Company or any Subsidiary from taking any corporate action which is deemed by it to be appropriate or in its best interest, whether or not such action would have an adverse effect on any awards made under the Plan. No employee, beneficiary or other person shall have any claim against the Company or any Subsidiary as a result of any such action.

(f) Non-alienation of Benefits. Except as expressly provided herein, no Participant or beneficiary shall have the power or right to transfer, anticipate, or otherwise encumber the Participant's interest under the Plan. The Company's obligations under this Plan are not assignable or transferable except to (i) a corporation which acquires all or substantially all of the Company's assets or (ii) any corporation into which the Company may be merged or consolidated. The provisions of the Plan shall inure to the benefit of each Participant and the Participant's beneficiaries; heirs, executors, administrators or successors in interest.

(g) Withholding. Any amount payable to a Participant or a beneficiary under this Plan shall be subject to any applicable Federal, state and local income and employment taxes and any other amounts that the Company or a Subsidiary is required at law to deduct and withhold from such payment.

(h) Severability. If any provision of this Plan is held unenforceable, the remainder of the Plan shall continue in full force and effect without regard to such unenforceable provision and shall be applied as though the unenforceable provision were not contained in the Plan.

(i) Governing Law. The Plan shall be construed in accordance with and governed by the laws of the State of New York, without reference to the principles of conflict of laws.

(j) Headings. Headings are inserted in this Plan for convenience of reference only and are to be ignored in a construction of the provisions of the Plan.

Exhibit B

MBIA INC.

AMENDED AND RESTATED DEFERRED COMPENSATION AND STOCK
OWNERSHIP PLAN FOR NON-EMPLOYEE DIRECTORS OF MBIA INC.

1. Purpose.

The purpose of the Deferred Compensation and Stock Ownership Plan for Non-Employee Directors of MBIA Inc. is to permit eligible directors of MBIA Inc. to defer compensation and to enhance the long-term mutuality of interest between the directors and shareholders of MBIA Inc. by providing eligible directors the opportunity to purchase the common stock of MBIA Inc and to otherwise share in the success of MBIA Inc.

2. Definitions.

"Accounts" means the Investment Account and Share Account maintained by the Company on behalf of each Participant in the Plan.

"Board" means the Board of Directors of the Company.

"Common Stock" means the common stock of the Company, par value $1.00 per share, any common stock into which such common stock may be changed and any common stock resulting from the reclassification of such common stock.

"Company" means MBIA Inc., a Connecticut corporation.

"Deferred Compensation" means, with respect to a Participant, the aggregate amount of the Retainer and/or Fees deferred by such Participant in accordance with Section 4(a) hereof.

"Eligible Director" means a director of the Company who is not an employee of the Company or any of its subsidiaries.

"Exchange Shares" means a Share granted to an Eligible Director pursuant to Section 5 hereof in exchange for such Eligible Director's election to forego receipt of all or a portion of his or her Retainer or Fees.

"Fair Market Value" means the average of the high and low sales prices of a Share on the date of determination, as reported on the consolidated tape of the New York Stock Exchange (or on such other recognized quotation system on which the trading prices of the Common Stock are quoted at the relevant time) on such date. In the event there are no Common Stock transactions reported on such tape (or such other system) on the date of determination, Fair Market Value shall mean the average of the high and low sales prices of a Share on the immediately preceding date on which Common Stock transactions were so reported.

"Fees" means the attendance fees and chairperson fees payable to an Eligible Director for his or her services as a director of the Company.

"Investment Account" means a book entry account established and maintained by the Company on behalf of a Participant to record the Deferred Compensation allocated to the Participant's Investment Account and any additions thereto or subtractions therefrom credited or charged in accordance with Section 4(b) hereof.

"Participant" means an Eligible Director who has elected in accordance with Section 4(a) of the Plan to defer receipt of any portion of the Retainer and/or Fees otherwise payable to such Eligible Director. An individual shall cease to

be a Participant upon the payment on behalf of such individual of all amounts then

standing to the credit of such individual's Accounts under the Plan. "Plan" means the Deferred Compensation and Stock Ownership Plan for Non-Employee Directors of MBIA Inc., as the same may be amended from time to time.

"Retainer" means the annual retainer payable to an Eligible Director for his or her services as a director of the Company.

"Share" means a share of Common Stock.

"Share Account" means a book entry account established and maintained by the Company on behalf of a Participant to record the Deferred Compensation allocated to the Participant's Share Account and any additions thereto or subtractions therefrom credited or charged in accordance with Section 4(b) hereof.

3. Administration.

(a) The Plan shall be administered by the Board. The Board may delegate its powers and functions hereunder to a duly appointed committee of the Board consisting of two or more members, each of whom is a "Non-Employee Director" within the meaning of Rule 16b-3, as promulgated under the Securities Exchange Act of 1934, as amended.

(b) The Board shall have full authority to interpret the Plan; to establish, amend and rescind rules for carrying out the Plan; to administer the Plan; and to make all other determinations and to take such steps in connection with the Plan, the Accounts and any Exchange Shares granted hereunder as the Board, in its discretion, deems necessary or desirable for administering the Plan.

(c) The Board may designate the Secretary of the Company, other employees of the Company or competent professional advisors to assist the Board in the administration of the Plan and may grant authority to such person to execute agreements or other documents on its behalf.

(d) The Board may employ such legal counsel, consultants and agents as it may deem desirable for the administration of the Plan and may rely upon any opinion received from any such counsel or consultant and any computation received from any such consultant or agent. No member or former member of the Board or any committee thereof or any person designated pursuant to subsection (c) above shall be liable for any action or determination made in good faith with respect to the Plan, any Account or any grant hereunder. To the maximum extent permitted by applicable law and the Certificate of Incorporation and By-Laws of the Company, each member or former member of the Board or any committee thereof or any person designated pursuant to subsection (c) above shall be indemnified and held harmless by the Company against any cost or expense (including counsel fees) or liability (including any sum paid with the approval of the Company in settlement of a claim) arising out of any act or omission to act in connection with the Plan, unless arising out of such person's own fraud or bad faith. Such indemnification shall be in addition to any rights of indemnification such person may have as a director, officer or employee of the Company or under the Certificate of Incorporation or the By-Laws of the Company. Expenses incurred by the Board in the engagement of any such counsel, consultant or agent shall be paid by the Company.

4. Deferral Program.

(a) Deferral Election.

(i) Participation. Prior to December 15 of any calendar year, an Eligible Director may elect to defer all or any portion, in 25% increments, of the Retainer payable for the calendar year following the calendar year in which such election is made. Prior to August 31 of any calendar year, an Eligible Director may elect to defer all or any portion, in 25% increments, of the Fees payable in the calendar year following the calendar year in which such election is made. Any person who shall become an Eligible Director during any calendar year may elect, not later than the 30th day following the commencement of his term as an Eligible Director, to defer payment of all or a portion, in 25% increments, of the Retainer and/or Fees payable for the portion of the calendar year following such election.

(ii) Form and Duration of Deferral Election. A deferral election shall be made by written notice filed with the Secretary of the Company. Such election shall continue in effect (including with respect to the Retainer and/or Fees payable for and/or in, respectively, subsequent calendar years) unless and until the Participant revokes or modifies such election by written notice filed with the Secretary of the Company. Any such revocation or modification of a deferral election with respect to the Retainer shall become effective as of the end of the calendar year in which such notice is given and only with respect to the Retainer payable for services as a director thereafter. Any such revocation or modification of a deferral election with respect to Fees shall become effective as of the September 1 next following the date such notice is given and only with respect to Fees payable for services as a director thereafter. Amounts credited to the Participant's Accounts prior to the effective date of any such revocation or modification of a deferral election shall not be affected by such revocation or modification and shall be distributed only in accordance with the otherwise applicable terms of the Plan.

(iii) Renewal. An Eligible Director who has revoked an election to participate in the Plan may file a new election in accordance with Section 4(a)(i) above to defer (A) the Retainer payable for services to be rendered in the calendar year following the calendar year in which such new election is filed and/or (B) the Fees payable in the calendar year following the calendar year in which such new election is filed for services to be rendered in calendar quarters commencing after the date such new election is filed.

(b) Participants' Accounts.

(i) Establishment of Accounts. The Company shall maintain an Investment Account and a Share Account on behalf of each Participant and shall make additions to and subtractions from such Accounts as provided herein.

(ii) Investment Account. Deferred Compensation allocated to a Participant's Investment Account pursuant to Section 4(b)(iv) shall be credited to the Investment Account as of the date such Deferred Compensation would have been paid to the Participant. As of the end of each calendar quarter, each Participant's Investment Account shall be credited with (or reduced by) an amount representing the hypothetical return (or loss) that would have been earned had the amount credited to such Account been invested in the manner described in the Participant's deferral election form (which notional investment or investments shall have been pre-approved by the Board for purposes of this Plan) during the portion of such calendar quarter that

such amounts were credited to the Participant's Investment Account.

(iii) Share Account. Deferred Compensation allocated to a Participant's Share Account pursuant to Section 4(b)(iv) shall be deemed to be invested in that number of notional Shares (the "Units") which is equal to the quotient obtained by dividing (i) the dollar amount of such Deferred Compensation by (ii) the Fair Market Value of a Share on the date the Deferred Compensation then being allocated to the Share Account would otherwise have been paid to the Participant. Whenever a dividend (other than a dividend payable in the form of Common Stock) is declared with respect to the Common Stock, the number of Units credited to a Participant's Share Account shall be increased by that number of Units which is equal to the quotient obtained by dividing

(x) an amount equal to the product of (x) the number of Units credited to the Participant's Share Account on the related dividend record date multiplied by (y) the amount of any cash dividend declared by the Company with respect to a Share (or, in the case of any dividend distributable in property other than Common Stock, the per share value of such dividend, as determined by the Company for purposes of income tax reporting) by

(y) the Fair Market Value of a Share on the related dividend payment date.

In the case of any dividend declared on the Common Stock which is payable in Common Stock, a Participant's Share Account shall be increased by that number of Units which is equal to the product of

(x) the number of Units credited to the Participant's Share Account on the related dividend record date multiplied by

(y) the number of Shares (including any fraction thereof) declared as a dividend with respect to a Share.

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(iv) Investment Elections with Respect to Deferred Compensation.

(A) General Rules. Each election with respect to the initial allocation of Deferred Compensation to a Participant's Share Account pursuant to subsection (B) below or a change in the manner in which Deferred Compensation is allocated between a Participant's Accounts pursuant to subsection (C) below shall be irrevocable once made; provided, however, that nothing herein shall preclude a Participant from making a subsequent election in accordance with subsection (C) below to change the manner in which Deferred Compensation is allocated between such Participant's Accounts under the Plan.

(B) Initial Investment Elections. At the time an Eligible Director elects to defer any portion of his or her Retainer or Fees pursuant to Section 4(a), such Eligible Director shall elect, by written notice delivered to the Secretary of the Company, the manner in which such Deferred Compensation shall be allocated between such Director's Investment Account and Share Account. Any Deferred Compensation to be credited to either Account shall be rounded to the nearest whole cent, with amounts equal to or greater than $.005 rounded up and amounts below $.005 rounded down. If an Eligible Director fails to notify the Secretary as to how to allocate the Deferred Compensation between the two Accounts, 100% of such Deferred Compensation shall be credited to such Director's Share Account.

(C) Change of Investment Elections. By written notice to the Secretary of the Company delivered not later than the last day of any calendar quarter, a Participant may elect to change the manner in which Deferred Compensation is to be allocated between such Participant's Investment Account and Share Account; provided, however, that any such election shall become effective six months following delivery of written notice thereof to the Secretary of the Company.

(c) Distributions from Accounts.

(i) Form of Distribution Election. At the time an Eligible Director makes a deferral election pursuant to Section 4(a) hereof, such Eligible Director shall also file with the Secretary of the Company a written election (a "Distribution Election") with respect to the timing, form of payment and manner of distribution of (A) the aggregate amount, if any, credited to the Director's Investment Account and (B) the value of any Units credited to the Director's Share Account. A Distribution Election shall specify that a distribution from the Investment Account and/or the Share Account shall be paid in one lump sum payment or in such number of installments as such Eligible Director may designate in accordance with subsection (ii) below.

Distributions under the Plan shall be made or commence to be made as of the first business day of the calendar month following the calendar month in which the Eligible Director's services as a director of the Company terminate. All amounts credited to the Eligible Director's Investment Account shall be payable in cash and amounts credited to the Eligible Director's Share Account shall be payable in Shares.

(ii) Installment Payments. In lieu of receiving payment in respect of a Participant's Accounts in one lump sum payment, a Participant may elect in accordance with this Section 4(c) to receive payment of his Accounts in substantially equal annual or monthly installments over a period not exceeding twenty years. In no event may the value of any annual or monthly payment be less than $10,000 or $1,000, respectively.

(iii) Amendment of Distribution Election. A Participant may at any time, and from time to time, elect by written notice delivered to the Secretary of the Company to change any Distribution Election; provided, however, that no such election shall be effective unless it is received by the Secretary of the Company prior to the calendar year in which the Participant ceases to be a director of the Company.

(iv) Payment of Plan Distributions. Any distribution hereunder, whether in the form of a lump sum payment or installments, shall commence in accordance with the Distribution Election made by the Participant in accordance with Section 4(c)(i) or (iii), whichever such Election is effective as of the date distributions hereunder commence. If a Participant fails to specify in accordance with Section 4(c)(i) or

(iii) that a distribution shall be made in a lump sum payment or a number of installments, such distribution shall be made in a lump sum payment. In the case of any distribution being made in annual or monthly installments, each installment after the first installment shall be paid on the first business day of each calendar year or calendar month, as applicable, following the year or month, as applicable, in which such first installment is paid until the entire amount subject to such installment Distribution Election shall

have been paid.

(v) Investment Account Installment Payments. Where a Participant receives the balance of his Investment Account in annual or monthly installments, the amount of each installment distribution shall be equal to the product of (i) the balance credited to such Participant's Investment Account on the date of such distribution and (ii) a fraction, the numerator of which is one (1) and the denominator of which is the total number of installments remaining to be paid at that time.

(vi) Share Account Installment Payments. Where a Participant receives any portion of the balance of his Share Account in annual or monthly installments, the number of Units subject to each installment distribution shall be equal to the product of (i) the number of Units in such Participant's Share Account on the date of such distribution and (ii) a fraction, the numerator of which is one (1) and the denominator of which is the total number of installments remaining to be paid at that time.

(vii) Distribution on Death. If a Participant shall die before payment of all amounts credited to the Participant's Accounts has been completed, the unpaid balance then credited to such Participant's Accounts shall be paid to the Participant's designated beneficiaries or estate in accordance with the Distribution Election then in effect; provided, however, that the Board may, in its discretion, elect to pay the entire unpaid balance then credited to such Participant's Accounts to such beneficiaries or estate in a single lump sum payment within 30 days after the Secretary of the Corporation receives notice of the Participant's death. A Participant may designate a beneficiary or beneficiaries (which may be an entity other than a natural person) to receive any payments to be made upon the Participant's death pursuant to this Section 4. At any time, and from time to time, any such designation may be changed or cancelled by the Participant without the consent of any beneficiary. Any such designation, change or cancellation must be made by written notice filed with the Secretary of the Company. If a Participant designates more than one beneficiary, any payments to such beneficiaries made pursuant to this Section 4 shall be made in equal shares unless the Participant has designated otherwise, in which case the payments shall be made in the shares designated by the Participant. If no beneficiary has been named by a Participant, payment shall be made to the Participant's estate.

5. Exchange Share Program.

(a) Grant. Subject to the provisions of subsection (c) below, each Eligible Director may elect, by written notice to the Secretary of the Company, to receive Exchange Shares pursuant to the formula set forth in subsection (d) below by agreeing to forgo all or any portion of such Eligible Director's Retainer and/or Fees payable in the calendar year following the calendar year in which such election is made.

(b) Date of Issuance. Exchange Shares shall be issued as of the first day of each calendar quarter with respect to which an Eligible Director has elected to forgo a portion of his or her Retainer or Fees, (i) with respect to the Retainer payable to such Eligible Director, payable for services to be performed during such calendar quarter and (ii) with respect to the Fees payable to such Eligible Director, payable for services rendered in the immediately preceding calendar quarter (the "Date of Issuance"), but based on the amount of such Retainer or Fees, as applicable, in effect at the time of the election described in subsection (c) below. Notwithstanding the foregoing, if the Date of Issuance in any calendar quarter is a date on which the New York Stock Exchange (or such other exchange on which the Common Stock is then traded) is not open for trading, the grant shall be made on the first day thereafter on which the New York Stock Exchange (or such other exchange) is

open for trading.

(c) Method of Election. An Eligible Director who wishes to elect to receive one or more Exchange Shares in accordance with Section 5(a) shall deliver to the Secretary of the Company a written irrevocable

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election, not later than June 30 of each calendar year with respect to the Retainer and/or Fees payable to such Eligible Director in the next following calendar year, specifying the amount of such Director's Retainer and/or Fees which he or she wishes to forgo. (If the date an election is due is not a business day, such election shall be due on the last business day immediately preceding such otherwise applicable date.) In the event that an Eligible Director elects to forgo less than 100% of his or her Retainer and/or Fees for a relevant year, such Director may provide in his or her election that such foregone amount be applied to the issuance of Exchange Shares pro rata in each calendar quarter or from the full amount of the Retainer and Fees otherwise payable for each quarter until the full amount elected has been so applied. If an Eligible Director fails to specify the timing of the deductions, the amount of such Director's forgone Retainer and/or Fees will be applied to the issuance of Exchange Shares pro rata in each calendar quarter.

(d) Number of Shares. The number of Exchange Shares to be issued as of each Date of Issuance shall be equal to the number of whole Shares determined by the quotient of (x) and (y) below, where (x) and (y) are:

(x) the dollar amount of the Retainer and/or Fees being foregone with respect to services to be performed during the applicable quarter in accordance with an election under this Section 5 to receive Exchange Shares; and

(y) the Fair Market Value of the Exchange Shares on the Date of Issuance.

If the above quotient produces a fractional Share, the Participant shall receive the cash value of such fractional Share, based on the then Fair Market Value, instead of receiving such fractional Share.

6. Shares; Adjustments in Event of Changes in Capitalization.

(a) Shares Authorized for Issuance. The total number of Shares subject to award under the Plan may not exceed 100,000 Shares, subject to adjustment pursuant to subsection (b) below. The Shares as to which awards are granted hereunder may be either authorized but unissued Shares or issued Shares that have been or may be reacquired by the Company, as determined from time to time by the Board. Any Shares subject to award hereunder which for any reason are cancelled or terminated without the issuance of any Common Stock or the payment of any dividends shall again be available for award under the Plan.

(b) Adjustments in Certain Events. In the event of any stock dividend or stock split, recapitalization, merger, consolidation, combination, spin-off, distribution of assets to stockholders (other than ordinary cash dividends), exchange of shares, rights offering to purchase Common Stock at a price substantially below fair market value or other similar corporate change, the Board shall make such equitable adjustments in the number of Shares or Units authorized to be granted hereunder, to the class of any award hereunder, or to any outstanding award, as it deems appropriate in order to prevent dilution or enlargement of rights.

7. Amendment and Termination.

The Board may at any time terminate the Plan and may from time to time alter or amend the Plan or any part thereof (including any amendment deemed necessary to ensure that the Company may comply with any regulatory requirement referred to in Section 8(d)); provided, that, unless otherwise required by law, the rights of an Eligible Director with respect to amounts, if any, standing to the credit of such Director's Investment or Share Account or with respect to Exchanges Shares granted to such Director prior to such termination, alteration or amendment may not be impaired without the consent of such Director.

8. Miscellaneous.

(a) Unfunded Plan. The Company shall not be obligated to fund its liabilities under the Plan, the separate memorandum Accounts established for each Participant shall not constitute trusts and no person shall have any claim against the Company or its assets in connection with the Plan other than as an unsecured general creditor.

(b) No Stock Ownership. The crediting of Units to the Share Accounts pursuant to Section 4(b) hereof shall not be deemed to create any interest in any class of equity securities of the Company and no Participant (or beneficiary) shall have any rights of a shareholder with respect to Units credited hereunder unless and until certificates representing the Shares subject to such Units are issued to such Participant (or his or her designated beneficiaries).

(c) Nonalienation. The right of a Participant to receive a distribution of the value of such Participant's Accounts payable pursuant to the Plan shall not be subject to assignment or alienation and shall not be transferable by the Participant other than by will or under the applicable laws of descent and distribution.

(d) Regulatory Compliance and Listing. The issuance or delivery of any Shares or other stock may be postponed by the Company for such period as may be required to comply with any applicable requirements under the Federal securities laws, any applicable listing requirements of any national securities exchange and requirements under any other law or regulation applicable to the issuance or delivery of such Shares, and the Company shall not be obligated to issue or deliver any Shares or other stock if the issuance or delivery of such Shares shall constitute a violation of any provision of any law or of any regulation of any governmental authority or any national securities exchange. The Company shall use reasonable efforts to comply with any such requirements.

(e) Status as a Director. Nothing in the Plan shall be deemed to create any obligation on the part of the Board to nominate any director for reelection by the Company's shareholders.

(f) Tax Withholding. The Company shall have the right to require, prior to the issuance or delivery of any Shares or other shares of stock or property or the making of any payment hereunder, payment by the Eligible Director of any taxes required by law with respect to the issuance or delivery of such shares or other property or the making of any such payment.

Exhibit C

MBIA INC.

RESTRICTED STOCK PLAN FOR NON-EMPLOYEE DIRECTORS

SECTION 1.

PURPOSE

The Plan is intended to attract, retain and motivate the best qualified directors for the benefit of the Company and its shareholders and to provide such directors with an economic interest in the Company's Common Stock, thereby enhancing a long-term mutuality of interest between such directors and the Company's shareholders.

SECTION 2.

DEFINITIONS

2.1 Definitions. Whenever used herein, the following terms shall have the respective meanings set forth below:

(a) "Act" means the Securities Exchange Act of 1934, as amended.

(b) "Adjustment Event" shall mean any stock dividend, stock split or share combination of, or extraordinary cash dividend on, the Common Stock or recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination, exchange of shares, warrants or rights offering to purchase Common Stock at a price substantially below Fair Market Value, or other similar event affecting the Common Stock of the Company.

(c) "Award Agreement" means the agreement, certificate or other instrument evidencing the grant of Restricted Stock under the Plan.

(d) "Board" means the Board of Directors of the Company.

(e) "Change in Control" shall mean the occurrence of any of the following events:

(i) any person (within the meaning of Section 3(a)(9) of the Act), including any group (within the meaning of Rule 13d-5(b) under the Act), but excluding any of the Company, any Subsidiary or any employee benefit plan sponsored or maintained by the Company or any Subsidiary, acquires "beneficial ownership" (within the meaning of Rule 13d-3 under the Act), directly or indirectly, of securities of the Company representing 25% or more of the combined Voting Power of the Company's securities;

(ii) within any 24-month period, the persons who were directors of the Company at the beginning of such period (the "Incumbent Directors") shall cease to constitute at least a majority of the Board or the board of directors of any successor to the Company; provided, however, that any director elected to the Board, or nominated for election, by a majority of the Incumbent Directors then still in office shall be deemed to be an Incumbent Director for purposes of this subclause (ii);

(iii) upon the consummation of a merger, consolidation, share exchange, division, sale or other disposition of all or substantially all of the assets of the Company which has been approved by the shareholders of the Company (a "Corporate Event"), and immediately following the consummation of which the stockholders of the Company immediately prior to such Corporate Event do not hold, directly or indirectly, a majority of the Voting Power of (x) in the case of a merger or consolidation, the surviving or resulting corporation, (y) in

the case of a share exchange, the acquiring corporation or (z) in the case of a division or a sale or other disposition of assets, each surviving, resulting or acquiring corporation which, immediately following the relevant Corporate Event, holds more than 25% of the consolidated assets of the Company immediately prior to such Corporate Event; or

(iv) any other event occurs which the Board declares to be a Change of Control.

(f) "Code" means the Internal Revenue Code of 1986, as amended.

(g) "Committee" means the Compensation and Organization Committee of the Board (or such other committee of the Board as the Board shall designate), which shall consist of two or more members, each of whom shall be a "Non-Employee Director" within the meaning of Rule 16b-3, as promulgated under the Act, and serving at the pleasure of the Board.

(h) "Common Stock" means the common stock of the Company, par value $1.00 per share.

(i) "Company" means MBIA Inc., a Connecticut corporation, and any successor thereto.

(j) "Director" means any non-employee director of the Company.

(k) "Disability", with respect to any Restricted Stock award, shall have the meaning assigned thereto in the Award Agreement evidencing such Restricted Stock award, or, if there is no such meaning assigned, shall mean a physical or mental disability or infirmity of a Participant, as defined in the long-term disability plan sponsored by the Company.

(l) "Fair Market Value" means, as of any date of determination, the closing price of a share of Common Stock on a national securities exchange on the day immediately preceding the date of determination, as reported for such day in the Wall Street Journal, or the last bid price for a share of Common Stock on such immediately preceding day, as reported on a nationally recognized system of price quotation. In the event that there are no Common Stock transactions reported on such exchange or system on such day, Fair Market Value shall mean the closing price or the last bid price, whichever is applicable, on the immediately preceding day on which Common Stock transactions were so reported.

(m) "Participant" means any Director designated by the Committee to receive Restricted Stock under the Plan.

(n) "Plan" means the MBIA Inc. Restricted Stock Plan for Non-Employee Directors, as set forth herein and as the same may be amended from time to time.

(o) "Restriction Period" means the period during which shares of Restricted Stock are subject to forfeiture or restrictions on transfer (if applicable) as described to Section 6 of the Plan and any applicable Award Agreement.

(p) "Restricted Stock" means Common Stock awarded to a Participant pursuant to the Plan which is subject to forfeiture and restrictions on transferability in accordance with Section 6 of the Plan.

(q) "Subsidiary" means any corporation or partnership in which the Company owns, directly or indirectly, 50% or more of the total combined voting power of all classes of stock of such corporation or of the capital interest or profits interest of such partnership.

(r) "Voting Power" means such number of the Voting Securities as shall enable the holders thereof to cast such percentage of all the votes which could be cast in an annual election of directors and "Voting Securities" shall mean all securities of a company entitling the holders thereof to vote in an annual election of directors.

2.2 Gender and Number. Except when otherwise indicated by the context, words in the masculine gender used in the Plan shall include the feminine gender, the singular shall include the plural, and the plural shall include the singular.

SECTION 3.

ELIGIBILITY AND PARTICIPATION

Participants in the Plan shall be those Directors selected by the Committee to participate in the Plan from time to time.

SECTION 4.

ADMINISTRATION

4.1 Power to Grant and Establish Terms of Awards. The Committee shall have the discretionary authority, subject to the terms of the Plan, to determine the Directors to whom Restricted Stock shall be granted and the terms and conditions of such Restricted Stock, including but not limited to the number of shares of Restricted Stock to be granted; the time or times at which Restricted Stock awards will vest; whether any restriction (including any provision as to vesting, payment or transferability) shall be modified or waived, in whole or in part, after the date of grant of the Restricted Stock award; the rights of a Participant (or his beneficiary or permitted transferee) with respect to Restricted Stock following the Participant's termination of service as a Director; whether and to what extent any Restricted Stock award may be transferred by the Participant; and the terms, provisions and conditions to be included in any Restricted Stock Award Agreement.

In accordance with the terms of the Plan, the terms and conditions of each Restricted Stock award shall be determined by the Committee at the time of grant, and such terms and conditions may be subsequently changed by the Committee, in its discretion, provided that no such change may be effected which would adversely affect a Participant's rights with respect to a Restricted Stock award then outstanding, without the consent of such Participant. The Committee may establish different terms and conditions for different Participants receiving Restricted Stock and for the same Participant for each grant of Restricted Stock such Participant may receive, whether or not granted at different times.

4.2 Administration. The Committee shall be responsible for the administration of the Plan. Any Restricted Stock granted by the Committee may be subject to such conditions, not inconsistent with the terms of the Plan, as the Committee shall determine, in its discretion. The Committee, by majority action thereof, has discretionary authority to prescribe, amend and rescind

rules and regulations relating to the Plan, to interpret and apply the provisions of the Plan, to provide for conditions deemed necessary or advisable to protect the interests of the Company or to interpret the Plan and to make all other determinations necessary or advisable for the administration and interpretation of the Plan and to carry out its provisions and purposes.

4.3 Discretionary Authority of Committee. All of the powers and authority conferred upon the Committee pursuant to any term of the Plan shall be exercised by the Committee, in its discretion. All determinations, interpretations or other actions made or taken by the Committee pursuant to the provisions of the Plan shall be final, binding and conclusive for all purposes and upon all persons and, in the event of any judicial review thereof, shall be overturned only if arbitrary and capricious. The Committee may consult with legal counsel, who may be counsel to the Company, and shall not incur any liability for any action taken in good faith in reliance upon the advice of counsel.

SECTION 5.

STOCK SUBJECT TO PLAN

5.1 Number. Subject to the provisions of Section 5.3, the number of shares of Common Stock available for Restricted Stock awards under the Plan (including shares that become available for grant pursuant to Section 5.2) may not exceed 100,000. The shares to be delivered under the Plan may consist, in whole or in part, of Common Stock held in treasury or authorized but unissued Common Stock, not reserved for any other purpose, or from Common Stock reacquired by the Company.

5.2 Canceled, Terminated, or Forfeited Awards. Any shares of Restricted Stock which for any reason, expire, or are canceled, terminated or otherwise settled, without the issuance of shares of Common Stock shall again be available for award under the Plan.

5.3 Adjustment in Capitalization. The aggregate number of shares of Common Stock available for Restricted Stock awards under Section 5.1 or subject to outstanding Restricted Stock awards and the respective vesting criteria applicable to outstanding Restricted Stock awards shall be proportionately adjusted to reflect, as deemed equitable and appropriate by the Committee, an Adjustment Event. To the extent deemed equitable and appropriate by the Committee, subject to any required action by stockholders, in any

merger, consolidation, reorganization, liquidation, dissolution or other similar transaction, any shares of Restricted Stock granted under the Plan shall pertain to the securities and other property to which a holder of the number of shares of Common Stock covered by the Restricted Stock award would have been entitled to receive in connection with such event.

Any shares of stock (whether Common Stock, shares of stock into which shares of Common Stock are converted or for which shares of Common Stock are exchanged or shares of stock distributed with respect to Common Stock) or cash or other property received with respect to any Restricted Stock award granted under the Plan as a result of any Adjustment Event, any distribution of property or any merger, consolidation, reorganization, liquidation, dissolution or other similar transaction shall, except as provided in Section 6.5 or as otherwise provided by the Committee at or after the date any such award is made, be subject to the same terms and conditions, including vesting and restrictions on transfer, as are applicable to the Restricted Stock award with respect to which

such shares, cash or other property is received and any Award Agreement and stock certificate(s) representing or evidencing any shares of stock or other property so received shall so provide and be legended as appropriate.

SECTION 6.

RESTRICTED STOCK AWARDS

6.1 Grant of Restricted Stock. The Committee may grant Restricted Stock to Participants at such times and in such amounts, and subject to such other terms and conditions not inconsistent with the Plan, as it shall determine. Unless the Committee provides otherwise at or after the date of grant, stock certificates evidencing any shares of Restricted Stock so granted shall be held in the custody of the Secretary of the Company until the Restriction Period lapses, and, as a condition to the grant of any shares of Restricted Stock, the Participant shall have delivered to the Company a stock power, endorsed in blank, relating to the shares of Common Stock covered by such Restricted Stock award. Each grant of Restricted Stock shall be evidenced by a Restricted Stock Award Agreement.

6.2 Payment. Upon the expiration or termination of the Restriction Period and the satisfaction (as determined by the Committee) of any other conditions determined by the Committee, the restrictions applicable to the Restricted Stock shall lapse and the Company shall cancel and direct its stock transfer agent to make (or to cause to be made) an appropriate book entry reflecting the Participant's ownership of such number of shares of Common Stock with respect to which the restrictions have lapsed, free of all such restrictions, other than any imposed by applicable law. Upon request, the Company shall deliver to the Participant a stock certificate registered in such Participant's name and representing the number of shares of Common Stock with respect to which the restrictions have lapsed, free of all such restrictions except any that may be imposed by law. No payment will be required to be made by the Participant upon the delivery of such shares of Common Stock, except as otherwise provided in Section 8.3 of the Plan. At or after the date of grant, the Committee may accelerate the vesting of any award of Restricted Stock or waive any conditions to the vesting of any such award.

6.3 Restriction Period; Restrictions on Transferability during Restriction Period. Unless otherwise determined by the Committee at or after the date of grant, the Restriction Period applicable to any award of Restricted Stock shall lapse, and such shares of Restricted Stock shall become freely transferable, on the earlier of (i) the date of the Participant's termination of services as a Director due to death or Disability, (ii) the occurrence of a Change in Control, (iii) the Company's failure to nominate the Participant for re-election as a Director (other than a failure to so nominate for "cause", as determined by a majority of the Board in accordance with the Company's By-Laws), (iv) the failure by the Company's shareholders to elect the Participant as a Director at any shareholders meeting for which the Board had nominated such Participant for election, or (v) the 10th anniversary of the date of grant for such Restricted Stock award, subject in any such case to the Participant's continuous service as Director of the Company through such date. Except as provided in Section 8.1, shares of Restricted Stock may not be sold, transferred, pledged, assigned or otherwise

alienated or hypothecated until such time as the Restriction Period applicable thereto shall have lapsed upon the satisfaction of such conditions, including without limitation, the completion of a minimum period of service, the satisfaction of performance goals or the occurrence of such event or events, as

shall be determined by the Committee either at or after the time of grant.

6.4 Termination of Services. Unless the Committee shall otherwise determine at or after the date of grant, if a Participant ceases to be a Director of the Company for any reason other than those specified in Section 6.3 at any time prior to the date when the Restriction Period lapses, all unvested shares of Restricted Stock owned by such Participant shall revert back to the Company upon the Participant's termination of service.

6.5 Rights as a Stockholder. Unless otherwise determined by the Committee at or after the date of grant, Participants granted shares of Restricted Stock shall be entitled to receive, either currently or at a future date, as specified by the Committee, all dividends and other distributions paid with respect to those shares, provided that if any such dividends or distributions are paid in shares of Common Stock or other property (other than cash), such shares and other property shall be subject to the same forfeiture restrictions and restrictions on transferability as apply to the shares of Restricted Stock with respect to which they were paid.

6.6 Legend. To the extent any stock certificate is issued to a Participant in respect of shares of Restricted Stock awarded under the Plan prior to the expiration of the applicable Restriction Period, such certificate shall be registered in the name of the Participant and shall bear the following (or similar) legend:

> "The shares of stock represented by this certificate are subject to the terms and conditions contained in the MBIA Inc. Restricted Stock Plan for Non-Employee Directors and the Restricted Stock Award Agreement, dated as of   , between the Company and the Participant, and may not be sold, pledged, transferred, assigned, hypothecated or otherwise encumbered in any manner (except as provided in Section 8.1 of the Plan or in such Restricted Stock Award Agreement) until   ."

Upon the lapse of the Restriction Period with respect to any such shares of Restricted Stock, the Company shall, upon the Participant's request, issue or have issued new share certificates without the legend described herein in exchange for those previously issued.

SECTION 7.

AMENDMENT, MODIFICATION, AND TERMINATION OF PLAN

The Board may at any time terminate or suspend the Plan, and from time to time may amend or modify the Plan, provided, however, that no action of the Board may, without the consent of a Participant, alter or impair such Participant's rights under any previously granted Restricted Stock award.

SECTION 8.

MISCELLANEOUS PROVISIONS

8.1 Nontransferability of Awards. Unless the Committee shall permit an award of Restricted Stock to be transferred to an immediate family member or a trust or partnership established by the Participant for estate planning purposes on such terms and conditions as it may specify, no shares of Restricted Stock granted under the Plan may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution. If any shares of Restricted Stock are transferred to a trust or partnership as contemplated by the previous sentence, all references herein and in the applicable Award Agreement to the Participant shall be deemed to refer to such permitted transferee, other than any such references with respect to the personal status of the Participant.

8.2 Beneficiary Designation. Each Participant under the Plan may from time to time name any beneficiary or beneficiaries (who may be named contingently or successively) to whom any benefit under the Plan is to be paid or by whom any right under the Plan is to be exercised in case of his death. Each designation will revoke all prior designations by the same Participant, shall be in a form prescribed by the Committee and

will be effective only when filed by the Participant in writing with the Committee during his lifetime. In the absence of any such designation, benefits remaining unpaid or Restricted Stock outstanding at the Participant's death shall be paid to the Participant's surviving spouse, if any, or otherwise to or by his estate.

8.3 Tax Withholding. The Company shall have the power to withhold, or require a Participant to remit to the Company promptly upon notification of the amount due, an amount determined by the Company, in its discretion, to be sufficient to satisfy all Federal, state and local withholding tax requirements in respect of any Restricted Stock award and the Company may defer payment of cash or issuance or delivery of Common Stock until such requirements are satisfied.

8.4 Indemnification. Each person who is or shall have been a member of the Committee or the Board shall be indemnified and held harmless by the Company against and from any loss, cost, liability or expense that may be imposed upon or reasonably incurred by him in connection with or resulting from any claim, action, suit or proceeding to which he may be made a party or in which he may be involved by reason of any action taken or failure to act under the Plan and against and from any and all amounts paid by him in settlement thereof, with the Company's approval, or paid by him in satisfaction of any judgment in any such action, suit or proceeding against him, provided he shall give the Company an opportunity, at its own expense, to handle and defend the same before he undertakes to handle and defend it on his own behalf. The foregoing right of indemnification shall not be exclusive and shall be independent of any other rights of indemnification to which such persons may be entitled under the Company's Articles of Incorporation or By-Laws, by contract, as a matter of law or otherwise.

8.5 Requirements of Law. The granting of Restricted Stock and the issuance of shares of Common Stock shall be subject to all applicable laws, rules and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be appropriate or required, as determined by the Committee.

8.6 Governing Law. The Plan, and all agreements hereunder, shall be construed in accordance with and governed by the laws of the State of New York.

8.7 Term of Plan. The Plan shall be effective upon its adoption by the Board. The Plan shall expire on the tenth anniversary of the date on which it is adopted by the Board (except as to Restricted Stock awards outstanding on that date), unless sooner terminated pursuant to Section 7.

8.8 Notices. Each Participant shall be responsible for furnishing the Committee with the current and proper address for the mailing of notices and delivery of agreements and shares of Common Stock. Any notices required or permitted to be given shall be deemed given if directed to the person to whom addressed at such address and mailed by regular United States mail, first-class and prepaid. If any item mailed to such address is returned as undeliverable to

the addressee, mailing will be suspended until the Participant furnishes the proper address.

8.9 Severability of Provisions. If any provision of this Plan shall be held invalid or unenforceable, such invalidity or unenforceability shall not affect any other provisions hereof, and this Plan shall be construed and enforced as if such provision had not been included.

8.10 Incapacity. Any benefit payable to or for the benefit of a minor, an incompetent person or other person incapable of receiving such benefit shall be deemed paid when paid to such person's guardian or to the party providing or reasonably appearing to provide for the care of such person, and such payment shall fully discharge the Committee, the Company and other parties with respect thereto.

8.11 Headings and Captions. The headings and captions herein are provided for reference and convenience only, shall not be considered part of this Plan and shall not be employed in the construction of this Plan.

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Exhibit D

MBIA Inc.

Audit Committee Charter

The Audit Committee of the Board of Directors of MBIA Inc. shall consist of at least three members, each of whom the Board deems independent as defined under applicable SEC and NYSE rules and qualified to perform the functions of Audit Committee member pursuant to the requirements of the NYSE. In particular, the Chairman of the Audit Committee shall have accounting or related financial management expertise. The Committee shall have and may exercise the powers of the Board of Directors in the oversight of (i) the financial statements issued by the Company, (ii) the Company's compliance with the legal and regulatory requirements applicable to financial reporting, and (iii) the independence of and the performance by both the internal and external auditors. In course of performing its functions, the Audit Committee shall make regular reports to the Board.

To perform its functions, the Audit Committee shall have the authority to retain special legal, accounting or other consultants to advise the Committee. The Audit Committee may request any officer or employee of the Company or the Company's outside counsel or independent auditor to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee. The Audit Committee may also meet with the Company's investment bankers or financial analysts who follow the Company.

The Audit Committee shall:

1. Review the Company's annual financial statements and related reports with management, including major issues regarding accounting and auditing principles and practices as well as adequacy of internal controls that could significantly affect the Company's financial statements.

2. Review any analysis prepared by management or the independent auditor of significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements, including an analysis of the effect of alternative GAAP methods on the Company's financial statements and a description of any transactions as to which

management obtained Statement on Auditing Standards No. 50 letters.

3. Review with management and the independent auditor the effect of regulatory and accounting initiatives, as well as off-balance sheet structures on the Company's financial statements.

4. Review with management and independent auditor the Company's quarterly financial statements prior to the filing of its Form 10-Q, including the results of the independent auditors' reviews of the quarterly financial statements.

5. Meet periodically with management to review the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures.

6. Review major changes to the Company's auditing and accounting principles and practices as suggested by the independent auditor, internal auditors or management.

7. Recommend to the Board the appointment of the independent auditor, which firm is ultimately accountable to the Audit Committee and the Board.

8. Review the experience and qualifications of the senior members of the independent auditor team and the quality control procedures of the independent auditor.

9. Approve the fees to be paid to the independent auditor for audit services.

10. Approve the retention of the independent auditor for any non-audit service and the fee for such service.

11. Receive periodic reports from the independent auditor regarding the auditor's independence, discuss such reports with the auditor, consider whether the provision of non-audit services is compatible

with maintaining the auditor's independence and, if so determined by the Committee, recommend that the Board take appropriate action to satisfy itself of the independence of the auditor.

12. Evaluate together with the Board the performance of the independent auditor and whether it is appropriate to adopt a policy of rotating independent auditors on a regular basis. If so determined by the Audit Committee, recommend that the Board replace the independent auditor.

13. Recommend to the Board guidelines for the Company's hiring of employees of the independent auditor who were engaged on the Company's account.

14. Discuss with the national office of the independent auditor issues on which it was consulted by the Company's audit teams and matters of audit quality and consistency.

15. Meet with independent auditor prior to the audit to review the planning and staffing of the audit.

16. Obtain from the independent auditor assurance that Section 10A of the Securities Exchange Act of 1934 has not been implicated.

17. Obtain reports from management, the Company's senior internal auditing executive and the independent auditor that the Company and the Company's subsidiary/foreign affiliated entities are in conformity with applicable legal requirements and the Company's code of ethical conduct, including disclosure of insider and affiliate party transactions.

18. Discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit.

19. Review with management and the independent auditor any correspondence with regulators or governmental agencies and any employee complaints or published reports that raise material issues regarding the Company's financial statements or accounting policies.

20. Review with the independent auditor any problems or difficulties the auditor may have encountered and any management letter provided by the auditor and the Company's response to that letter. Such review should include:

(a) Any difficulties encountered the course of the audit work, including any restrictions on the scope of activities or access to required information, and any disagreements with management.

(b) Any changes required in the planned scope of the internal audit.

(c) The internal audit department responsibilities, budget and staffing.

21. Review the reports of the Company's internal auditor and management's response thereto.

22. Review the Company's financial reporting processes and the appropriateness of the Company's accounting principles, and consider any significant changes proposed to either those processes or principles.

23. Review the Company's code of ethical conduct and its system of monitoring adherence to that code and advise the Board regarding compliance with applicable laws and regulations and with the Company's code of ethical conduct.

24. Review the qualifications, activities and organizational structure of the Company's internal audit department and review the appointment and replacement of senior internal auditing executive made by the Company.

25. Meet at least quarterly separately in executive session with the independent auditors, the chief financial officer and the senior internal auditing executive. In addition, meet separately in executive session with any other officer or employee of the Company or the Company's outside counsel in connection with fulfilling the Committee's responsibilities.

26. Review with the Company's General Counsel all legal compliance matters and any legal matter that could have a material impact on the Company's financial statements, the Company's compliance policies and any material reports or inquiries received from regulators or government agencies.

27. Review the adequacy of this Charter at least annually and make any recommended changes to the Board for consideration and approval. 28.Conduct special investigations and engage special legal, accounting or other consultants to help advise the Committee in connection with such investigations. The results of these investigations are to be reported to the full Board.

29. Prepare the annual report of the Committee required by the rules of the SEC to be included in the Company's proxy statement.

30. Review the findings of examinations conducted by any regulatory agencies and report the results of such findings to the full Board.

31. Perform such other duties as may be delegated to the Committee by the Board or as may be consistent with this Charter or the Company's by-laws.

While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company's financial statements are complete and accurate and are in accordance with generally accepted accounting principles. This is the responsibility of management and the independent auditor. Nor is it the duty of the Audit Committee to conduct investigations, to resolve disagreements, if any, between management and the independent auditor or to assure compliance with laws and regulations and the Company's code of ethical conduct.

Effective March 21, 2002

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MBIA INC.

ANNUAL MEETING OF SHAREHOLDERS--THURSDAY, MAY 9, 2002
THE PROXY IS SOLICITED ON BEHALF OF
THE BOARD OF DIRECTORS OF MBIA INC.

The undersigned hereby appoints James A. Lebenthal and Freda S. Johnson and each of them, the proxies and agents of the undersigned, each with power of substitution, to vote all shares of Common Stock of MBIA INC. (the "Company"), which the undersigned is entitled to vote at the Annual Meeting of Shareholders of the Company to be held at MBIA INC., 113 King Street, Armonk, New York, on Thursday, May 9, 2002, at 10:00 A.M., New York time, and at any adjournment thereof, with all the powers which the undersigned would possess if personally present, hereby revoking any prior proxy to vote at such meeting and hereby ratifying and confirming all that said proxies and agents or their substitutes or any of them may lawfully do by virtue hereof, upon the following matters, as described in the MBIA INC. Proxy Statement, receipt of which is hereby acknowledged, and in their discretion, upon such other business as may properly come before the meeting or any adjournment thereof.

(Continued and to be signed on reverse side)

/\ FOLD AND DETACH HERE /\

MBIA INC.

ANNUAL MEETING OF SHAREHOLDERS
THURSDAY, MAY 9, 2002
10:00 A.M.

Corporate Headquarters
MBIA INC.
113 King Street
Armonk, New York 10504

IF YOU PROPERLY EXECUTE THIS PROXY, IT WILL BE VOTED IN THE MANNER YOU DIRECT. IF YOU DO NOT DIRECT HOW THIS PROXY SHOULD BE VOTED, IT WILL BE VOTED FOR THE ELECTION OF THE NOMINEES LISTED BELOW AND FOR PROPOSALS 2, 3, 4 AND 5 BELOW.

Please mark your votes as indicated in this example [X]

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR PROPOSALS 1, 2, 3, 4 AND 5

	FOR ALL NOMINEES	WITHHOLD AUTHORITY FOR ALL NOMINEES
1. Election of Directors, Nominees: 01 Joseph W. Brown, David C. Clapp, 03 Gary C. Dunton, 04 Claire L. Gaudiani, 05 William H. Gray, III, 06 Freda S. Johnson, 07 Daniel P. Kearney, 08 James A. Lebenthal, and 09 John A. Rolls.	[_]	[_]

(INSTRUCTION: TO WITHHOLD AUTHORITY TO VOTE FOR ANY INDIVIDUAL NOMINEE, WRITE THAT NOMINEE'S NAME ON THE LINE PROVIDED BELOW.)

PLEASE RETURN THIS PROXY CARD PROMPTLY
USING THE ENCLOSED ENVELOPE.

	FOR	AGAINST	ABSTAIN
2. Approval of the Company's Annual and Long-Term Incentive Plan.	[_]	[_]	[_]
3. Approval of the Amended and Restated Deferred Compensation and Stock Ownership Plan for Non-Employee Directors.	[_]	[_]	[_]
4. Approval of the Restricted Stock Plan for Non-Employee Directors.	[_]	[_]	[_]
5. Approval of Appointment of PricewaterhouseCoopers LLP as			

independent auditors. [_] [_] [_]

Signature_________________________Signature_________________________Date__________

NOTE: PLEASE SIGN EXACTLY AS NAME APPEARS HEREON. JOINT OWNERS SHOULD EACH SIGN. WHEN SIGNING AS ATTORNEY, EXECUTOR, ADMINISTRATOR, TRUSTEE OR GUARDIAN, PLEASE GIVE FULL TITLE AS SUCH.

/\ FOLD AND DETACH HERE /\

Instructions for Voting by Internet or Telephone or Mail

24 Hours a Day, 7 Days a Week

Internet and telephone voting is available through 4PM Eastern Time on May 8, 2002, the business day prior to annual meeting day.

Your telephone or Internet vote authorizes the named proxies to vote your shares in the same manner as if you marked, signed and returned your proxy card.

Internet		Telephone		Mail
http://www.eproxy.com/mbi		1-800-435-6710		
Use the Internet to vote your proxy. Have your proxy card in hand when you access the web site. You will be prompted to enter your control number, located in the box below, to create and submit an electronic ballot.	OR	Use any touch-tone telephone to vote your proxy. Have your proxy card in hand when you call. You will be prompted to enter your control number, located in the box below, and then follow the directions given.	OR	Mark, sign and date your proxy card and return it in the enclosed postage-paid envelope.

If you vote your proxy by Internet or by telephone, you do NOT need to mail back your proxy card.

You can view the Annual Report and Proxy Statement on the internet at: http://www.mbia.com/investor

:inherit;font-size:10pt;">

2017
Interest income:

Available-for-sale securities	$ 230,607	$ 163,904	$ 604,790	$ 449,141
Residential mortgage loans held-for-investment in securitization trusts	—	29,865	—	92,319
Residential mortgage loans held-for-sale	332	479	988	1,380
Other	5,759	1,841	12,299	7,144

Total interest income
236,698

196,089

618,077

549,984

Interest expense:

Repurchase agreements
138,343

59,694

322,735

135,756

Collateralized borrowings in securitization trusts
—

23,970

—

74,199

Federal Home Loan Bank advances
5,301

10,317

14,655

30,554

Revolving credit facilities
3,973

701

5,776

1,727

Convertible senior notes
4,779

4,745

14,204

13,157

Total interest expense
152,396

99,427

357,370

255,393

Net interest income
84,302

96,662

260,707

294,591

Other-than-temporary impairments:

Total other-than-temporary impairment losses
(95
)

—

(363
)

(429
)
Other income (loss):

(Loss) gain on investment securities
(42,996
)

5,618

(95,549
)

(15,485
)
Servicing income
89,618

57,387

238,473

148,468

Gain (loss) on servicing asset
20,591

(29,245
)

102,251

(90,440
)
Gain (loss) on interest rate swap, cap and swaption agreements
75,857

(207
)

255,535

(66,990
)
Loss on other derivative instruments
(31,463
)

(18,924
)

(15,735
)

(66,328
)
Other income
907

8,431

2,695

21,053

Total other income (loss)
112,514

23,060

487,670

(69,722
)
Expenses:

Management fees
(5,041
)

10,146

18,120

29,801

Servicing expenses
16,433

8,560

42,526

25,154

Other operating expenses
17,033

13,138

47,040

44,373

Acquisition transaction costs
86,703

—

86,703

—

Restructuring charges
8,238

—

8,238

—

Total expenses
123,366

31,844

202,627

99,328

Income from continuing operations before income taxes
73,355

87,878

545,387

125,112

Provision for (benefit from) income taxes
37,409

(5,342
)

35,142

(21,100
)
Net income from continuing operations
35,946

93,220

510,245

146,212

Income from discontinued operations, net of tax
—

11,518

—

39,169

Net income
35,946

104,738

510,245

185,381

Income from discontinued operations attributable to noncontrolling interest
—

2,674

—

2,714

Net income attributable to Two Harbors Investment Corp.
35,946

102,064

510,245

182,667

Dividends on preferred stock
18,951

8,888

46,445

13,173

Net income attributable to common stockholders
$
16,995

$
93,176

$
463,800

$
169,494

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

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (unaudited), continued
(in thousands, except share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Basic earnings per weighted average common share:				
Continuing operations	$0.08	$ 0.48	$2.42	$ 0.76
Discontinued operations	—	0.05	—	0.21
Net income	$0.08	$ 0.53	$2.42	$ 0.97
Diluted earnings per weighted average common share:				
Continuing operations	$0.08	$ 0.47	$2.28	$ 0.76
Discontinued operations	—	0.05	—	0.21
Net income	$0.08	$ 0.52	$2.28	$ 0.97
Dividends declared per common share	$0.47	$ 0.52	$1.41	$ 1.54
Weighted average number of shares of common stock:				
Basic	224,399,436	174,488,296	191,846,212	174,415,232
Diluted	224,399,436	188,907,356	209,607,146	174,415,232
Comprehensive (loss) income:				
Net income	$35,946	$ 104,738	$510,245	$ 185,381
Other comprehensive (loss) income, net of tax:				
Unrealized (loss) gain on available-for-sale securities	(119,796)	68,433	(499,460)	223,823
Other comprehensive (loss) income	(119,796)	68,433	(499,460)	223,823
Comprehensive (loss) income	(83,850)	173,171	10,785	409,204
Comprehensive income attributable to noncontrolling interest	—	2,682	—	2,724
Comprehensive (loss) income attributable to Two Harbors Investment Corp.	(83,850)	170,489	10,785	406,480
Dividends on preferred stock	18,951	8,888	46,445	13,173
Comprehensive (loss) income attributable to common stockholders	$(102,801)	$ 161,601	$(35,660)	$ 393,307

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

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (unaudited)
(in thousands)

	Preferred Stock	Common Stock Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Cumulative Earnings	Cumulative Distributions to Stockholders	Total Stockholders' Equity	Non-controlling Interest	Total Equity
Balance, December 31, 2016	$—	$ 1,738	$3,661,712	$ 199,227	$2,038,033	$(2,499,599)	$3,401,111	$—	$3,401,111
Net income	—	—	—	—	182,667	—	182,667	2,714	185,381
Other comprehensive income before reclassifications, net of tax expense of $35,708	—	—	—	215,994	—	—	215,994	10	216,004
Amounts reclassified from accumulated other comprehensive income, net of tax benefit of $2,722	—	—	—	7,815	—	—	7,815	—	7,815
Other comprehensive income, net of tax expense of $32,986	—	—	—	223,809	—	—	223,809	10	223,819
Contribution of TH Commercial Holdings LLC to Granite Point	—	—	(13,777)	6	—	—	(13,771)	195,646	181,875
Acquisition of noncontrolling interests	—	—	(69)	—	—	—	(69)	(5,376)	(5,445)
Issuance of preferred stock, net of offering costs	416,966	—	—	—	—	—	416,966	—	416,966
Issuance of common stock, net of offering costs	—	—	332	—	—	—	332	—	332
Preferred dividends declared	—	—	—	—	—	(13,173)	(13,173)	—	(13,173)
Common dividends declared	—	—	—	—	—	(268,697)	(268,697)	(3,177)	(271,874)
Non-cash equity award compensation	—	7	12,382	—	—	—	12,389	—	12,389
Balance, September 30, 2017	$416,966	$ 1,745	$3,660,580	$ 423,042	$2,220,700	$(2,781,469)	$3,941,564	$189,817	$4,131,381
Balance, December 31, 2017	$702,537	$ 1,745	$3,672,003	$ 334,813	$2,386,604	$(3,526,278)	$3,571,424	$—	$3,571,424
Cumulative effect of adoption of new accounting principles	—	—	25	9,918	(9,943)	—	—	—	—
Adjusted balance, January 1, 2018	702,537	1,745	3,672,028	344,731	2,376,661	(3,526,278)	3,571,424	—	3,571,424
Net income	—	—	—	—	510,245	—	510,245	—	510,245
Other comprehensive loss before reclassifications, net of tax benefit of $14,890	—	—	—	(552,477)	—	—	(552,477)	—	(552,477)
Amounts reclassified from accumulated other comprehensive income, net of tax benefit of $0	—	—	—	53,017	—	—	53,017	—	53,017
Other comprehensive loss, net of tax benefit of $14,890	—	—	—	(499,460)	—	—	(499,460)	—	(499,460)
Acquisition of CYS Investments, Inc.	275,000	726	1,124,388	—	—	—	1,400,114	—	1,400,114
Issuance of preferred stock, net of offering costs	13	—	—	—	—	—	13	—	13
Issuance of common stock, net of offering costs	—	—	329	—	—	—	329	—	329
Preferred dividends declared	—	—	—	—	—	(46,445)	(46,445)	—	(46,445)
Common dividends declared	—	—	—	—	—	(270,023)	(270,023)	—	(270,023)
Non-cash equity award compensation	—	10	9,775	—	—	—	9,785	—	9,785
Balance, September 30, 2018	$977,550	$ 2,481	$4,806,520	$ (154,729)	$2,886,906	$(3,842,746)	$4,675,982	$—	$4,675,982

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

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2018	**2017**
Cash Flows From Operating Activities:		
Net income from continuing operations	$510,245	$146,212
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Amortization of premiums and discounts on investment securities, net	73,441	45,500
Amortization of deferred debt issuance costs on convertible senior notes	728	429
Other-than-temporary impairment losses	363	429
Realized and unrealized losses on investment securities	96,842	15,485
(Gain) loss on servicing asset	(102,251)	90,440
Gain on residential mortgage loans held-for-sale	(851)	(2,149)
Gain on residential mortgage loans held-for-investment and collateralized borrowings in securitization trusts	—	(14,884)
Realized and unrealized (gain) loss on interest rate swaps, caps and swaptions	(221,649)	56,123
Unrealized loss on other derivative instruments	27,457	37,586
Equity based compensation	9,785	11,703
Depreciation of fixed assets	504	776
Excess consideration in the acquisition of CYS Investments, Inc.	77,602	—
Purchases of residential mortgage loans held-for-sale	—	(567)
Proceeds from sales of residential mortgage loans held-for-sale	—	3,708
Proceeds from repayment of residential mortgage loans held-for-sale	3,325	5,019
Net change in assets and liabilities:		
Decrease (increase) in accrued interest receivable	13,698	(20,653)
Decrease (increase) in deferred income taxes, net	35,094	(21,505)
(Increase) decrease in income taxes receivable	(460)	1,411
Decrease (increase) in prepaid and fixed assets	7,367	(251)
(Increase) decrease in other receivables	(9,136)	10,244
Decrease in servicing advances	4,916	5,489
Increase in accrued interest payable	1,823	31,551
Increase in income taxes payable	4	142
Decrease in accrued expenses and other liabilities	(7,481)	(11,753)
Net cash provided by operating activities of discontinued operations	—	28,280
Net cash provided by operating activities	$521,366	$418,765

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

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited), continued
(in thousands)

	Nine Months Ended September 30,	
	2018	**2017**
Cash Flows From Investing Activities:		
Purchases of available-for-sale securities	$(6,319,252)	$(13,677,423)
Proceeds from sales of available-for-sale securities	9,156,686	5,726,616
Principal payments on available-for-sale securities	1,792,168	1,075,961
Purchases of mortgage servicing rights, net of purchase price adjustments	(475,451)	(327,341)
Proceeds from sales of mortgage servicing rights	395	132
(Purchases) short sales of derivative instruments, net	(82,971)	(93,812)
Proceeds from sales and settlement (payments for termination and settlement) of derivative instruments, net	498,425	84,791
Proceeds from reverse repurchase agreements	1,442,798	—
Repayments of reverse repurchase agreements	(1,440,713)	—
Proceeds from repayment of residential mortgage loans held-for-investment in securitization trusts	—	285,695
Net cash paid for the acquisition of CYS Investments, Inc.	(13,552)	—
Purchases of equity securities	—	(5,445)
Proceeds from sales of equity securities	31,276	—
Redemptions of Federal Home Loan Bank stock	12,981	82,681
Decrease in due to counterparties, net	(187,146)	(32,881)
Net cash used in investing activities of discontinued operations	—	(753,021)
Net cash provided by (used in) investing activities	4,415,644	(7,634,047)
Cash Flows From Financing Activities:		
Proceeds from repurchase agreements	103,348,835	113,602,702
Principal payments on repurchase agreements	(107,736,938)	(105,645,758)
Principal payments on collateralized borrowings in securitization trusts	—	(282,468)
Principal payments on Federal Home Loan Bank advances	(350,000)	(2,001,238)
Proceeds from revolving credit facilities	377,400	123,000
Principal payments on revolving credit facilities	(87,400)	(153,000)
Proceeds from convertible senior notes	—	282,469
Proceeds from issuance of preferred stock, net of offering costs	13	416,966
Proceeds from issuance of common stock, net of offering costs	329	332
Dividends paid on preferred stock	(39,443)	(4,285)
Dividends paid on common stock	(193,318)	(261,400)
Net cash provided by financing activities of discontinued operations	—	1,205,947
Net cash (used in) provided by financing activities	(4,680,522)	7,283,267
Net increase in cash, cash equivalents and restricted cash	256,488	67,985
Cash, cash equivalents and restricted cash of continuing operations at beginning of period	1,054,995	758,916
Cash, cash equivalents and restricted cash of discontinued operations at beginning of period	—	56,279
Cash, cash equivalents and restricted cash at beginning of period	1,054,995	815,195
Cash, cash equivalents and restricted cash at end of period	$1,311,483	$883,180

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

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited), continued
(in thousands)

	Nine Months Ended September 30,	
	2018	**2017**
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$300,573	$169,464
Cash paid (received) for taxes	$502	$(1,152)
Noncash Activities:		
Acquisition of the assets and liabilities of CYS Investments, Inc.		
Available-for-sale securities	$10,034,557	$—
Cash and cash equivalents	$386	$—
Restricted cash	$1,062	$—
Accrued interest receivable	$30,646	$—
Reverse repurchase agreements	$761,460	$—
Other assets	$11,977	$—
Repurchase agreements	$(8,743,527)	$—
Derivative liabilities, net	$(451,026)	$—
Due to counterparties, net	$(279,715)	$—
Accrued interest payable	$(27,487)	$—
Other liabilities	$(821)	$—
Issuance of preferred stock in connection with the acquisition of CYS Investments, Inc.	$275,000	$—
Issuance of common stock in connection with the acquisition of CYS Investments, Inc.	$1,125,114	$—
Transfers of residential mortgage loans held-for-sale to other receivables for foreclosed government-guaranteed loans	$403	$2,909
Transfer of fair value of mortgage servicing rights to fair value of Ginnie Mae residential mortgage loans held-for-sale upon buyout	$—	$9
Additions to mortgage servicing rights due to sale of residential mortgage loans held-for-sale	$—	$20
Cumulative-effect adjustment for adoption of new accounting principle	$9,918	$—
Dividends declared but not paid at end of period	$96,259	$102,799
Reconciliation of residential mortgage loans held-for-sale:		
Residential mortgage loans held-for-sale at beginning of period	$30,414	$40,146
Purchases of residential mortgage loans held-for-sale	—	567
Transfers to other receivables for foreclosed government-guaranteed loans	(403)	(2,909)
Transfer of fair value of mortgage servicing rights to fair value of Ginnie Mae residential mortgage loans held-for-sale upon buyout	—	(9)
Proceeds from sales of residential mortgage loans held-for-sale	—	(3,708)
Proceeds from repayment of residential mortgage loans held-for-sale	(3,325)	(5,019)
Realized and unrealized gains on residential mortgage loans held-for-sale	851	2,129
Residential mortgage loans held-for-sale at end of period	$27,537	$31,197

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

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TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

Note 1. Organization and Operations
Two Harbors Investment Corp., or the Company, is a Maryland corporation investing in, financing and managing Agency residential mortgage-backed securities, or Agency RMBS, non-Agency securities, mortgage servicing rights, or MSR, and other financial assets. The Company's Chief Investment Officer manages the investment portfolio as a whole and resources are allocated and financial performance is assessed on a consolidated basis. The Company is externally managed and advised by PRCM Advisers LLC, or PRCM Advisers, which is a subsidiary of Pine River Capital Management L.P., or Pine River. The Company's common stock is listed on the NYSE under the symbol "TWO".
The Company was incorporated on May 21, 2009, and commenced operations as a publicly traded company on October 28, 2009, upon completion of a merger with Capitol Acquisition Corp., or Capitol, which became a wholly owned indirect subsidiary of the Company as a result of the merger.
The Company has elected to be treated as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code, for U.S. federal income tax purposes. As long as the Company continues to comply with a number of requirements under federal tax law and maintains its qualification as a REIT, the Company generally will not be subject to U.S. federal income taxes to the extent that the Company distributes its taxable income to its stockholders on an annual basis and does not engage in prohibited transactions. However, certain activities that the Company may perform may cause it to earn income which will not be qualifying income for REIT purposes. The Company has designated certain of its subsidiaries as taxable REIT subsidiaries, or TRSs, as defined in the Code, to engage in such activities.
On June 28, 2017, the Company completed the contribution of its portfolio of commercial real estate assets to Granite Point Mortgage Trust Inc., or Granite Point, a newly formed Maryland corporation intended to qualify as a REIT, externally managed and advised by Pine River, and focused on directly originating, investing in and managing senior floating-rate commercial mortgage loans and other debt and debt-like commercial real estate investments. The Company contributed its equity interests in its wholly owned subsidiary, TH Commercial Holdings LLC, to Granite Point and, in exchange for its contribution, received approximately 33.1 million shares of common stock of Granite Point, which represented approximately 76.5% of the outstanding stock of Granite Point upon completion of the initial public offering, or IPO, of its common stock on June 28, 2017. On November 1, 2017, the Company distributed, on a pro rata basis, the 33.1 million shares of Granite Point common stock that it acquired in connection with the contribution to stockholders holding shares of Two Harbors common stock outstanding as of the close of business on October 20, 2017.
On April 26, 2018, the Company announced that it had entered into a definitive merger agreement pursuant to which the Company would acquire CYS Investments, Inc., or CYS, a Maryland corporation investing in primarily Agency RMBS and treated as a REIT for U.S. federal income tax purposes. The transaction was approved by the stockholders of both the Company and CYS on July 27, 2018, and the merger was completed on July 31, 2018, at which time CYS became a wholly owned subsidiary of the Company. In exchange for all of the shares of CYS common stock outstanding immediately prior to the effective time of the merger, the Company issued approximately 72.6 million new shares of common stock, as well as aggregate cash consideration of $15.0 million, to CYS common stockholders. In addition, the Company issued 3 million shares of newly classified Series D cumulative redeemable preferred stock and 8 million shares of newly classified Series E cumulative redeemable preferred stock in exchange for all shares of CYS's Series A and Series B cumulative redeemable preferred stock outstanding prior to the effective time of the merger.

Note 2. Basis of Presentation and Significant Accounting Policies
Consolidation and Basis of Presentation

The interim unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission, or SEC. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles, or U.S. GAAP, have been condensed or omitted according to such SEC rules and regulations. However, management believes that the disclosures included in these interim condensed consolidated financial statements are adequate to make the information presented not misleading.

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The condensed consolidated financial statements of the Company include the accounts of all subsidiaries; inter-company accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation. All per share amounts, common shares outstanding and restricted shares for all prior periods presented have been adjusted on a retroactive basis to reflect the Company's one-for-two reverse stock split effected on November 1, 2017 (refer to Note 18 - *Stockholders' Equity* for additional information). The accompanying condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at September 30, 2018 and results of operations for all periods presented have been made. The results of operations for the three and nine months ended September 30, 2018 should not be construed as indicative of the results to be expected for future periods or the full year.

Due to its controlling ownership interest in Granite Point through November 1, 2017, the Company consolidated Granite Point on its financial statements. Effective November 1, 2017 (the date the 33.1 million shares of Granite Point common stock were distributed to the Company's common stockholders), the Company no longer had a controlling interest in Granite Point and, therefore, deconsolidated Granite Point and its subsidiaries from its financial statements and reclassified all of Granite Point's prior period assets, liabilities and results of operations to discontinued operations.

The Company retains debt securities and excess servicing rights purchased from securitization trusts sponsored by either third parties or the Company's subsidiaries. The securitization trusts are considered variable interest entities, or VIEs, for financial reporting purposes and, thus, are reviewed for consolidation under the applicable consolidation guidance. Whenever the Company has both the power to direct the activities of a trust that most significantly impact the entities' performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant, the Company consolidates the trust. During the majority of 2017, the Company retained the most subordinate security in each of the securitization trusts, which gave the Company the power to direct the activities of the trusts that most significantly impact the trusts' performance and the obligation to absorb losses or the right to receive benefits of the securitization trusts that could be significant. As a result, the Company consolidated all of the securitization trusts on its condensed consolidated balance sheet. During the fourth quarter of 2017, the Company sold all of the retained subordinated securities thereby removing the Company's power to direct the activities of the trusts and the obligation to absorb losses or the right to receive benefits of the securitization trusts. As a result, the securitization trusts are no longer consolidated on the Company's condensed consolidated balance sheet and the remaining retained securities are included within non-Agency available-for-sale, or AFS, securities.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make a number of significant estimates. These include estimates of fair value of certain assets and liabilities, amount and timing of credit losses, prepayment rates, the period of time during which the Company anticipates an increase in the fair values of real estate securities sufficient to recover unrealized losses in those securities, and other estimates that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses during the reported period. It is likely that changes in these estimates (*e.g.*, valuation changes due to supply and demand, credit performance, prepayments, interest rates, or other reasons) will occur in the near term. The Company's estimates are inherently subjective in nature and actual results could differ from its estimates and the differences may be material.

Significant Accounting Policies

Included in Note 2 to the Consolidated Financial Statements of the Company's 2017 Annual Report on Form 10-K is a summary of the Company's significant accounting policies. Provided below is a summary of additional accounting policies that are significant to the Company's consolidated financial condition and results of operations for the nine months ended September 30, 2018.

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Asset Acquisition
In accordance with U.S. GAAP, the acquirer in a merger transaction is to evaluate whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If that threshold is met, the set of acquired assets and associated activities is not deemed a business and is required to be accounted for as an asset acquisition. Upon completion of the merger with CYS on July 31, 2018, approximately 89% of the CYS assets acquired were Agency RMBS. The Company concluded that they were similar identifiable assets to be grouped to evaluate whether the "substantially all" threshold was met as the Agency RMBS are financial assets with similar risk characteristics associated with managing these assets. Given the concentration of the fair value of the Agency RMBS of the gross assets acquired, the Company concluded that the fair value of the gross assets acquired was concentrated in a group of similar identifiable assets and, therefore, the merger was accounted for as an asset acquisition. The financial results of CYS since the closing date of the acquisition have been included in the Company's condensed consolidated financial statements.
Asset acquisitions are generally accounted for by allocating the cost of the acquisition plus direct transaction costs to the individual assets acquired, including identified intangible assets, and liabilities assumed on a relative fair value basis. This allocation may cause identified assets to be recognized at amounts that are greater than their fair values. However, "non-qualifying" assets, which include financial assets and other current assets, should not be assigned an amount greater than their fair value. The gross assets acquired in the merger consisted most significantly of financial assets and other current assets. The cost of the acquisition of CYS plus direct transaction costs exceeded gross assets acquired less liabilities assumed in the merger. As there were no meaningful nonfinancial assets and non-current assets in this transaction and no identified intangible assets to assign value, the excess consideration and transaction costs were recognized in the condensed consolidated statements of comprehensive (loss) income as an expense and an associated reduction in stockholders' equity.
Reverse Repurchase Agreements
The Company may borrow U.S. Treasury securities through reverse repurchase transactions under its master repurchase agreements to cover short sales. The Company accounts for these reverse repurchase agreements as securities borrowing transactions and records them at amortized cost, which approximates fair value due to their short-term nature, on its condensed consolidated balance sheets.
Offsetting Assets and Liabilities
Certain of the Company's repurchase agreements are governed by underlying agreements that provide for a right of setoff in the event of default by either party to the agreement. The Company also has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association, or ISDA, or central clearing exchange agreements, in the case of centrally cleared interest rate swaps. The Company and the counterparty or clearing agency are required to post cash collateral based upon the net underlying market value of the Company's open positions with the counterparty. Additionally, the Company's centrally cleared interest rate swaps require that the Company posts an "initial margin" amount determined by the clearing exchange, which is generally intended to be set at a level sufficient to protect the exchange from the interest rate swap's maximum estimated single-day price movement. The Company also exchanges "variation margin" based upon daily changes in fair value, as measured by the exchange.
Under U.S. GAAP, if the Company has a valid right of setoff, it may offset the related asset and liability and report the net amount. As a result of amendments to rules governing certain central clearing activities, the exchange of variation margin is considered a settlement of the interest rate swap, as opposed to pledged collateral. Accordingly, beginning in the first quarter of 2018 and in subsequent periods, the Company accounts for the receipt or payment of variation margin as a direct reduction to the carrying value of the interest rate swap asset or liability. The receipt or payment of initial margin will continue to be accounted for separate from the interest rate swap asset or liability. As of December 31, 2017, variation margin pledged or received was netted on a counterparty basis and classified within restricted cash, due from counterparties, or due to counterparties on the Company's condensed consolidated balance

sheets.

The Company presents repurchase agreements subject to master netting arrangements or similar agreements on a gross basis and derivative assets and liabilities (other than centrally cleared interest rate swaps) subject to such arrangements on a net basis, based on derivative type and counterparty, in its condensed consolidated balance sheets. Separately, the Company presents cash collateral subject to such arrangements (other than variation margin on centrally cleared interest rate swaps) on a net basis, based on counterparty, in its condensed consolidated balance sheets. However, the Company does not offset repurchase agreements or derivative assets and liabilities (other than centrally cleared interest rate swaps) with the associated cash collateral on its condensed consolidated balance sheets.

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The following tables present information about the Company's assets and liabilities that are subject to master netting arrangements or similar agreements and can potentially be offset on the Company's condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017:

September 30, 2018

(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Consolidated Balance Sheets	Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Balance Sheets [1]		
				Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$864,680	$ (461,449)	$403,231	$(44,643)	$ —	$358,588
Reverse repurchase agreements	759,375	—	759,375	(752,861)	—	6,514
Total Assets	$1,624,055	$ (461,449)	$1,162,606	$(797,504)	$ —	$365,102
Liabilities						
Repurchase agreements	$(23,806,631)	$ —	$(23,806,631)	$23,806,631	$ —	$—
Derivative liabilities	(1,258,953)	461,449	(797,504)	797,504	—	—
Total Liabilities	$(25,065,584)	$ 461,449	$(24,604,135)	$24,604,135	$ —	$—

December 31, 2017

(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Consolidated Balance Sheets	Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Balance Sheets [1]		
				Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$340,576	$ (30,658)	$309,918	$(31,903)	$ —	$278,015
Total Assets	$340,576	$ (30,658)	$309,918	$(31,903)	$ —	$278,015
Liabilities						
Repurchase agreements	$(19,451,207)	$ —	$(19,451,207)	$19,451,207	$ —	$—
Derivative liabilities	(62,561)	30,658	(31,903)	31,903	—	—
Total Liabilities	$(19,513,768)	$ 30,658	$(19,483,110)	$19,483,110	$ —	$—

(1) Amounts presented are limited in total to the net amount of assets or liabilities presented in the condensed consolidated balance sheets by instrument. Excess cash collateral or financial assets that are pledged to counterparties may exceed the financial liabilities subject to a master netting arrangement or similar agreement, or counterparties may have pledged excess cash collateral to the Company that exceed the corresponding financial assets. These excess amounts are excluded from the table above, although separately reported within restricted cash, due from counterparties, or due to counterparties in the Company's condensed consolidated balance sheets.

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Recently Issued and/or Adopted Accounting Standards

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board, or FASB, issued ASU No. 2014-09, which is a comprehensive revenue recognition standard that supersedes virtually all existing revenue guidance under U.S. GAAP. The standard's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. As a result of the issuance of ASU No. 2015-14 in August 2015 deferring the effective date of ASU No. 2014-09 by one year, the ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2017, with early adoption prohibited. The Company has evaluated the new guidance and determined that interest income, gains and losses on financial instruments and income from servicing residential mortgage loans are outside the scope of ASC 606, *Revenues from Contracts with Customers*, or ASC 606. For income from servicing residential mortgage loans, the Company considered that the FASB Transition Resource Group members generally agreed that an entity should look to ASC 860, *Transfers and Servicing*, to determine the appropriate accounting for these fees and ASC 606 contains a scope exception for contracts that fall under ASC 860. As a result, the adoption of this ASU did not have a material impact on the Company's financial condition, results of operations or financial statement disclosures.

Lease Classification and Accounting

In February 2016, the FASB issued ASU No. 2016-02, which requires lessees to recognize on their balance sheets both a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. The ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2018, with early adoption permitted. The Company has determined this ASU will not have a material impact on the Company's financial condition, results of operations or financial statement disclosures.

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU No. 2016-13, which changes the impairment model for most financial assets and certain other instruments. Valuation allowances for credit losses on AFS debt securities will be recognized, rather than direct reductions in the amortized cost of the investments, regardless of whether the impairment is considered to be other-than-temporary. The new model also requires the estimation of lifetime expected credit losses and corresponding recognition of allowance for losses on trade and other receivables, held-to-maturity debt securities, loans, and other instruments held at amortized cost. The ASU requires certain recurring disclosures and is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2019, with early adoption permitted for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2018. The Company is evaluating the adoption of this ASU to determine the impact it may have on its condensed consolidated financial statements, which at the date of adoption, will establish an allowance for credit losses on AFS securities which will be derived from the current designated credit reserve with a resulting increase to amortized cost on the securities. The Company also expects adoption of this ASU to impact the recording for the purchase of certain non-Agency securities with purchased credit deterioration by recording an allowance for credit losses with an increase in amortized cost above the purchase price of the same amount. Subsequent changes in expected credit losses will be recognized immediately in earnings as a provision for credit losses until the allowance is reduced to zero. Further favorable changes will result in prospective yield adjustments.

Clarifying the Definition of a Business

In January 2017, the FASB issued ASU No. 2017-01, which changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business. The ASU requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of transferred assets and activities is not a business. The guidance also requires a business to include at least one substantive process and narrows the definition of outputs by more closely aligning it

with how outputs are described in ASC 606. The ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2017, with early adoption permitted. The Company's adoption of this ASU impacted how the Company accounted for the acquisition of CYS (see discussion above).

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Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income
In February 2018, the FASB issued ASU No. 2018-02, which permits entities to reclassify tax effects stranded in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act, or TCJA, to retained earnings and requires entities to disclose whether or not they elected to reclassify the tax effects related to the TCJA as well as their policy for releasing income tax effects from accumulated other comprehensive income. The ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2018, with early adoption permitted. Early adoption of this ASU was elected and applied by recording a cumulative-effect adjustment of $9.9 million to retained earnings, with the offsetting impact to accumulated other comprehensive income as of January 1, 2018.
Accounting for Share-Based Payments to Nonemployees
In June 2018, the FASB issued ASU No. 2018-07 to simplify the accounting for share-based payments to nonemployees by aligning it with the accounting for share-based payments to employees, with certain exceptions. Under the guidance, equity-classified nonemployee awards will be measured on and fixed at the grant date, rather than measured at fair value at each reporting date until the date at which the nonemployee's performance is complete. The ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2018, with early adoption permitted. Early adoption of this ASU was elected on July 1, 2018 and applied by recording a cumulative-effect adjustment to retained earnings as of January 1, 2018, which did not have a material impact on the Company's financial condition, results of operations or financial statement disclosures.
Fair Value Measurement Disclosure Requirements
In August 2018, the FASB issued ASU No. 2018-13, which eliminates, adds and modifies certain disclosure requirements for fair value measurements. Under the guidance, entities are no longer required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but public companies are required to disclose (1) the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements of instruments held at the end of the reporting period and (2) the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. The ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2019, with early adoption permitted. Early adoption of this ASU did not have an impact on the Company's financial condition or results of operations but resulted in some modified financial statement disclosures.
SEC Disclosure Update and Simplification
In August 2018, the SEC adopted a final rule that amends certain disclosure requirements that have become duplicative, overlapping, or outdated in light of other SEC disclosure requirements, U.S. GAAP, or changes in the information environment. However, the guidance also added requirements for entities to include in their interim financial statements a reconciliation of changes in stockholders' equity for each period for which an income statement is required (both year-to-date and quarterly periods). The final rule is effective for all filings made on or after November 5, 2018. However, the SEC staff said it would not object to a registrant waiting to comply with the new interim disclosure requirement until the filing of its Form 10-Q for the quarter that begins after the effective date. As a result, the Company plans to adopt the new interim disclosure requirement in its Form 10-Q for the three months ended March 31, 2019. The Company has determined this final rule will not have a material impact on the Company's financial condition, results of operations or financial statement disclosures.

Note 3. Acquisition of CYS Investments, Inc.
On July 31, 2018, the Company completed the acquisition of CYS through a merger of CYS with and into a wholly owned subsidiary of Two Harbors, in exchange for approximately 72.6 million shares of Two Harbors common stock, as well as aggregate cash consideration of $15.0 million. In accordance with the merger agreement, the number of shares of Two Harbors common stock issued was based on an exchange ratio of 0.4680 and the cash consideration received by CYS common stockholders was $0.0965 per share. In addition, the Company issued 3 million shares of

newly classified Series D cumulative redeemable preferred stock and 8 million shares of newly classified Series E cumulative redeemable preferred stock in exchange for all shares of CYS's Series A and Series B cumulative redeemable preferred stock outstanding prior to the effective time of the merger.

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The total purchase price for the merger of $1.4 billion consists primarily of Two Harbors common stock issued in exchange for shares of CYS common stock and was calculated based on the closing price of Two Harbors common stock on July 31, 2018 of $15.50.

(dollars in thousands, except per share prices)	July 31, 2018	
Common Stock Exchange:		
CYS common stock outstanding	155,102,543	
Common exchange ratio	0.4680	
Two Harbors common stock to be issued	72,587,990	
Less: fractional shares	218	
Two Harbors common stock issued	72,587,772	
Two Harbors share price	$15.50	
		$1,125,114
Cash in Lieu of Common Stock:		
Fractional shares	218	
Cash in lieu rate	$15.59	
		$3
Per Share Cash Consideration:		
CYS common stock outstanding	155,102,543	
Per share cash consideration	0.0965	
		$14,967
Preferred Stock Exchange:	Shares	
Series D preferred stock	3,000,000	$75,000
Series E preferred stock	8,000,000	$200,000
Total Purchase Price		$1,415,084

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As discussed in Note 2 - *Basis of Presentation and Significant Accounting Policies*, the merger was accounted for as an asset acquisition. The total purchase price for the merger including direct transaction costs, which exceeded gross assets acquired less liabilities assumed in the merger, was allocated to the individual assets acquired and liabilities assumed on a relative fair value basis, as shown below:

(in thousands)	July 31, 2018
Assets:	
Available-for-sale securities, at fair value	$10,034,557
Cash and cash equivalents	386
Restricted cash	1,062
Accrued interest receivable	30,646
Due from counterparties	21,572
Derivative assets, at fair value	314,811
Reverse repurchase agreements	761,460
Other assets	11,947
Total Assets	$11,176,441
Liabilities:	
Repurchase agreements	$8,743,527
Derivative liabilities, at fair value	765,837
Due to counterparties	301,287
Accrued interest payable	27,487
Other liabilities	821
Total Liabilities	9,838,959
Stockholders' Equity	
Cumulative deficit (acquisition transaction costs)	(77,602)
Total Stockholders' Equity	$(77,602)
Total Purchase Price	$1,415,084

As there were no meaningful nonfinancial assets and non-current assets in this transaction and no identified intangible assets to assign value, the excess consideration and transaction costs were recognized in the condensed consolidated statements of comprehensive (loss) income as an expense and an associated reduction in stockholders' equity.
The Company also incurred the following charges in connection with the acquisition of CYS, which are included within restructuring charges on the Company's condensed consolidated statements of comprehensive (loss) income, for the three and nine months ended September 30, 2018:

(in thousands)	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Termination benefits	$ 6,216	$ 6,216
Contract terminations	979	979
Other associated costs	1,043	1,043
Total	$ 8,238	$ 8,238

The Company does not expect to incur additional restructuring costs related to the acquisition of CYS in 2018 or beyond.

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Note 4. Discontinued Operations
On June 28, 2017, the Company contributed its equity interests in its wholly owned subsidiary, TH Commercial Holdings LLC, to Granite Point and, in exchange for its contribution, received approximately 33.1 million shares of common stock of Granite Point, representing approximately 76.5% of the outstanding stock of Granite Point upon completion of the IPO of its common stock on June 28, 2017. On November 1, 2017, the Company distributed, on a pro rata basis, the 33.1 million shares of Granite Point common stock that it acquired in connection with the contribution to stockholders holding shares of Two Harbors common stock outstanding as of the close of business on October 20, 2017. Due to the Company's controlling ownership interest in Granite Point through November 1, 2017, its results of operations and financial condition through such date reflect Granite Point's commercial strategy, which is focused on directly originating, investing in and managing senior floating-rate commercial mortgage loans and other debt and debt-like commercial real estate investments. As of November 1, 2017, the Company no longer had a controlling interest in Granite Point and, therefore, deconsolidated Granite Point and its subsidiaries from its financial statements and reclassified all of Granite Point's prior period assets, liabilities and results of operations to discontinued operations. In accordance with ASC 845, *Nonmonetary Transactions*, the pro rata distribution of a consolidated subsidiary is recognized at carrying amount within stockholders' equity. As a result, no gain or loss was recognized on the distribution.
Summarized financial information for the discontinued operations are presented below.

(in thousands)	November 1, 2017
Assets:	
Commercial real estate assets	$ 2,233,080
Available-for-sale securities, at fair value	12,814
Cash and cash equivalents	84,183
Restricted cash	2,838
Accrued interest receivable	6,588
Other assets	22,774
Total Assets	$ 2,362,277
Liabilities:	
Repurchase agreements	$ 1,516,294
Dividends payable	48
Other liabilities	10,337
Total Liabilities	$ 1,526,679

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(in thousands)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Interest income:				
Commercial real estate assets	$ —	$ 30,595	$ —	$ 80,005
Available-for-sale securities	—	265	—	767
Other	—	4	—	10
Total interest income	—	30,864	—	80,782
Interest expense	—	12,497	—	26,376
Net interest income	—	18,367	—	54,406
Expenses:				
Management fees	—	3,130	—	6,717
Servicing expenses	—	333	—	962
Other operating expenses	—	3,388	—	7,561
Total expenses	—	6,851	—	15,240
Income from discontinued operations before income taxes	—	11,516	—	39,166
Benefit from income taxes	—	(2)	—	(3)
Income from discontinued operations	—	11,518	—	39,169
Income from discontinued operations attributable to noncontrolling interest	—	2,674	—	2,714
Income from discontinued operations attributable to common stockholders	$ —	$ 8,844	$ —	$ 36,455

Note 5. Available-for-Sale Securities, at Fair Value

The Company holds AFS investment securities which are carried at fair value on the condensed consolidated balance sheets. The following table presents the Company’s AFS investment securities by collateral type as of September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Agency		
Federal National Mortgage Association	$ 16,905,970	$ 13,920,721
Federal Home Loan Mortgage Corporation	4,138,060	3,616,967
Government National Mortgage Association	1,074,916	701,037
Non-Agency	3,819,970	2,982,094
Total available-for-sale securities	$ 25,938,916	$ 21,220,819

At September 30, 2018 and December 31, 2017, the Company pledged AFS securities with a carrying value of $24.6 billion and $21.0 billion, respectively, as collateral for repurchase agreements and advances from the Federal Home Loan Bank of Des Moines, or the FHLB. See Note 14 - *Repurchase Agreements* and Note 15 - *Federal Home Loan Bank of Des Moines Advances*.

At September 30, 2018 and December 31, 2017, the Company did not have any securities purchased from and financed with the same counterparty that did not meet the conditions of ASC 860, to be considered linked transactions and, therefore, classified as derivatives.

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The Company is not required to consolidate VIEs for which it has concluded it does not have both the power to direct the activities of the VIEs that most significantly impact the entities' performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant. The Company's investments in these unconsolidated VIEs include all non-Agency securities, which are classified within available-for-sale securities, at fair value on the condensed consolidated balance sheets. As of September 30, 2018 and December 31, 2017, the carrying value, which also represents the maximum exposure to loss, of all non-Agency securities in unconsolidated VIEs was $3.8 billion and $3.0 billion, respectively.
The following tables present the amortized cost and carrying value of AFS securities by collateral type as of September 30, 2018 and December 31, 2017:

	September 30, 2018							
(in thousands)	**Principal/ Current Face**	**Un-amortized Premium**	**Accretable Purchase Discount**	**Credit Reserve Purchase Discount**	**Amortized Cost**	**Unrealized Gain**	**Unrealized Loss**	**Carrying Value**
Agency								
Principal and interest	$21,566,476	$ 1,065,985	$(38,957)	$—	$22,593,504	$ 7,285	$(665,408)	$21,935,381
Interest-only	3,228,729	218,997	—	—	218,997	14,812	(50,244)	183,565
Total Agency	24,795,205	1,284,982	(38,957)	—	22,812,501	22,097	(715,652)	22,118,946
Non-Agency								
Principal and interest	5,076,875	6,566	(684,614)	(1,194,749)	3,204,078	552,816	(9,093)	3,747,801
Interest-only	5,196,493	70,511	—	—	70,511	4,264	(2,606)	72,169
Total Non-Agency	10,273,368	77,077	(684,614)	(1,194,749)	3,274,589	557,080	(11,699)	3,819,970
Total	$35,068,573	$ 1,362,059	$(723,571)	$(1,194,749)	$26,087,090	$ 579,177	$(727,351)	$25,938,916

	December 31, 2017							
(in thousands)	**Principal/ Current Face**	**Un-amortized Premium**	**Accretable Purchase Discount**	**Credit Reserve Purchase Discount**	**Amortized Cost**	**Unrealized Gain**	**Unrealized Loss**	**Carrying Value**
Agency								
Principal and interest	$17,081,849	$ 1,079,246	$(24,638)	$—	$18,136,457	$ 42,149	$(134,969)	$18,043,637
Interest-only	2,941,772	223,289	—	—	223,289	10,955	(39,156)	195,088
Total Agency	20,023,621	1,302,535	(24,638)	—	18,359,746	53,104	(174,125)	18,238,725
Non-Agency								
Principal and interest	3,758,134	2,757	(676,033)	(653,613)	2,431,245	488,931	(3,166)	2,917,010
Interest-only	5,614,925	65,667	—	—	65,667	2,163	(2,746)	65,084
Total Non-Agency	9,373,059	68,424	(676,033)	(653,613)	2,496,912	491,094	(5,912)	2,982,094
Total	$29,396,680	$ 1,370,959	$(700,671)	$(653,613)	$20,856,658	$ 544,198	$(180,037)	$21,220,819

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The following tables present the carrying value of the Company’s AFS securities by rate type as of September 30, 2018 and December 31, 2017:

	September 30, 2018		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$19,594	$ 3,446,632	$3,466,226
Fixed Rate	22,099,352	373,338	22,472,690
Total	$22,118,946	$ 3,819,970	$25,938,916

	December 31, 2017		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$23,220	$ 2,622,710	$2,645,930
Fixed Rate	18,215,505	359,384	18,574,889
Total	$18,238,725	$ 2,982,094	$21,220,819

The following table presents the Company’s AFS securities according to their estimated weighted average life classifications as of September 30, 2018:

	September 30, 2018		
(in thousands)	Agency	Non-Agency	Total
≤ 1 year	$11,626	$ 89,957	$101,583
> 1 and ≤ 3 years	110,610	192,192	302,802
> 3 and ≤ 5 years	273,557	399,152	672,709
> 5 and ≤ 10 years	18,130,930	2,501,914	20,632,844
> 10 years	3,592,223	636,755	4,228,978
Total	$22,118,946	$ 3,819,970	$25,938,916

When the Company purchases a credit-sensitive AFS security at a significant discount to its face value, the Company often does not amortize into income a significant portion of this discount that the Company is entitled to earn because the Company does not expect to collect the entire discount due to the inherent credit risk of the security. The Company may also record an other-than-temporary impairment, or OTTI, for a portion of its investment in the security to the extent the Company believes that the amortized cost will exceed the present value of expected future cash flows. The amount of principal that the Company does not amortize into income is designated as a credit reserve on the security, with unamortized net discounts or premiums amortized into income over time to the extent realizable.

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The following table presents the changes for the three and nine months ended September 30, 2018 and 2017 of the net unamortized discount/premium and designated credit reserves on non-Agency AFS securities.

	Nine Months Ended September 30,					
	2018			**2017**		
(in thousands)	**Designated Credit Reserve**	**Net Unamortized Discount/Premium**	**Total**	**Designated Credit Reserve**	**Net Unamortized Discount/Premium**	**Total**
Beginning balance at January 1	$(653,613)	$ (607,609)	$(1,261,222)	$(367,437)	$ (623,440)	$(990,877)
Acquisitions	(606,728)	(37,924)	(644,652)	(217,206)	(111,938)	(329,144)
Accretion of net discount	—	64,538	64,538	—	67,219	67,219
Realized credit losses	20,983	—	20,983	11,385	—	11,385
Reclassification adjustment for other-than-temporary impairments	(363)	—	(363)	(429)	—	(429)
Transfers from (to)	44,972	(44,972)	—	44,412	(44,412)	—
Sales, calls, other	—	18,430	18,430	3,588	81,846	85,434
Ending balance at September 30	$(1,194,749)	$ (607,537)	$(1,802,286)	$(525,687)	$ (630,725)	$(1,156,412)

The following table presents the components comprising the carrying value of AFS securities not deemed to be other than temporarily impaired by length of time that the securities had an unrealized loss position as of September 30, 2018 and December 31, 2017. At September 30, 2018, the Company held 1,605 AFS securities, of which 522 were in an unrealized loss position for less than twelve consecutive months and 361 were in an unrealized loss position for more than twelve consecutive months. At December 31, 2017, the Company held 1,435 AFS securities, of which 253 were in an unrealized loss position for less than twelve consecutive months and 234 were in an unrealized loss position for more than twelve consecutive months. Of the $15.4 billion and $12.2 billion of AFS securities in an unrealized loss position for less than twelve consecutive months as of September 30, 2018 and December 31, 2017, $14.8 billion, or 96.6%, and $12.0 billion, or 98.5%, respectively, were Agency AFS securities, whose principal and interest are guaranteed by the GSEs.

	Unrealized Loss Position for					
	Less than 12 Months		**12 Months or More**		**Total**	
(in thousands)	**Estimated Fair Value**	**Gross Unrealized Losses**	**Estimated Fair Value**	**Gross Unrealized Losses**	**Estimated Fair Value**	**Gross Unrealized Losses**
September 30, 2018	$15,358,443	$(309,999)	$6,941,115	$(417,352)	$22,299,558	$(727,351)
December 31, 2017	$12,198,870	$(65,313)	$2,464,544	$(114,724)	$14,663,414	$(180,037)

Evaluating AFS Securities for Other-Than-Temporary Impairments
In evaluating AFS securities for OTTI, the Company determines whether there has been a significant adverse quarterly change in the cash flow expectations for a security. The Company compares the amortized cost of each security in an unrealized loss position against the present value of expected future cash flows of the security. The Company also considers whether there has been a significant adverse change in the regulatory and/or economic environment as part of this analysis. If the amortized cost of the security is greater than the present value of expected

future cash flows using the original yield as the discount rate, an other-than-temporary credit impairment has occurred. If the Company does not intend to sell and will not be more likely than not required to sell the security, the credit loss is recognized in earnings and the balance of the unrealized loss is recognized in either other comprehensive (loss) income, net of tax, or (loss) gain on investment securities, depending on the accounting treatment. If the Company intends to sell the security or will be more likely than not required to sell the security, the full unrealized loss is recognized in earnings.

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During the three and nine months ended September 30, 2018, the Company recorded $0.1 million and $0.4 million in other-than-temporary credit impairments on a total of three non-Agency securities where the future expected cash flows for each security were less than its amortized cost. During the nine months ended September 30, 2017, the Company recorded $0.4 million in other-than-temporary credit impairments on one non-Agency security where its future expected cash flows were less than its amortized cost. The Company did not record any other-than-temporary credit impairments during the three months ended September 30, 2017. As of September 30, 2018, impaired securities with a carrying value of $140.3 million had actual weighted average cumulative losses of 8.3%, weighted average three-month prepayment speed of 7.0%, weighted average 60+ day delinquency of 19.0% of the pool balance, and weighted average FICO score of 668. At September 30, 2018, the Company did not intend to sell the securities and determined that it was not more likely than not that the Company will be required to sell the securities; therefore, only the projected credit loss was recognized in earnings.
The following table presents the changes in OTTI included in earnings for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2018**	**2017**	**2018**	**2017**
Cumulative credit loss at beginning of period	$(6,663)	$(6,035)	$(6,395)	$(5,606)
Additions:				
Other-than-temporary impairments not previously recognized	(72)	—	(157)	(429)
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	(23)	—	(206)	—
Reductions:				
Decreases related to other-than-temporary impairments on securities paid down	—	—	—	—
Decreases related to other-than-temporary impairments on securities sold	—	—	—	—
Cumulative credit loss at end of period	$(6,758)	$(6,035)	$(6,758)	$(6,035)

Cumulative credit losses related to OTTI may be reduced for securities sold as well as for securities that mature, are paid down, or are prepaid such that the outstanding principal balance is reduced to zero. Additionally, increases in cash flows expected to be collected over the remaining life of the security cause a reduction in the cumulative credit loss.

Gross Realized Gains and Losses

Gains and losses from the sale of AFS securities are recorded as realized gains (losses) within (loss) gain on investment securities in the Company's condensed consolidated statements of comprehensive (loss) income. For the three and nine months ended September 30, 2018, the Company sold AFS securities for $5.4 billion and $9.2 billion with an amortized cost of $5.5 billion and $9.3 billion for net realized losses of $42.2 million and $100.7 million, respectively. For the three and nine months ended September 30, 2017, the Company sold AFS securities for $0.6 billion and $5.7 billion with an amortized cost of $0.6 billion and $5.7 billion for net realized losses of $3.9 million and $21.0 million, respectively.
The following table presents the gross realized gains and losses on sales of AFS securities for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,	Nine Months Ended September 30,

(in thousands)	2018	2017	2018	2017
Gross realized gains	$6,603	$408	$16,357	$57,133
Gross realized losses	(48,758)	(4,342)	(117,075)	(78,125)
Total realized losses on sales, net	$(42,155)	$(3,934)	$(100,718)	$(20,992)

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Note 6. Servicing Activities
Mortgage Servicing Rights, at Fair Value
One of the Company’s wholly owned subsidiaries has approvals from Fannie Mae and Freddie Mac to own and manage MSR, which represent the right to control the servicing of mortgage loans. The Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with appropriately licensed subservicers to handle substantially all servicing functions in the name of the subservicer for the loans underlying the Company’s MSR.
The following table summarizes activity related to MSR for the three and nine months ended September 30, 2018 and 2017.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2018	2017	2018	2017
Balance at beginning of period	$1,450,261	$898,025	$1,086,717	$693,815
Additions from purchases of mortgage servicing rights	201,197	66,280	480,462	340,156
Additions from sales of residential mortgage loans	—	—	—	20
Subtractions from sales of mortgage servicing rights	—	—	—	(946)
Changes in fair value due to:				
Changes in valuation inputs or assumptions used in the valuation model	62,680	(154)	209,610	(23,083)
Other changes in fair value [(1)]	(42,085)	(28,595)	(107,754)	(66,543)
Other changes [(2)]	(8,029)	(4,943)	(5,011)	(12,806)
Balance at end of period	$1,664,024	$930,613	$1,664,024	$930,613

(1) Other changes in fair value primarily represents changes due to the realization of expected cash flows.
(2) Other changes includes purchase price adjustments, contractual prepayment protection, and changes due to the Company’s purchase of the underlying collateral.

At September 30, 2018 and December 31, 2017, the Company pledged MSR with a carrying value of $1.2 billion and $0.6 billion, respectively, as collateral for repurchase agreements and revolving credit facilities. See Note 14 - *Repurchase Agreements* and Note 16 - *Revolving Credit Facilities*.
As of September 30, 2018 and December 31, 2017, the key economic assumptions and sensitivity of the fair value of MSR to immediate 10% and 20% adverse changes in these assumptions were as follows:

(dollars in thousands)	September 30, 2018	December 31, 2017
Weighted average prepayment speed:	7.3 %	9.8 %
Impact on fair value of 10% adverse change	$ (45,151)	$ (40,100)
Impact on fair value of 20% adverse change	$ (87,971)	$ (77,483)
Weighted average delinquency:	1.2 %	1.7 %
Impact on fair value of 10% adverse change	$ (5,824)	$ (4,274)
Impact on fair value of 20% adverse change	$ (11,593)	$ (8,875)
Weighted average discount rate:	9.7 %	9.9 %
Impact on fair value of 10% adverse change	$ (55,024)	$ (35,137)
Impact on fair value of 20% adverse change	$ (106,220)	$ (68,246)

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These assumptions and sensitivities are hypothetical and should be considered with caution. Changes in fair value based on 10% and 20% variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of MSR is calculated without changing any other assumptions. In reality, changes in one factor may result in changes in another (*e.g.*, increased market interest rates may result in lower prepayments and increased credit losses) that could magnify or counteract the sensitivities. Further, these sensitivities show only the change in the asset balances and do not show any expected change in the fair value of the instruments used to manage the interest rates and prepayment risks associated with these assets.

Risk Mitigation Activities

The primary risk associated with the Company's MSR is interest rate risk and the resulting impact on prepayments. A significant decline in interest rates could lead to higher-than-expected prepayments that could reduce the value of the MSR. The Company economically hedges the impact of these risks with its Agency RMBS portfolio.

Mortgage Servicing Income

The following table presents the components of servicing income recorded on the Company's condensed consolidated statements of comprehensive (loss) income for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(in thousands)	**2018**	**2017**	**2018**	**2017**
Servicing fee income	$80,690	$53,989	$218,022	$141,923
Ancillary and other fee income	358	310	1,004	615
Float income	8,570	3,088	19,447	5,930
Total	$89,618	$57,387	$238,473	$148,468

Mortgage Servicing Advances

In connection with the servicing of loans, the Company's subservicers make certain payments for property taxes and insurance premiums, default and property maintenance payments, as well as advances of principal and interest payments before collecting them from individual borrowers. Servicing advances, including contractual interest, are priority cash flows in the event of a loan principal reduction or foreclosure and ultimate liquidation of the real estate-owned property, thus making their collection reasonably assured. These servicing advances, which are funded by the Company, totaled $26.1 million and $31.1 million and were included in other assets on the condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017, respectively.

Serviced Mortgage Assets

The Company's total serviced mortgage assets consist of residential mortgage loans underlying MSR, residential mortgage loans held in previous on-balance sheet securitization trusts for which the Company is the named servicing administrator and loans owned and classified as residential mortgage loans held-for-sale. The following table presents the number of loans and unpaid principal balance of the mortgage assets for which the Company manages the servicing as of September 30, 2018 and December 31, 2017:

	September 30, 2018		**December 31, 2017**	
(dollars in thousands)	**Number of Loans**	**Unpaid Principal Balance**	**Number of Loans**	**Unpaid Principal Balance**
Mortgage servicing rights	581,677	$131,114,538	454,028	$101,344,054
Residential mortgage loans in securitization trusts	3,663	2,443,368	3,845	2,618,016
Residential mortgage loans held-for-sale	206	33,448	236	37,632

Other assets	17	1,339	24	2,590
Total serviced mortgage assets	585,563	$133,592,693	458,133	$104,002,292

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Note 7. Residential Mortgage Loans Held-for-Sale, at Fair Value
Residential mortgage loans held-for-sale consists of residential mortgage loans carried at fair value as a result of a fair value option election. The following table presents the carrying value of the Company's residential mortgage loans held-for-sale as of September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Unpaid principal balance	$ 33,448	$ 37,632
Fair value adjustment	(5,911)	(7,218)
Carrying value	$ 27,537	$ 30,414

Note 8. Cash, Cash Equivalents and Restricted Cash
Cash and cash equivalents include cash held in bank accounts and cash held in money market funds on an overnight basis.
The Company is required to maintain certain cash balances with counterparties for securities and derivatives trading activity and collateral for the Company's repurchase agreements and FHLB advances in restricted accounts. The Company has also placed cash in a restricted account pursuant to a letter of credit on an office space lease.
The following table presents the Company's restricted cash balances as of September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Restricted cash balances held by trading counterparties:		
For securities and loan trading activity	$ 47,450	$ 27,050
For derivatives trading activity	283,034	191,421
As restricted collateral for repurchase agreements and Federal Home Loan Bank advances	558,088	417,018
Total restricted cash balances held by trading counterparties	888,572	635,489
Restricted cash balance pursuant to letter of credit on office lease	60	347
Total	$ 888,632	$ 635,836

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported on the Company's condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017 that sum to the total of the same such amounts shown in the statements of cash flows:

(in thousands)	September 30, 2018	December 31, 2017
Cash and cash equivalents	$ 422,851	$ 419,159
Restricted cash	888,632	635,836
Total cash, cash equivalents and restricted cash	$ 1,311,483	$ 1,054,995

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Note 9. Accrued Interest Receivable
The following table presents the Company’s accrued interest receivable by collateral type as of September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Available-for-sale securities:		
Agency		
Federal National Mortgage Association	$ 56,484	$ 46,517
Federal Home Loan Mortgage Corporation	16,258	12,255
Government National Mortgage Association	5,987	4,635
Non-Agency	5,492	4,740
Total available-for-sale securities	84,221	68,147
Residential mortgage loans held-for-sale	155	162
Reverse repurchase agreements	881	—
Total	$ 85,257	$ 68,309

Note 10. Derivative Instruments and Hedging Activities
The Company enters into a variety of derivative and non-derivative instruments in connection with its risk management activities. The primary objective for executing these derivative and non-derivative instruments is to mitigate the Company’s economic exposure to future events that are outside its control, principally market risk and cash flow volatility associated with interest rate risk (including associated prepayment risk). Specifically, the Company enters into derivative and non-derivative instruments to economically hedge interest rate risk or “duration mismatch (or gap)” by adjusting the duration of its floating-rate borrowings into fixed-rate borrowings to more closely match the duration of its assets. This particularly applies to floating-rate borrowing agreements with maturities or interest rate resets of less than six months. Typically, the interest receivable terms (*i.e.*, LIBOR) of certain derivatives match the terms of the underlying debt, resulting in an effective conversion of the rate of the related borrowing agreement from floating to fixed. The objective is to manage the cash flows associated with current and anticipated interest payments on borrowings, as well as the ability to roll or refinance borrowings at the desired amount by adjusting the duration.

To help manage the adverse impact of interest rate changes on the value of the Company’s portfolio as well as its cash flows, the Company may, at times, enter into various forward contracts, including short securities, Agency to-be-announced securities, or TBAs, options, futures, swaps, caps and total return swaps. In executing on the Company’s current risk management strategy, the Company has entered into interest rate swap, cap and swaption agreements, TBAs, put and call options for TBAs and total return swaps (based on the Markit IOS Index). The Company has also entered into a number of non-derivative instruments to manage interest rate risk, principally MSR and Agency interest-only securities (see discussion below).

The following summarizes the Company’s significant asset and liability classes, the risk exposure for these classes, and the Company’s risk management activities used to mitigate these risks. The discussion includes both derivative and non-derivative instruments used as part of these risk management activities. Any of the Company’s derivative and non-derivative instruments may be entered into in conjunction with one another in order to mitigate risks. As a result, the following discussions of each type of instrument should be read as a collective representation of the Company’s risk mitigation efforts and should not be considered independent of one another. While the Company uses derivative and non-derivative instruments to achieve the Company’s risk management activities, it is possible that these instruments will not effectively mitigate all or a substantial portion of the Company’s market rate risk. In addition, the Company might elect, at times, not to enter into certain hedging arrangements in order to maintain compliance with

REIT requirements.

Balance Sheet Presentation

In accordance with ASC 815, *Derivatives and Hedging*, or ASC 815, the Company records derivative financial instruments on its condensed consolidated balance sheets as assets or liabilities at fair value. Changes in fair value are accounted for depending on the use of the derivative instruments and whether they are designated or qualifying as hedge instruments. Due to the volatility of the credit markets and difficulty in effectively matching pricing or cash flows, the Company has not designated any current derivatives as hedging instruments.

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The following tables present the gross fair value and notional amounts of the Company's derivative financial instruments treated as trading derivatives as of September 30, 2018 and December 31, 2017.

	September 30, 2018			
	Derivative Assets		Derivative Liabilities	
(in thousands)	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$67,665	$498,826	$—	$—
Interest rate swap agreements	238,116	28,128,766	—	2,375,000
Interest rate cap contracts	52,370	2,500,000	—	—
Swaptions, net	24,912	164,000	—	—
TBAs	15,212	1,108,000	(43,314)	8,216,000
Put and call options for TBAs, net	4,954	780,000	(1,329)	130,000
Markit IOS total return swaps	2	49,691	—	—
Short U.S. Treasuries	—	—	(752,861)	800,000
Total	$403,231	$33,229,283	$(797,504)	$11,521,000

	December 31, 2017			
	Derivative Assets		Derivative Liabilities	
(in thousands)	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$91,827	$588,246	$—	$—
Interest rate swap agreements	206,773	21,516,125	(29,867)	6,966,000
Swaptions, net	10,405	2,666,000	—	—
TBAs	913	733,000	(1,930)	1,306,000
Markit IOS total return swaps	—	—	(106)	63,507
Total	$309,918	$25,503,371	$(31,903)	$8,335,507

Comprehensive (Loss) Income Statement Presentation
The Company has not applied hedge accounting to its current derivative portfolio held to mitigate interest rate risk and credit risk. As a result, the Company is subject to volatility in its earnings due to movement in the unrealized gains and losses associated with its derivative instruments.

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The following table summarizes the location and amount of gains and losses on derivative instruments reported in the condensed consolidated statements of comprehensive (loss) income:

Derivative Instruments	**Location of Gain (Loss) Recognized in Income on Derivatives**	**Amount of Gain (Loss) Recognized in Income on Derivatives**			
		Three Months Ended		**Nine Months Ended**	
(in thousands)		**September 30,**		**September 30,**	
		2018	**2017**	**2018**	**2017**
Interest rate risk management					
TBAs	Loss on other derivative instruments	$(45,231)	$(16,891)	$(55,766)	$(45,671)
Short U.S. Treasuries	Loss on other derivative instruments	1,606	—	1,606	—
Put and call options for TBAs	Loss on other derivative instruments	13,489	(3,405)	43,328	(22,467)
Interest rate swaps - Payers	Gain (loss) on interest rate swap, cap and swaption agreements	105,195	17,422	412,291	(27,723)
Interest rate swaps - Receivers	Gain (loss) on interest rate swap, cap and swaption agreements	(54,653)	(5,280)	(252,375)	22,813
Swaptions	Gain (loss) on interest rate swap, cap and swaption agreements	24,629	(12,349)	94,933	(62,080)
Interest rate caps	Gain (loss) on interest rate swap, cap and swaption agreements	686	—	686	—
Markit IOS total return swaps	Loss on other derivative instruments	(302)	(134)	371	(821)
Non-risk management					
Inverse interest-only securities	Loss on other derivative instruments	(1,025)	1,506	(5,274)	2,631
Total		$44,394	$(19,131)	$239,800	$(133,318)

For the three and nine months ended September 30, 2018, the Company recognized $16.2 million and $33.9 million, respectively, of income for the accrual and/or settlement of the net interest expense associated with its interest rate swaps and caps. The income results from receiving either LIBOR interest or a fixed interest rate and paying either a fixed interest rate or LIBOR interest on an average $31.8 billion and $26.2 billion notional, respectively. For the three and nine months ended September 30, 2017, the Company recognized $0.4 million and $10.9 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with its interest rate swaps and caps. The expenses result from paying either a fixed interest rate or LIBOR interest and receiving either LIBOR interest or a fixed interest rate on an average $16.7 billion and $17.6 billion notional, respectively.

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The following tables present information with respect to the volume of activity in the Company's derivative instruments during the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018					
(in thousands)	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net [(1)]
Inverse interest-only securities	$529,056	$—	$(30,230)	$498,826	$514,879	$—
Interest rate swap agreements	26,047,264	12,544,820	(8,088,318)	30,503,766	30,144,641	(50,240)
Interest rate cap contracts	—	2,500,000	—	2,500,000	1,684,783	—
Swaptions, net	(738,000)	1,164,000	(262,000)	164,000	(157,663)	10,374
TBAs, net	3,049,000	21,060,000	(14,785,000)	9,324,000	6,430,924	(23,067)
Short U.S. Treasuries	—	(800,000)	—	(800,000)	(539,130)	—
Put and call options for TBAs, net	(320,000)	(1,710,000)	1,120,000	(910,000)	(1,106,120)	910
Markit IOS total return swaps	51,541	—	(1,850)	49,691	50,296	(516)
Total	$28,618,861	$34,758,820	$(22,047,398)	$41,330,283	$37,022,610	$(62,539)

	Three Months Ended September 30, 2017					
(in thousands)	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net [(1)]
Inverse interest-only securities	$659,768	$—	$(38,219)	$621,549	$642,143	$(40)
Interest rate swap agreements	14,764,719	9,878,549	(4,626,391)	20,016,877	16,710,894	36,171
Swaptions, net	1,350,000	5,364,000	(3,900,000)	2,814,000	2,213,533	(3,264)
TBAs, net	(1,140,000)	(1,585,000)	1,320,000	(1,405,000)	(1,370,043)	(14,997)
Put and call options for TBAs, net	1,285,000	1,905,000	(1,190,000)	2,000,000	54,402	(3,980)
Markit IOS total return swaps	68,629	—	(2,734)	65,895	66,802	—
Total	$16,988,116	$15,562,549	$(8,437,344)	$24,113,321	$18,317,731	$13,890

	Nine Months Ended September 30, 2018					
(in thousands)	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net [(1)]
Inverse interest-only securities	$588,246	$—	$(89,420)	$498,826	$544,691	$—
Interest rate swap agreements	28,482,125	37,894,452	(35,872,811)	30,503,766	25,588,646	(46,101)
Interest rate cap contracts	—	2,500,000	—	2,500,000	567,766	—
Swaptions, net	2,666,000	(74,000)	(2,428,000)	164,000	(2,015,260)	78,266
TBAs, net	(573,000)	38,773,000	(28,876,000)	9,324,000	3,210,355	(28,681)
Short U.S. Treasuries	—	(800,000)	—	(800,000)	(181,685)	—
Put and call options for TBAs, net	—	2,892,000	(3,802,000)	(910,000)	(590,168)	39,452
Markit IOS total return swaps	63,507	—	(13,816)	49,691	57,303	(765)
Total	$31,226,878	$81,185,452	$(71,082,047)	$41,330,283	$27,181,648	$42,171

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	Nine Months Ended September 30, 2017					
(in thousands)	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net (1)
Inverse interest-only securities	$740,844	$—	$(119,295)	$621,549	$681,126	$(40)
Interest rate swap agreements	20,371,063	23,408,358	(23,762,544)	20,016,877	17,617,836	47,691
Swaptions, net	225,000	1,109,000	1,480,000	2,814,000	669,377	21,164
TBAs, net	(1,489,000)	(5,710,400)	5,794,400	(1,405,000)	(1,231,793)	(57,424)
Put and call options for TBAs, net	(1,136,000)	4,460,000	(1,324,000)	2,000,000	(13,289)	20,166
Markit IOS total return swaps	90,593	—	(24,698)	65,895	76,670	(181)
Total	$18,802,500	$23,266,958	$(17,956,137)	$24,113,321	$17,799,927	$31,376

(1) Excludes net interest paid or received in full settlement of the net interest spread liability.

Cash flow activity related to derivative instruments is reflected within the operating activities and investing activities sections of the condensed consolidated statements of cash flows. Realized gains and losses and derivative fair value adjustments are reflected within the realized and unrealized (gain) loss on interest rate swaps, caps and swaptions and unrealized loss on other derivative instruments line items within the operating activities section of the condensed consolidated statements of cash flows. The remaining cash flow activity related to derivative instruments is reflected within the (purchases) short sales of other derivative instruments, proceeds from sales (payments for termination) of other derivative instruments, net and decrease in due to counterparties, net line items within the investing activities section of the condensed consolidated statements of cash flows.

Interest Rate Sensitive Assets/Liabilities

The Company's Agency RMBS portfolio is generally subject to change in value when mortgage rates decline or increase, depending on the type of investment. Rising mortgage rates generally result in a slowing of refinancing activity, which slows prepayments and results in a decline in the value of the Company's fixed-rate Agency pools. To mitigate the impact of this risk on the Company's fixed-rate Agency pool portfolio, the Company maintains a portfolio of fixed-rate interest-only securities and MSR, which increase in value when interest rates increase. As of September 30, 2018 and December 31, 2017, the Company had $139.5 million and $117.8 million, respectively, of interest-only securities, and $1.7 billion and $1.1 billion, respectively, of MSR in place to economically hedge its Agency RMBS. Interest-only securities are included in AFS securities, at fair value, in the condensed consolidated balance sheets.

The Company monitors its borrowings under repurchase agreements, FHLB advances and revolving credit facilities, which are generally floating-rate debt, in relation to the rate profile of its portfolio. In connection with its risk management activities, the Company enters into a variety of derivative and non-derivative instruments to economically hedge interest rate risk or "duration mismatch (or gap)" by adjusting the duration of its floating-rate borrowings into fixed-rate borrowings to more closely match the duration of its assets. This particularly applies to borrowing agreements with maturities or interest rate resets of less than six months. Typically, the interest receivable terms (*i.e.*, LIBOR) of certain derivatives match the terms of the underlying debt, resulting in an effective conversion of the rate of the related borrowing agreement from floating to fixed. The objective is to manage the cash flows associated with current and anticipated interest payments on borrowings, as well as the ability to roll or refinance borrowings at the desired amount by adjusting the duration. To help manage the adverse impact of interest rate changes on the value of the Company's portfolio as well as its cash flows, the Company may, at times, enter into various forward contracts, including short securities, TBAs, options, futures, swaps, caps, credit default swaps and

total return swaps. In executing on the Company's current interest rate risk management strategy, the Company has entered into TBAs, put and call options for TBAs, interest rate swap, cap and swaption agreements and Markit IOS total return swaps.

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TBAs. At times, the Company may use TBAs as a means of deploying capital until targeted investments are available or to take advantage of temporary displacements, funding advantages or valuation differentials in the marketplace. Additionally, the Company may use TBAs independently, or in conjunction with other derivative and non-derivative instruments, in order to mitigate risks. TBAs are forward contracts for the purchase (long notional positions) or sale (short notional positions) of Agency RMBS. The issuer, coupon and stated maturity of the Agency RMBS are predetermined as well as the trade price, face amount and future settle date (published each month by the Securities Industry and Financial Markets Association). However, the specific Agency RMBS to be delivered upon settlement is not known at the time of the TBA transaction. As a result, and because physical delivery of the Agency RMBS upon settlement cannot be assured, the Company accounts for TBAs as derivative instruments.
The Company may hold both long and short notional TBA positions, which are disclosed on a gross basis according to the unrealized gain or loss position of each TBA contract regardless of long or short notional position. The following tables present the notional amount, cost basis, market value and carrying value (which approximates fair value) of the Company's TBA positions as of September 30, 2018 and December 31, 2017:

	September 30, 2018				
				Net Carrying Value [4]	
(in thousands)	**Notional Amount [1]**	**Cost Basis [2]**	**Market Value [3]**	**Derivative Assets**	**Derivative Liabilities**
Purchase contracts	$11,916,000	$12,393,443	$12,351,423	$1,159	$(43,179)
Sale contracts	(2,592,000)	(2,564,838)	(2,550,920)	14,053	(135)
TBAs, net	$9,324,000	$9,828,605	$9,800,503	$15,212	$(43,314)

	December 31, 2017				
				Net Carrying Value [4]	
(in thousands)	**Notional Amount [1]**	**Cost Basis [2]**	**Market Value [3]**	**Derivative Assets**	**Derivative Liabilities**
Purchase contracts	$733,000	$769,446	$770,359	$913	$—
Sale contracts	(1,306,000)	(1,316,367)	(1,318,297)	—	(1,930)
TBAs, net	$(573,000)	$(546,921)	$(547,938)	$913	$(1,930)

(1) Notional amount represents the face amount of the underlying Agency RMBS.
(2) Cost basis represents the forward price to be paid (received) for the underlying Agency RMBS.
(3) Market value represents the current market value of the TBA (or of the underlying Agency RMBS) as of period-end.
(4) Net carrying value represents the difference between the market value of the TBA as of period-end and its cost basis, and is reported in derivative assets / (liabilities), at fair value, in the condensed consolidated balance sheets.

Short U.S. Treasuries. The Company may use short U.S. Treasury securities independently, or in conjunction with other derivative and non-derivative instruments, in order to mitigate risks. As of September 30, 2018, the Company had short sold U.S. Treasuries with a notional amount of $800.0 million with a fair market value of $752.9 million included in derivative liabilities, at fair value, on the condensed consolidated balance sheet as of September 30, 2018. The Company did not hold any short U.S. Treasuries as of December 31, 2017.
Put and Call Options for TBAs. The Company may use put and call options for TBAs independently, or in conjunction with other derivative and non-derivative instruments, in order to mitigate risks. As of September 30, 2018, the Company had purchased put and call options for TBAs with a notional amount of $3.7 billion and short sold put and call options for TBAs with a notional amount of $4.6 billion. The put and call options had a fair market value of $5.0 million included in derivative assets, at fair value, and $1.3 million included in derivative liabilities, at fair value, on

the condensed consolidated balance sheet as of September 30, 2018. The Company did not hold any put and call options for TBAs as of December 31, 2017.

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Interest Rate Swap Agreements. The Company may use interest rate swaps independently, or in conjunction with other derivative and non-derivative instruments, in order to mitigate risks. As of September 30, 2018 and December 31, 2017, the Company held the following interest rate swaps that were utilized as economic hedges of interest rate exposure (or duration) whereby the Company receives interest at a three-month LIBOR rate:

(notional in thousands)

September 30, 2018

Swaps Maturities	Notional Amount [1]	Weighted Average Fixed Pay Rate [2]		Weighted Average Receive Rate [2]		Weighted Average Maturity (Years) [2]
2018	$1,000,000	1.008	%	2.336	%	0.01
2019	4,336,897	1.769	%	2.336	%	1.04
2020	5,140,000	1.705	%	2.334	%	2.07
2021	4,117,000	1.550	%	2.362	%	2.94
2022 and Thereafter	8,807,431	2.309	%	2.343	%	7.14
Total	$23,401,328	1.876	%	2.343	%	3.77

(notional in thousands)

December 31, 2017

Swaps Maturities	Notional Amount [1]	Weighted Average Fixed Pay Rate [2]		Weighted Average Receive Rate [2]		Weighted Average Maturity (Years) [2]
2018	$4,320,000	1.155	%	1.508	%	0.50
2019	5,448,135	1.767	%	1.386	%	1.79
2020	5,490,000	1.945	%	1.509	%	2.87
2021	2,417,000	1.788	%	1.628	%	3.92
2022 and Thereafter	5,245,000	1.764	%	1.516	%	6.44
Total	$22,920,135	1.694	%	1.493	%	3.01

(1) Notional amount includes $567.8 million and $570.0 million in forward starting interest rate swaps as of September 30, 2018 and December 31, 2017, respectively.

(2) Weighted averages exclude forward starting interest rate swaps. As of September 30, 2018 and December 31, 2017, the weighted average fixed pay rate on forward starting interest rate swaps was 2.8% and 2.1%, respectively.

Additionally, as of September 30, 2018 and December 31, 2017, the Company held the following interest rate swaps in order to mitigate mortgage interest rate exposure (or duration) risk whereby the Company pays interest at a three-month LIBOR rate:

(notional in thousands)

September 30, 2018

Swaps Maturities	Notional Amounts	Weighted Average Pay Rate	Weighted Average Fixed Receive	Weighted Average Maturity (Years)

				Rate		
2020	$250,000	2.347	%	2.258	%	1.31
2021	2,477,438	2.338	%	2.736	%	2.49
2022 and Thereafter	4,375,000	2.333	%	2.696	%	7.32
Total	$7,102,438	2.335	%	2.694	%	5.42

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(notional in thousands)

December 31, 2017

Swaps Maturities	**Notional Amounts**	**Weighted Average Pay Rate**	**Weighted Average Fixed Receive Rate**	**Weighted Average Maturity (Years)**
2020	$200,000	1.391 %	1.642 %	2.60
2021	500,000	1.357 %	1.327 %	3.05
2022 and Thereafter	4,861,990	1.475 %	2.325 %	8.34
Total	$5,561,990	1.462 %	2.211 %	7.66

Interest Rate Swaptions. The Company may use interest rate swaptions (agreements to enter into interest rate swaps in the future for which the Company would either pay or receive a fixed rate) independently, or in conjunction with other derivative and non-derivative instruments, in order to mitigate risks. As of September 30, 2018 and December 31, 2017, the Company had the following outstanding interest rate swaptions that were utilized as macro-economic hedges:

September 30, 2018

(notional and dollars in thousands)	**Option**				**Underlying Swap**			
Swaption	**Expiration**	**Cost Basis**	**Fair Value**	**Average Months to Expiration**	**Notional Amount**	**Average Pay Rate**	**Average Receive Rate**	**Average Term (Years)**
Purchase contracts:								
Payer	< 6 Months	$9,400	$30,608	3.64	$5,225,000	3.20 %	3M Libor	7.6
Sale contracts:								
Receiver	< 6 Months	$(9,730)	$(5,696)	3.87	$(5,061,000)	3M Libor	2.70 %	7.7

December 31, 2017

(notional and dollars in thousands)	**Option**				**Underlying Swap**			
Swaption	**Expiration**	**Cost**	**Fair Value**	**Average Months to Expiration**	**Notional Amount**	**Average Fixed Pay Rate**	**Average Receive Rate**	**Average Term (Years)**
Purchase contracts:								
Payer	< 6 Months	$21,380	$17,736	4.03	$7,200,000	2.27 %	3M Libor	3.8
Receiver	< 6 Months	$4,660	$2,982	3.72	$2,300,000	3M Libor	2.10 %	10.0
Sale contracts:								
Payer	< 6 Months	$(7,950)	$(5,619)	4.66	$(1,693,000)	2.70 %	3M Libor	10.0
Receiver	< 6 Months	$(16,260)	$(4,694)	5.17	$(5,141,000)		1.89 %	5.6

3M
Libor

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Interest Rate Cap Contracts. The Company may use interest rate caps independently, or in conjunction with other derivative and non-derivative instruments, in order to mitigate risks. As of September 30, 2018, the Company held the following interest rate caps that were utilized as economic hedges of interest rate exposure (or duration) whereby the Company receives interest at a three-month LIBOR rate, net of a fixed cap rate:

(notional in thousands)

September 30, 2018

Caps Maturities	Notional Amount	Weighted Average Cap Rate	Weighted Average Receive Rate	Weighted Average Maturity (Years)
2019	$800,000	1.344 %	2.339 %	0.78
2020	1,700,000	1.250 %	2.364 %	1.54
Total	$2,500,000	1.280 %	2.356 %	1.29

The Company did not hold any interest rate caps as of December 31, 2017.

Markit IOS Total Return Swaps. The Company may use total return swaps (agreements whereby the Company receives or makes payments based on the total return of an underlying instrument or index, such as the Markit IOS Index, in exchange for fixed or floating rate interest payments) independently, or in conjunction with other derivative and non-derivative instruments, in order to mitigate risks. The Company enters into total return swaps to help mitigate the potential impact of larger increases or decreases in interest rates on the performance of our portfolio (referred to as "convexity risk"). Total return swaps based on the Markit IOS Index are intended to synthetically replicate the performance of interest-only securities. The Company had the following total return swap agreements in place at September 30, 2018 and December 31, 2017:

(notional and dollars in thousands)

September 30, 2018

Maturity Date	Current Notional Amount	Fair Value	Cost Basis	Unrealized Gain (Loss)
January 12, 2043	$(22,010)	$ (1)	$(30)	$ 29
January 12, 2044	(27,681)	3	(29)	32
Total	$(49,691)	$ 2	$(59)	$ 61

(notional and dollars in thousands)

December 31, 2017

Maturity Date	Current Notional Amount	Fair Value	Cost Basis	Unrealized Gain (Loss)
January 12, 2043	$(24,362)	$(24)	$ 201	$ (225)
January 12, 2044	(39,145)	(82)	366	(448)
Total	$(63,507)	$(106)	$ 567	$ (673)

Credit Risk

The Company's exposure to credit losses on its Agency RMBS portfolio is limited due to implicit or explicit backing from the GSEs. The payment of principal and interest on the Freddie Mac and Fannie Mae mortgage-backed securities are guaranteed by those respective agencies, and the payment of principal and interest on the Ginnie Mae mortgage-backed securities are backed by the full faith and credit of the U.S. government.

For non-Agency investment securities and residential mortgage loans, the Company may enter into credit default swaps to hedge credit risk. In future periods, the Company could enhance its credit risk protection, enter into further paired derivative positions, including both long and short credit default swaps, and/or seek opportunistic trades in the event of a market disruption (see discussion under *"Non-Risk Management Activities"* below). The Company also has processes and controls in place to monitor, analyze, manage and mitigate its credit risk with respect to non-Agency securities and residential mortgage loans.

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Derivative financial instruments contain an element of credit risk if counterparties are unable to meet the terms of the agreements. Credit risk associated with derivative financial instruments is measured as the net replacement cost should the counterparties that owe the Company under such contracts completely fail to perform under the terms of these contracts, assuming there are no recoveries of underlying collateral, as measured by the market value of the derivative financial instruments. As of September 30, 2018, the fair value of derivative financial instruments as an asset and liability position was $403.2 million and $797.5 million, respectively.

The Company attempts to mitigate its credit risk exposure on derivative financial instruments by limiting its counterparties to banks and financial institutions that meet established credit guidelines. The Company also seeks to spread its credit risk exposure across multiple counterparties in order to reduce its exposure to any single counterparty. Additionally, the Company reduces credit risk on the majority of its derivative instruments by entering into agreements that permit the closeout and netting of transactions with the same counterparty or clearing agency, in the case of centrally cleared interest rate swaps, upon the occurrence of certain events. To further mitigate the risk of counterparty default, the Company maintains collateral agreements with certain of its counterparties and clearing agencies, which require both parties to maintain cash deposits in the event the fair values of the derivative financial instruments exceed established thresholds. The Company's centrally cleared interest rate swaps require that the Company posts an "initial margin" amount determined by the clearing exchange, which is generally intended to be set at a level sufficient to protect the exchange from the interest rate swap's maximum estimated single-day price movement. The Company also exchanges "variation margin" based upon daily changes in fair value, as measured by the exchange. As a result of amendments to rules governing certain central clearing activities, the exchange of variation margin is considered a settlement of the interest rate swap, as opposed to pledged collateral. Accordingly, beginning in the first quarter of 2018 and in subsequent periods, the Company accounts for the receipt or payment of variation margin as a direct reduction to the carrying value of the interest rate swap asset or liability. As of December 31, 2017, variation margin pledged or received was netted on a counterparty basis and classified within restricted cash, due from counterparties, or due to counterparties on the Company's condensed consolidated balance sheets.

Non-Risk Management Activities

The Company has entered into certain financial instruments that are considered derivative contracts under ASC 815 that are not for purposes of hedging. These contracts are currently limited to inverse interest-only Agency RMBS.

Inverse Interest-Only Securities. As of September 30, 2018 and December 31, 2017, inverse interest-only securities with a carrying value of $67.7 million and $91.8 million, including accrued interest receivable of $0.6 million and $0.9 million, respectively, are accounted for as derivative financial instruments in the condensed consolidated financial statements. The following table presents the amortized cost and carrying value (which approximates fair value) of inverse interest-only securities as of September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Face Value	$ 498,826	$ 588,246
Amortized Cost	$ 73,098	$ 86,734
Gross unrealized gains	2,668	6,843
Gross unrealized losses	(8,726)	(2,602)
Market Value	$ 67,040	$ 90,975

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Note 11. Other Assets
Other assets as of September 30, 2018 and December 31, 2017 are summarized in the following table:

(in thousands)	September 30, 2018	December 31, 2017
Property and equipment at cost	$ 6,970	$ 6,776
Accumulated depreciation [1]	(6,107)	(5,550)
Net property and equipment	863	1,226
Equity securities, at fair value	—	29,413
Prepaid expenses	2,592	1,755
Income taxes receivable	590	130
Deferred tax assets, net [2]	5,751	25,956
Servicing advances	26,134	31,050
Federal Home Loan Bank stock	40,848	53,826
Equity investments	6,529	3,000
Other receivables	39,121	29,482
Total other assets	$ 122,428	$ 175,838

(1) Depreciation expense for the three and nine months ended September 30, 2018 was $0.2 million and $0.5 million, respectively.
(2) Net of valuation allowance of $2.4 million and $2.7 million, respectively.

Note 12. Other Liabilities
Other liabilities as of September 30, 2018 and December 31, 2017 are summarized in the following table:

(in thousands)	September 30, 2018	December 31, 2017
Accrued expenses	$ 14,979	$ 24,737
Income taxes payable	4	—
Other	6,141	3,043
Total other liabilities	$ 21,124	$ 27,780

Note 13. Fair Value
Fair Value Measurements
ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices available in active markets (*i.e.*, observable inputs) and the lowest priority to data lacking transparency (*i.e.*, unobservable inputs). Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability.
ASC 820 establishes a three-level hierarchy to be used when measuring and disclosing fair value. An instrument's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. Following is a description of the three levels:

Level 1 Inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date under current market conditions. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.

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Level 2	Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full-term of the assets or liabilities.
Level 3	Unobservable inputs are supported by little or no market activity. The unobservable inputs represent the assumptions that market participants would use to price the assets and liabilities, including risk. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

The following are descriptions of the valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized.
Available-for-sale securities. The Company holds a portfolio of AFS securities that are carried at fair value in the condensed consolidated balance sheets and primarily comprised of Agency RMBS and non-Agency securities. The Company determines the fair value of its Agency RMBS based upon prices obtained from third-party pricing providers or broker quotes received using bid price, which are deemed indicative of market activity. The third-party pricing providers and brokers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. In determining the fair value of its non-Agency securities, management judgment may be used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company classified 99.8% and 0.2% of its AFS securities as Level 2 and Level 3 fair value assets, respectively, at September 30, 2018. AFS securities account for 92.5% of all assets reported at fair value at September 30, 2018.
Mortgage servicing rights. The Company holds a portfolio of MSR that are carried at fair value on the condensed consolidated balance sheets. The Company determines fair value of its MSR based on prices obtained from third-party pricing providers. Although MSR transactions are observable in the marketplace, the valuation is based upon cash flow models that include unobservable market data inputs (including prepayment speeds, delinquency levels and discount rates). As a result, the Company classified 100% of its MSR as Level 3 fair value assets at September 30, 2018.
Residential mortgage loans held-for-sale. The Company holds residential mortgage loans held-for-sale that are carried at fair value in the condensed consolidated balance sheets as a result of a fair value option election. The Company determines fair value of its residential mortgage loans based on prices obtained from third-party pricing providers and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon cash flow models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels and credit losses). The Company classified 1.7% and 98.3% of its residential mortgage loans held-for-sale as Level 2 and Level 3 fair value assets, respectively, at September 30, 2018.
Derivative instruments. The Company may enter into a variety of derivative financial instruments as part of its hedging strategies. The Company principally executes over-the-counter, or OTC, derivative contracts, such as interest rate swaps, caps, swaptions, put and call options for TBAs and Markit IOS total return swaps. The Company utilizes third-party pricing providers to value its financial derivative instruments. The Company classified 100% of the interest rate swaps, caps, swaptions, put and call options for TBAs and Markit IOS total return swaps reported at fair value as Level 2 at September 30, 2018.
The Company may also enter into certain other derivative financial instruments, such as TBAs, short U.S. Treasuries and inverse interest-only securities. These instruments are similar in form to the Company's AFS securities and the

Company utilizes a pricing service to value TBAs and broker quotes to value short U.S. Treasuries and inverse interest-only securities. The Company classified 100% of its short U.S. Treasuries and inverse interest-only securities at fair value as Level 2 at September 30, 2018. The Company reported 100% of its TBAs as Level 1 as of September 30, 2018.

The Company's risk management committee governs trading activity relating to derivative instruments. The Company's policy is to minimize credit exposure related to financial derivatives used for hedging by limiting the hedge counterparties to major banks, financial institutions, exchanges, and private investors who meet established capital and credit guidelines as well as by limiting the amount of exposure to any individual counterparty.

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The Company has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by ISDA, or central clearing exchange agreements, in the case of centrally cleared interest rate swaps. Additionally, both the Company and the counterparty or clearing agency are required to post cash collateral based upon the net underlying market value of the Company's open positions with the counterparty. Posting of cash collateral typically occurs daily, subject to certain dollar thresholds. Due to the existence of netting arrangements, as well as frequent cash collateral posting at low posting thresholds, credit exposure to the Company and/or to the counterparty or clearing agency is considered materially mitigated. Based on the Company's assessment, there is no requirement for any additional adjustment to derivative valuations specifically for credit.

Equity securities. The Company's equity securities are carried at fair value and reported in other assets on the condensed consolidated balance sheets. Changes in fair value are recorded as a component of (loss) gain on investment securities in the condensed consolidated statements of comprehensive (loss) income. The Company determines fair value of its equity securities based on the closing market price of the securities at period end. The Company did not hold any equity securities at September 30, 2018.

The following tables display the Company's assets and liabilities measured at fair value on a recurring basis. The Company often economically hedges the fair value change of its assets or liabilities with derivatives and other financial instruments. The tables below display the hedges separately from the hedged items, and therefore do not directly display the impact of the Company's risk management activities.

	Recurring Fair Value Measurements September 30, 2018			
(in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Available-for-sale securities	$—	$25,898,916	$40,000	$25,938,916
Mortgage servicing rights	—	—	1,664,024	1,664,024
Residential mortgage loans held-for-sale	—	456	27,081	27,537
Derivative assets	15,212	388,019	—	403,231
Total assets	$15,212	$26,287,391	$1,731,105	$28,033,708
Liabilities				
Derivative liabilities	$43,314	$754,190	$—	$797,504
Total liabilities	$43,314	$754,190	$—	$797,504

	Recurring Fair Value Measurements December 31, 2017			
(in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Available-for-sale securities	$—	$21,067,678	$153,141	$21,220,819
Mortgage servicing rights	—	—	1,086,717	1,086,717
Residential mortgage loans held-for-sale	—	474	29,940	30,414
Derivative assets	913	309,005	—	309,918
Equity securities	29,413	—	—	29,413
Total assets	$30,326	$21,377,157	$1,269,798	$22,677,281
Liabilities				
Derivative liabilities	1,930	29,973	—	31,903
Total liabilities	$1,930	$29,973	$—	$31,903

The Company may be required to measure certain assets or liabilities at fair value from time to time. These periodic fair value measures typically result from application of certain impairment measures under U.S. GAAP. These items

would constitute nonrecurring fair value measures under ASC 820. As of September 30, 2018, the Company did not have any assets or liabilities measured at fair value on a nonrecurring basis in the periods presented.

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The valuation of Level 3 instruments requires significant judgment by the third-party pricing providers and/or management. The third-party pricing providers and/or management rely on inputs such as market price quotations from market makers (either market or indicative levels), original transaction price, recent transactions in the same or similar instruments, and changes in financial ratios or cash flows to determine fair value. Level 3 instruments may also be discounted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by the third-party pricing provider in the absence of market information. Assumptions used by the third-party pricing provider due to lack of observable inputs may significantly impact the resulting fair value and therefore the Company's condensed consolidated financial statements. The Company's valuation committee reviews all valuations that are based on pricing information received from a third-party pricing provider. As part of this review, prices are compared against other pricing or input data points in the marketplace, along with internal valuation expertise, to ensure the pricing is reasonable. In addition, the Company performs back-testing of pricing information to validate price information and identify any pricing trends of a third-party price provider.

In determining fair value, third-party pricing providers use various valuation approaches, including market and income approaches. Inputs that are used in determining fair value of an instrument may include pricing information, credit data, volatility statistics, and other factors. In addition, inputs can be either observable or unobservable.

The availability of observable inputs can vary by instrument and is affected by a wide variety of factors, including the type of instrument, whether the instrument is new and not yet established in the marketplace and other characteristics particular to the instrument. The third-party pricing provider uses prices and inputs that are current as of the measurement date, including during periods of market dislocations. In periods of market dislocation, the availability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified to or from various levels within the fair value hierarchy.

Securities for which market quotations are readily available are valued at the bid price (in the case of long positions) or the ask price (in the case of short positions) at the close of trading on the date as of which value is determined. Exchange-traded securities for which no bid or ask price is available are valued at the last traded price. OTC derivative contracts, including interest rate swaps, caps and swaption agreements, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, credit default swaps and Markit IOS total return swaps, are valued by the Company using observable inputs, specifically quotations received from third-party pricing providers, and are therefore classified within Level 2.

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The following tables present the reconciliation for all of the Company’s Level 3 assets measured at fair value on a recurring basis:

	Three Months Ended September 30, 2018		
(in thousands)	**Available-For-Sale Securities**	**Mortgage Servicing Rights**	**Residential Mortgage Loans Held-For-Sale**
Beginning of period level 3 fair value	$153,424	$1,450,261	$ 28,351
Gains (losses) included in net income:			
Realized (losses) gains	—	(42,089)	167
Unrealized gains	—	62,680 (1)	129 (3)
Net gains (losses) included in net income	—	20,591	296
Other comprehensive (loss) income	(424)	—	—
Purchases	—	201,197	—
Sales	—	4	—
Settlements	(113,000)	(8,029)	(1,566)
Gross transfers into level 3	—	—	—
Gross transfers out of level 3	—	—	—
End of period level 3 fair value	$40,000	$1,664,024	$ 27,081
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period	$—	$62,275 (2)	$ 127 (4)
Change in unrealized gains or losses for the period included in other comprehensive (loss) income for assets held at the end of the reporting period	$—	$—	$ —

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(in thousands)	Nine Months Ended September 30, 2018		
	Available-For-Sale Securities	Mortgage Servicing Rights	Residential Mortgage Loans Held-For-Sale
Beginning of period level 3 fair value	$153,141	$1,086,717	$ 29,940
Gains (losses) included in net income:			
Realized losses	—	(107,359)	(41)
Unrealized gains	—	209,610 [1]	901 [3]
Net gains (losses) included in net income	—	102,251	860
Other comprehensive (loss) income	(141)	—	—
Purchases	—	480,462	—
Sales	—	(395)	—
Settlements	(113,000)	(5,011)	(3,719)
Gross transfers into level 3	—	—	—
Gross transfers out of level 3	—	—	—
End of period level 3 fair value	$40,000	$1,664,024	$ 27,081
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period	$—	$201,666 [2]	$ 806 [4]
Change in unrealized gains or losses for the period included in other comprehensive (loss) income for assets held at the end of the reporting period	$—	$—	$ —

(1) The change in unrealized gains or losses on MSR was recorded in gain (loss) on servicing asset on the condensed consolidated statements of comprehensive (loss) income.

(2) The change in unrealized gains or losses on MSR that were held at the end of the reporting period was recorded in gain (loss) on servicing asset on the condensed consolidated statements of comprehensive (loss) income.

(3) The change in unrealized gains or losses on residential mortgage loans held-for-sale was recorded in other income on the condensed consolidated statements of comprehensive (loss) income.

(4) The change in unrealized gains or losses on residential mortgage loans held-for-sale that were held at the end of the reporting period was recorded in other income on the condensed consolidated statements of comprehensive (loss) income.

The Company did not incur transfers between Level 1, Level 2 or Level 3 during the three and nine months ended September 30, 2018 and 2017. Transfers between Levels are deemed to take place on the first day of the reporting period in which the transfer has taken place.

The Company used broker quotes in the fair value measurement of its Level 3 available-for-sale securities. The significant unobservable inputs used by the broker included expected default, severity and discount rate. Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement.

The Company also used multiple third-party pricing providers in the fair value measurement of its Level 3 MSR. The table below presents information about the significant unobservable inputs used by the third-party pricing providers in the fair value measurement of the Company's MSR classified as Level 3 fair value assets at September 30, 2018:

September 30, 2018			
Valuation Technique	**Unobservable Input [1]**	**Range**	**Weighted Average [2]**
Discounted cash flow	Constant prepayment speed	6.4-8.1 %	7.3%
	Delinquency	0.9-1.4 %	1.2%

Discount rate	8.6-10.8%	9.7%

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Valuation Technique	Unobservable Input [(1)]	Range	Weighted Average [(2)]
Discounted cash flow	Constant prepayment speed	8.2 - 11.2 %	9.8%
	Delinquency	1.3 - 2.0 %	1.7%
	Discount rate	8.3 - 11.2 %	9.9%

(1) Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement. A change in the assumption used for discount rates may be accompanied by a directionally similar change in the assumption used for the probability of delinquency and a directionally opposite change in the assumption used for prepayment rates.

(2) Calculated by averaging the weighted average significant unobservable inputs used by the multiple third-party pricing providers in the fair value measurement of MSR.

The Company used a third-party pricing provider in the fair value measurement of its Level 3 residential mortgage loans held-for-sale. The significant unobservable inputs used by the third-party pricing provider included expected default, severity and discount rate. Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement.

Fair Value Option for Financial Assets and Financial Liabilities

On July 1, 2015, the Company elected the fair value option for Agency interest-only securities acquired on or after such date. The fair value option was elected to simplify the reporting of changes in fair value. Agency interest-only securities are carried within AFS securities on the condensed consolidated balance sheets. The Company's policy is to separately record interest income, net of premium amortization or including discount accretion, on these fair value elected securities. Fair value adjustments are reported in (loss) gain on investment securities on the condensed consolidated statements of comprehensive (loss) income.

The Company elected the fair value option for its previously held residential mortgage loans held-for-investment in securitization trusts and the collateralized borrowings in securitization trusts. The fair value option was elected to better reflect the economics of the Company's retained interests. The Company's policy was to separately record interest income on the fair value elected loans and interest expense on the fair value elected borrowings. Upfront fees and costs were not deferred or capitalized. Fair value adjustments were reported in other income on the condensed consolidated statements of comprehensive (loss) income. During the fourth quarter of 2017, the Company sold all of these retained subordinated securities thereby causing the deconsolidation of the securitization trusts from the Company's consolidated balance sheet. The remaining retained securities are included within non-Agency AFS securities.

The Company has elected the fair value option for its residential mortgage loans held-for-sale. The fair value option was elected to mitigate earnings volatility by better matching the accounting for the assets with the related hedges. The mortgage loans are carried within residential mortgage loans held-for-sale on the condensed consolidated balance sheets. The Company's policy is to separately record interest income on these fair value elected loans. Upfront fees and costs related to the fair value elected loans are not deferred or capitalized. Fair value adjustments are reported in other income on the condensed consolidated statements of comprehensive (loss) income.

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The following tables summarize the fair value option elections and information regarding the line items and amounts recognized in the condensed consolidated statements of comprehensive (loss) income for each fair value option-elected item.

	Three Months Ended September 30, 2018				
(in thousands)	Interest income (expense)	(Loss) gain on investment securities	Other income	Total included in net income	Change in fair value due to credit risk
Assets					
Available-for-sale securities	$(121)	$ (469)	$ —	$ (590)	N/A
Residential mortgage loans held-for-investment in securitization trusts	— [(1)]	—	—	—	$— [(2)]
Residential mortgage loans held-for-sale	332 [(1)]	—	295	627	(251) [(3)]
Liabilities					
Collateralized borrowings in securitization trusts	—	—	—	—	— [(2)]
Total	$211	$ (469)	$ 295	$ 37	$(251)

	Three Months Ended September 30, 2017				
(in thousands)	Interest income (expense)	(Loss) gain on investment securities	Other income	Total included in net income	Change in fair value due to credit risk
Assets					
Available-for-sale securities	$(2,283)	$ 4,757	$—	$2,474	N/A
Residential mortgage loans held-for-investment in securitization trusts	29,865 [(1)]	—	14,670	44,535	$— [(2)]
Residential mortgage loans held-for-sale	479 [(1)]	—	355	834	(400) [(3)]
Liabilities					
Collateralized borrowings in securitization trusts	(23,970)	—	(7,863)	(31,833)	— [(2)]
Total	$4,091	$ 4,757	$7,162	$16,010	$(400)

	Nine Months Ended September 30, 2018				
(in thousands)	Interest income (expense)	(Loss) gain on investment securities	Other income	Total included in net income	Change in fair value due to credit risk
Assets					
Available-for-sale securities	$(3,438)	$ 8,848	$ —	$ 5,410	N/A
Residential mortgage loans held-for-investment in securitization trusts	— [(1)]	—	—	—	$— [(2)]
Residential mortgage loans held-for-sale	988 [(1)]	—	851	1,839	$(220) [(3)]
Liabilities					
Collateralized borrowings in securitization trusts	—	—	—	—	— [(2)]
Total	$(2,450)	$ 8,848	$ 851	$ 7,249	$(220)

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(in thousands)	Nine Months Ended September 30, 2017				
	Interest income (expense)	(Loss) gain on investment securities	Other income	Total included in net income	Change in fair value due to credit risk
Assets					
Available-for-sale securities	$(5,565)	$ 9,124	$—	$3,559	N/A
Residential mortgage loans held-for-investment in securitization trusts	92,319 (1)	—	45,569	137,888	$— (2)
Residential mortgage loans held-for-sale	1,380 (1)	—	2,149	3,529	(1,281) (3)
Liabilities					
Collateralized borrowings in securitization trusts	(74,199)	—	(30,685)	(104,884)	— (2)
Total	$13,935	$ 9,124	$17,033	$40,092	$(1,281)

(1) Interest income on residential mortgage loans held-for-sale and residential mortgage loans held-for-investment in securitization trusts is measured by multiplying the unpaid principal balance on the loans by the coupon rate and the number of days of interest due.
(2) The change in fair value on residential mortgage loans held-for-investment in securitization trusts and collateralized borrowings in securitization trusts was due entirely to changes in market interest rates.
(3) The change in fair value due to credit risk on residential mortgage loans held-for-sale was quantified by holding yield constant in the cash flow model in order to isolate credit risk component.

The table below provides the fair value and the unpaid principal balance for the Company's fair value option-elected loans.

(in thousands)	September 30, 2018		December 31, 2017	
	Unpaid Principal Balance	Fair Value (1)	Unpaid Principal Balance	Fair Value (1)
Residential mortgage loans held-for-sale				
Total loans	$33,448	$27,537	$37,632	$30,414
Nonaccrual loans	$10,129	$8,357	$13,511	$10,963
Loans 90+ days past due	$8,932	$7,270	$12,136	$9,857

(1) Excludes accrued interest receivable.

Fair Value of Financial Instruments

In accordance with ASC 820, the Company is required to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the condensed consolidated balance sheets, for which fair value can be estimated.

The following describes the Company's methods for estimating the fair value for financial instruments.

- AFS securities, MSR, residential mortgage loans held-for-sale, derivative assets and liabilities and equity securities are recurring fair value measurements; carrying value equals fair value. See discussion of valuation methods and assumptions within the *Fair Value Measurements* section of this Note 13.
- Cash and cash equivalents and restricted cash have a carrying value which approximates fair value because of the short maturities of these instruments. The Company categorizes the fair value measurement of these assets as Level 1.
- Reverse repurchase agreements have a carrying value which approximates fair value due to their short-term nature. The Company categorizes the fair value measurement of these assets as Level 2.

- As a condition to membership in the FHLB, the Company is required to purchase and hold a certain amount of FHLB stock, which is considered a non-marketable, long-term investment, and is carried at cost. Because this stock can only be redeemed or sold at its par value, and only to the FHLB, carrying value, or cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.

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- Equity investments include cost method investments for which fair value is not estimated. Carrying value, or cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- The carrying value of repurchase agreements, FHLB advances and revolving credit facilities that mature in less than one year generally approximates fair value due to the short maturities. As of September 30, 2018, the Company held $200.0 million of repurchase agreements, $50.0 million of FHLB advances and $290.0 million of revolving credit facilities that are considered long-term. The Company's long-term repurchase agreements, FHLB advances and revolving credit facilities have floating rates based on an index plus a spread and, for members of the FHLB, the credit spread is typically consistent with those demanded in the market. Accordingly, the interest rates on these borrowings are at market and thus carrying value approximates fair value. The Company categorizes the fair value measurement of these liabilities as Level 2.
- Convertible senior notes are carried at their unpaid principal balance, net of any unamortized deferred issuance costs. The Company estimates the fair value of its convertible senior notes using the market transaction price nearest to September 30, 2018. The Company categorizes the fair value measurement of these assets as Level 2.

The following table presents the carrying values and estimated fair values of assets and liabilities that are required to be recorded or disclosed at fair value at September 30, 2018 and December 31, 2017.

	September 30, 2018		**December 31, 2017**	
(in thousands)	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
Assets				
Available-for-sale securities	$25,938,916	$25,938,916	$21,220,819	$21,220,819
Mortgage servicing rights	$1,664,024	$1,664,024	$1,086,717	$1,086,717
Residential mortgage loans held-for-sale	$27,537	$27,537	$30,414	$30,414
Cash and cash equivalents	$422,851	$422,851	$419,159	$419,159
Restricted cash	$888,632	$888,632	$635,836	$635,836
Derivative assets	$403,231	$403,231	$309,918	$309,918
Reverse repurchase agreements	$759,375	$759,375	$—	$—
Equity securities	$—	$—	$29,413	$29,413
Federal Home Loan Bank stock	$40,848	$40,848	$53,826	$53,826
Equity investments	$6,529	$6,529	$3,000	$3,000
Liabilities				
Repurchase agreements	$23,806,631	$23,806,631	$19,451,207	$19,451,207
Federal Home Loan Bank advances	$865,024	$865,024	$1,215,024	$1,215,024
Revolving credit facilities	$310,000	$310,000	$20,000	$20,000
Convertible senior notes	$283,555	$296,312	$282,827	$306,351
Derivative liabilities	$797,504	$797,504	$31,903	$31,903

Note 14. Repurchase Agreements

As of September 30, 2018 and December 31, 2017, the Company had outstanding $23.8 billion and $19.5 billion, respectively, of repurchase agreements. Excluding the effect of the Company's interest rate swaps and caps, the repurchase agreements had a weighted average borrowing rate of 2.45% and 1.69% and weighted average remaining maturities of 92 and 83 days as of September 30, 2018 and December 31, 2017, respectively.

At September 30, 2018 and December 31, 2017, the repurchase agreement balances were as follows:

(in thousands)	**September 30, 2018**	**December 31, 2017**
Short-term	$ 23,606,631	$ 19,338,707

Long-term	200,000	112,500
Total	$ 23,806,631	$ 19,451,207

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At September 30, 2018 and December 31, 2017, the repurchase agreements had the following characteristics and remaining maturities:

	September 30, 2018 Collateral Type				
(in thousands)	Agency RMBS	Non-Agency Securities	Agency Derivatives	Mortgage Servicing Rights	Total Amount Outstanding
Within 30 days	$6,408,843	$485,289	$16,494	$—	$6,910,626
30 to 59 days	1,956,414	494,990	13,884	—	2,465,288
60 to 89 days	5,041	—	—	—	5,041
90 to 119 days	5,034,622	501,372	—	—	5,535,994
120 to 364 days	8,099,969	568,631	21,082	—	8,689,682
One year and over	—	—	—	200,000	200,000
Total	$21,504,889	$2,050,282	$51,460	$200,000	$23,806,631
Weighted average borrowing rate	2.32 %	3.59 %	3.20 %	4.37 %	2.45 %

	December 31, 2017 Collateral Type				
(in thousands)	Agency RMBS	Non-Agency Securities	Agency Derivatives	Mortgage Servicing Rights	Total Amount Outstanding
Within 30 days	$3,634,541	$613,500	$21,423	$—	$4,269,464
30 to 59 days	3,522,256	261,835	47,020	—	3,831,111
60 to 89 days	3,165,834	290,628	2,478	—	3,458,940
90 to 119 days	2,119,490	332,614	322	—	2,452,426
120 to 364 days	4,883,432	443,334	—	—	5,326,766
One year and over	—	—	—	112,500	112,500
Total	$17,325,553	$1,941,911	$71,243	$112,500	$19,451,207
Weighted average borrowing rate	1.53 %	2.98 %	2.15 %	3.78 %	1.69 %

The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of repurchase agreements:

(in thousands)	September 30, 2018	December 31, 2017
Available-for-sale securities, at fair value	$ 23,636,891	$ 19,780,175
Mortgage servicing rights, at fair value	733,206	424,740
Cash and cash equivalents	—	15,000
Restricted cash	558,088	417,018
Due from counterparties	1,219,860	773,422
Derivative assets, at fair value	66,980	90,895
Total	$ 26,215,025	$ 21,501,250

Although the transactions under repurchase agreements represent committed borrowings until maturity, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets would

require the Company to provide additional collateral or fund margin calls.

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The following table summarizes certain characteristics of the Company’s repurchase agreements and counterparty concentration at September 30, 2018 and December 31, 2017:

	September 30, 2018				December 31, 2017			
(dollars in thousands)	Amount Outstanding	Net Counterparty Exposure (1)	Percent of Equity	Weighted Average Days to Maturity	Amount Outstanding	Net Counterparty Exposure (1)	Percent of Equity	Weighted Average Days to Maturity
Royal Bank of Canada	$1,898,455	$316,471	7 %	146	$1,261,956	$223,347	6 %	75
All other counterparties (2)	21,908,176	1,590,085	34 %	87	18,189,251	1,519,776	43 %	84
Total	$23,806,631	$1,906,556			$19,451,207	$1,743,123		

(1) Represents the net carrying value of the assets sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest. Payables due to broker counterparties for unsettled securities purchases of $421.1 million are not included in the September 30, 2018 amounts presented above. The Company did not have any such payables at December 31, 2017.

(2) Represents amounts outstanding with 34 and 26 counterparties at September 30, 2018 and December 31, 2017, respectively.

The Company does not anticipate any defaults by its repurchase agreement counterparties. There can be no assurance, however, that any such default or defaults will not occur.

Note 15. Federal Home Loan Bank of Des Moines Advances

The Company’s wholly owned subsidiary, TH Insurance Holdings Company LLC, or TH Insurance, is a member of the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances. As of September 30, 2018 and December 31, 2017, TH Insurance had $0.9 billion and $1.2 billion in outstanding secured advances with a weighted average borrowing rate of 2.48% and 1.79%, respectively. As of September 30, 2018 and December 31, 2017, TH Insurance had an additional $2.7 billion and $2.2 billion of available uncommitted capacity for borrowings, respectively, insofar as TH Insurance holds adequate total assets to support a new advance. To the extent TH Insurance has uncommitted capacity, it may be adjusted at the sole discretion of the FHLB.

The ability to borrow from the FHLB is subject to the Company’s continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB’s credit and collateral guidelines, as may be revised from time to time by the FHLB. Eligible collateral may include conventional 1-4 family residential mortgage loans, Agency RMBS and certain non-Agency securities with a rating of A and above.

On January 11, 2016, the Federal Housing Finance Agency, or FHFA, released a final rule regarding membership in the Federal Home Loan Bank system. Among other effects, the final rule excludes captive insurers from membership eligibility, including the Company’s subsidiary member, TH Insurance. Since TH Insurance was admitted as a member in 2013, it is eligible for a membership grace period that runs through February 19, 2021, during which new advances or renewals that mature beyond the grace period will be prohibited; however, any existing advances that mature beyond this grace period will be permitted to remain in place subject to their terms insofar as the Company maintains good standing with the FHLB. If any new advances or renewals occur, TH Insurance’s outstanding advances will be limited to 40% of its total assets.

At September 30, 2018 and December 31, 2017, FHLB advances had the following remaining maturities:

(in thousands)	September 30, 2018	December 31, 2017
≤ 1 year	$ 815,024	$ —

> 1 and ≤ 3 years	—	815,024
> 3 and ≤ 5 years	—	—
> 5 and ≤ 10 years	—	—
> 10 years	50,000	400,000
Total	$ 865,024	$ 1,215,024

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The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of FHLB advances:

(in thousands)	September 30, 2018	December 31, 2017
Available-for-sale securities, at fair value	$ 913,608	$ 1,210,715
Due from counterparties	—	62,959
Total	$ 913,608	$ 1,273,674

The FHLB retains the right to mark the underlying collateral for FHLB advances to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral. In addition, as a condition to membership in the FHLB, the Company is required to purchase and hold a certain amount of FHLB stock, which is based, in part, upon the outstanding principal balance of advances from the FHLB. At September 30, 2018 and December 31, 2017, the Company had stock in the FHLB totaling $40.8 million and $53.8 million, respectively, which is included in other assets on the condensed consolidated balance sheets. FHLB stock is considered a non-marketable, long-term investment, is carried at cost and is subject to recoverability testing under applicable accounting standards. This stock can only be redeemed or sold at its par value, and only to the FHLB. Accordingly, when evaluating FHLB stock for impairment, the Company considers the ultimate recoverability of the par value rather than recognizing temporary declines in value. As of September 30, 2018 and December 31, 2017, the Company had not recognized an impairment charge related to its FHLB stock.

Note 16. Revolving Credit Facilities

To finance MSR, the Company has entered into revolving credit facilities collateralized by the value of the MSR pledged. As of September 30, 2018 and December 31, 2017, the Company had outstanding short- and long-term borrowings under revolving credit facilities of $310.0 million and $20.0 million with a weighted average borrowing rate of 5.36% and 5.14% and weighted average remaining maturities of 4.44 and 0.96 years, respectively.
At September 30, 2018 and December 31, 2017, borrowings under revolving credit facilities had the following remaining maturities:

(in thousands)	September 30, 2018	December 31, 2017
Within 30 days	$ —	$ —
30 to 59 days	—	—
60 to 89 days	20,000	—
90 to 119 days	—	—
120 to 364 days	—	20,000
One year and over	290,000	—
Total	$ 310,000	$ 20,000

Although the transactions under revolving credit facilities represent committed borrowings from the time of funding until maturity, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets below a designated threshold would require the Company to provide additional collateral or pay down the facility. As of September 30, 2018 and December 31, 2017, MSR with a carrying value of $488.5 million and $159.5 million, respectively, was pledged as collateral for the Company’s future payment obligations under its revolving credit facilities. The Company does not anticipate any defaults by its revolving credit facility counterparties, although there can be no assurance that any such default or defaults will not occur.

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Note 17. Convertible Senior Notes

On January 19, 2017, the Company closed an underwritten public offering of $287.5 million aggregate principal amount of convertible senior notes due 2022. The net proceeds from the offering were approximately $282.2 million after deducting underwriting discounts and estimated offering expenses payable by the Company. The notes are unsecured, pay interest semiannually at a rate of 6.25% per annum and are convertible at the option of the holder into shares of the Company's common stock. The notes will mature in January 2022, unless earlier converted or repurchased in accordance with their terms. The Company does not have the right to redeem the notes prior to maturity, but may be required to repurchase the notes from holders under certain circumstances. As of September 30, 2018 and December 31, 2017, the notes had a conversion rate of 62.0780 and 61.4698 shares of common stock per $1,000 principal amount of the notes, respectively. The outstanding amount due on the convertible senior notes as of September 30, 2018 and December 31, 2017 was $283.6 million and $282.8 million, respectively, net of deferred issuance costs.

Note 18. Stockholders' Equity

Redeemable Preferred Stock

On March 14, 2017, the Company issued 5,000,000 shares of 8.125% Series A Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share, in a public offering at a price of $25.00 per share. On March 21, 2017, an additional 750,000 shares were sold by the Company to the underwriters of the offering pursuant to an overallotment option. Holders of the preferred stock are entitled to receive, when and as declared, a dividend at a fixed rate of 8.125% per annum of the $25.00 liquidation preference. On and after April 27, 2027, dividends will accumulate and be payable at a floating rate of three-month LIBOR plus a spread of 5.66% per annum of the $25.00 liquidation preference. The preferred stock ranks senior to the Company's common stock and on parity with the Company's 7.625% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.25% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.75% Series D Cumulative Redeemable Preferred Stock and 7.50% Series E Cumulative Redeemable Preferred Stock with respect to the payment of dividends and the distribution of assets upon the voluntary or involuntary liquidation, dissolution or winding up of the Company. Under certain circumstances upon a change of control, the preferred stock is convertible into shares of the Company's common stock. The preferred stock will not be redeemable before April 27, 2027, except under certain limited circumstances. On or after April 27, 2027, the Company may, at its option, redeem, in whole or in part, at any time or from time to time, the preferred stock at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) up to, but excluding, the redemption date. The net proceeds from the offering were approximately $138.9 million, after deducting underwriting discounts and estimated offering expenses payable by the Company.

On July 19, 2017, the Company issued 11,500,000 shares of 7.625% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share, in a public offering at a price of $25.00 per share, which included 1,500,000 shares sold to the underwriters of the offering pursuant to an overallotment option. Holders of the preferred stock are entitled to receive, when and as declared, a dividend at a fixed rate of 7.625% per annum of the $25.00 liquidation preference. On and after July 27, 2027, dividends will accumulate and be payable at a floating rate of three-month LIBOR plus a spread of 5.352% per annum of the $25.00 liquidation preference. The preferred stock ranks senior to the Company's common stock and on parity with the Company's 8.125% Series A Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.25% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.75% Series D Cumulative Redeemable Preferred Stock and 7.50% Series E Cumulative Redeemable Preferred Stock with respect to the payment of dividends and the distribution of assets upon the voluntary or involuntary liquidation, dissolution or winding up of the Company. Under certain circumstances upon a change of control, the preferred stock is convertible into shares of the Company's common stock. The preferred stock will not be redeemable before July 27, 2027, except under certain limited circumstances. On or after July 27, 2027, the

Company may, at its option, redeem, in whole or in part, at any time or from time to time, the preferred stock at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) up to, but excluding, the redemption date. The net proceeds from the offering were approximately $278.1 million, after deducting underwriting discounts and estimated offering expenses payable by the Company.

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On November 27, 2017, the Company issued 11,000,000 shares of 7.25% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share, in a public offering at a price of $25.00 per share. On December 1, 2017, an additional 800,000 shares were sold by the Company to the underwriters of the offering pursuant to an overallotment option. Holders of the preferred stock are entitled to receive, when and as declared, a dividend at a fixed rate of 7.25% per annum of the $25.00 liquidation preference. On and after January 27, 2025, dividends will accumulate and be payable at a floating rate of three-month LIBOR plus a spread of 5.011% per annum of the $25.00 liquidation preference. The preferred stock ranks senior to the Company's common stock and on parity with the Company's 8.125% Series A Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.625% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.75% Series D Cumulative Redeemable Preferred Stock and 7.50% Series E Cumulative Redeemable Preferred Stock with respect to the payment of dividends and the distribution of assets upon the voluntary or involuntary liquidation, dissolution or winding up of the Company. Under certain circumstances upon a change of control, the preferred stock is convertible into shares of the Company's common stock. The preferred stock will not be redeemable before January 27, 2025, except under certain limited circumstances. On or after January 27, 2025, the Company may, at its option, redeem, in whole or in part, at any time or from time to time, the preferred stock at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) up to, but excluding, the redemption date. The net proceeds from the offering were approximately $285.6 million, after deducting underwriting discounts and estimated offering expenses payable by the Company.

On July 31, 2018, upon the closing of the merger with CYS, the Company issued 3,000,000 shares of newly classified 7.75% Series D Cumulative Redeemable Preferred Stock, par value $0.01 per share, and 8,000,000 shares of newly classified 7.50% Series E Cumulative Redeemable Preferred Stock, par value $0.01 per share, in exchange for all shares of CYS's Series A and Series B cumulative redeemable preferred stock outstanding prior to the effective time of the merger. Pursuant to the terms of the merger agreement with CYS, the terms of the Company's Series D and Series E Cumulative Redeemable Preferred Stock are substantially similar to the terms of CYS's Series A and Series B Cumulative Redeemable Preferred Stock.

Holders of the 7.75% Series D Cumulative Redeemable Preferred Stock are entitled to receive, when and as declared, a dividend at a fixed rate of 7.75% per annum of the $25.00 liquidation preference. The preferred stock ranks senior to the Company's common stock and on parity with the Company's 8.125% Series A Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.625% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.25% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock and 7.50% Series E Cumulative Redeemable Preferred Stock with respect to the payment of dividends and the distribution of assets upon the voluntary or involuntary liquidation, dissolution or winding up of the Company. Under certain circumstances upon a change of control, the preferred stock is convertible into shares of the Company's common stock. The Company may, at its option, redeem, in whole or in part, at any time or from time to time, the preferred stock at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) up to, but excluding, the redemption date.

Holders of the 7.50% Series E Cumulative Redeemable Preferred Stock are entitled to receive, when and as declared, a dividend at a fixed rate of 7.50% per annum of the $25.00 liquidation preference. The preferred stock ranks senior to the Company's common stock and on parity with the Company's 8.125% Series A Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.625% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, 7.25% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock and 7.75% Series D Cumulative Redeemable Preferred Stock with respect to the payment of dividends and the distribution of assets upon the voluntary or involuntary liquidation, dissolution or winding up of the Company. Under certain circumstances upon a change of control, the preferred stock is convertible into shares of the Company's common stock. The Company may, at its option, redeem, in whole or in part, at any time or from time to time, the preferred stock at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) up to,

but excluding, the redemption date.

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Distributions to Preferred Stockholders
The following table presents cash dividends declared by the Company on its preferred stock since their issuances:

Declaration Date	Record Date	Payment Date	Cash Dividend Per Preferred Share
Series A Preferred Stock:			
September 20, 2018	October 12, 2018	October 29, 2018	$0.507810
June 19, 2018	July 12, 2018	July 27, 2018	$0.507810
March 20, 2018	April 12, 2018	April 27, 2018	$0.507810
December 14, 2017	January 12, 2018	January 29, 2018	$0.507810
September 14, 2017	October 12, 2017	October 27, 2017	$0.507810
June 15, 2017	July 12, 2017	July 27, 2017	$0.750430
Series B Preferred Stock:			
September 20, 2018	October 12, 2018	October 29, 2018	$0.476560
June 19, 2018	July 12, 2018	July 27, 2018	$0.476560
March 20, 2018	April 12, 2018	April 27, 2018	$0.476560
December 14, 2017	January 12, 2018	January 29, 2018	$0.476560
September 14, 2017	October 12, 2017	October 27, 2017	$0.518920
Series C Preferred Stock:			
September 20, 2018	October 12, 2018	October 29, 2018	$0.453130
June 19, 2018	July 12, 2018	July 27, 2018	$0.453130
March 20, 2018	April 12, 2018	April 27, 2018	$0.453130
December 14, 2017	January 12, 2018	January 29, 2018	$0.302080
Series D Preferred Stock:			
September 20, 2018	October 1, 2018	October 15, 2018	$0.484375
Series E Preferred Stock:			
September 20, 2018	October 1, 2018	October 15, 2018	$0.468750

Common Stock
Reverse Stock Split
On September 14, 2017, the Company’s board of directors approved a one-for-two reverse stock split of its outstanding shares of common stock. The reverse stock split was effected on November 1, 2017 at 5:01 p.m. Eastern Time, following the special dividend of Granite Point common stock. At the effective time, every two issued and outstanding shares of the Company’s common stock were converted into one share of common stock. No fractional shares were issued in connection with the reverse stock split; instead, each stockholder holding fractional shares was entitled to receive, in lieu of such fractional shares, cash in an amount determined on the basis of the volume weighted average price of the Company’s common stock on the NYSE on November 1, 2017. In connection with the reverse stock split, the number of authorized shares of the Company’s common stock was also reduced on a one-for-two basis, from 900 million to 450 million. The par value of each share of common stock remained unchanged. All per share amounts, common shares outstanding and restricted shares for all periods presented have been adjusted on a retroactive basis to reflect the reverse stock split.
Issuance of Common Stock in Connection with Acquisition of CYS Investments, Inc.

On July 31, 2018, in exchange for all of the shares of CYS common stock outstanding immediately prior to the effective time of the merger, the Company issued approximately 72.6 million new shares of common stock, as well as aggregate cash consideration of $15.0 million, to CYS common stockholders.

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As of September 30, 2018, the Company had 248,078,170 shares of common stock outstanding. The following table presents a reconciliation of the common shares outstanding for the nine months ended September 30, 2018 and 2017:

	Number of common shares
Common shares outstanding, December 31, 2016	173,826,163
Issuance of common stock	19,688
Issuance of restricted stock [(1)]	643,505
Common shares outstanding, September 30, 2017	174,489,356
Common shares outstanding, December 31, 2017	174,496,587
Issuance of common stock	72,608,932
Issuance of restricted stock [(1)]	972,651
Common shares outstanding, September 30, 2018	248,078,170

(1) Represents shares of restricted stock granted under the Second Restated 2009 Equity Incentive Plan, net of forfeitures, of which 1,593,701 restricted shares remained subject to vesting requirements at September 30, 2018.

Distributions to Common Stockholders

The following table presents cash dividends declared by the Company on its common stock from December 31, 2016 through September 30, 2018:

Declaration Date	Record Date	Payment Date	Cash Dividend Per Common Share
September 20, 2018	October 1, 2018	October 29, 2018	$0.311630
July 13, 2018	July 25, 2018	July 30, 2018	$0.158370
June 19, 2018	June 29, 2018	July 27, 2018	$0.470000
March 20, 2018	April 2, 2018	April 27, 2018	$0.470000
December 14, 2017	December 26, 2017	December 29, 2017	$0.470000
September 14, 2017	September 29, 2017	October 27, 2017	$0.520000
June 15, 2017	June 30, 2017	July 27, 2017	$0.520000
March 14, 2017	March 31, 2017	April 27, 2017	$0.500000

On September 14, 2017, the Company's board of directors declared a special dividend pursuant to which the 33.1 million shares of Granite Point common stock acquired by the Company in exchange for the contribution of its equity interests in TH Commercial Holdings LLC to Granite Point on June 28, 2017 would be distributed, on a pro rata basis, to the holders of Two Harbors common stock outstanding at the close of business on October 20, 2017. The Granite Point common stock was distributed on November 1, 2017. Due to its controlling ownership interest in Granite Point through November 1, 2017, the Company consolidated Granite Point on its financial statements. Effective November 1, 2017 (the date the 33.1 million shares of Granite Point common stock were distributed to the Company's common stockholders), the Company no longer had a controlling interest in Granite Point and, therefore, deconsolidated Granite Point and its subsidiaries from its financial statements and reclassified all of Granite Point's prior period assets, liabilities and results of operations to discontinued operations.

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Dividend Reinvestment and Direct Stock Purchase Plan
The Company sponsors a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of the Company's common stock by reinvesting some or all of the cash dividends received on shares of the Company's common stock. Stockholders may also make optional cash purchases of shares of the Company's common stock subject to certain limitations detailed in the plan prospectus. The plan allows for the issuance of up to an aggregate of 3,750,000 shares of the Company's common stock. As of September 30, 2018, 220,301 shares have been issued under the plan for total proceeds of approximately $4.3 million, of which 8,692 and 21,160 shares were issued for total proceeds of $0.1 million and $0.3 million during the three and nine months ended September 30, 2018, respectively. During the three and nine months ended September 30, 2017, 6,469 and 19,688 shares were issued for total proceeds of $0.1 million and $0.4 million, respectively.
Share Repurchase Program
The Company's share repurchase program allows for the repurchase of up to an aggregate of 37,500,000 shares of the Company's common stock. Shares may be repurchased from time to time through privately negotiated transactions or open market transactions, pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934, as amended, or the Exchange Act, or by any combination of such methods. The manner, price, number and timing of share repurchases are subject to a variety of factors, including market conditions and applicable SEC rules. The share repurchase program does not require the purchase of any minimum number of shares, and, subject to SEC rules, purchases may be commenced or suspended at any time without prior notice. The share repurchase program does not have an expiration date. As of September 30, 2018, a total of 12,067,500 shares had been repurchased by the Company under the program for an aggregate cost of $200.4 million. No shares were repurchased during the three and nine months ended September 30, 2018 and 2017.
At-the-Market Offering
The Company has entered into an equity distribution agreement under which the Company may sell up to an aggregate of 10,000,000 shares of its common stock from time to time in any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 under the Securities Act of 1933, as amended, or the Securities Act. As of September 30, 2018, 3,792,935 shares of common stock have been sold under the equity distribution agreement for total accumulated net proceeds of approximately $77.6 million. No shares were sold during the three and nine months ended September 30, 2018 and 2017.
Accumulated Other Comprehensive (Loss) Income
Accumulated other comprehensive (loss) income at September 30, 2018 and December 31, 2017 was as follows:

(in thousands)	**September 30, 2018**	**December 31, 2017**
Available-for-sale securities		
Unrealized gains	$ 522,365	$ 475,694
Unrealized losses	(677,094)	(140,881)
Accumulated other comprehensive (loss) income	$ (154,729)	$ 334,813

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Reclassifications out of Accumulated Other Comprehensive (Loss) Income
The Company reclassifies unrealized gains and losses on AFS securities in accumulated other comprehensive income to net income upon the recognition of any other-than-temporary impairments and realized gains and losses on sales, net of income tax effects, as individual securities are impaired or sold. The following table summarizes reclassifications out of accumulated other comprehensive income for the three and nine months ended September 30, 2018 and 2017:

(in thousands)	Affected Line Item in the Condensed Consolidated Statements of Comprehensive (Loss) Income	Amount Reclassified out of Accumulated Other Comprehensive (Loss) Income			
		Three Months Ended September 30,		Nine Months Ended September 30,	
		2018	2017	2018	2017
Other-than-temporary impairments on AFS securities	Total other-than-temporary impairment losses	$95	$—	$363	$429
Realized losses (gains) on sales of certain AFS securities, net of tax	(Loss) gain on investment securities	30,368	4,220	52,654	7,386
Total		$30,463	$4,220	$53,017	$7,815

Noncontrolling Interest
On June 28, 2017, the Company contributed its equity interests in its wholly owned subsidiary, TH Commercial Holdings LLC, to Granite Point and, in exchange for its contribution, received approximately 33.1 million shares of common stock of Granite Point, representing approximately 76.5% of the outstanding stock of Granite Point upon completion of the IPO of its common stock on June 28, 2017. Granite Point issued 10,000,000 shares of its common stock in the IPO at a price of $19.50 per share, for gross proceeds of $195.0 million. Net proceeds were approximately $181.9 million, net of issuance costs of approximately $13.1 million.
Due to its controlling ownership interest in Granite Point through November 1, 2017 (the date the 33.1 million shares of Granite Point common stock were distributed to the Company's common stockholders), the Company consolidated Granite Point on its financial statements and reflected noncontrolling interest for the portion of equity and comprehensive income not attributable to the Company. During the period from June 28, 2017 through November 1, 2017, in accordance with ASC 810, *Consolidation*, the carrying amount of noncontrolling interest was adjusted to reflect (i) changes in its ownership interest in Granite Point as a result of purchases of Granite Point common stock and (ii) the portion of comprehensive income and dividends declared by Granite Point that are not attributable to the Company, with the offset to equity. Effective November 1, 2017, the Company no longer had a controlling interest in Granite Point and, therefore, deconsolidated Granite Point and its subsidiaries, including any noncontrolling interest, from its financial statements and reclassified all of Granite Point's prior period assets, liabilities and results of operations to discontinued operations.

Note 19. Equity Incentive Plan
The Company's Second Restated 2009 Equity Incentive Plan, or the Plan, provides incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers and affiliates and employees of PRCM Advisers and its affiliates, and any joint venture affiliates of the Company. The Plan is administered by the compensation committee of the Company's board of directors. The compensation committee has the full authority to administer and interpret the Plan, to authorize the granting of awards, to determine the eligibility of directors, officers, advisors, consultants and other personnel, including PRCM Advisers and affiliates

and personnel of PRCM Advisers and its affiliates, and any joint venture affiliates of the Company, to receive an award, to determine the number of shares of common stock to be covered by each award (subject to the individual participant limitations provided in the Plan), to determine the terms, provisions and conditions of each award (which may not be inconsistent with the terms of the Plan), to prescribe the form of instruments evidencing awards and to take any other actions and make all other determinations that it deems necessary or appropriate in connection with the Plan or the administration or interpretation thereof. In connection with this authority, the compensation committee may, among other things, establish performance goals that must be met in order for awards to be granted or to vest, or for the restrictions on any such awards to lapse.

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The Company’s Plan provides for grants of restricted common stock, phantom shares, dividend equivalent rights and other equity-based awards, subject to a ceiling of 6,500,000 shares available for issuance under the Plan. The Plan allows for the Company’s board of directors to expand the types of awards available under the Plan to include long-term incentive plan units in the future. If an award granted under the Plan expires or terminates, the shares subject to any portion of the award that expires or terminates without having been exercised or paid, as the case may be, will again become available for the issuance of additional awards. Unless earlier terminated by the Company’s board of directors, no new award may be granted under the Plan after the tenth anniversary of the date that such Plan was initially approved by the Company’s board of directors. No award may be granted under the Plan to any person who, assuming payment of all awards held by such person, would own or be deemed to own more than 9.8% of the outstanding shares of the Company’s common stock.

All per share amounts, common shares outstanding and restricted shares for all periods presented reflect the Company’s one-for-two reverse stock split effected on November 1, 2017 (refer to Note 18 - *Stockholders’ Equity* for additional information).

During the nine months ended September 30, 2018 and 2017, the Company granted 55,553 and 34,559 shares of common stock, respectively, to its independent directors pursuant to the Plan. The estimated fair value of these awards was $15.48 and $19.82 per share on grant date, based on the adjusted closing price of the Company’s common stock on the NYSE on such date. The grants vested immediately.

Additionally, during the nine months ended September 30, 2018 and 2017, the Company granted 941,371 and 637,286 shares of restricted common stock, respectively, to key employees of PRCM Advisers pursuant to the terms of the Plan and the associated award agreements. The estimated fair value of these awards was $15.12 and $17.48 per share on grant date, based on the adjusted closing market price of the Company’s common stock on the NYSE on such date. The shares underlying the grants vest in three equal annual installments commencing on the first anniversary of the grant date, as long as such grantee complies with the terms and conditions of his or her applicable restricted stock award agreement.

The following table summarizes the activity related to restricted common stock for the nine months ended September 30, 2018 and 2017:

	Nine Months Ended September 30,			
	2018		**2017**	
	Shares	**Weighted Average Grant Date Fair Market Value**	**Shares**	**Weighted Average Grant Date Fair Market Value**
Outstanding at Beginning of Period	1,284,010	$ 17.15	1,319,712	$ 17.10
Granted	996,924	14.96	671,845	17.60
Vested	(673,118)	(17.12)	(645,325)	(17.90)
Forfeited	(14,115)	(15.59)	(22,789)	(17.90)
Outstanding at End of Period	1,593,701	$ 15.81	1,323,443	$ 16.95

For the three and nine months ended September 30, 2018, the Company recognized compensation related to restricted common stock granted pursuant to the Plan of $3.4 million and $9.8 million, respectively. For the three and nine months ended September 30, 2017, the Company recognized compensation related to restricted common stock granted pursuant to the Plan of $3.5 million and $11.7 million, respectively.

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TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

Note 20. Income Taxes

The TCJA significantly revises the U.S. corporate income tax laws by, among other things, lowering the federal income tax rate applicable to corporations from 35% to 21% and repealing the corporate alternative minimum tax. The Company has not completed its determination of the accounting implications of the TCJA on its tax accruals. However, the Company reasonably estimated the effects of the TCJA and recognized a tax provision of $17.5 million in its financial statements as of December 31, 2017. This amount represents the remeasurement of federal net deferred tax assets resulting from the permanent reduction in the U.S. statutory corporate tax rate from 35% to 21%. The TCJA requires complex computations to be performed that were not previously required in U.S. tax law, significant judgments to be made in interpretation of the provisions of the TCJA and significant estimates in calculations, and the preparation and analysis of information not previously relevant or regularly produced. The U.S. Treasury, the IRS, and other standard-setting bodies could interpret or issue guidance on how provisions of the TCJA will be applied or otherwise administered that is different from the Company’s interpretation. As the Company completes its analysis of the TCJA, collects and prepares necessary data, and interprets any additional guidance, it may make adjustments to the provisional amounts. Those adjustments may materially impact the Company’s provision for income taxes in the period in which the adjustments are made.

For the three and nine months ended September 30, 2018 and 2017, the Company qualified to be taxed as a REIT under the Code for U.S. federal income tax purposes. As long as the Company qualifies as a REIT, the Company generally will not be subject to U.S. federal income taxes on its taxable income to the extent it annually distributes its net taxable income to stockholders, and does not engage in prohibited transactions. The Company intends to distribute 100% of its REIT taxable income and comply with all requirements to continue to qualify as a REIT. The majority of states also recognize the Company’s REIT status. The Company’s TRSs file separate tax returns and are fully taxed as standalone U.S. C-corporations. It is assumed that the Company will retain its REIT status and will incur no REIT level taxation as it intends to comply with the REIT regulations and annual distribution requirements.

During the three and nine months ended September 30, 2018, the Company’s TRSs recognized a provision for income taxes of $37.4 million and $35.1 million, respectively, which was primarily due to realized gains on sales of AFS securities and gains recognized on MSR held in the TRSs as well as the write-down of net deferred tax assets resulting from the deemed liquidation of one of the Company’s TRSs due to its TRS election revocation, offset by net losses incurred on derivative instruments held in the TRSs. During the three and nine months ended September 30, 2017, the Company’s TRSs recognized a benefit from income taxes of $5.3 million and $21.1 million, respectively, which was primarily due to realized losses on sales of AFS securities and net losses incurred on derivative instruments held in the TRSs. As of September 30, 2018 and December 31, 2017, a $2.4 million and a $2.7 million valuation allowance was recorded, respectively, because the Company determined that it is more likely than not that the associated deferred tax asset will not be realized.

Based on the Company’s evaluation, it has been concluded that there are no significant uncertain tax positions requiring recognition in the Company’s condensed consolidated financial statements of a contingent tax liability for uncertain tax positions. Additionally, there were no amounts accrued for penalties or interest as of or during the periods presented in these consolidated financial statements.

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Note 21. Earnings Per Share

The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted earnings per share for the three and nine months ended September 30, 2018 and 2017. All per share amounts, common shares outstanding and restricted shares for all periods presented reflect the Company's one-for-two reverse stock split effected on November 1, 2017 (refer to Note 18 - *Stockholders' Equity* for additional information).

	Three Months Ended		**Nine Months Ended**	
	September 30,		**September 30,**	
(in thousands, except share data)	**2018**	**2017**	**2018**	**2017**
Numerator:				
Net income from continuing operations	$35,946	$ 93,220	$510,245	$ 146,212
Income from discontinued operations, net of tax	—	11,518	—	39,169
Net income	35,946	104,738	510,245	185,381
Income from discontinued operations attributable to noncontrolling interest	—	2,674	—	2,714
Net income attributable to Two Harbors Investment Corp.	35,946	102,064	510,245	182,667
Dividends on preferred stock	18,951	8,888	46,445	13,173
Net income attributable to common stockholders - basic	16,995	93,176	463,800	169,494
Interest expense attributable to convertible notes [(1)]	—	4,727	14,151	—
Net income attributable to common stockholders - diluted	$16,995	$ 97,903	$477,951	$ 169,494
Denominator:				
Weighted average common shares outstanding	222,805,735	173,162,988	190,229,850	173,022,717
Weighted average restricted stock shares	1,593,701	1,325,308	1,616,362	1,392,515
Basic weighted average shares outstanding	224,399,436	174,488,296	191,846,212	174,415,232
Effect of dilutive shares issued in an assumed conversion	—	14,419,060	17,760,934	—
Diluted weighted average shares outstanding	224,399,436	188,907,356	209,607,146	174,415,232
Basic Earnings Per Share:				
Continuing operations	$0.08	$ 0.48	$2.42	$ 0.76
Discontinued operations	—	0.05	—	0.21
Net income	$0.08	$ 0.53	$2.42	$ 0.97
Diluted Earnings Per Share:				
Continuing operations	$0.08	$ 0.47	$2.28	$ 0.76
Discontinued operations	—	0.05	—	0.21
Net income	$0.08	$ 0.52	$2.28	$ 0.97

(1) Includes a nondiscretionary adjustment for the assumed change in the management fee calculation.

For the three months ended September 30, 2018, excluded from the calculation of diluted earnings per share is the effect of adding back $4.8 million of interest expense, net of a nondiscretionary adjustment for the assumed change in the management fee calculation, and 17,847,425 weighted average common share equivalents related to the assumed conversion of the Company's convertible senior notes, as their inclusion would be antidilutive.

For the nine months ended September 30, 2017, excluded from the calculation of diluted earnings per share is the effect of adding back $13.1 million of interest expense, net of a nondiscretionary adjustment for the assumed change in the management fee calculation, and 13,447,072 weighted average common share equivalents related to the assumed conversion of the Company's convertible senior notes, as their inclusion would be antidilutive.

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Note 22. Related Party Transactions

The following summary provides disclosure of the material transactions with affiliates of the Company.

In accordance with the Management Agreement between the Company and PRCM Advisers dated as of October 28, 2009 and subsequently amended, the Company incurred $12.4 million and $35.6 million as a management fee to PRCM Advisers for the three and nine months ended September 30, 2018, respectively, and $10.1 million and $29.8 million as a management fee to PRCM Advisers for the three and nine months ended September 30, 2017, respectively, which represents approximately 1.5% of stockholders' equity on an annualized basis as defined by the Management Agreement. For purposes of calculating the management fee, stockholders' equity is adjusted as discussed below, and to exclude the consolidated stockholders' equity of Granite Point and its subsidiaries previously included in the Company's condensed consolidated balance sheet and any common stock repurchases, as well as any unrealized gains, losses or other items that do not affect realized net income, among other adjustments, in accordance with the Management Agreement.

In connection with the acquisition of CYS, the Management Agreement was amended to (i) reduce PRCM Advisers' base management fee with respect to the additional equity under management resulting from the merger to 0.75% from the effective time through the first anniversary of the effective time and (ii) for the fiscal quarter in which closing of the merger occurs, to make a one-time downward adjustment of Pine River's management fees payable by Two Harbors for such quarter by $15.0 million to offset the cash consideration payable to stockholders of CYS, plus an additional downward adjustment of up to $3.3 million for certain transaction-related expenses. For both the three and nine months ended September 30, 2018, the total downward adjustment to management fees was $17.5 million. The Company does not anticipate any further downward adjustments to management fees for transaction-related expenses.

In addition, the Company reimbursed PRCM Advisers for direct and allocated costs incurred by PRCM Advisers on behalf of the Company. These direct and allocated costs totaled approximately $5.3 million and $16.1 million for the three and nine months ended September 30, 2018, respectively, and $4.8 million and $13.1 million for the three and nine months ended September 30, 2017, respectively.

The Company has direct relationships with the majority of its third-party vendors. The Company will continue to have certain costs allocated to it by PRCM Advisers for compensation, data services, technology and certain office lease payments, but most direct expenses with third-party vendors are paid directly by the Company.

The Company recognized $3.4 million and $9.8 million of compensation during the three and nine months ended September 30, 2018, respectively, and $3.5 million and $11.7 million of compensation during the three and nine months ended September 30, 2017, respectively, related to restricted common stock issued to employees of PRCM Advisers and the Company's independent directors pursuant to the Plan.

During the year ended December 31, 2017, the Company purchased 1,658,008 shares of Granite Point common stock in the open market for a cost of $30.0 million. These equity securities were carried at fair value and reported in other assets on the condensed consolidated balance sheets. As of December 31, 2017, the carrying value of the equity securities was $29.4 million, which included $0.6 million in unrealized losses. During the three months ended September 30, 2018, the Company sold all of the Granite Point common stock it held for $31.2 million, resulting in a realized gain of $1.2 million for both the three and nine months ended September 30, 2018.

Note 23. Subsequent Events

Events subsequent to September 30, 2018, were evaluated through the date these financial statements were issued and no additional events were identified requiring further disclosure in these condensed consolidated financial statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
The following discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes included elsewhere in this Quarterly Report on Form 10-Q as well as our Annual Report on Form 10-K for the year ended December 31, 2017.

General
We are a Maryland corporation focused on investing in, financing and managing Agency residential mortgage-backed securities, or Agency RMBS, non-Agency securities, mortgage servicing rights, or MSR, and other financial assets, which we collectively refer to as our target assets. We operate as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code. We are externally managed by PRCM Advisers LLC, or PRCM Advisers, which is a wholly owned subsidiary of Pine River Capital Management L.P., or Pine River. Our objective is to provide attractive risk-adjusted total return to our stockholders over the long term, primarily through dividends and secondarily through capital appreciation. We selectively acquire and manage an investment portfolio of our target assets, which is constructed to generate attractive returns through market cycles. We focus on asset selection and implement a relative value investment approach across various sectors within the mortgage market. Our target assets include the following:

- Agency RMBS (which includes inverse interest-only Agency securities classified as "Agency Derivatives" for purposes of U.S. generally accepted accounting principles, or U.S. GAAP), meaning RMBS whose principal and interest payments are guaranteed by the Government National Mortgage Association (or Ginnie Mae), the Federal National Mortgage Association (or Fannie Mae), or the Federal Home Loan Mortgage Corporation (or Freddie Mac), or collectively, the government sponsored entities, or GSEs;
- Non-Agency securities, meaning securities that are not issued or guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac;
- MSR; and
- Other financial assets comprising approximately 5% to 10% of the portfolio.

We generally view our target assets in two strategies that are based on our core competencies of understanding and managing prepayment and credit risk. Our rates strategy includes assets that are sensitive to changes in interest rates and prepayment speeds, specifically Agency RMBS and MSR. Our credit strategy includes assets with inherent credit risk, including non-Agency securities. Other assets include financial and mortgage-related assets other than the target assets in our rates and credit strategies, including residential mortgage loans and certain non-hedging transactions that may produce non-qualifying income for purposes of the REIT gross income tests.
As opportunities in the residential mortgage marketplace change, we continue to evolve our business model. From a capital allocation perspective, we expect to continue to increase our allocation towards MSR over time and allocate capital towards Agency RMBS based on opportunities in the marketplace, the cost of financing and the cost of hedging interest rate, prepayment, credit and other portfolio risks. Within our non-Agency securities portfolio, we have a substantial emphasis on "legacy" securities, which include securities issued prior to 2009. We have also allocated capital towards "new issue" non-Agency securities, which we believe have enabled us to find attractive returns and further diversify our non-Agency securities portfolio. In addition, we continue to hold certain securities from our previously consolidated securitization trusts.
Within our MSR business, we purchase the right to control the servicing of residential mortgage loans from high-quality originators. We do not directly service the mortgage loans on our consolidated balance sheet, nor the mortgage loans underlying the MSR we acquire; rather, we contract with appropriately licensed third-party subservicers to handle substantially all servicing functions in the name of the subservicer.
On June 28, 2017, we completed the contribution of our portfolio of commercial real estate assets to Granite Point Mortgage Trust Inc., or Granite Point, a newly formed Maryland corporation intended to qualify as a REIT and focused on directly originating, investing in and managing senior floating-rate commercial mortgage loans and other debt and debt-like commercial real estate investments. We contributed our equity interests in our wholly owned

subsidiary, TH Commercial Holdings LLC, to Granite Point and, in exchange for our contribution,
received approximately 33.1 million shares of common stock of Granite Point, representing approximately 76.5% of the outstanding stock of Granite Point upon completion of the initial public offering, or IPO, of its common stock on June 28, 2017.

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On November 1, 2017, we distributed, on a pro rata basis, the 33.1 million shares of Granite Point common stock that we acquired in connection with the contribution to the holders of our common stock outstanding as of the close of business on October 20, 2017. Due to our controlling ownership interest in Granite Point through November 1, 2017, our results of operations and financial condition through such date reflect Granite Point's commercial strategy. As of November 1, 2017, we no longer had a controlling interest in Granite Point and, therefore, deconsolidated Granite Point and its subsidiaries from our financial statements and reclassified all of Granite Point's prior period assets, liabilities and results of operations to discontinued operations.

On April 26, 2018, we announced that we had entered into a definitive merger agreement pursuant to which we would acquire CYS Investments, Inc., or CYS, a Maryland corporation investing in primarily Agency RMBS and treated as a REIT for U.S. federal income tax purposes. The transaction was approved by the stockholders of both Two Harbors and CYS on July 27, 2018, and the merger was completed on July 31, 2018, at which time CYS became our wholly owned subsidiary. In exchange for all of the shares of CYS common stock outstanding immediately prior to the effective time of the merger, we issued approximately 72.6 million new shares of common stock, as well as aggregate cash consideration of $15.0 million, to CYS common stockholders. In addition, we issued 3 million shares of newly classified Series D cumulative redeemable preferred stock and 8 million shares of newly classified Series E cumulative redeemable preferred stock in exchange for all shares of CYS's Series A and Series B cumulative redeemable preferred stock outstanding prior to the effective time of the merger. The financial results of CYS since the closing date of the acquisition have been included in our condensed consolidated financial statements.

We believe our investment model allows management to allocate capital across various sectors within the mortgage market, with a focus on asset selection and the implementation of a relative value investment approach. Our capital allocation decisions factor in the opportunities in the marketplace, the cost of financing and the cost of hedging interest rate, prepayment, credit and other portfolio risks. As a result, capital allocation reflects management's flexible approach to investing in the marketplace. The following table provides our capital allocation in each of our investment strategies as of September 30, 2018 and the four immediately preceding period ends:

	As of September 30, 2018	**June 30, 2018**	**March 31, 2018**	**December 31, 2017**	**September 30, 2017**
Rates strategy	76%	68%	69%	68%	55%
Credit strategy	24%	32%	31%	32%	29%
Commercial strategy [1]	—%	—%	—%	—%	16%

(1) Represents capital allocated to our controlling interest in Granite Point's commercial strategy, included in discontinued operations.

As our capital allocation shifts, our annualized yields and cost of financing shift. Our capital allocation at September 30, 2018 was 76% to our rates strategy and 24% to our credit strategy. The increased allocation to our rates strategy during the quarter was driven by the acquisition of CYS's Agency portfolio. We expect to continue to reallocate capital from Agency RMBS into MSR and non-Agency securities in the fourth quarter and into 2019, though we do not have a fixed allocation target between our rates and credit strategies. As previously discussed, our investment decisions are not driven solely by annualized yields, but rather a multitude of macroeconomic drivers, including market environments and their respective impacts (*e.g.,* uncertainty of prepayment speeds, extension risk and credit events).

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For the three months ended September 30, 2018, our net yield realized on the portfolio was lower than recent periods due to an increase in our cost of financing as a result of increases in LIBOR and correlated borrowing rates offered by counterparties. Our average annualized portfolio yield for the three months ended September 30, 2018 was lower than the prior quarter due to the addition of Agency pools at yields lower than our overall portfolio yield as a result of the acquisition of CYS, but relatively consistent with the three quarters prior. The following table provides the average annualized yield on our assets, including Agency RMBS, non-Agency securities, MSR, residential mortgage loans held-for-investment, net of collateralized borrowings, in securitization trusts, and residential mortgage loans held-for-sale for the three months ended September 30, 2018, and the four immediately preceding quarters:

	Three Months Ended				
	September 30, 2018	**June 30, 2018**	**March 31, 2018**	**December 31, 2017**	**September 30, 2017**
Average annualized portfolio yield [(1)]	3.76%	3.91%	3.77%	3.69%	3.66%
Cost of financing [(2)]	2.28%	1.98%	1.84%	1.72%	1.68%
Net portfolio yield	1.48%	1.93%	1.93%	1.97%	1.98%

(1) Average annualized yield incorporates future prepayment, credit loss and other assumptions, all of which are estimates and subject to change.
(2) Cost of financing includes swap and cap interest rate spread.

We seek to deploy moderate leverage as part of our investment strategy. We generally finance our Agency RMBS and non-Agency securities through short- and long-term borrowings structured as repurchase agreements and advances from the Federal Home Loan Bank of Des Moines, or the FHLB. We also finance our MSR through repurchase agreements and revolving credit facilities. In addition, in January 2017, we closed an underwritten public offering of $287.5 million aggregate principal amount of convertible senior notes due 2022. The notes are unsecured, pay interest semiannually at a rate of 6.25% per annum and are convertible at the option of the holder into shares of our common stock. The notes will mature in January 2022, unless earlier converted or repurchased in accordance with their terms. We do not have the right to redeem the notes prior to maturity, but may be required to repurchase the notes from holders under certain circumstances. The net proceeds from the offering were approximately $282.2 million after deducting underwriting discounts and estimated offering expenses. The majority of these proceeds were used to help fund our MSR assets, which previously had largely been funded with cash. As of September 30, 2018, the notes had a conversion rate of 62.0780 shares of common stock per $1,000 principal amount of the notes.
Our Agency RMBS, given their liquidity and high credit quality, are eligible for higher levels of leverage, while non-Agency securities and MSR, with less liquidity and/or more exposure to credit risk, utilize lower levels of leverage. As a result, our debt-to-equity ratio is determined by our portfolio mix as well as many additional factors, including the liquidity of our portfolio, the sustainability and price of our financing, diversification of our counterparties and their available capacity to finance our assets, and anticipated regulatory developments. Over the past several quarters, we have generally maintained a debt-to-equity ratio range of 4.0 to 6.0 times to finance our securities portfolio, MSR and commercial real estate assets (included in assets of discontinued operations), on a fully deployed capital basis. Our debt-to-equity ratio is directly correlated to the composition of our portfolio; specifically, the higher percentage of Agency RMBS we hold, the higher our debt-to-equity ratio is, while the higher percentage of non-Agency securities and MSR we hold, the lower our debt-to-equity ratio is. We may alter the percentage allocation of our portfolio among our target assets depending on the relative value of the assets that are available to purchase from time to time, including at times when we are deploying proceeds from offerings we conduct. As we allocate capital toward Agency RMBS and deploy financing on MSR, our debt-to-equity ratio may increase beyond 6.0 times in the future. See the section titled *“Management’s Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition - Repurchase Agreements”* for further discussion.
We recognize that investing in our target assets is competitive and we compete with other entities for attractive investment opportunities. We rely on our management team and our dedicated team of investment professionals

provided by our external manager to identify investment opportunities. We believe that our significant focus in the residential market, the extensive mortgage market expertise of our investment team, our strong analytics and our disciplined relative value investment approach give us a competitive advantage versus our peers.

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We have elected to be treated as a REIT for U.S. federal income tax purposes. To qualify as a REIT we are required to meet certain investment and operating tests and annual distribution requirements. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders, do not participate in prohibited transactions and maintain our intended qualification as a REIT. However, certain activities that we may perform may cause us to earn income which will not be qualifying income for REIT purposes. We have designated certain of our subsidiaries as taxable REIT subsidiaries, or TRSs, as defined in the Code, to engage in such activities. We also operate our business in a manner that will permit us to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or the 1940 Act. While we do not currently originate or service residential mortgage loans, certain of our subsidiaries have obtained the requisite licenses and approvals to purchase and sell residential mortgage loans in the secondary market and to own and manage MSR.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains, or incorporates by reference, not only historical information, but also forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act, and that are subject to the safe harbors created by such sections. Forward-looking statements involve numerous risks and uncertainties. Our actual results may differ from our beliefs, expectations, estimates, and projections and, consequently, you should not rely on these forward-looking statements as predictions of future events. Forward-looking statements are not historical in nature and can be identified by words such as “anticipate,” “estimate,” “will,” “should,” “expect,” “target,” “believe,” “inten “plan,” “goals,” “future,” “likely,” “may” and similar expressions or their negative forms, or by references to strategy, plans, or intentions. These forward-looking statements are subject to risks and uncertainties, including, among other things, those described in our Annual Report on Form 10-K for the year ended December 31, 2017, under the caption “Risk Factors.” Other risks, uncertainties and factors that could cause actual results to differ materially from those projected are described below and may be described from time to time in reports we file with the Securities and Exchange Commission, or SEC, including our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update or revise any such forward-looking statements, whether as a result of new information, future events, or otherwise.

Important factors, among others, that may affect our actual results include:

- changes in interest rates and the market value of our target assets;
- changes in prepayment rates of mortgages underlying our target assets;
- the occurrence, extent and timing of credit losses within our portfolio;
- our exposure to adjustable-rate and negative amortization mortgage loans underlying our target assets;
- the state of the credit markets and other general economic conditions, particularly as they affect the price of earning assets and the credit status of borrowers;
- the concentration of the credit risks to which we are exposed;
- legislative and regulatory actions affecting our business;
- the availability and cost of our target assets;
- the availability and cost of financing for our target assets, including repurchase agreement financing, lines of credit, revolving credit facilities and financing through the FHLB;
- declines in home prices;
- increases in payment delinquencies and defaults on the mortgages comprising and underlying our target assets;
- changes in liquidity in the market for real estate securities, the re-pricing of credit risk in the capital markets, inaccurate ratings of securities by rating agencies, rating agency downgrades of securities, and increases in the supply of real estate securities available-for-sale;

- changes in the values of securities we own and the impact of adjustments reflecting those changes on our condensed consolidated statements of comprehensive (loss) income and balance sheets, including our stockholders' equity;
- our ability to generate cash flow from our target assets;
- our ability to effectively execute and realize the benefits of strategic transactions and initiatives we have pursued or may in the future pursue;
- our ability to realize the anticipated benefits of our merger with CYS;
- changes in the competitive landscape within our industry, including changes that may affect our ability to attract and retain personnel;

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- our exposure to legal and regulatory claims, penalties or enforcement activities, including those arising from our ownership and management of MSR and prior securitization transactions;
- our exposure to counterparties involved in our MSR business and prior securitization transactions and our ability to enforce representations and warranties made by them;
- our ability to acquire MSR and successfully operate our seller-servicer subsidiary and oversee the activities of our subservicers;
- our ability to successfully diversify our business into new asset classes, and manage the new risks to which they may expose us;
- our ability to manage various operational and regulatory risks associated with our business;
- interruptions in or impairments to our communications and information technology systems;
- our ability to maintain appropriate internal controls over financial reporting;
- our ability to establish, adjust and maintain appropriate hedges for the risks in our portfolio;
- our ability to maintain our REIT qualification for U.S. federal income tax purposes; and
- limitations imposed on our business due to our REIT status and our status as exempt from registration under the 1940 Act.

This Quarterly Report on Form 10-Q may contain statistics and other data that, in some cases, have been obtained or compiled from information made available by mortgage loan servicers and other third-party service providers.

Factors Affecting our Operating Results

Our net interest income includes income from our securities portfolio, including the amortization of purchase premiums and accretion of purchase discounts, and income from our residential mortgage loans. Net interest income, as well as our servicing income, net of subservicing expenses, will fluctuate primarily as a result of changes in market interest rates, our financing costs and prepayment speeds on our assets. Interest rates, financing costs and prepayment rates vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. Our operating results will also be affected by default rates and credit losses with respect to the mortgage loans underlying our non-Agency securities and in our residential mortgage loan portfolio.

Fair Value Measurement

A significant portion of our assets and liabilities are reported at fair value and, therefore, our condensed consolidated balance sheets and statements of comprehensive (loss) income are significantly affected by fluctuations in market prices. At September 30, 2018, approximately 88.9% of our total assets, or $28.0 billion, consisted of financial instruments recorded at fair value. See Note 13 - *Fair Value* to the condensed consolidated financial statements, included in this Quarterly Report on Form 10-Q, for descriptions of valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized. Although we execute various hedging strategies to mitigate our exposure to changes in fair value, we cannot fully eliminate our exposure to volatility caused by fluctuations in market prices. Although markets for asset-backed securities, including RMBS, have modestly stabilized since the severe dislocations experienced as a result of the 2008 Financial Crisis, these markets continue to experience volatility and, as a result, our assets and liabilities will be subject to valuation adjustment as well as changes in the inputs we use to measure fair value.
Any temporary change in the fair value of our available-for-sale, or AFS, securities, excluding Agency interest-only mortgage-backed securities, is recorded as a component of accumulated other comprehensive (loss) income and does not impact our earnings. Our reported earnings for U.S. GAAP purposes, or GAAP net income, is affected, however, by fluctuations in market prices on the remainder of our financial assets and liabilities recorded at fair value, including interest rate swap, cap and swaption agreements and certain other derivative instruments (*i.e.*, TBAs, put and call options for TBAs, Markit IOS total return swaps and inverse interest-only securities), which are accounted for as derivative trading instruments under U.S. GAAP, Agency interest-only mortgage-backed securities, MSR, residential

mortgage loans held-for-sale and equity securities.

We have numerous internal controls in place to help ensure the appropriateness of fair value measurements. Significant fair value measures are subject to detailed analytics and management review and approval. Our entire investment portfolio reported at fair value is priced by third-party brokers and/or by independent pricing providers. We generally receive three or more broker and vendor quotes on pass-through Agency RMBS, and generally receive multiple broker or vendor quotes on all other securities, including interest-only Agency RMBS, inverse interest-only Agency RMBS, and non-Agency securities. We also currently receive three vendor quotes for the MSR in our investment portfolio. For Agency RMBS, the third-party pricing providers and brokers use pricing models that commonly incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. For non-Agency securities, the third-party pricing providers and brokers utilize both observable and unobservable inputs such as pool specific characteristics (*i.e.*, loan age, loan size, credit quality of borrowers, vintage, servicer quality), floating rate indices, prepayment and default assumptions, and recent trading of the same or similar securities. For MSR and residential mortgage loans, vendors use pricing models that generally incorporate observable inputs such as principal balance, note rate, geographical location, loan-to-value (LTV) ratios, FICO, appraised value and other loan characteristics, along with observed market yields, securitization economics and trading levels. Additionally for MSR, pricing providers will customarily incorporate loan servicing cost, servicing fee, ancillary income, and earnings rate on escrow as observable inputs. Unobservable or model-driven inputs include forecast cumulative defaults, default curve, forecast loss severity and forecast voluntary prepayment.

We evaluate the prices we receive from both brokers and independent pricing providers by comparing those prices to actual purchase and sale transactions, our internally modeled prices calculated based on market observable rates and credit spreads, and to each other both in current and prior periods. We review and may challenge broker quotes and valuations from third-party pricing providers to ensure that such quotes and valuations are indicative of fair value as a result of this analysis. We then estimate the fair value of each security based upon the median of the final broker quotes received, and we estimate the fair value of MSR based upon the average of prices received from independent providers, subject to internally-established hierarchy and override procedures.

We utilize “bid side” pricing for our Agency RMBS and non-Agency securities and, as a result, certain assets, especially the most recent purchases, may realize a markdown due to the “bid-offer” spread. To the extent that this occurs, any economic effect of this would be reflected in accumulated other comprehensive income.

Considerable judgment is used in forming conclusions and estimating inputs to our Level 3 fair value measurements. Level 3 inputs such as interest rate movements, prepayments speeds, credit losses and discount rates are inherently difficult to estimate. Changes to these inputs can have a significant effect on fair value measurements. Accordingly, there is no assurance that our estimates of fair value are indicative of the amounts that would be realized on the ultimate sale or exchange of these assets. The Company classified 5.5% of its total assets as Level 3 fair value assets at September 30, 2018.

Market Conditions and Outlook

The key macroeconomic factors that impact our business are U.S. residential property prices, national employment rates and the interest rate environment. Home prices increased modestly during the third quarter of 2018 and are expected to gradually appreciate over the next several years, albeit at a slower rate. Employment market conditions remain solid as jobless claims, unemployment and payroll data continue to show improvement at this stage of the business cycle, although new job creation has yet to generate excessive wage growth. Other than LTV ratios and cash reserves, we believe employment is the most powerful determinant of homeowners’ ongoing likelihood to pay their mortgages. Home price performance and employment are particularly important to our non-Agency portfolio.

The Federal Reserve has continued to modestly raise the federal funds target rate, noting a roughly balanced outlook. At the same time, due in part to the absence of meaningful inflation, longer term rates in the U.S. have not been increasing as quickly as short term rates, thus leading to a flattening of the interest rate curve. The Trump administration continues to focus on several issues that could impact interest rates, the U.S. economy and U.S.

businesses, including deregulation, trade and taxes. While there is much uncertainty regarding the timing and specifics of many policy changes, any such actions could affect our business. While interest rates have increased, they are still at historically low levels, and the Federal Reserve has reiterated it will take a measured and conservative approach to future interest rate decisions. While the Federal Reserve has begun to reduce its mortgage-backed securities holdings in the near term, the plan continues to focus on a gradual and predictable approach which reduces reinvestment of principal and interest.

We believe our blended Agency and non-Agency securities portfolio and our investing expertise, as well as our operational capabilities to invest in MSR, will allow us to better navigate the dynamic mortgage market while future regulatory and policy activities take shape. Having a diversified portfolio allows us to mitigate a variety of risks, including interest rate and RMBS spread volatility.

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We expect that the majority of our assets will remain in whole-pool Agency RMBS in light of the long-term attractiveness of the asset class and in order to continue to satisfy the requirements of our exemption from registration under the 1940 Act. Interest-only Agency securities and MSR also provide a complementary investment and risk-management strategy to our principal and interest Agency RMBS. Risk-adjusted returns in our Agency RMBS portfolio may decline if we are required to pay higher purchase premiums due to lower interest rates or additional liquidity in the market. Additionally, the Federal Reserve's prior quantitative easing programs and reinvestment of its mortgage-backed security principal repayments and other policy changes may impact the returns of our Agency RMBS portfolio.

The following table provides the carrying value of our securities portfolio by product type:

(dollars in thousands)	September 30, 2018		December 31, 2017	
Agency				
Fixed Rate	$22,099,352	85.0%	$18,215,505	85.5%
Hybrid ARM	19,594	0.1 %	23,220	0.1 %
Total Agency	22,118,946	85.1%	18,238,725	85.6%
Agency Derivatives	67,040	0.2 %	90,975	0.4 %
Non-Agency				
Senior	2,771,651	10.7%	1,956,145	9.2 %
Mezzanine	976,150	3.7 %	960,865	4.5 %
Interest-only securities	72,169	0.3 %	65,084	0.3 %
Total Non-Agency	3,819,970	14.7%	2,982,094	14.0%
Total	$26,005,956		$21,311,794	

Prepayment speeds and volatility due to interest rates

Our Agency RMBS portfolio is subject to inherent prepayment risk. We seek to offset a portion of our Agency pool exposure to prepayment speeds through our MSR and interest-only Agency RMBS portfolios. Generally, a decline in interest rates that leads to rising prepayment speeds will cause the market value of our interest-only securities and MSR to deteriorate, and our fixed coupon Agency pools to increase. The inverse relationship occurs when interest rates increase and prepayments slow. As previously discussed, despite the Federal Reserve raising rates throughout 2017 and in early 2018, the low interest rate environment is expected to persist in the near term. However, changes in home price performance, key employment metrics and government programs, among other macroeconomic factors, could cause prepayment speeds to increase on many RMBS, which could lead to less attractive reinvestment opportunities. Nonetheless, we believe our portfolio management approach, including our asset selection process, positions us to respond to a variety of market scenarios, including an overall faster prepayment environment.

The following table provides the three-month weighted average constant prepayment rate, or CPR, on our Agency RMBS for the three months ended September 30, 2018, and the four immediately preceding quarters:

Agency RMBS	Three Months Ended				
	September 30, 2018	June 30, 2018	March 31, 2018	December 31, 2017	September 30, 2017
Weighted Average CPR	8.1%	9.2 %	7.0 %	7.6 %	8.0 %

Although we are unable to predict the movement in interest rates in the remainder of 2018 and beyond, our diversified portfolio management strategy is intended to generate attractive yields with a low level of sensitivity to changes in the yield curve, prepayments and interest rate cycles.

Our Agency RMBS are collateralized by pools of fixed-rate mortgage loans and hybrid adjustable-rate mortgage loans, or hybrid ARMs, which are mortgage loans that have interest rates that are fixed for an initial period and adjustable thereafter. Our Agency portfolio also includes securities with implicit or explicit prepayment protection, including lower loan balances (securities collateralized by loans of less than $175,000 in initial principal balance), higher LTVs (securities collateralized by loans with LTVs greater than or equal to 80%), certain geographic concentrations and lower FICO scores. Our overall allocation of Agency RMBS and holdings of pools with specific characteristics are viewed in the context of our aggregate rates strategy, including MSR and related derivative hedging instruments. Additionally, the selection of securities with certain attributes is driven by the perceived relative value of the securities, which factors in the opportunities in the marketplace, the cost of financing and the cost of hedging interest rate, prepayment, credit and other portfolio risks. As a result, Agency RMBS capital allocation reflects management's flexible approach to investing in the marketplace.

The following tables provide the carrying value of our Agency RMBS portfolio by underlying mortgage loan rate type:

	September 30, 2018						
(dollars in thousands)	**Principal/ Current Face**	**Carrying Value**	**% of Agency Portfolio**	**% Prepayment Protected**	**Weighted Average Coupon Rate**	**Amortized Cost**	**Weighted Average Loan Age (months)**
Agency RMBS AFS:							
30-Year Fixed							
3.0-3.5%	$4,163,798	$4,108,203	18.5 %	72.1 %	3.5 %	$4,269,987	21
4.0-4.5%	16,558,938	16,954,572	76.4 %	84.4 %	4.2 %	17,445,235	21
≥ 5%	531,375	569,693	2.6 %	100.0 %	5.3 %	569,336	58
	21,254,111	21,632,468	97.5 %	82.5 %	4.1 %	22,284,558	22
15-Year & Other Fixed	293,912	283,319	1.3 %	0.3 %	4.7 %	289,530	146
Hybrid ARM	18,453	19,594	0.1 %	— %	5.2 %	19,416	175
Interest-only	3,228,729	183,565	0.8 %	— %	2.0 %	218,997	90
Agency Derivatives	498,826	67,040	0.3 %	— %	4.3 %	73,098	170
Total Agency RMBS	$25,294,031	$22,185,986	100.0 %	80.4 %		$22,885,599	

	December 31, 2017						
(dollars in thousands)	**Principal/ Current Face**	**Carrying Value**	**% of Agency Portfolio**	**% Prepayment Protected**	**Weighted Average Coupon Rate**	**Amortized Cost**	**Weighted Average Loan Age (months)**
Agency RMBS AFS:							
30-Year Fixed							
3.0-3.5%	$4,370,847	$4,509,743	24.6 %	95.9 %	3.5 %	$4,569,946	13
4.0-4.5%	11,990,911	12,764,960	69.7 %	99.1 %	4.2 %	12,812,335	17
≥ 5%	453,054	500,880	2.7 %	100.0 %	5.4 %	489,312	90
	16,814,812	17,775,583	97.0 %	98.3 %	4.1 %	17,871,593	18
15-Year & Other Fixed	245,383	244,834	1.3 %	0.6 %	4.9 %	242,033	153
Hybrid ARM	21,654	23,220	0.1 %	— %	5.0 %	22,831	166
Interest-only	2,941,772	195,088	1.1 %	— %	2.2 %	223,289	77
Agency Derivatives	588,246	90,975	0.5 %	— %	4.9 %	86,734	163
Total Agency RMBS	$20,611,867	$18,329,700	100.0 %	95.4 %		$18,446,480	

Our non-Agency securities yields are expected to increase if prepayment rates on such assets exceed our prepayment assumptions. To the extent that prepayment speeds increase due to macroeconomic factors, we expect to benefit from

the ability to recognize the income from the heavily discounted prices that principally arose from credit or payment default expectations.

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The following tables provide net unamortized discount/premium information on our non-Agency securities portfolio:

	September 30, 2018				
(in thousands)	Principal/ Current Face	Un-amortized Premium	Accretable Purchase Discount	Credit Reserve Purchase Discount	Amortized Cost
Principal and interest securities					
Senior	$3,911,771	$ 5,473	$(458,063)	$(1,073,946)	$2,385,235
Mezzanine	1,165,104	1,093	(226,551)	(120,803)	818,843
Total P&I securities	5,076,875	6,566	(684,614)	(1,194,749)	3,204,078
Interest-only	5,196,493	70,511	—	—	70,511
Total Non-Agency	$10,273,368	$ 77,077	$(684,614)	$(1,194,749)	$3,274,589

	December 31, 2017				
(in thousands)	Principal/ Current Face	Un-amortized Premium	Accretable Purchase Discount	Credit Reserve Purchase Discount	Amortized Cost
Principal and interest securities					
Senior	$2,552,972	$ 2,435	$(424,580)	$(534,160)	$1,596,667
Mezzanine	1,205,162	322	(251,453)	(119,453)	834,578
Total P&I securities	3,758,134	2,757	(676,033)	(653,613)	2,431,245
Interest-only	5,614,925	65,667	—	—	65,667
Total Non-Agency	$9,373,059	$ 68,424	$(676,033)	$(653,613)	$2,496,912

Credit losses

Although our Agency portfolio is supported by U.S. government agency and federally chartered corporation guarantees of payment of principal and interest, we are exposed to credit risk in our non-Agency securities and residential mortgage loans.

The credit support built into non-Agency securities deal structures is designed to provide a level of protection from potential credit losses for more senior tranches. We evaluate credit risk on our non-Agency investments through a comprehensive asset selection process, which is predominantly focused on quantifying and pricing credit risk, including extensive initial modeling and scenario analysis. In addition, the discounted purchase prices paid for our non-Agency securities provide additional insulation from credit losses in the event we receive less than 100% of par on such assets. At purchase, we estimate the portion of the discount we do not expect to recover and factor that into our expected yield and accretion methodology. We may also record an other-than-temporary impairment, or OTTI, for a portion of our investment in a security to the extent we believe that the amortized cost exceeds the present value of expected future cash flows. We review our non-Agency securities on an ongoing basis using quantitative and qualitative analysis of the risk-adjusted returns on such investments and through on-going asset surveillance. Nevertheless, unanticipated credit losses could occur, adversely impacting our operating results.

We evaluate and review credit risk on our residential mortgage loans on an ongoing basis using quantitative and qualitative analysis and through on-going asset surveillance.

Counterparty exposure and leverage ratio

We monitor counterparty exposure in our broker, banking and lending counterparties on a daily basis. We believe our broker and banking counterparties are well-capitalized organizations and we attempt to manage our cash balances across these organizations to reduce our exposure to a single counterparty.

As of September 30, 2018, we had entered into repurchase agreements with 46 counterparties, 35 of which had outstanding balances at September 30, 2018. In addition, we held short- and long-term secured advances from the

FHLB, short- and long-term borrowings under revolving credit facilities and long-term unsecured convertible senior notes. As of September 30, 2018, the debt-to-equity ratio funding our AFS securities, MSR and Agency Derivatives, which includes unsecured borrowings under convertible senior notes, was 5.4:1.0.

As of September 30, 2018, we held $422.9 million in cash and cash equivalents, approximately $313.8 million of unpledged Agency securities and derivatives and $1.1 billion of unpledged non-Agency securities. As a result, we had an overall estimated unused borrowing capacity on our unpledged securities of approximately $1.0 billion. As of September 30, 2018, we held approximately $442.3 million of unpledged MSR and had an overall estimated unused borrowing capacity on MSR financing facilities of $260.0 million. We also held approximately $27.5 million of unpledged residential mortgage loans held-for-sale, for which we had no unused borrowing capacity. Generally, unused borrowing capacity may be the result of our election not to utilize certain financing, as well as delays in the timing in which funding is provided or the inability to meet lenders' eligibility requirements for specific types of asset classes. If borrowing rates and collateral requirements change in the near term, we believe we are subject to less earnings volatility than if we carried higher leverage.

We also monitor exposure to our MSR and mortgage loan counterparties. In connection with our previous securitization transactions, we were required to make certain representations and warranties to the investors in the RMBS we issued. We may also be required to make representations and warranties to investors in the loans underlying the MSR we own; however, some of our MSR were purchased on a bifurcated basis, meaning the representation and warranty obligations remain with the seller. If the representations and warranties we make prove to be inaccurate, we may be obligated to repurchase certain mortgage loans, which may impact the profitability of our portfolio. Although we obtain similar representations and warranties from the counterparty from which we acquired the relevant asset, if those representations and warranties do not directly mirror those we make to the investor, or if we are unable to enforce the representations and warranties against the counterparty for a variety of reasons, including the financial condition or insolvency of the counterparty, we may not be able to seek indemnification from our counterparties for any losses attributable to the breach.

Summary of Results of Operations and Financial Condition

On September 14, 2017, our board of directors approved a one-for-two reverse stock split of our outstanding shares of common stock. The reverse stock split was effected on November 1, 2017 at 5:01 p.m. Eastern Time, following the special dividend of Granite Point common stock. At the effective time, every two issued and outstanding shares of our common stock were converted into one share of common stock. No fractional shares were issued in connection with the reverse stock split; instead, each stockholder holding fractional shares was entitled to receive, in lieu of such fractional shares, cash in an amount determined on the basis of the volume weighted average price of our common stock on the NYSE on November 1, 2017. In connection with the reverse stock split, the number of authorized shares of our common stock was also reduced on a one-for-two basis, from 900 million to 450 million. The par value of each share of common stock remained unchanged. All per share amounts, common shares outstanding and restricted shares for all periods presented have been adjusted on a retroactive basis to reflect the reverse stock split.

Our GAAP net income attributable to common stockholders was $17.0 million and $463.8 million ($0.08 and $2.28 per diluted weighted average share) for the three and nine months ended September 30, 2018, as compared to GAAP net income attributable to common stockholders of $93.2 million and $169.5 million ($0.52 and $0.97 per diluted weighted average share) for the three and nine months ended September 30, 2017.

With our accounting treatment for AFS securities, unrealized fluctuations in the market values of AFS securities, excluding Agency interest-only securities, do not impact our GAAP net income or taxable income but are recognized on our condensed consolidated balance sheets as a change in stockholders' equity under "accumulated other comprehensive (loss) income." As a result of this fair value accounting through stockholders' equity, we expect our net income to have less significant fluctuations and result in less U.S. GAAP to taxable income timing differences, than if the portfolio were accounted for as trading instruments. For the three and nine months ended September 30, 2018, net unrealized losses on AFS securities recognized as other comprehensive loss, net of tax, were $119.8 million and $499.5 million, respectively. This, combined with GAAP net income attributable to common stockholders of $17.0 million and $463.8 million, resulted in comprehensive loss attributable to common stockholders of $102.8 million and $35.7 million for the three and nine months ended September 30, 2018, respectively. For the three and nine months

ended September 30, 2017, net unrealized gains on AFS securities recognized as other comprehensive income, net of tax, were $68.4 million and $223.8 million, respectively. This, combined with GAAP net income attributable to common stockholders of $93.2 million and $169.5 million, resulted in comprehensive income attributable to common stockholders of $161.6 million and $393.3 million for the three and nine months ended September 30, 2017, respectively.

Our book value per common share for U.S. GAAP purposes was $14.81 at September 30, 2018, a decrease from $16.31 book value per common share at December 31, 2017. During this nine month period, we declared common dividends of $270.0 million and recognized comprehensive loss attributable to common stockholders of $35.7 million, which drove the overall decrease in book value.

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The following tables present the components of our comprehensive (loss) income for the three and nine months ended September 30, 2018 and 2017:

(in thousands, except share data)	Three Months Ended		Nine Months Ended	
Income Statement Data:	**September 30,**		**September 30,**	
	2018	**2017**	**2018**	**2017**
Interest income:	(unaudited)			
Available-for-sale securities	$230,607	$163,904	$604,790	$449,141
Residential mortgage loans held-for-investment in securitization trusts	—	29,865	—	92,319
Residential mortgage loans held-for-sale	332	479	988	1,380
Other	5,759	1,841	12,299	7,144
Total interest income	236,698	196,089	618,077	549,984
Interest expense:				
Repurchase agreements	138,343	59,694	322,735	135,756
Collateralized borrowings in securitization trusts	—	23,970	—	74,199
Federal Home Loan Bank advances	5,301	10,317	14,655	30,554
Revolving credit facilities	3,973	701	5,776	1,727
Convertible senior notes	4,779	4,745	14,204	13,157
Total interest expense	152,396	99,427	357,370	255,393
Net interest income	84,302	96,662	260,707	294,591
Other-than-temporary impairment losses	(95)	—	(363)	(429)
Other income (loss):				
(Loss) gain on investment securities	(42,996)	5,618	(95,549)	(15,485)
Servicing income	89,618	57,387	238,473	148,468
Gain (loss) on servicing asset	20,591	(29,245)	102,251	(90,440)
Gain (loss) on interest rate swap, cap and swaption agreements	75,857	(207)	255,535	(66,990)
Loss on other derivative instruments	(31,463)	(18,924)	(15,735)	(66,328)
Other income	907	8,431	2,695	21,053
Total other income (loss)	112,514	23,060	487,670	(69,722)
Expenses:				
Management fees	(5,041)	10,146	18,120	29,801
Servicing expenses	16,433	8,560	42,526	25,154
Other operating expenses	17,033	13,138	47,040	44,373
Acquisition transaction costs	86,703	—	86,703	—
Restructuring charges	8,238	—	8,238	—
Total expenses	123,366	31,844	202,627	99,328
Income from continuing operations before income taxes	73,355	87,878	545,387	125,112
Provision for (benefit from) income taxes	37,409	(5,342)	35,142	(21,100)
Net income from continuing operations	35,946	93,220	510,245	146,212
Income from discontinued operations, net of tax	—	11,518	—	39,169
Net income	35,946	104,738	510,245	185,381
Income from discontinued operations attributable to noncontrolling interest	—	2,674	—	2,714
Net income attributable to Two Harbors Investment Corp.	35,946	102,064	510,245	182,667
Dividends on preferred stock	18,951	8,888	46,445	13,173
Net income attributable to common stockholders	$16,995	$93,176	$463,800	$169,494

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(in thousands) **Income Statement Data:**	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**
Basic earnings per weighted average share:	(unaudited)			
Continuing operations	$0.08	$ 0.48	$2.42	$ 0.76
Discontinued operations	—	0.05	—	0.21
Net income	$0.08	$ 0.53	$2.42	$ 0.97
Diluted earnings per weighted average share:				
Continuing operations	$0.08	$ 0.47	$2.28	$ 0.76
Discontinued operations	—	0.05	—	0.21
Net income	$0.08	$ 0.52	$2.28	$ 0.97
Dividends declared per common share	$0.47	$ 0.52	$1.41	$ 1.54
Weighted average number of shares of common stock:				
Basic	224,399,436	174,488,296	191,846,212	174,415,232
Diluted	224,399,436	188,907,356	209,607,146	174,415,232
Comprehensive (loss) income:				
Net income	$35,946	$ 104,738	$510,245	$ 185,381
Other comprehensive (loss) income, net of tax:				
Unrealized (loss) gain on available-for-sale securities	(119,796)	68,433	(499,460)	223,823
Other comprehensive (loss) income	(119,796)	68,433	(499,460)	223,823
Comprehensive (loss) income	(83,850)	173,171	10,785	409,204
Comprehensive income attributable to noncontrolling interest	—	2,682	—	2,724
Comprehensive (loss) income attributable to Two Harbors Investment Corp.	(83,850)	170,489	10,785	406,480
Dividends on preferred stock	18,951	8,888	46,445	13,173
Comprehensive (loss) income attributable to common stockholders	$(102,801)	$ 161,601	$(35,660)	$ 393,307

(in thousands) **Balance Sheet Data:**	**September 30, 2018**	**December 31, 2017**
	(unaudited)	
Available-for-sale securities	$ 25,938,916	$ 21,220,819
Mortgage servicing rights	$ 1,664,024	$ 1,086,717
Total assets	$ 31,530,079	$ 24,789,313
Repurchase agreements	$ 23,806,631	$ 19,451,207
Federal Home Loan Bank advances	$ 865,024	$ 1,215,024
Total stockholders’ equity	$ 4,675,982	$ 3,571,424

Results of Operations

The following analysis focuses on financial results during the three and nine months ended September 30, 2018 and 2017.

Interest Income

Interest income increased from $196.1 million and $550.0 million for the three and nine months ended September 30, 2017, respectively, to $236.7 million and $618.1 million for the same periods in 2018 due to the growth of our AFS securities portfolio as a result of the acquisition of CYS, offset by sales of retained interests from our on-balance sheet securitizations resulting in the deconsolidation of all securitization trusts in the fourth quarter of 2017.

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Interest Expense

Interest expense increased from $99.4 million and $255.4 million for the three and nine months ended September 30, 2017, respectively, to $152.4 million and $357.4 million for the same periods in 2018 due to increased financing on AFS securities as a result of the acquisition of CYS and on MSR due to portfolio growth, an increase in the proportion of total borrowings financed through repurchase agreements (relative to FHLB advances) and increases in the borrowing rates offered by counterparties, offset by sales of retained interests from our on-balance sheet securitizations resulting in the deconsolidation of all securitization trusts in the fourth quarter of 2017.

Net Interest Income

The following tables present the components of interest income and average annualized net asset yield earned by asset type, the components of interest expense and average annualized cost of funds on borrowings incurred by liability and/or collateral type, and net interest income and average annualized net interest rate spread for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018				Nine Months Ended September 30, 2018			
(dollars in thousands)	**Average Balance [1]**	**Interest Income/Expense**	**Net Yield/Cost of Funds [2]**		**Average Balance [1]**	**Interest Income/Expense**	**Net Yield/Cost of Funds [2]**	
Interest-earning assets								
Agency available-for-sale securities	$22,443,273	$ 174,459	3.1	%	$19,278,634	$ 443,584	3.1	%
Non-Agency available-for-sale securities	3,027,030	56,148	7.4	%	2,764,818	161,206	7.8	%
Residential mortgage loans held-for-sale	29,249	332	4.5	%	30,686	988	4.3	%
Other		5,759				12,299		
Total interest income/net asset yield	$25,499,552	$ 236,698	3.7	%	$22,074,138	$ 618,077	3.7	%
Interest-bearing liabilities								
Repurchase agreements, FHLB advances, revolving credit facilities and borrowings in securitization trusts collateralized by:								
Agency available-for-sale securities	$20,793,417	$ 119,197	2.3	%	$18,206,059	$ 271,772	2.0	%
Non-Agency available-for-sale securities	2,282,735	20,803	3.6	%	2,181,769	55,970	3.4	%
Agency derivatives [3]	53,834	427	3.2	%	59,185	1,246	2.8	%
Mortgage servicing rights [4]	508,550	7,190	5.7	%	349,664	14,178	5.4	%
Other unassignable								
Convertible senior notes	283,453	4,779	6.7	%	283,211	14,204	6.7	%
Total interest expense/cost of funds	$23,921,989	152,396	2.5	%	$21,079,888	357,370	2.3	%
Net interest income/spread [5]		$ 84,302	1.2	%		$ 260,707	1.4	%

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(dollars in thousands)	Three Months Ended September 30, 2017				Nine Months Ended September 30, 2017			
	Average Balance (1)	Interest Income/Expense	Net Yield/Cost of Funds (2)		Average Balance (1)	Interest Income/Expense	Net Yield/Cost of Funds (2)	
Interest-earning assets								
Agency available-for-sale securities	$16,470,462	$ 122,130	3.0	%	$14,805,036	$ 333,288	3.0	%
Non-Agency available-for-sale securities	2,051,084	41,774	8.1	%	1,827,069	115,852	8.5	%
Residential mortgage loans held-for-investment in securitization trusts	3,068,728	29,865	3.9	%	3,159,352	92,320	3.9	%
Residential mortgage loans held-for-sale	34,082	479	5.6	%	36,324	1,380	5.1	%
Other		1,841				7,144		
Total interest income/net asset yield	$21,624,356	$ 196,089	3.6	%	$19,827,781	$ 549,984	3.7	%
Interest-bearing liabilities								
Repurchase agreements, FHLB advances, revolving credit facilities and borrowings in securitization trusts collateralized by:								
Agency available-for-sale securities	$15,809,657	$ 56,190	1.4	%	$14,084,616	$ 127,495	1.2	%
Non-Agency available-for-sale securities	1,584,133	11,880	3.0	%	1,404,579	30,521	2.9	%
Residential mortgage loans held-for-investment in securitization trusts	3,010,900	25,056	3.3	%	3,096,905	77,166	3.3	%
Agency derivatives (3)	79,106	418	2.1	%	85,334	1,260	2.0	%
Mortgage servicing rights (4)	47,989	701	5.8	%	38,092	1,727	6.0	%
Other unassignable								
Convertible senior notes	282,448	4,745	6.7	%	268,886	13,157	6.5	%
Other		437				4,067		
Total interest expense/cost of funds	$20,814,233	99,427	1.9	%	$18,978,412	255,393	1.8	%
Net interest income/spread (5)		$ 96,662	1.7	%		$ 294,591	1.9	%

(1) Average asset balance represents average amortized cost on AFS securities and Agency Derivatives and average unpaid principal balance, adjusted for purchase price changes, on residential mortgage loans held-for-investment in securitization trusts and residential mortgage loans held-for-sale.

(2) Cost of funds does not include the accrual and settlement of interest associated with interest rate swaps and caps. In accordance with U.S. GAAP, those costs are included in gain (loss) on interest rate swap, cap and swaption agreements in the condensed consolidated statements of comprehensive (loss) income. For the three and nine months ended September 30, 2018, our total average cost of funds on the assets assigned as collateral for borrowings shown in the table above, including interest spread expense associated with interest rate swaps and caps, was 2.3% and 2.1%, respectively, compared to 2.0% and 1.9% for the same periods in 2017.

(3) Yields on Agency Derivatives not shown as interest income is included in loss on other derivative instruments in the condensed consolidated statements of comprehensive (loss) income.

(4) Yields on mortgage servicing rights not shown as these assets do not earn interest.

(5) Net interest spread does not include the accrual and settlement of interest associated with interest rate swaps and caps. In accordance with U.S. GAAP, those costs are included in gain (loss) on interest rate swap, cap and swaption agreements in the condensed consolidated statements of comprehensive (loss) income. For the three and nine months ended September 30, 2018, our total average net interest rate spread on the assets and liabilities shown in the table above, including interest spread expense associated with interest rate swaps and caps, was 1.3% and 1.6%, respectively, compared to 1.6% and 1.8% for the same periods in 2017.

The increase in yields on Agency AFS securities for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was predominantly driven by purchases of pools with higher yields and sales of pools with lower yields. The increase in cost of funds associated with the financing of Agency AFS securities for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was the result of

increases in the borrowing rates offered by financing counterparties.
The decrease in yields on non-Agency securities for the three and nine months ended September 30, 2018, as compared to the same period in 2017, was predominantly driven by purchases of non-Agency securities at lower yields than our existing portfolio. The increase in cost of funds associated with the financing of non-Agency AFS securities for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was the result of increases in the borrowing rates offered by counterparties.

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During the fourth quarter of 2017, we sold all of the subordinated securities retained from our previous securitization transactions thereby causing the deconsolidation of the securitization trusts and the associated residential mortgage loans held-for-investment and collateralized borrowings from our consolidated balance sheet.
The decrease in yields on residential mortgage loans held-for-sale for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was due to an increase in delinquencies on credit sensitive and Ginnie Mae buyout residential mortgage loans. We did not have any financing of residential mortgage loans held-for-sale in place for the three and nine months ended September 30, 2018 and 2017.
The increase in cost of funds associated with the financing of Agency Derivatives for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was the result of increases in the borrowing rates offered by counterparties.
The decrease in cost of funds associated with the financing of MSR for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was the result of an increase in the proportion of total average borrowings financed through repurchase agreements (relative to revolving credit facilities, which have higher interest rates) and improvement in MSR financing rates in the market.
Our convertible senior notes were issued in January 2017, are unsecured and pay interest semiannually at a rate of 6.25% per annum. The increase cost of funds associated with our convertible senior notes for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was the result of higher amortization of deferred debt issuance costs.
The following tables present the components of the yield earned by investment type on our AFS securities portfolio as a percentage of our average amortized cost of securities for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018			**Nine Months Ended September 30, 2018**		
	Agency (1)	**Non-Agency**	**Total**	**Agency (1)**	**Non-Agency**	**Total**
Gross yield/stated coupon	4.0 %	4.8 %	4.1 %	4.0 %	4.7 %	4.1 %
Net (premium amortization) discount accretion	(0.9)%	2.6 %	(0.5)%	(0.9)%	3.1 %	(0.4)%
Net yield (2)	3.1 %	7.4 %	3.6 %	3.1 %	7.8 %	3.7 %

	Three Months Ended September 30, 2017			**Nine Months Ended September 30, 2017**		
	Agency (1)	**Non-Agency**	**Total**	**Agency (1)**	**Non-Agency**	**Total**
Gross yield/stated coupon	4.1 %	3.7 %	4.0 %	4.0 %	3.6 %	4.0 %
Net (premium amortization) discount accretion	(1.1)%	4.4 %	(0.5)%	(1.0)%	4.9 %	(0.4)%
Net yield (2)	3.0 %	8.1 %	3.5 %	3.0 %	8.5 %	3.6 %

(1) Excludes Agency Derivatives. For the three and nine months ended September 30, 2018, the average annualized net yield on total Agency RMBS, including Agency Derivatives, was 3.1% and 3.1%, respectively, compared to 3.0% and 3.1% for the same periods in 2017.
(2) These yields have not been adjusted for cost of delay and cost to carry purchase premiums.

Other-Than-Temporary Impairments
We review each of our securities on a quarterly basis to determine if an OTTI charge is necessary. During the three and nine months ended September 30, 2018, we recorded $0.1 million and $0.4 million in other-than-temporary credit impairments on a total of three non-Agency securities where the future expected cash flows for each security were less than its amortized cost. During the nine months ended September 30, 2017, we recorded $0.4 million in other-than-temporary credit impairments on one non-Agency security where the future expected cash flows for the security were less than its amortized cost. We did not record any other-than-temporary credit impairments during

the three months ended September 30, 2017. For further information about evaluating AFS securities for OTTI, refer to Note 5 - *Available-for-Sale Securities, at Fair Value* of the notes to the condensed consolidated financial statements.

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(Loss) Gain on Investment Securities
During the three and nine months ended September 30, 2018, we sold AFS securities for $5.4 billion and $9.2 billion with an amortized cost of $5.5 billion and $9.3 billion, for net realized losses of $42.2 million and $100.7 million, respectively. During the three and nine months ended September 30, 2017, we sold AFS securities for $0.6 billion and $5.7 billion with an amortized cost of $0.6 billion and $5.7 billion, for net realized losses of $3.9 million and $21.0 million, respectively. We do not expect to sell assets on a frequent basis, but may sell assets to reallocate capital into new assets that we believe have higher risk-adjusted returns.
For the three and nine months ended September 30, 2018, Agency interest-only mortgage-backed securities experienced a change in unrealized losses of $1.7 million and a change in unrealized gains of $2.0 million, respectively. For the three and nine months ended September 30, 2017, Agency interest-only mortgage-backed securities experienced a change in unrealized gains of $9.6 million and $5.5 million, respectively. The decrease in change in unrealized gains (increase in change in unrealized losses) for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was predominantly driven by higher prepayment expectations on Agency interest-only mortgage-backed securities.
For the nine months ended September 30, 2018, we recognized $1.3 million in dividend income on equity securities. We did not recognize any dividend income on equity securities during the three months ended September 30, 2018. For the three and nine months ended September 30, 2018, equity securities experienced a change in unrealized losses of $0.4 million and a change in unrealized gains of $0.6 million, respectively. Additionally, during both the three and nine months ended September 30, 2018, we sold equity securities for $31.2 million with a cost basis of $30.0 million for net realized gains of $1.2 million. We did not hold any equity securities during the three and nine months ended September 30, 2017.
Servicing Income
For the three and nine months ended September 30, 2018, we recognized total servicing income from our MSR portfolio of $89.6 million and $238.5 million, respectively. These amounts include servicing fee income of $80.7 million and $218.0 million, ancillary and other fee income of $0.3 million and $1.0 million, and float income of $8.6 million and $19.5 million, respectively. For the three and nine months ended September 30, 2017, we recognized total servicing income of $57.4 million and $148.5 million, respectively. These amounts include servicing fee income of $54.0 million and $141.9 million, ancillary and other fee income of $0.3 million and $0.6 million, and float income of $3.1 million and $5.9 million, respectively. The increase in servicing income for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was the result of an increase in the size of our MSR portfolio. Additionally, the increase in float income was the result of both the increased size of our MSR portfolio and increased float earning rates.
Gain (Loss) on Servicing Asset
For the three and nine months ended September 30, 2018, gain on servicing asset of $20.6 million and $102.3 million, respectively, includes an increase in fair value of MSR due to changes in valuation inputs or assumptions of $62.7 million and $209.6 million, respectively, offset by a decrease in fair value of MSR due to realization of cash flows (runoff) of $42.1 million and $107.7 million, respectively. Additionally, we recognized losses on sales of MSR of $3,977 and gains on sales of MSR of $0.4 million for the three and nine months ended September 30, 2018, respectively. For the three and nine months ended September 30, 2017, loss on servicing asset of $29.2 million and $90.4 million, respectively, includes a decrease in fair value of MSR due to changes in valuation inputs or assumptions of $0.2 million and $23.1 million, respectively, and a decrease in fair value of MSR due to realization of cash flows (runoff) of $28.6 million and $66.5 million, respectively. The increase in gain (decrease in loss) on servicing asset for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was predominantly driven by a decrease in prepayment speed assumptions and an increase in market demand, offset by higher portfolio runoff during the three and nine months ended September 30, 2018 due to an increase in the size of our MSR portfolio.
Gain (Loss) on Interest Rate Swap, Cap and Swaption Agreements

For the three and nine months ended September 30, 2018, we recognized $16.2 million and $33.9 million of income, respectively, for the accrual and/or settlement of the net interest expense associated with our interest rate swaps and caps. The income results from receiving either LIBOR interest or a fixed interest rate and paying either a fixed interest rate or LIBOR interest on an average $31.8 billion and $26.2 billion notional, respectively, held to economically hedge/mitigate portfolio interest rate exposure (or duration) risk. For the three and nine months ended September 30, 2017, we recognized $0.4 million and $10.9 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with our interest rate swaps and caps. The expenses result from paying either a fixed interest rate or LIBOR interest and receiving either LIBOR interest or a fixed interest rate on an average $16.7 billion and $17.6 billion notional, respectively, held to economically hedge/mitigate portfolio interest rate exposure (or duration) risk.

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During the three and nine months ended September 30, 2018, we terminated, had agreements mature or had options expire on 33 and 116 interest rate swap, cap and swaption positions of $14.9 billion and $69.5 billion notional, respectively. Upon settlement of the early terminations and option expirations, we paid $11.7 million and $18.1 million in full settlement of our net interest spread asset/liability and recognized $39.9 million in realized losses and $32.2 million in realized gains on the swaps, caps and swaptions for the three and nine months ended September 30, 2018, respectively, including early termination penalties. During the three and nine months ended September 30, 2017, we terminated, had agreements mature or had options expire on 49 and 121 interest rate swap, cap and swaption positions of $17.9 billion and $55.4 billion notional, respectively. Upon settlement of the early terminations and option expirations, we received $3.1 million and paid $19.5 million in full settlement of our net interest spread liability and recognized $32.9 million and $68.9 million in realized gains on the swaps, caps and swaptions for the three and nine months ended September 30, 2017, respectively, including early termination penalties. We elected to terminate certain swaps and swaptions during these periods to align with our investment portfolio.
Also included in our financial results for the three and nine months ended September 30, 2018, was the recognition of a change in unrealized valuation gains of $99.5 million and $189.5 million, respectively, on our interest rate swap, cap and swaption agreements that were accounted for as trading instruments, compared to a change in unrealized valuation losses of $32.7 million and $125.0 million for the same periods in 2017. The change in fair value of interest rate swaps and caps was a result of changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the three and nine months ended September 30, 2018 and 2017. Since these swaps, caps and swaptions are used for purposes of hedging our interest rate exposure, their unrealized valuation gains and losses are generally offset by unrealized losses and gains in our Agency RMBS AFS portfolio, which are recorded either directly to stockholders' equity through other comprehensive (loss) income, net of tax, or to (loss) gain on investment securities, in the case of Agency interest-only securities.
The following table provides the net interest spread and gains and losses associated with our interest rate swap, cap and swaption positions:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(in thousands)	**2018**	**2017**	**2018**	**2017**
Net interest spread	$16,237	$(389)	$33,886	$(10,867)
Early termination, agreement maturation and option expiration (losses) gains	(39,866)	32,906	32,164	68,854
Change in unrealized gain (loss) on interest rate swap, cap and swaption agreements, at fair value	99,486	(32,724)	189,485	(124,977)
Gain (loss) on interest rate swap, cap and swaption agreements	$75,857	$(207)	$255,535	$(66,990)

Loss on Other Derivative Instruments
Included in our financial results for the three and nine months ended September 30, 2018, was the recognition of $31.5 million and $15.7 million of losses, respectively, on other derivative instruments we hold for purposes of both hedging and non-hedging activities, principally TBAs, put and call options for TBAs, Markit IOS total return swaps and inverse interest-only securities. Included within these results for the three and nine months ended September 30, 2018, was the recognition of $0.9 million and $5.0 million of interest income, net of accretion on inverse interest-only securities on an average amortized cost basis of $75.2 million and $80.4 million, respectively. The remainder represented realized and unrealized net gains (losses) on other derivative instruments.
Included in our financial results for the three and nine months ended September 30, 2017, was the recognition of $18.9 million and $66.3 million of losses, respectively, on other derivative instruments we hold for purposes of both hedging and non-hedging activities, principally TBAs, put and call options for TBAs, Markit IOS total return swaps and inverse interest-only securities. Included within these results for the three and nine months ended September 30, 2017, was the recognition of $2.8 million and $10.0 million of interest income, net of accretion on inverse

interest-only securities on an average amortized cost basis of $93.4 million and $96.7 million, respectively. The remainder represented realized and unrealized net gains (losses) on other derivative instruments. As these derivative instruments are considered trading instruments, our financial results include both realized and unrealized gains (losses) associated with these instruments.

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Other Income

For the three and nine months ended September 30, 2018, we recorded other income of $0.9 million and $2.7 million, which includes $0.3 million and $0.9 million of gains on residential mortgage loans held-for-sale and $0.6 million and $1.8 million of dividend income on our FHLB stock. For the three and nine months ended September 30, 2017, we recorded other income of $8.4 million and $21.1 million, which includes $0.4 million and $2.1 million of gains on residential mortgage loans held-for-sale, $14.7 million and $45.6 million in gains on residential mortgage loans held-for-investment in securitization trusts, $7.9 million and $30.7 million in losses on collateralized borrowings in securitization trusts and $1.2 million and $4.0 million of dividend income on our FHLB stock. The decrease in other income for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was predominantly driven by sales of retained interests from our on-balance sheet securitizations resulting in the deconsolidation of all securitization trusts in the fourth quarter of 2017.

Management Fees

We incurred management fees of $12.4 million and $35.6 million for the three and nine months ended September 30, 2018 and $10.1 million and $29.8 million for the three and nine months ended September 30, 2017, respectively, which are payable to PRCM Advisers, our external manager, under the terms of our management agreement, dated as of October 28, 2009 and subsequently amended. The management fee is calculated based on our stockholders' equity with certain adjustments outlined in the management agreement.

In connection with the acquisition of CYS, the management agreement was amended to (i) reduce PRCM Advisers' base management fee with respect to the additional equity under management resulting from the merger to 0.75% from the effective time through the first anniversary of the effective time and (ii) for the fiscal quarter in which closing of the merger occurs, to make a one-time downward adjustment of Pine River's management fees payable by Two Harbors for such quarter by $15.0 million to offset the cash consideration payable to stockholders of CYS, plus an additional downward adjustment of up to $3.3 million for certain transaction-related expenses. For both the three and nine months ended September 30, 2018, the total downward adjustment to management fees was $17.5 million. We do not anticipate any further downward adjustments to management fees for transaction-related expenses.

Servicing Expenses

For the three and nine months ended September 30, 2018, we recognized $16.4 million and $42.5 million, respectively, in servicing expenses generally related to the subservicing of MSR and residential mortgage loans, compared to $8.6 million and $25.2 million for the same periods in 2017. The increase in servicing expenses during the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was the result of an increase in the size of our MSR portfolio as well as the release of MSR representation and warranty reserves during the three months ended March 31, 2017, offset by a decrease in servicing expenses related to residential mortgage loans due to the deconsolidation of all securitization trusts in the fourth quarter of 2017.

Other Operating Expenses

For the three and nine months ended September 30, 2018, we recognized $17.0 million and $47.0 million of other operating expenses, which represents an annualized expense ratio of 1.6% and 1.6% of average common equity, respectively. Excluding non-cash equity compensation expenses (amortization of restricted stock), our annualized expense ratio was 1.3% and 1.3% of average common equity for the three and nine months ended September 30, 2018, respectively. For the three and nine months ended September 30, 2017, we recognized $13.1 million and $44.4 million of other operating expenses, which, for the nine months ended September 30, 2017, includes $2.2 million of transaction expenses associated with the contribution of TH Commercial Holdings LLC to Granite Point. Excluding these transaction expenses, our annualized expense ratio was 1.4% and 1.5% of average common equity for the three and nine months ended September 30, 2017, respectively. Excluding non-cash equity compensation expenses (and transaction expenses associated with the contribution of TH Commercial Holdings LLC to Granite Point), our annualized expense ratio was 1.0% and 1.2% of average common equity for the three and nine months ended September 30, 2017, respectively.

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Included in other operating expenses are direct and allocated costs incurred by PRCM Advisers on our behalf and reimbursed by us. For the three and nine months ended September 30, 2018, these direct and allocated costs totaled approximately $5.3 million and $16.1 million, respectively, compared to $4.8 million and $13.1 million for the same periods in 2017. Included in these reimbursed costs was compensation paid to employees of Pine River serving as our principal financial officer and general counsel of $0.2 million and $1.5 million for the three and nine months ended September 30, 2018 and $0.2 million and $1.5 million for the three and nine months ended September 30, 2017, respectively. The allocation of compensation paid to employees of Pine River serving as our principal financial officer and general counsel is based on time spent overseeing our company's activities in accordance with the management agreement; we do not reimburse PRCM Advisers for any expenses related to the compensation of our chief executive officer or chief investment officer. Equity based compensation expense for the three and nine months ended September 30, 2018 also includes the amortization of restricted stock awarded to our executive officers, including our chief executive officer, chief investment officer, principal financial officer and general counsel of $1.8 million and $5.0 million, compared to $2.0 million and $6.4 million for the three and nine months ended September 30, 2017, respectively. The decrease in amortization of restricted stock was due to the decline in our share price following the special dividend of Granite Point common stock in the fourth quarter of 2017 and resulting grant price of restricted shares issued in 2018.

We have direct relationships with the majority of our third-party vendors. We will continue to have certain costs allocated to us by PRCM Advisers for compensation, data services, technology and certain office lease payments, but most of our expenses with third-party vendors are paid directly by us.

Acquisition Transaction Costs

As there were no meaningful nonfinancial assets and non-current assets acquired in the merger with CYS and no identified intangible assets to assign value, the excess consideration and costs associated with the transaction were recognized in the condensed consolidated statements of comprehensive (loss) income as acquisition transaction costs. For both the three and nine months ended September 30, 2018, these acquisition transaction costs totaled approximately $86.7 million.

Restructuring Charges

In connection with the acquisition of CYS, we incurred restructuring charges, including termination benefits, contract terminations and other associated costs, of $8.2 million for both the three and nine months ended September 30, 2018.

Income Taxes

During the three and nine months ended September 30, 2018, our TRSs recognized a provision for income taxes of $37.4 million and $35.1 million, which was primarily due to realized gains on sales of AFS securities and gains recognized on MSR held in the TRSs as well as the write-down of net deferred tax assets resulting from the deemed liquidation of one of our TRSs due to its TRS election revocation, offset by net losses incurred on derivative instruments held in the TRSs. During the three and nine months ended September 30, 2017, our TRSs recognized a benefit from income taxes of $5.3 million and $21.1 million, respectively, which was primarily due to realized losses on sales of AFS securities and net losses incurred on derivative instruments held in the TRSs. As of September 30, 2018 and December 31, 2017, a $2.4 million and a $2.7 million valuation allowance was recorded, respectively, because we determined that it is more likely than not that the associated deferred tax asset will not be realized. We currently intend to distribute 100% of our REIT taxable income and comply with all requirements to continue to qualify as a REIT.

The Tax Cuts and Jobs Act, or TCJA, significantly revises the U.S. corporate income tax laws by, among other things, lowering the federal income tax rate applicable to corporations from 35% to 21% and repealing the corporate alternative minimum tax. We have not completed our determination of the accounting implications of the TCJA on our tax accruals. However, we reasonably estimated the effects of the TCJA and recognized a tax provision of $17.5 million in our financial statements as of December 31, 2017. This amount represents the remeasurement of federal net deferred tax assets resulting from the permanent reduction in the U.S. statutory corporate tax rate from 35% to 21%. The TCJA requires complex computations to be performed that were not previously required in U.S. tax law,

significant judgments to be made in interpretation of the provisions of the TCJA and significant estimates in calculations, and the preparation and analysis of information not previously relevant or regularly produced. The U.S. Treasury, the IRS, and other standard-setting bodies could interpret or issue guidance on how provisions of the TCJA will be applied or otherwise administered that is different from our interpretation. As we complete our analysis of the TCJA, collect and prepare necessary data, and interpret any additional guidance, we may make adjustments to the provisional amounts. Those adjustments may materially impact our provision for income taxes in the period in which the adjustments are made.

Discontinued Operations

On June 28, 2017, we completed the contribution of our portfolio of commercial real estate assets to Granite Point. We contributed our equity interests in our wholly owned subsidiary, TH Commercial Holdings LLC, to Granite Point and, in exchange for our contribution, received approximately 33.1 million shares of common stock of Granite Point, representing approximately 76.5% of the outstanding stock of Granite Point upon completion of the initial public offering, or IPO, of its common stock on June 28, 2017.

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On November 1, 2017, we distributed, on a pro rata basis, the 33.1 million shares of Granite Point common stock that we acquired in connection with the contribution to the holders of our common stock outstanding as of the close of business on October 20, 2017. Due to our controlling ownership interest in Granite Point through November 1, 2017, our results of operations and financial condition through such date reflect Granite Point's commercial strategy, which is focused on directly originating, investing in and managing senior floating-rate commercial mortgage loans and other debt and debt-like commercial real estate investments. As of November 1, 2017, we no longer had a controlling interest in Granite Point and, therefore, deconsolidated Granite Point and its subsidiaries from our financial statements and reclassified all of Granite Point's prior period assets, liabilities and results of operations to discontinued operations. For the three and nine months ended September 30, 2017, we recognized $8.8 million and $36.5 million, respectively, in income from discontinued operations, net of noncontrolling interest, related to Granite Point.

Financial Condition

Available-for-Sale Securities, at Fair Value

Agency RMBS

Our Agency RMBS AFS portfolio is comprised of adjustable rate and fixed rate mortgage-backed securities backed by single-family and multi-family mortgage loans. All of our principal and interest ("P&I") Agency RMBS AFS were Fannie Mae or Freddie Mac mortgage pass-through certificates or collateralized mortgage obligations that carry an implied rating of "AAA," or Ginnie Mae mortgage pass-through certificates, which are backed by the guarantee of the U.S. government. The majority of these securities consist of whole pools in which we own all of the investment interests in the securities.

The tables below summarize certain characteristics of our Agency RMBS AFS at September 30, 2018:

	September 30, 2018							
(dollars in thousands, except purchase price)	**Principal/ Current Face**	**Net (Discount) Premium**	**Amortized Cost**	**Unrealized Gain**	**Unrealized Loss**	**Carrying Value**	**Weighted Average Coupon Rate**	**Weighted Average Purchase Price**
P&I securities								
Fixed	$21,548,023	$1,026,065	$22,574,088	$ 6,994	$(665,295)	$21,915,787	4.10 %	$ 105.15
Hybrid ARM	18,453	963	19,416	291	(113)	19,594	5.21 %	$ 107.61
Total P&I securities	21,566,476	1,027,028	22,593,504	7,285	(665,408)	21,935,381	4.10 %	$ 105.15
Interest-only securities								
Fixed	841,488	61,908	61,908	5,844	(452)	67,300	2.84 %	$ 13.80
Fixed Other [(1)]	2,387,241	157,089	157,089	8,968	(49,792)	116,265	1.53 %	$ 8.81
Total	$24,795,205	$1,246,025	$22,812,501	$ 22,097	$(715,652)	$22,118,946		

(1) Fixed Other represents weighted-average coupon interest-only securities that are not generally used for our interest-rate risk management purposes. These securities pay variable coupon interest based on the weighted average of the fixed rates of the underlying loans of the security, less the weighted average rates of the applicable issued P&I securities.

Our three-month average constant prepayment rate, or CPR, experienced by Agency RMBS AFS owned by us as of September 30, 2018, on an annualized basis, was 8.1%.

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Non-Agency Securities

Our non-Agency securities portfolio is comprised of senior and mezzanine tranches of mortgage-backed and asset-backed securities. The following tables provide investment information on our non-Agency securities as of September 30, 2018:

	September 30, 2018							
(in thousands)	Principal/Current Face	Unamortized Premium	Accretable Purchase Discount	Credit Reserve Purchase Discount	Amortized Cost	Unrealized Gain	Unrealized Loss	Carrying Value
P&I securities								
Senior	$3,911,771	$ 5,473	$(458,063)	$(1,073,946)	$2,385,235	$392,623	$(6,207)	$2,771,651
Mezzanine	1,165,104	1,093	(226,551)	(120,803)	818,843	160,193	(2,886)	976,150
Total P&I	5,076,875	6,566	(684,614)	(1,194,749)	3,204,078	552,816	(9,093)	3,747,801
Interest-only securities	5,196,493	70,511	—	—	70,511	4,264	(2,606)	72,169
Total	$10,273,368	$ 77,077	$(684,614)	$(1,194,749)	$3,274,589	$557,080	$(11,699)	$3,819,970

The majority of our non-Agency securities were rated at September 30, 2018. Note that credit ratings are based on the par value of the non-Agency securities, whereas the distressed non-Agency securities in our portfolio were acquired at heavily discounted prices. The following table summarizes the credit ratings of our non-Agency securities portfolio, based on the Bloomberg Index Rating, a composite of each of the four major credit rating agencies (*i.e.*, DBRS Ltd., Moody’s Investors Services, Inc., Standard & Poor’s Corporation and Fitch, Inc.), as of September 30, 2018:

	September 30, 2018
AAA	0.6 %
AA	— %
A	0.1 %
BBB	2.7 %
BB	0.6 %
B	4.9 %
Below B	72.1 %
Not rated	19.0 %
Total	100.0 %

Within our non-Agency securities portfolio, we have a substantial emphasis on “legacy” securities, which include securities issued up to and including 2009, many of which are subprime. We believe these deeply discounted securities can add relative value as the economy and housing markets continue to improve, as there remains upside optionality to lower delinquencies, higher recoveries and faster prepays. We also hold “new issue” non-Agency securities (issued after 2009), which include commercial mortgage-backed securities, term notes backed by MSR-related collateral, certain securities from our previously consolidated securitization trusts and other newly issued non-Agency securities. We believe these “new issue” securities have enabled us to find attractive returns and further diversify our non-Agency securities portfolio.

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The following table provides the carrying value of our "legacy" and "new issue" non-Agency securities at September 30, 2018:

	September 30, 2018		
(dollars in thousands)	Carrying Value	% of Total Non-Agency Portfolio	
"Legacy" non-Agency P&I securities	$3,564,511	93.3	%
"Legacy" non-Agency interest-only securities	12,854	0.3	%
"New issue" non-Agency securities	242,605	6.4	%
Total	$3,819,970	100.0	%

Due to acquisitions of "legacy" non-Agency securities, our designated credit reserve as a percentage of total discount increased from September 30, 2017 to September 30, 2018 (as disclosed in Note 5 - *Available-for-Sale Securities, at Fair Value* of the notes to the condensed consolidated financial statements). From September 30, 2017 to September 30, 2018, our designated credit reserve as a percentage of total discount increased from 44.5% to 63.6%.
A subprime bond may generally be considered higher risk; however, if purchased at a discount that reflects a high expectation of credit losses, it could be viewed as less risky than a prime bond, which is subject to unanticipated credit loss performance. Accordingly, we believe our risk profile in owning a heavily discounted subprime bond with known delinquencies affords us the ability to assume a higher percentage of expected credit loss with comparable risk-adjusted returns to a less discounted prime bond with a lower percentage of expected credit loss.
The following tables present certain information by investment type and their respective underlying loan characteristics for our "legacy" senior and mezzanine non-Agency securities, excluding our non-Agency interest-only portfolio, at September 30, 2018:

	September 30, 2018					
"Legacy" Non-Agency P&I Securities	**Senior**		**Mezzanine**		**Total**	
Carrying value (in thousands)	$2,719,558		$844,953		$3,564,511	
% of total	76.3	%	23.7	%	100.0	%
Average purchase price [(1)]	$60.53		$65.35		$61.68	
Average coupon	3.1	%	2.9	%	3.1	%
Average fixed coupon	5.9	%	5.2	%	5.8	%
Average floating coupon	2.9	%	2.8	%	2.9	%
Average hybrid coupon	3.9	%	—	%	3.9	%
Collateral attributes						
Average loan age (months)	145		154		147	
Average loan size (in thousands)	$378		$381		$378	
Average original loan-to-value	67.8	%	67.3	%	67.7	%
Average original FICO [(2)]	618		576		608	
Current performance						
60+ day delinquencies	20.2	%	17.8	%	19.6	%
Average credit enhancement [(3)]	5.4	%	16.4	%	8.0	%
3-month CPR [(4)]	6.2	%	8.0	%	6.6	%

(1) Average purchase price utilized carrying value for weighting purposes. If current face were utilized for weighting purposes, the average purchase price for senior, mezzanine, and total "legacy" non-Agency securities, excluding our non-Agency interest-only portfolio, would be $57.96, $62.77 and $58.95, respectively, at September 30, 2018.
(2) FICO represents a mortgage industry accepted credit score of a borrower, which was developed by Fair Isaac Corporation.

(3) Average credit enhancement remaining on our "legacy" non-Agency securities portfolio, which is the average amount of protection available to absorb future credit losses due to defaults on the underlying collateral.

(4) Three-month CPR is reflective of the prepayment speed on the underlying securitization; however, it does not necessarily indicate the proceeds received on our investment tranche. Proceeds received for each security are dependent on the position of the individual security within the structure of each deal.

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(dollars in thousands)	**September 30, 2018 "Legacy" Non-Agency P&I Securities**					
	Senior		**Mezzanine**		**Total**	
Collateral Type	**Carrying Value**	**% of Senior**	**Carrying Value**	**% of Mezzanine**	**Carrying Value**	**% of Total**
Prime	$26,457	1.0 %	$13,652	1.6 %	$40,109	1.1 %
Alt-A	373,768	13.7 %	93,604	11.1 %	467,372	13.1 %
POA	218,609	8.0 %	178,184	21.1 %	396,793	11.2 %
Subprime	2,100,724	77.3 %	559,513	66.2 %	2,660,237	74.6 %
Total	$2,719,558	100.0%	$844,953	100.0 %	$3,564,511	100.0%

(dollars in thousands)	**September 30, 2018 "Legacy" Non-Agency P&I Securities**					
	Senior		**Mezzanine**		**Total**	
Coupon Type	**Carrying Value**	**% of Senior**	**Carrying Value**	**% of Mezzanine**	**Carrying Value**	**% of Total**
Fixed rate	$195,890	7.2 %	$20,590	2.4 %	$216,480	6.1 %
Hybrid or floating	2,523,668	92.8 %	824,363	97.6 %	3,348,031	93.9 %
Total	$2,719,558	100.0%	$844,953	100.0 %	$3,564,511	100.0%

(dollars in thousands)	**September 30, 2018 "Legacy" Non-Agency P&I Securities**					
	Senior		**Mezzanine**		**Total**	
Origination Year	**Carrying Value**	**% of Senior**	**Carrying Value**	**% of Mezzanine**	**Carrying Value**	**% of Total**
2006 and thereafter	$2,498,492	91.9 %	$325,496	38.5 %	$2,823,988	79.2 %
2002-2005	215,584	7.9 %	517,878	61.3 %	733,462	20.6 %
Pre-2002	5,482	0.2 %	1,579	0.2 %	7,061	0.2 %
Total	$2,719,558	100.0%	$844,953	100.0 %	$3,564,511	100.0%

Mortgage Servicing Rights, at Fair Value

One of our wholly owned subsidiaries has approvals from Fannie Mae and Freddie Mac to own and manage MSR, which represent the right to control the servicing of mortgage loans. We do not directly service mortgage loans, and instead contract with appropriately licensed subservicers to handle substantially all servicing functions in the name of the subservicer for the loans underlying our MSR. As of September 30, 2018, our MSR had a fair market value of $1.7 billion.

As of September 30, 2018, our MSR portfolio included MSR on 581,677 loans with an unpaid principal balance of approximately $131.1 billion. The following table summarizes certain characteristics of the loans underlying our MSR at September 30, 2018:

	September 30, 2018
Unpaid principal balance (in thousands)	$131,114,538
Number of loans	581,677
Average coupon	4.1 %
Average loan age (months)	28
Average loan size (in thousands)	$225
Average original loan-to-value	74.4 %
Average original FICO	751
60+ day delinquencies	0.4 %

3-month CPR	8.7	%

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Discontinued Operations

On June 28, 2017, we contributed our equity interests in our wholly owned subsidiary, TH Commercial Holdings LLC, to Granite Point and, in exchange for the contribution, received approximately 33.1 million shares of common stock of Granite Point, representing approximately 76.5% of the outstanding stock of Granite Point upon completion of the IPO of its common stock on June 28, 2017. On November 1, 2017, we distributed, on a pro rata basis, the 33.1 million shares of Granite Point common stock that we acquired in connection with the contribution to stockholders holding shares of Two Harbors common stock outstanding as of the close of business on October 20, 2017. Due to our controlling ownership interest in Granite Point through November 1, 2017, our results of operations and financial condition through such date reflect Granite Point's commercial strategy, which is focused on directly originating, investing in and managing senior floating-rate commercial mortgage loans and other debt and debt-like commercial real estate investments. As of November 1, 2017, we no longer have a controlling interest in Granite Point and, therefore, have deconsolidated Granite Point and its subsidiaries from our financial statements and reclassified all of Granite Point's prior period assets, liabilities and results of operations to discontinued operations.

Summarized financial information for the discontinued operations are presented below.

(in thousands)	**November 1, 2017**
Assets:	
Available-for-sale securities, at fair value	$12,814
Commercial real estate assets	2,233,080
Cash and cash equivalents	84,183
Restricted cash	2,838
Accrued interest receivable	6,588
Other assets	22,774
Total Assets	$2,362,277
Liabilities:	
Repurchase agreements	$1,516,294
Dividends payable	48
Other liabilities	10,337
Total Liabilities	$1,526,679

Financing

Our borrowings consist primarily of repurchase agreements, FHLB advances and revolving credit facilities collateralized by our pledge of AFS securities, derivative instruments, MSR and certain cash balances. Substantially all of our Agency RMBS are currently pledged as collateral, and the majority of our non-Agency securities have been pledged as collateral, either through repurchase agreements or FHLB advances. Additionally, on January 19, 2017, we closed an underwritten public offering of $287.5 million aggregate principal amount of 6.25% convertible senior notes due 2022. The net proceeds from the offering were approximately $282.2 million after deducting underwriting discounts and estimated offering expenses. The majority of these proceeds were used to help fund our MSR assets, which previously had largely been funded with cash.

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At September 30, 2018, borrowings under repurchase agreements, FHLB advances, revolving credit facilities and convertible senior notes had the following characteristics:

(dollars in thousands) **September 30, 2018**

Collateral Type	Amount Outstanding	Weighted Average Borrowing Rate		Weighted Average Haircut on Collateral Value	
Agency RMBS	$22,368,319	2.33	%	4.8	%
Non-Agency securities	2,051,876	3.59	%	24.8	%
Agency Derivatives	51,460	3.20	%	26.5	%
Mortgage servicing rights	510,000	4.97	%	38.5	%
Other [(1)]	283,555	6.25	%	NA	
Total	$25,265,210	2.53	%	7.1	%

(1) Includes unsecured convertible senior notes paying interest semiannually at a rate of 6.25% per annum on the aggregate principal amount of $287.5 million.

As of September 30, 2018, we had outstanding $23.8 billion of repurchase agreements, and the term to maturity ranged from one day to over 14 months. Repurchase agreements had a weighted average borrowing rate of 2.45% and weighted average remaining maturities of 92 days as of September 30, 2018.

As of September 30, 2018, we had outstanding $865.0 million of FHLB advances with a weighted average term to maturity of 19 months, ranging from approximately 7 months to over 16 years. The weighted average cost of funds for our advances was 2.48% at September 30, 2018.

As of September 30, 2018, we had outstanding $310.0 million of short- and long-term borrowings under revolving credit facilities with a weighted average borrowing rate of 5.36% and weighted average remaining maturities of 4.44 years.

As of September 30, 2018, the outstanding amount due on convertible senior notes was $283.6 million, net of deferred issuance costs. These notes are unsecured, pay interest semiannually at a rate of 6.25% per annum and mature in January 2022.

As of September 30, 2018, the debt-to-equity ratio funding our AFS securities, MSR and Agency Derivatives, which includes unsecured borrowings under convertible senior notes, was 5.4:1.0. We believe our debt-to-equity ratio provides unused borrowing capacity and, thus, improves our liquidity and the strength of our balance sheet.

The following table provides a summary of our borrowings under repurchase agreements, FHLB advances, revolving credit facilities and convertible senior notes, our net TBA notional amounts and our debt-to-equity ratios for the three months ended September 30, 2018, and the four immediately preceding quarters:

(dollars in thousands)

For the Three Months Ended	Quarterly Average [(1)]	End of Period Balance [(1)]	Maximum Balance of Any Month-End [(1)]	End of Period Total Borrowings to Equity Ratio	End of Period Net Long (Short) TBA Notional	End of Period Economic Debt-to-Equity Ratio [(2)]
September 30, 2018	$23,921,989	$25,265,210	$27,528,323	5.4:1.0	$9,324,000	7.3:1.0
June 30, 2018	$19,123,370	$18,524,115	$19,237,474	5.3:1.0	$3,049,000	6.2:1.0
March 31, 2018	$20,194,305	$20,316,757	$20,466,930	5.9:1.0	$445,000	6.0:1.0

December 31, 2017	$19,270,237	$20,969,058	$20,969,058	5.9:1.0	$(573,000)	5.7:1.0
September 30, 2017	$17,959,764	$19,143,433	$19,143,433	5.0:1.0 [3]	$(1,405,000)	4.7:1.0 [3]

(1) Includes borrowings under repurchase agreements, FHLB advances, revolving credit facilities and convertible senior notes and excludes collateralized borrowings in securitization trusts.

(2) Defined as total borrowings under repurchase agreements, FHLB advances, revolving credit facilities and convertible senior notes, plus implied debt on net TBA notional, divided by total equity.

(3) Includes total borrowings of discontinued operations.

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Equity

The tables below provide details of our changes in stockholders’ equity from June 30, 2018 to September 30, 2018 as well as a reconciliation of comprehensive income and GAAP net income to non-GAAP measures.

(dollars in millions, except per share amounts)	Book Value	Common Shares Outstanding	Common Book Value Per Share
Common stockholders' equity at June 30, 2018	$2,753.9	175.5	$ 15.69
Core Earnings, net of tax benefit of $0.1 million [1]	93.1		
Dividends on preferred stock	(19.0)		
Core Earnings attributable to common stockholders [1]	74.1		
Dollar roll income	32.9		
Core Earnings attributable to common stockholders, including dollar roll income [1]	107.0		
Realized and unrealized gains and losses, net of tax expense of $37.5 million	(3.3)		
Transaction expenses and purchase premium associated with the acquisition of CYS Investments, Inc.	(86.7)		
Other comprehensive loss, net of tax	(119.8)		
Dividend declaration	(105.1)		
Other	3.4	—	
Acquisition of CYS Investments, Inc.	1,125.1	72.6	
Issuance of common stock, net of offering costs	0.2	—	
Common stockholders' equity at September 30, 2018	$3,674.7	248.1	$ 14.81
Total preferred stock liquidation preference	1,001.3		
Total equity at September 30, 2018	$4,676.0		

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(in millions)	Three Months Ended September 30, 2018
Comprehensive loss attributable to common stockholders	$ (102.8)
Adjustment for other comprehensive loss attributable to common stockholders:	
Unrealized losses on available-for-sale securities	119.8
Net income attributable to common stockholders	17.0
Adjustments for non-Core Earnings:	
Realized loss on investment securities and residential mortgage loans held-for-sale	40.8
Unrealized loss on investment securities and residential mortgage loans held-for-sale	1.9
Other-than-temporary impairment loss	0.1
Realized loss on termination or expiration of interest rate swaps, caps and swaptions	39.9
Unrealized gain on interest rate swaps, caps and swaptions	(99.5)
Loss on other derivative instruments	28.7
Realized and unrealized gains on mortgage servicing rights	(73.1)
Change in servicing reserves	0.2
Non-cash equity compensation expense	3.2
Management fee reduction associated with the acquisition of CYS Investments, Inc.	(17.5)
Transaction expenses and purchase premium associated with the acquisition of CYS Investments, Inc.	86.7
Restructuring charges	8.2
Net provision for income taxes on non-Core Earnings	37.5
Core Earnings attributable to common stockholders [1]	74.1
Dollar roll income	32.9
Core Earnings attributable to common stockholders, including dollar roll income [1]	$ 107.0

(1) Core Earnings is a non-U.S. GAAP measure that we define as comprehensive (loss) income attributable to common stockholders, excluding "realized and unrealized gains and losses" (impairment losses, realized and unrealized gains and losses on the aggregate portfolio, reserve expense for representation and warranty obligations on MSR, non-cash compensation expense related to restricted common stock and restructuring charges) and transaction costs associated with the acquisition of CYS. As defined, Core Earnings includes interest income or expense and premium income or loss on derivative instruments and servicing income, net of estimated amortization on MSR. Dollar roll income is the economic equivalent to holding and financing Agency RMBS using short-term repurchase agreements. We believe the presentation of Core Earnings, including dollar roll income, provides investors greater transparency into our period-over-period financial performance and facilitates comparisons to peer REITs.

Liquidity and Capital Resources

Our liquidity and capital resources are managed and forecast on a daily basis. We believe this ensures that we have sufficient liquidity to absorb market events that could negatively impact collateral valuations and result in margin calls, and that we have the flexibility to manage our portfolio to take advantage of market opportunities.

Our principal sources of cash consist of borrowings under repurchase agreements, FHLB advances, revolving credit facilities, payments of principal and interest we receive on our target assets, cash generated from our operating results, and proceeds from capital market transactions. We typically use cash to repay principal and interest on our repurchase agreements, FHLB advances and revolving credit facilities, to purchase our target assets, to make dividend payments on our capital stock, and to fund our operations.

To the extent that we raise additional equity capital through capital market transactions, we anticipate using cash proceeds from such transactions to purchase additional Agency RMBS, non-Agency securities, MSR and other target assets and for other general corporate purposes.

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As of September 30, 2018, we held $422.9 million in cash and cash equivalents available to support our operations; $28.0 billion of AFS securities, MSR, residential mortgage loans held-for-sale and derivative assets held at fair value; and $25.3 billion of outstanding debt in the form of repurchase agreements, FHLB advances, borrowings under revolving credit facilities and convertible senior notes. During the three and nine months ended September 30, 2018, the debt-to-equity ratio funding our AFS securities, MSR and Agency Derivatives, which includes unsecured borrowings under convertible senior notes, increased from 5.3:10 to 5.4:1.0 and decreased from 5.9:1.0 to 5.4:1.0, respectively. The increase during the three months ended September 30, 2018 was driven by an increase in Agency RMBS held during the period as a result of the acquisition of CYS. The decrease during the nine months ended September 30, 2018 was predominantly driven by the repositioning of financing on AFS securities to TBA positions. During the three and nine months ended September 30, 2018, our economic debt-to-equity ratio funding our AFS securities, MSR and Agency Derivatives, which includes unsecured borrowings under convertible senior notes and implied debt on net TBA notional, increased from 6.2:10 to 7.3:1.0 and from 5.7:1.0 to 7.3:1.0, respectively.

As of September 30, 2018, we held approximately $313.8 million of unpledged Agency securities and derivatives and $1.1 billion of unpledged non-Agency securities. As a result, we had an overall estimated unused borrowing capacity on unpledged securities of approximately $1.0 billion. As of September 30, 2018, we held approximately $442.3 million of unpledged MSR and had an overall estimated unused borrowing capacity on MSR financing facilities of $260.0 million. We also held approximately $27.5 million of unpledged residential mortgage loans held-for-sale, for which we had no unused borrowing capacity. Generally, unused borrowing capacity may be the result of our election not to utilize certain financing, as well as delays in the timing in which funding is provided or the inability to meet lenders' eligibility requirements for specific types of asset classes. On a daily basis, we monitor and forecast our available, or excess, liquidity. Additionally, we frequently perform shock analyses against various market events to monitor the adequacy of our excess liquidity. If borrowing rates and/or collateral requirements change in the near term, we believe we are subject to less earnings volatility than a more leveraged organization.

During the nine months ended September 30, 2018, we did not experience any restrictions to our funding sources, although balance sheet capacity of counterparties have tightened due to compliance with the Basel III regulatory capital reform rules as well as management of perceived risk in the volatile interest rate environment. We expect ongoing sources of financing to be primarily repurchase agreements, FHLB advances, revolving credit facilities, convertible notes and similar financing arrangements. We plan to finance our assets with a moderate amount of leverage, the level of which may vary based upon the particular characteristics of our portfolio and market conditions.

As of September 30, 2018, we had master repurchase agreements in place with 46 counterparties (lenders), the majority of which are U.S. domiciled financial institutions, and we continue to evaluate additional counterparties to manage and reduce counterparty risk. Under our repurchase agreements, we are required to pledge additional assets as collateral to our lenders when the estimated fair value of the existing pledged collateral under such agreements declines and such lenders, through a margin call, demand additional collateral. Lenders generally make margin calls because of a perceived decline in the value of our assets collateralizing the repurchase agreements. This may occur following the monthly principal reduction of assets due to scheduled amortization and prepayments on the underlying mortgages, or may be caused by changes in market interest rates, a perceived decline in the market value of the investments and other market factors. To cover a margin call, we may pledge additional assets or cash. At maturity, any cash on deposit as collateral is generally applied against the repurchase agreement balance, thereby reducing the amount borrowed. Should the value of our assets suddenly decrease, significant margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

The following table summarizes our repurchase agreements and counterparty geographical concentration at September 30, 2018 and December 31, 2017:

	September 30, 2018			**December 31, 2017**		
(dollars in thousands)	**Amount Outstanding**	**Net Counterparty Exposure**[(1)]	**Percent of Funding**	**Amount Outstanding**	**Net Counterparty Exposure**[(1)]	**Percent of Funding**

North America	$12,484,592	$ 1,106,390	58.0	%	$10,746,447	$ 993,279	57.0	%
Europe [2]	7,178,006	568,089	29.8	%	6,109,169	615,150	35.3	%
Asia [2]	4,144,033	232,077	12.2	%	2,595,591	134,694	7.7	%
Total	$23,806,631	$ 1,906,556	100.0	%	$19,451,207	$ 1,743,123	100.0	%

(1) Represents the net carrying value of the assets sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest. Payables due to broker counterparties for unsettled securities purchases of $421.1 million are not included in the September 30, 2018 amounts presented above. We did not have any such payables at December 31, 2017.

(2) Exposure to European and Asian domiciled banks and their U.S. subsidiaries.

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In addition to our master repurchase agreements to fund our Agency and non-Agency securities, we have one repurchase facility and two revolving credit facilities that provide short- and long-term financing for our MSR portfolio. An overview of the facilities is presented in the table below:

(dollars in thousands)

September 30, 2018

Expiration Date [1]	Committed	Amount Outstanding	Unused Capacity	Total Capacity	Eligible Collateral
December 1, 2019	Yes [2]	$ 200,000	$200,000	$400,000	Mortgage servicing rights [3]
June 22, 2023	Yes [2]	$ 290,000	$40,000	$330,000	Mortgage servicing rights
December 17, 2018	No	$ 20,000	$20,000	$40,000	Mortgage servicing rights

(1) The facilities are set to mature on the stated expiration date, unless extended pursuant to their terms.
(2) Commitment fee charged on unused capacity.
(3) This repurchase facility is secured by MSR notes, which are collateralized by our MSR.

Our wholly owned subsidiary, TH Insurance, is a member of the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances. As of September 30, 2018, TH Insurance had $865.0 million in outstanding secured advances with a weighted average borrowing rate of 2.48%, and an additional $2.7 billion of available uncommitted capacity for borrowings insofar as TH Insurance holds adequate total assets to support a new advance. To the extent TH Insurance has uncommitted capacity, it may be adjusted at the sole discretion of the FHLB.

The ability to borrow from the FHLB is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB’s credit and collateral guidelines, as may be revised from time to time by the FHLB. Eligible collateral may include conventional 1-4 family residential mortgage loans, Agency RMBS and certain non-Agency securities with a rating of A and above.

In January 2016, the FHFA released a final rule regarding membership in the Federal Home Loan Bank system. Among other effects, the final rule excludes captive insurers from membership eligibility, including our subsidiary member, TH Insurance. Since TH Insurance was admitted as a member in 2013, it is eligible for a membership grace period that runs through February 19, 2021, during which new advances or renewals that mature beyond the grace period will be prohibited; however, any existing advances that mature beyond this grace period will be permitted to remain in place subject to their terms insofar as we maintain good standing with the FHLB. If any new advances or renewals occur, TH Insurance’s outstanding advances will be limited to 40% of its total assets.

We are subject to a variety of financial covenants under our lending agreements. The following represent the most restrictive financial covenants across the agreements as of September 30, 2018:

- Total indebtedness to net worth must be less than a specified threshold ratio in a repurchase agreement. As of September 30, 2018, our debt to net worth, as defined, was 5.6:1.0 while our threshold ratio, as defined, was 6.6:1.0.
- Cash liquidity must be greater than $100.0 million. As of September 30, 2018, our liquidity, as defined, was $422.9 million.
- Net worth must be greater than $1.75 billion. As of September 30, 2018, our net worth, as defined, was $4.7 billion.

We are also subject to additional financial covenants in connection with various other agreements we enter into in the normal course of our business. We intend to continue to operate in a manner which complies with all of our financial covenants.

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The following table summarizes assets at carrying values that were pledged or restricted as collateral for the future payment obligations of repurchase agreements, FHLB advances and revolving credit facilities at September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Available-for-sale securities, at fair value	$ 24,550,499	$ 20,990,890
Mortgage servicing rights, at fair value	1,221,748	584,247
Cash and cash equivalents	—	15,000
Restricted cash	558,088	417,018
Due from counterparties	1,219,860	836,381
Derivative assets, at fair value	66,980	90,895
Total	$ 27,617,175	$ 22,934,431

Although we generally intend to hold our target assets as long-term investments, we may sell certain of our assets in order to manage our interest rate risk and liquidity needs, to meet other operating objectives and to adapt to market conditions. Our Agency RMBS and non-Agency securities are generally actively traded and thus, in most circumstances, readily liquid. However, certain of our assets, including MSR and residential mortgage loans, are subject to longer trade timelines, and, as a result, market conditions could significantly and adversely affect the liquidity of our assets. Any illiquidity of our assets may make it difficult for us to sell such assets if the need or desire arises. Our ability to quickly sell certain assets, such as MSR and residential mortgage loans, may be limited by delays encountered while obtaining certain regulatory approvals required for such dispositions and may be further limited by delays due to the time period needed for negotiating transaction documents, conducting diligence, and complying with regulatory requirements regarding the transfer of such assets before settlement may occur. Consequently, even if we identify a buyer for our MSR and residential mortgage loans, there is no assurance that we would be able to quickly sell such assets if the need or desire arises.

In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we previously recorded our assets. Assets that are illiquid are more difficult to finance, and to the extent that we use leverage to finance assets that become illiquid, we may lose that leverage or have it reduced. Assets tend to become less liquid during times of financial stress, which is often the time that liquidity is most needed. As a result, our ability to sell assets or vary our portfolio in response to changes in economic and other conditions may be limited by liquidity constraints, which could adversely affect our results of operations and financial condition.

We cannot predict the timing and impact of future sales of our assets, if any. Because many of our assets are financed with repurchase agreements, FHLB advances and revolving credit facilities, a significant portion of the proceeds from sales of our assets (if any), prepayments and scheduled amortization are used to repay balances under these financing sources.

The following table provides the maturities of our repurchase agreements, FHLB advances, revolving credit facilities and convertible senior notes as of September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Within 30 days	$ 6,910,626	$ 4,269,464
30 to 59 days	2,465,288	3,831,111
60 to 89 days	25,041	3,458,940
90 to 119 days	5,535,994	2,452,426
120 to 364 days	9,504,706	5,346,766
One to three years	200,000	927,524
Three to five years	573,555	282,827
Five to ten years	—	—

Ten years and over	50,000	400,000
Total	$ 25,265,210	$ 20,969,058

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For the three months ended September 30, 2018, our restricted and unrestricted cash balance increased approximately $329.3 million to $1.3 billion at September 30, 2018. The cash movements can be summarized by the following:

- *Cash flows from operating activities.* For the three months ended September 30, 2018, operating activities increased our cash balances by approximately $161.9 million, primarily driven by our financial results for the quarter.
- *Cash flows from investing activities*. For the three months ended September 30, 2018, investing activities increased our cash balances by approximately $2.3 billion, primarily driven by sales of AFS securities.
- *Cash flows from financing activities.* For the three months ended September 30, 2018, financing activities decreased our cash balance by approximately $2.1 billion, primarily driven by repayment of repurchase agreements as a result of sales of AFS securities.

Inflation

Substantially all of our assets and liabilities are financial in nature. As a result, changes in interest rates and other factors impact our performance far more than does inflation. Our financial statements are prepared in accordance with U.S. GAAP and dividends are based upon net ordinary income and capital gains as calculated for tax purposes; in each case, our results of operations and reported assets, liabilities and equity are measured with reference to historical cost or fair value without considering inflation.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while providing an opportunity to stockholders to realize attractive risk-adjusted total return through ownership of our capital stock. Although we do not seek to avoid risk completely, we believe that risk can be quantified from historical experience and we seek to manage our risk levels in order to earn sufficient compensation to justify the risks we undertake and to maintain capital levels consistent with taking such risks.

To reduce the risks to our portfolio, we employ portfolio-wide and asset-specific risk measurement and management processes in our daily operations. Risk management tools include software and services licensed or purchased from third parties as well as proprietary and third-party analytical tools and models. There can be no guarantee that these tools and methods will protect us from market risks.

Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and related financing obligations. Subject to maintaining our qualification as a REIT, we engage in a variety of interest rate management techniques that seek to mitigate the influence of interest rate changes on the values of our assets.

We may enter into a variety of derivative and non-derivative instruments to economically hedge interest rate risk or “duration mismatch (or gap)” by adjusting the duration of our floating-rate borrowings into fixed-rate borrowings to more closely match the duration of our assets. This particularly applies to borrowing agreements with maturities or interest rate resets of less than six months. Typically, the interest receivable terms (*i.e.*, LIBOR) of certain derivatives match the terms of the underlying debt, resulting in an effective conversion of the rate of the related borrowing agreement from floating to fixed. The objective is to manage the cash flows associated with current and anticipated interest payments on borrowings, as well as the ability to roll or refinance borrowings at the desired amount by adjusting the duration. To help manage the adverse impact of interest rate changes on the value of our portfolio as well as our cash flows, we may, at times, enter into various forward contracts, including short securities, Agency to-be-announced securities, or TBAs, options, futures, swaps, caps, credit default swaps and total return swaps. In executing on the Company’s current interest rate risk management strategy, the Company has entered into TBAs, put and call options for TBAs, interest rate swap, cap and swaption agreements and Markit IOS total return swaps. In addition, because MSR are negative duration assets, they provide a natural hedge to interest rate exposure on our Agency RMBS portfolio. In hedging interest rate risk, we seek to reduce the risk of losses on the value of our

investments that may result from changes in interest rates in the broader markets, improve risk-adjusted returns and, where possible, obtain a favorable spread between the yield on our assets and the cost of our financing.

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Income of a REIT arising from "clearly identified" hedging transactions that are entered into to manage the risk of interest rate or price changes with respect to borrowings, including gain from the disposition of such hedging transactions, to the extent the hedging transactions hedge indebtedness incurred, or to be incurred, by the REIT to acquire or carry real estate assets, will not be treated as gross income for purposes of the either the 75% or the 95% gross income tests. In general, for a hedging transaction to be "clearly identified," (i) it must be identified as a hedging transaction before the end of the day on which it is acquired, originated, or entered into; and (ii) the items of risks being hedged must be identified "substantially contemporaneously" with entering into the hedging transaction (generally not more than 35 days after entering into the hedging transaction). We intend to structure any hedging transactions in a manner that does not jeopardize our qualification as a REIT, although this determination depends on an analysis of the facts and circumstances concerning each hedging transaction. We also implement part of our hedging strategy through our TRSs, which are subject to U.S. federal, state and, if applicable, local income tax.

We intend to treat our TBAs as qualifying assets for purposes of the 75% asset test, to the extent set forth in an opinion from Sidley Austin LLP substantially to the effect that, for purposes of the 75% asset test, our ownership of a TBA should be treated as ownership of the underlying Agency RMBS, and to treat income and gains from our TBAs as qualifying income for purposes of the 75% gross income test, to the extent set forth in an opinion from Sidley Austin LLP substantially to the effect that, for purposes of the 75% gross income test, any gain recognized by us in connection with the settlement of our TBAs should be treated as gain from the sale or disposition of the underlying Agency RMBS.

Interest Rate Effect on Net Interest Income

Our operating results depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. The costs associated with our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase while the yields earned on our existing portfolio of leveraged fixed-rate Agency RMBS and non-Agency securities and residential mortgage loans held-for-sale will remain static. Moreover, interest rates may rise at a faster pace than the yields earned on our leveraged adjustable-rate and hybrid securities and adjustable-rate residential mortgage loans held-for-sale. Both of these factors could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time, as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our target assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

Our hedging techniques are partly based on assumed levels of prepayments of our target assets. If prepayments are slower or faster than assumed, the life of the investment will be longer or shorter, which could reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

We acquire adjustable-rate and hybrid Agency RMBS and non-Agency securities. These are assets in which some of the underlying mortgages are typically subject to periodic and lifetime interest rate caps and floors, which may limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements are not subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation, while the interest-rate yields on our adjustable-rate and hybrid securities could effectively be limited by caps. This issue will be magnified to the extent we acquire adjustable-rate and hybrid securities that are not based on mortgages that are fully indexed. In addition, adjustable-rate and hybrid securities may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. If this happens, we could receive less cash income on such assets than we would need to pay for interest costs on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

Our adjustable-rate residential mortgage loans held-for-sale are typically subject to periodic and lifetime interest rate caps and floors, which may limit the amount by which the loan's interest yield may change during any given period. Therefore, in a period of increasing interest rates, the interest-rate yields on our adjustable-rate residential mortgage loans held-for-sale could effectively be limited by caps.

Interest Rate Mismatch Risk

We fund the majority of our adjustable-rate and hybrid Agency RMBS and non-Agency securities and adjustable-rate commercial real estate assets with borrowings that are based on LIBOR, while the interest rates on these assets may be indexed to other index rates, such as the one-year Constant Maturity Treasury index, or CMT, the Monthly Treasury Average index, or MTA, or the 11th District Cost of Funds Index, or COFI. Accordingly, any increase in LIBOR relative to these indices may result in an increase in our borrowing costs that is not matched by a corresponding increase in the interest earnings on these assets. Any such interest rate index mismatch could adversely affect our profitability, which may negatively impact distributions to our stockholders. To mitigate interest rate mismatches, we utilize the hedging strategies discussed above.

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The following table provides the indices of our variable rate Agency RMBS, non-Agency securities and residential mortgage loans held-for-sale of September 30, 2018 and December 31, 2017, respectively, based on carrying value (dollars in thousands).

	September 30, 2018				December 31, 2017			
Index Type	**Floating**	**Hybrid (1)**	**Total**	**Index %**	**Floating**	**Hybrid (1)**	**Total**	**Index %**
CMT	$10,267	$15,905	$26,172	1 %	$11,832	$18,497	$30,329	1 %
LIBOR	3,351,751	10,565	3,362,316	93 %	2,563,850	13,284	2,577,134	92 %
Other (2)	52,985	153,559	206,544	6 %	48,894	142,502	191,396	7 %
Total	$3,415,003	$180,029	$3,595,032	100%	$2,624,576	$174,283	$2,798,859	100%

(1) "Hybrid" amounts reflect those assets with greater than twelve months to reset.
(2) "Other" includes COFI, MTA and other indices.

The following analyses of risks are based on our experience, estimates, models and assumptions. They rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of decisions may produce results that differ significantly from the estimates and assumptions used in our models.

We perform interest rate sensitivity analyses on various measures of our financial results and condition by examining how our assets, financing, and hedges will perform in various interest rate "shock" scenarios. Two of these measures are presented here in more detail. The first measure is change in annualized net interest income over the next 12 months, including interest spread from our interest rate swaps and caps and float income from custodial accounts associated with our MSR. The change in annualized net interest income does not reflect any potential changes to dollar roll income associated with our TBA positions. To the extent we hold long TBAs, we would expect dollar roll income to decrease as interest rates rise and vice versa. The second measure is change in value of financial position, including the value of our derivative assets and liabilities. All changes in value are measured as the change from the September 30, 2018 financial position. All projected changes in annualized net interest income are measured as the change from the projected annualized net interest income based off current performance returns.

Computation of the cash flows for the rate-sensitive assets underpinning change in annualized net interest income are based on assumptions related to, among other things, prepayment speeds, yield on future acquisitions, slope of the yield curve, and size of the portfolio. (The assumption for prepayment speeds for Agency RMBS, non-Agency securities, and MSR, for example, is that they do not change in response to changes in interest rates.) Assumptions for the interest rate sensitive liabilities relate to, among other things, collateral requirements as a percentage of borrowings and amount/term of borrowing. These assumptions may not hold in practice; realized net interest income results may therefore be significantly different from the net interest income produced in scenario analyses. We also note that the uncertainty associated with the estimate of a change in net interest income is directly related to the size of interest rate move considered.

Computation of results for portfolio value involves a two-step process. The first is the use of models to project how the value of interest rate sensitive instruments will change in the scenarios considered. We use both recognized industry models and proprietary models to make these projections. The second, and equally important, step is the improvement of the model projections based on application of our experience in assessing how current market and macroeconomic conditions will affect the prices of various interest rate sensitive instruments. Judgment is best applied to localized (less than 25 bps) interest rate moves. The more an instantaneous interest rate move exceeds 25 bps, the greater the likelihood that accompanying market events are significant enough to warrant reconsideration of interest rate sensitivities. As with net interest income, the uncertainty associated with the estimate of change in portfolio value is therefore directly related to the size of interest rate move considered.

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The following interest rate sensitivity table displays the potential impact of instantaneous, parallel changes in interest rates of +/- 25 and +/- 50 bps on annualized net interest income and portfolio value, based on our interest sensitive financial instruments at September 30, 2018. The preceding discussion shows that the results for the 25 bps move scenarios are the best representation of our interest rate exposure, followed by those for the 50 bps move scenarios. This hierarchy reflects our localized approach to managing interest rate risk: monitoring rates and rebalancing our hedges on a day to day basis, where rate moves only rarely exceed 25 bps in either direction.

	Changes in Interest Rates			
(dollars in thousands)	**-50 bps**	**-25 bps**	**+25 bps**	**+50 bps**
Change in annualized net interest income [(1)]:	$(29,545)	$(14,797)	$14,791	$29,582
% change in net interest income [(1)]	*(6.4)%*	*(3.2)%*	*3.2%*	*6.4%*
Change in value of financial position:				
Available-for-sale securities	$528,078	$255,927	$(283,609)	$(613,166)
As a % of equity	*11.3%*	*5.5%*	*(6.1)%*	*(13.1)%*
Mortgage servicing rights	$(162,861)	$(75,955)	$66,930	$126,613
As a % of equity	*(3.5)%*	*(1.6)%*	*1.4%*	*2.7%*
Residential mortgage loans held-for-sale	$146	$41	$(75)	$(283)
As a % of equity	*—%*	*—%*	*—%*	*—%*
Derivatives, net	$(319,040)	$(149,161)	$151,859	$315,939
As a % of equity	*(6.8)%*	*(3.2)%*	*3.3%*	*6.8%*
Reverse repurchase agreements	$158	$79	$(79)	$(158)
As a % of equity	*—%*	*—%*	*—%*	*—%*
Repurchase agreements	$(29,750)	$(14,875)	$14,875	$29,750
As a % of equity	*(0.6)%*	*(0.3)%*	*0.3%*	*0.6%*
Federal Home Loan Bank advances	$(180)	$(90)	$90	$180
As a % of equity	*—%*	*—%*	*—%*	*—%*
Revolving credit facilities	$(129)	$(65)	$65	$129
As a % of equity	*—%*	*—%*	*—%*	*—%*
Convertible senior notes	$(3,781)	$(1,882)	$1,865	$3,713
As a % of equity	*(0.1)%*	*(0.1)%*	*0.1%*	*0.1%*
Total Net Assets	$12,641	$14,019	$(48,079)	$(137,283)
As a % of total assets	*—%*	*—%*	*(0.2)%*	*(0.4)%*
As a % of equity	*0.3%*	*0.3%*	*(1.0)%*	*(2.9)%*

(1) Amounts include the effect of interest spread from our interest rate swaps and caps and float income from custodial accounts associated with our MSR, but do not reflect any potential changes to dollar roll income associated with our TBA positions, which are accounted for as derivative instruments in accordance with U.S. GAAP.

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at September 30, 2018. As discussed, the analysis utilizes assumptions and estimates based on our experience and judgment. Furthermore, future purchases and sales of assets could materially change our interest rate risk profile. The information set forth in the interest rate sensitivity table above and all related disclosures constitutes forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. While this table reflects the estimated impact of interest rate changes on the static portfolio, we actively manage our portfolio and continuously make adjustments to the size and composition of our asset and hedge portfolio. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

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Prepayment Risk

Prepayment risk is the risk that principal will be repaid at a different rate than anticipated. As we receive prepayments of principal on our Agency RMBS and non-Agency securities, premiums paid on such assets will be amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the assets. Conversely, discounts on such assets are accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the assets.

We believe that we will be able to reinvest proceeds from scheduled principal payments and prepayments at acceptable yields; however, no assurances can be given that, should significant prepayments occur, market conditions would be such that acceptable investments could be identified and the proceeds timely reinvested.

MSR are also subject to prepayment risk in that, generally, an increase in prepayment rates would result in a decline in value of the MSR.

Market Risk

Market Value Risk. Our AFS securities are reflected at their estimated fair value, with the difference between amortized cost and estimated fair value for all AFS securities except Agency interest-only securities reflected in accumulated other comprehensive income. The estimated fair value of these securities fluctuates primarily due to changes in interest rates, market valuation of credit risks, and other factors. Generally, in a rising interest rate environment, we would expect the fair value of these securities to decrease; conversely, in a decreasing interest rate environment, we would expect the fair value of these securities to increase. As market volatility increases or liquidity decreases, the fair value of our assets may be adversely impacted.

Our MSR are reflected at their estimated fair value. The estimated fair value fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, we would expect prepayments to decrease, resulting in an increase in the fair value of our MSR. Conversely, in a decreasing interest rate environment, we would expect prepayments to increase, resulting in a decline in fair value.

Our residential mortgage loans are reflected at their estimated fair value. The estimated fair value fluctuates primarily due to changes in interest rates, market valuation of credit risks and other factors. Generally in a rising rate environment, we would expect the fair value of these loans to decrease; conversely, in a decreasing rate environment, we would expect the fair value of these loans to increase. However, the fair value of the CSL and Ginnie Mae buyout residential mortgage loans included in residential mortgage loans held-for-sale is generally less sensitive to interest rate changes.

Real estate risk. Residential property values are subject to volatility and may be affected adversely by a number of factors, including national, regional and local economic conditions; local real estate conditions (such as an oversupply of housing); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; retroactive changes to building or similar codes; and natural disasters and other catastrophes. Decreases in property values reduce the value of the collateral for residential mortgage loans and the potential proceeds available to borrowers to repay the loans, which could cause us to suffer losses on our non-Agency securities and residential mortgage loans.

Liquidity Risk

Our liquidity risk is principally associated with our financing of long-maturity assets with shorter-term borrowings in the form of repurchase agreements, FHLB advances and borrowings under revolving credit facilities. Although the interest rate adjustments of these assets and liabilities fall within the guidelines established by our operating policies, maturities are not required to be, nor are they, matched.

Should the value of our assets pledged as collateral suddenly decrease, lender margin calls could increase, causing an adverse change in our liquidity position. Moreover, the portfolio construction of MSR, which generally have negative duration, combined with levered RMBS, which generally have positive duration, may in certain market scenarios lead to variation margin calls, which could negatively impact our excess cash position. Additionally, if the FHLB or one or more of our repurchase agreement or revolving credit facility counterparties chose not to provide ongoing funding, our

ability to finance would decline or exist at possibly less advantageous terms. As such, we cannot assure that we will always be able to roll over our repurchase agreements, FHLB advances and revolving credit facilities. See Item 2, "*Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources*" in this Annual Report on Form 10-K for further information about our liquidity and capital resource management.

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Credit Risk

We believe that our investment strategy will generally keep our risk of credit losses low to moderate. However, we retain the risk of potential credit losses on all of the loans underlying our non-Agency securities and on our residential mortgage loans. With respect to our non-Agency securities that are senior in the credit structure, credit support contained in deal structures provide a level of protection from losses. We seek to manage the remaining credit risk through our pre-acquisition due diligence process, which includes comprehensive underwriting, and by factoring assumed credit losses into the purchase prices we pay for non-Agency securities and residential mortgage assets. In addition, with respect to any particular target asset, we evaluate relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates, recovery of various sectors and vintage of collateral. At times, we enter into credit default swaps or other derivative instruments in an attempt to manage our credit risk. Nevertheless, unanticipated credit losses could adversely affect our operating results.

Item 4. Controls and Procedures

A review and evaluation was performed by our management, including our Chief Executive Officer, or CEO, and Acting Chief Financial Officer, or CFO, of the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, were effective. Although our CEO and CFO have determined our disclosure controls and procedures were effective at the end of the period covered by this Quarterly Report on Form 10-Q, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the reports we submit under the Exchange Act.

There was no change in our internal control over financial reporting that occurred during the quarter ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings
From time to time we may be involved in various legal claims and/or administrative proceedings that arise in the ordinary course of our business. As of the date of this filing, we are not party to any litigation or legal proceedings or, to the best of our knowledge, any threatened litigation or legal proceedings, which, in our opinion, individually or in the aggregate, would have a material adverse effect on our results of operations or financial condition.

Item 1A. Risk Factors
Except as set forth in our Quarterly Report of Form 10-Q for the period ended March, 31 2018, or the Q1 Form 10-Q, there have been no material changes to the risk factors set forth under the heading “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2017, or the Form 10-K. The materialization of any risks and uncertainties identified in our Forward-Looking Statements contained in this Quarterly Report on Form 10-Q, together with those previously disclosed in the Form 10-K, the Q1 Form 10-Q, or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations, and cash flows. See Item 2, “*Management’s Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements*” in this Quarterly Report on Form 10-Q.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
(a)None.
(b)None.
(c)The Company’s share repurchase program allows for the repurchase of up to an aggregate of 37,500,000 shares of the Company’s common stock. Shares may be repurchased from time to time through privately negotiated transactions or open market transactions, pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Exchange Act or by any combination of such methods. The manner, price, number and timing of share repurchases are subject to a variety of factors, including market conditions and applicable SEC rules. The share repurchase program does not require the purchase of any minimum number of shares, and, subject to SEC rules, purchases may be commenced or suspended at any time without prior notice. The share repurchase program does not have an expiration date. As of September 30, 2018, we had repurchased 12,067,500 shares under the program for a total cost of $200.4 million. We did not repurchase shares during the three months ended September 30, 2018.

Item 3. Defaults Upon Senior Securities
None.

Item 4. Mine Safety Disclosures
None.

Item 5. Other Information
None.

Item 6. Exhibits
(a) Exhibits
The exhibits listed on the accompanying Index of Exhibits are filed or incorporated by reference as a part of this report. Such Index is incorporated herein by reference.

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Exhibit Number	Exhibit Index
3.1	Articles of Amendment and Restatement of Two Harbors Investment Corp. (incorporated by reference to Exhibit 99.1 to Annex B filed with Amendment No. 4).
3.2	Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. (incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 19, 2012).
3.3	Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp., effective as of 5:01 PM Eastern Time on November 1, 2017 (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on November 2, 2017).
3.4	Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp., effective as of 5:02 PM Eastern Time on November 1, 2017 (incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed with the SEC on November 2, 2017).
3.5	Articles Supplementary to the Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. designating the shares of 8.125% Series A Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, $0.01 par value per share (incorporated by reference to Exhibit 3.3 of the Registrant's Form 8-A filed with the SEC on March 13, 2017).
3.6	Articles Supplementary to the Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. designating the shares of 7.625% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, $0.01 par value per share (incorporated by reference to Exhibit 3.4 of the Registrant's Form 8-A filed with the SEC on July 17, 2017).
3.7	Articles Supplementary to the Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. designating the shares of 7.25% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, $0.01 par value per share (incorporated by reference to Exhibit 3.7 of the Registrant's Form 8-A filed with the SEC on November 22, 2017).
3.8	Articles Supplementary to the Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. designating the shares of 7.75% Series D Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, $0.01 par value per share (incorporated by reference to Exhibit 3.8 of the Registrant's Form 8-A filed with the SEC on July 31, 2018).
3.9	Articles Supplementary to the Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. designating the shares of 7.50% Series E Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, $0.01 par value per share (incorporated by reference to Exhibit 3.9 of the Registrant's Form 8-A filed with the SEC on July 31, 2018).
3.10	Amended and Restated Bylaws of Two Harbors Investment Corp. (incorporated by reference to Exhibit 3.4 to the Registrant's Current Report on Form 8-K filed with the SEC on April 6, 2017).
31.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
31.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
32.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)
32.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)
101	Financial statements from the Quarterly Report on Form 10-Q of Two Harbors Investment Corp. for the three months ended September 30, 2018, filed with the SEC on November 7, 2018, formatted in Inline XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Comprehensive (Loss) Income, (iii) the Condensed Consolidated Statements of Stockholders' Equity, (iv) the Condensed

Consolidated Statements of Cash Flows, and (v) the Notes to the Condensed Consolidated Financial Statements. (filed herewith)

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* Management or compensatory agreement

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

			TWO HARBORS INVESTMENT CORP.
Dated:	November 7, 2018	By:	/s/ Thomas E. Siering
			Thomas E. Siering
			Chief Executive Officer, President and Director
			(Principal Executive Officer)
Dated:	November 7, 2018	By:	/s/ Mary Riskey
			Mary Riskey
			Acting Chief Financial Officer and Treasurer
			(Principal Financial and Accounting Officer)