MGIC INVESTMENT CORP
Form 10-Q
August 04, 2017

FORM 10-Q
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017

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

Commission file number 1-10816
(Exact name of registrant as specified in its charter)

WISCONSIN	39-1486475
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
250 E. KILBOURN AVENUE MILWAUKEE, WISCONSIN	53202 (Zip Code)
(Address of principal executive offices)	

(414) 347-6480
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o	(Do not check if a smaller reporting company)
Emerging growth company o	If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o			

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO x

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

CLASS OF STOCK	PAR VALUE	DATE	NUMBER OF SHARES
Common stock	$1.00	July 31, 2017	370,561,601

Forward Looking and Other Statements

All statements in this report that address events, developments or results that we expect or anticipate may occur in the future are "forward looking statements." Forward looking statements consist of statements that relate to matters other than historical fact. In most cases, forward looking statements may be identified by words such as "believe," "anticipate" or "expect," or words of similar import. The risk factors referred to in "Forward Looking Statements and Risk Factors – Location of Risk Factors" in Management's Discussion and Analysis of Financial Condition and Results of Operations below, may cause our actual results to differ materially from the results contemplated by forward looking statements that we may make. We are not undertaking any obligation to update any forward looking statements or other statements we may make in this document even though these statements may be affected by events or circumstances occurring after the forward looking statements or other statements were made. Therefore no reader of this document should rely on these statements being current as of any time other than the time at which this document was filed with the Securities and Exchange Commission.

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2017

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GLOSSARY OF TERMS AND ACRONYMS

/ A

ARMs
Adjustable rate mortgages

ABS
Asset-backed securities

ASC
Accounting Standards Codification

Available Assets
Assets, as designated under the PMIERs, that are readily available to pay claims, and include the most liquid investments

/ B

Book or book year
A group of loans insured in a particular calendar year

BPMI
Borrower-paid mortgage insurance

/ C

CFPB
Consumer Financial Protection Bureau

CLO
Collateralized loan obligations

CMBS
Commercial mortgage-backed securities

/ D

DAC
Deferred insurance policy acquisition costs

/ F

Fannie Mae
Federal National Mortgage Association

FCRA
Fair Credit Reporting Act

FHA
Federal Housing Administration

FHFA
Federal Housing Finance Agency

FHLB
Federal Home Loan Bank of Chicago, of which MGIC is a member

FICO score
A measure of consumer credit risk provided by credit bureaus, typically produced from statistical models by Fair Isaac Corporation utilizing data collected by the credit bureaus

Freddie Mac
Federal Home Loan Mortgage Corporation

/ G
GAAP
Generally Accepted Accounting Principles in the United States

GSEs
Collectively, Fannie Mae and Freddie Mac

/ H
HAMP
Home Affordable Modification Program

HARP
Home Affordable Refinance Program

HOPA
Homeowners Protection Act

/ I
IBNR
Losses incurred but not reported

IIF
Insurance in force, which for loans insured by us, is equal to the unpaid principal balance, as reported to us

/ J
JCT
Joint Committee on Taxation

/ L
LAE
Loss adjustment expenses

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Legacy book
Mortgage insurance policies written prior to 2009

Loan-to-value ("LTV") ratio
The ratio, expressed as a percentage, of the dollar amount of the first mortgage loan to the value of the property at the time the loan became insured and does not reflect subsequent housing price appreciation or depreciation. Subordinate mortgages may also be present.

Long-term debt:
5% Notes
5% Convertible Senior Notes due on May 1, 2017, with interest payable semi-annually on May 1 and November 1 of each year

2% Notes
2% Convertible Senior Notes due on April 1, 2020, with interest payable semi-annually on April 1 and October 1 of each year

5.75% Notes
5.75% Senior Notes due on August 15, 2023, with interest payable semi-annually on February 15 and August 15 of each year

9% Debentures
9% Convertible Junior Subordinated Debentures due on April 1, 2063, with interest payable semi-annually on April 1 and October 1 of each year

FHLB Advance or the Advance
1.91% Fixed rate advance from the FHLB due on February 10, 2023, with interest payable monthly

Loss ratio
The ratio, expressed as a percentage, of the sum of incurred losses and LAE to NPE

Low down payment loans or mortgages
Loans with less than 20% down payments

LPMI
Lender-paid mortgage insurance

/ M
MBS
Mortgage-backed securities

MD&A
Management's discussion and analysis of financial condition and results of operations

MGIC
Mortgage Guaranty Insurance Corporation, a subsidiary of MGIC Investment Corporation

MIC

MGIC Indemnity Corporation, a subsidiary of MGIC

Minimum Required Assets
The minimum amount of Available Assets that must be held under the PMIERs, which is generally the greater of $400 million or an amount based upon a percentage of RIF weighted by certain risk attributes

MPP
Minimum Policyholder Position, as required under certain state requirements. The “policyholder position” of a mortgage insurer is its net worth or surplus, contingency reserve and a portion of the reserves for unearned premiums

/ N
N/A
Not applicable for the period presented

NAIC
The National Association of Insurance Commissioners

NIW
New Insurance Written

N/M
Data, or calculation, deemed not meaningful for the period presented

NPE
The amount of premiums earned, net of premiums assumed and ceded under reinsurance agreements

NPL
Non-performing loan, which is a delinquent loan, at any stage in its delinquency

NPW
The amount of premiums written, net of premiums assumed and ceded under reinsurance agreements

/ O
OCI
Office of the Commissioner of Insurance of the State of Wisconsin

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/ P
Persistency
The percentage of our insurance remaining in force from one year prior

PMI
Private Mortgage Insurance (as an industry or product type)

PMIERs
Private Mortgage Insurer Eligibility Requirements issued by the GSEs

Premium Yield
The ratio of NPE divided by the average IIF outstanding for the period measured

/ Q
QSR Transaction
Quota share reinsurance transaction

/ R
REMIC
Real Estate Mortgage Investment Conduit

RESPA
Real Estate Settlement Procedures Act

RIF
Risk in force, which for an individual loan insured by us, is equal to the unpaid loan principal balance, as reported to us, multiplied by the insurance coverage percentage. RIF is sometimes referred to as exposure

Risk-to-capital
The ratio of RIF, net of reinsurance and exposure on policies currently in default and for which loss reserves have been established, to the level of statutory capital

RMBS
Residential mortgage-backed securities

/ U
Underwriting Expense ratio
The ratio, expressed as a percentage, of the underwriting and operating expenses, net and amortization of DAC of our combined insurance operations (which excludes underwriting and operating expenses of our non-insurance operations) to NPW

Underwriting profit
NPE minus incurred losses

/ V
VA
U.S. Department of Veterans Affairs

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands)	Note	June 30, 2017	December 31, 2016
ASSETS			
Investment portfolio:	7 / 8		
Securities, available-for-sale, at fair value:			
Fixed income (amortized cost, 2017 - $4,674,965; 2016 - $4,717,211)		$4,701,211	$4,685,222
Equity securities		7,209	7,128
Total investment portfolio		4,708,420	4,692,350
Cash and cash equivalents		127,908	155,410
Accrued investment income		44,030	44,073
Reinsurance recoverable on loss reserves	4	44,783	50,493
Reinsurance recoverable on paid losses		6,151	4,964
Premiums receivable		51,344	52,392
Home office and equipment, net		42,212	36,088
Deferred insurance policy acquisition costs		18,677	17,759
Deferred income taxes, net	11	481,389	607,655
Other assets		75,254	73,345
Total assets		$5,600,168	$5,734,529
LIABILITIES AND SHAREHOLDERS’ EQUITY			
Liabilities:			
Loss reserves	12	$1,187,089	$1,438,813
Unearned premiums		352,010	329,737
Federal Home Loan Bank advance	3	155,000	155,000
Senior notes	3	417,983	417,406
Convertible senior notes	3	—	349,461
Convertible junior subordinated debentures	3	256,872	256,872
Other liabilities		236,153	238,398
Total liabilities		2,605,107	3,185,687
Contingencies	5		
Shareholders’ equity:	13		
Common stock (one dollar par value, shares authorized 1,000,000; shares issued 2017 - 370,557; 2016 - 359,400; shares outstanding 2017 - 370,557; 2016 - 340,663)		370,557	359,400
Paid-in capital		1,842,601	1,782,337
Treasury stock at cost (shares 2016 - 18,737)		—	(150,359)
Accumulated other comprehensive loss, net of tax		(37,494)	(75,100)
Retained earnings		819,397	632,564
Total shareholders’ equity		2,995,061	2,548,842
Total liabilities and shareholders’ equity		$5,600,168	$5,734,529

See accompanying notes to consolidated financial statements.

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except per share data)	Note	Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Revenues:					
Premiums written:					
Direct		$275,245	$282,113	$541,068	$547,404
Assumed		685	182	1,973	390
Ceded	4	(30,096)	(32,280)	(60,505)	(66,498)
Net premiums written		245,834	250,015	482,536	481,296
Increase in unearned premiums, net		(14,698)	(18,559)	(22,297)	(28,499)
Net premiums earned		231,136	231,456	460,239	452,797
Investment income, net of expenses		29,716	27,248	59,193	55,057
Net realized investment (losses) gains	7	(42)	836	(164)	3,892
Other revenue		2,502	3,994	4,924	10,367
Total revenues		263,312	263,534	524,192	522,113
Losses and expenses:					
Losses incurred, net	12	27,339	46,590	54,958	131,602
Amortization of deferred policy acquisition costs		2,584	2,245	4,814	4,206
Other underwriting and operating expenses, net		38,511	35,348	79,276	75,125
Interest expense		14,197	12,244	30,506	26,945
Loss on debt extinguishment		65	1,868	65	15,308
Total losses and expenses		82,696	98,295	169,619	253,186
Income before tax		180,616	165,239	354,573	268,927
Provision for income taxes	11	61,994	56,018	146,153	90,515
Net income		$118,622	$109,221	$208,420	$178,412
Earnings per share:					
Basic	6	$0.32	$0.32	$0.59	$0.52
Diluted	6	$0.31	$0.26	$0.55	$0.43
Weighted average common shares outstanding - basic	6	366,918	340,678	354,035	340,411
Weighted average common shares outstanding - diluted	6	394,470	446,139	398,302	450,354

See accompanying notes to consolidated financial statements.

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

		Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	Note	2017	2016	2017	2016
Net income		$118,622	$109,221	$208,420	$178,412
Other comprehensive (loss) income, net of tax:	9				
Change in unrealized investment gains and losses	7	25,749	56,338	37,870	107,165
Benefit plan adjustments		(142)	(173)	(295)	(481)
Foreign currency translation adjustment		—	11	31	(964)
Other comprehensive income, net of tax		25,607	56,176	37,606	105,720
Comprehensive income		$144,229	$165,397	$246,026	$284,132

See accompanying notes to consolidated financial statements

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)

(In thousands)	Note	Six Months Ended June 30, 2017	2016
Common stock			
Balance, beginning of period		$359,400	$340,097
Net common stock issued under share-based compensation plans		771	979
Issuance of common stock	13	10,386	—
Balance, end of period		370,557	341,076
Paid-in capital			
Balance, beginning of period		1,782,337	1,670,238
Net common stock issued under share-based compensation plans		(7,494)	(5,954)
Issuance of common stock	13	60,903	—
Tax benefit from share-based compensation		—	115
Equity compensation		6,855	6,017
Reacquisition of convertible junior subordinated debentures-equity component		—	(6,337)
Balance, end of period		1,842,601	1,664,079
Treasury stock			
Balance, beginning of period		(150,359)	(3,362)
Reissuance of treasury stock, net		150,359	—
Balance, end of period		—	(3,362)
Accumulated other comprehensive loss			
Balance, beginning of period		(75,100)	(60,880)
Other comprehensive income, net of tax	9	37,606	105,720
Balance, end of period		(37,494)	44,840
Retained earnings			
Balance, beginning of period	2 / 13	632,717	290,047
Net income		208,420	178,412
Reissuance of treasury stock, net		(21,740)	—
Balance, end of period		819,397	468,459
Total shareholders' equity		$2,995,061	$2,515,092

See accompanying notes to consolidated financial statements.

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
(In thousands)	2017	2016
Cash flows from operating activities:		
Net income	$208,420	$178,412
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,191	28,477
Deferred tax expense	106,163	88,157
Net realized investment losses (gains)	164	(3,892)
Loss on debt extinguishment	65	15,308
Change in certain assets and liabilities:		
Accrued investment income	43	515
Prepaid insurance premium	25	48
Reinsurance recoverable on loss reserves	5,710	(728)
Reinsurance recoverable on paid losses	(1,187)	(1,454)
Premium receivable	1,048	1,867
Deferred insurance policy acquisition costs	(918)	(1,439)
Profit commission receivable	(4,603)	(2,793)
Loss reserves	(251,724)	(261,069)
Unearned premiums	22,273	28,451
Return premium accrual	(11,900)	(7,300)
Income taxes payable - current	32,991	523
Other, net	(14,205)	(8,090)
Net cash provided by operating activities	125,556	54,993
Cash flows from investing activities:		
Purchases of investments:		
Fixed income	(545,281)	(723,409)
Equity securities	(38)	(3,128)
Proceeds from sales of fixed income	166,606	649,776
Proceeds from maturity of fixed income	390,344	313,484
Proceeds from sale of equity securities	—	2,525
Net increase in payable for securities	3,447	24,519
Additions to property and equipment	(9,659)	(2,724)
Net cash provided by investing activities	5,419	261,043
Cash flows from financing activities:		
Proceeds from revolving credit facility	150,000	—
Repayment of revolving credit facility	(150,000)	—
Proceeds from issuance of long-term debt	—	155,000
Purchase or repayment of convertible senior notes	(145,620)	(182,846)
Payment of original issue discount - convertible senior notes	(4,504)	(5,655)
Purchase of convertible junior subordinated debentures	—	(100,860)
Payment of original issue discount - convertible junior subordinated debentures	—	(41,540)
Cash portion of loss on debt extinguishment	—	(15,308)
Payment of debt issuance costs	(1,630)	—

Payment of withholding taxes related to share-based compensation net share settlement	(6,723)	(4,973)
Net cash used in financing activities	(158,477)	(196,182)
Net (decrease) increase in cash and cash equivalents	(27,502)	119,854
Cash and cash equivalents at beginning of period	155,410	181,120
Cash and cash equivalents at end of period	$ 127,908	$ 300,974

See accompanying notes to consolidated financial statements.

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(Unaudited)

Note 1. Nature of Business and Basis of Presentation

MGIC Investment Corporation is a holding company which, through Mortgage Guaranty Insurance Corporation (“MGIC”) is principally engaged in the mortgage insurance business. We provide mortgage insurance to lenders throughout the United States and to government sponsored entities (“GSEs”) to protect against loss from defaults on low down payment residential mortgage loans.

The accompanying unaudited consolidated financial statements of MGIC Investment Corporation and its wholly-owned subsidiaries have been prepared in accordance with the instructions to Form 10-Q as prescribed by the Securities and Exchange Commission (“SEC”) for interim reporting and do not include all of the other information and disclosures required by accounting principles generally accepted in the United States of America (“GAAP”). These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2016 included in our Annual Report on Form 10-K. As used below, “we,” “our” and “us” refer to MGIC Investment Corporation’s consolidated operations or to MGIC Investment Corporation, as the context requires.

In the opinion of management the accompanying financial statements include all adjustments, consisting primarily of normal recurring accruals, necessary to fairly state our consolidated financial position and consolidated results of operations for the periods indicated. The consolidated results of operations for the interim period may not be indicative of the results that may be expected for the year ending December 31, 2017.

Substantially all of our insurance written since 2008 has been for loans purchased by the GSEs. We operate under the Private Mortgage Insurer Eligibility Requirements ("PMIERs") of the GSEs that became effective December 31, 2015 and have been amended from time to time. The financial requirements of the PMIERs require a mortgage insurer’s "Available Assets" (generally only the most liquid assets of an insurer) to equal or exceed its "Minimum Required Assets" (which are based on an insurer's book and are calculated from tables of factors with several risk dimensions and are subject to a floor amount). Based on our interpretation of the PMIERs, as of June 30, 2017, MGIC’s Available Assets are in excess of its Minimum Required Assets; and MGIC is in compliance with the financial requirements of the PMIERs and eligible to insure loans purchased by the GSEs.

Reclassifications

Certain reclassifications to 2016 amounts have been made in the accompanying financial statements to conform to the 2017 presentation.

Subsequent events

We have considered subsequent events through the date of this filing.

Note 2. New Accounting Pronouncements

Adopted Accounting Standards

Improvements to Employee Share-Based Compensation Accounting

In March 2016, the Financial Accounting Standards Board (“FASB”) issued updated guidance that simplifies several aspects of the accounting for employee share-based compensation including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification of related amounts within the statement of cash flows. The updated guidance requires that, prospectively, all tax effects related to share-based compensation be made through the statement of operations at the time of settlement. In contrast, the previous guidance required excess tax benefits to be recognized in paid-in capital. The updated guidance also removes the requirement to delay recognition of a tax benefit until it reduces current taxes payable. This change is required to be applied on a modified retrospective basis, with a cumulative effect adjustment to opening retained earnings. Additionally, all tax related cash flows resulting from share-based compensation are to be reported as operating activities on the statement of cash flows, a change from the existing requirement to present tax benefits as an inflow from financing activities and an outflow from operating activities. Finally, for tax withholding purposes, entities will be allowed to withhold an amount of shares up to the employee’s maximum individual tax rate (as opposed to the minimum statutory tax rate) in the relevant jurisdiction without resulting in liability classification of the award. The change in tax withholding is to be applied on a modified retrospective approach. This updated guidance became effective January 1, 2017. We adopted this guidance in the first quarter of 2017 and as a result of the adoption:

- We recognized discrete tax benefits of $1.5 million in the provision for income taxes on our statement of operations for the six months ended June 30, 2017 related to excess tax benefits upon vesting of share-based awards during the period.
- We recognized a cumulative effect adjustment related to the recognition of a deferred tax asset related to

suspended tax benefits from vesting transactions occurring in prior years and from the elimination of our forfeiture estimate on share-based awards, which was previously applied only to awards with service conditions.

- Prior to adoption, cash flows related to excess tax benefits from share-based compensation were included in financing activities. We have reclassified excess tax benefits related to share-based compensation for the prior year period to operating activities.
- Prior to adoption, cash flows related to employee taxes paid for withheld shares were included in operating activities. We have reclassified employee taxes paid for withheld shares for the prior year period to financing activities.

Prospective Accounting Standards

Stock Compensation - Scope of Modification Accounting

In May 2017, the FASB issued updated guidance related to a change in the terms or conditions (modification) of a share-based award. The updated guidance provides that an entity should account for the effects of a modification unless the fair value and vesting conditions of the modified award and the classification of the award (equity or liability instrument) are the same as the original award immediately before the modification. The updated guidance addresses the current diversity in practice on applying modification accounting, as some entities evaluate whether changes to awards are substantive, which is not prescribed within the current accounting guidance. The updated guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Early adoption is permitted, including adoption in any interim period. We are currently evaluating the impacts the adoption of this guidance will have on our consolidated financial statements, but do not expect it to have a material impact on our consolidated financial statements or disclosures.

Premium Amortization on Purchased Callable Debt Securities

In March 2017, the FASB issued updated guidance to amend the amortization period for certain purchased callable debt securities held at a premium shortening the amortization period to the earliest call date. Under current GAAP, there is diversity in practice in the amortization period for premiums of callable debt securities and in how the potential for exercise of a call is factored into current impairment assessments. This updated guidance aligns with how callable debt securities, in the United States, are generally quoted, priced, and traded assuming a model that incorporates consideration of calls (also referred to as “yield-to-worst” pricing). The updated guidance is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods. We are currently evaluating the impacts the adoption of this

guidance will have on our consolidated financial statements, but do not expect it to have a material impact on our consolidated financial statements or disclosures. We currently account for premium amortization on our purchased callable debt securities on a yield-to-worst basis, which generally aligns with the earliest call date.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In March 2017, the FASB issued updated guidance that improves the reporting of net benefit cost in the financial statements. The updated guidance requires that an employer report the service cost component in the same financial statement caption as other compensation costs arising from services rendered by employees during the period. The other components of net benefit cost are required to be presented in the statement of operations separately from the service cost component and outside a subtotal of income from operations, if one is presented. Current guidance does not prescribe where the amount of net benefit cost should be presented in an employer’s statement of operations and does not require entities to disclose by line item the amount of net benefit cost that is included in the statement of operations. The updated guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. We are currently evaluating the impacts the adoption of this guidance will have on our consolidated financial statements, but do not expect it to have a material impact on our consolidated financial statements or disclosures.

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued updated guidance that requires immediate recognition of estimated credit losses expected to occur over the remaining life of many financial instruments. Entities will be required to utilize a current expected credit losses ("CECL") methodology that incorporates their forecasts of future economic conditions into their loss estimate unless such forecast is not reasonable and supportable, in which case the entity will revert to historical loss experience. Any allowance for CECL reduces the amortized cost basis of the financial instrument to the amount an entity expects to collect. Credit losses relating to available-for-sale fixed maturity securities are to be recorded through an allowance for credit losses, rather than a write-down of the asset, with the amount of the allowance limited to the amount by which fair value is less than amortized cost. In addition, the length of time a security has been in an unrealized loss position will no longer impact the determination of whether a credit loss exists. The updated guidance is not prescriptive about certain aspects of estimating expected credit losses, including the specific methodology to use, and therefore will require significant judgment in application. The updated guidance is effective for annual periods beginning after December 15, 2019, including interim periods within those annual periods. Early adoption is permitted for annual and interim periods in fiscal years beginning after December 15, 2018. We are currently evaluating the impacts the adoption of this guidance will have on our consolidated financial statements, but do not expect it to have a material impact on our consolidated financial statements or disclosures.

Recognition and Measurement of Financial Assets and Financial Liabilities
In January 2016, the FASB issued updated guidance to address the recognition, measurement, presentation, and disclosure of certain financial instruments. The updated guidance requires equity investments, except those accounted for under the equity method of accounting, that have a readily determinable fair value to be measured at fair value with changes in fair value recognized in net income. Equity investments that do not have readily determinable fair values may be remeasured at fair value either upon the occurrence of an observable price change or upon identification of an impairment. A qualitative assessment for impairment is required for equity investments without readily determinable fair values. The updated guidance also eliminates the requirement to disclose the method and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet. Further, the updated guidance clarifies that entities should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entities other deferred tax assets. The updated guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods and will require recognition of a cumulative effect adjustment at adoption. We do not currently expect the adoption of this guidance to impact our consolidated financial position or liquidity.

Note 3. Debt
2017 debt transactions
2% Notes
On March 21, 2017, we issued an irrevocable notice of redemption in respect of our outstanding 2% Notes, with a redemption date of April 21, 2017. In April, holders of approximately $202.5 million of the outstanding principal exercised their rights to convert their notes into shares of our common stock. The remaining $5.1 million of outstanding principal was redeemed for cash. The conversions of the 2% Notes at a rate of 143.8332 shares per $1,000 principal amount resulted in the issuance of approximately 29.1 million shares of our common stock in April. The conversions and cash redemption eliminated our debt obligation. A loss on debt extinguishment of $0.07 million was recognized on the redemption of the $5.1 million of 2% Notes. No gain or loss was recognized from the conversions as the outstanding debt issuance costs associated with the conversions are included in the debt

carrying value, which was credited to shareholders’ equity at the time of conversion.

Credit Facility
On March 21, 2017, we entered into a Credit Agreement with various lenders which provides for a $175 million unsecured revolving credit facility maturing on March 21, 2020. Revolving credit borrowings bear interest at a floating rate, which will be, at our option, either a eurocurrency rate or a base rate, in each case plus an applicable margin. The applicable margins are subject to adjustment based on our senior unsecured long-term debt rating, or if we do not have such a rating, our corporate or issuer rating. Amounts under the facility may be borrowed, repaid and reborrowed from time to time until the maturity of the revolving credit facility. Voluntary prepayments and commitment reductions are permitted at any time without fee subject to a minimum dollar requirement and, for outstanding eurocurrency loans, customary breakage costs.

We are required under the Credit Agreement to pay commitment fees on the average daily amount of the unused revolving commitments of the lenders, and an annual administrative fee to the administrative agent. The Credit Agreement contains affirmative, negative and financial covenants which are customary for financings of this type, including, among other things, limits on the creation of liens, limits on the incurrence of indebtedness, restrictions on dispositions, maximum debt-to-capital ratio, minimum consolidated stockholders' equity, minimum policyholder's position of MGIC, and compliance with the financial requirements of the PMIERs. The Credit Agreement includes customary events of default for facilities of this type (with customary grace periods, as applicable) and provides that, upon the occurrence of an event of default, payments of all outstanding loans may be accelerated and/or the lenders' commitments may be terminated. Upon the occurrence of certain insolvency or bankruptcy related events of default, all amounts payable under the Credit Agreements shall automatically become immediately due and payable, and the lenders' commitments will automatically terminate. In addition, upon the occurrence of certain insolvency or bankruptcy related events of default, or the failure to pay interest, principal or fees, the interest rates on all outstanding obligations will be increased.

In March, we borrowed $150 million under the revolving credit facility, to fund a portion of the redemption price of the 2% Notes if holders did not elect to convert their 2% Notes. In April, we repaid the amount borrowed under the revolving credit facility because most holders elected to convert their notes. Costs incurred to enter into the Credit Agreement have been deferred and recorded as Other

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assets and will be amortized over the term of the Credit Agreement.

5% Notes
On May 1, 2017, our 5% Notes due in 2017 ("5% Notes") matured and we repaid the outstanding $145 million in aggregate par value, plus accrued interest with cash at our holding company.

First half 2016 debt transactions
5% Notes
During the first six months of 2016, we purchased $188.5 million in aggregate par value of our 5% Notes at an aggregate purchase price of $195.5 million for which we recognized losses on debt extinguishment on our consolidated statements of operations for the three and six months ended June 30, 2016.

9% Debentures
In February 2016, MGIC purchased $132.7 million in aggregate par value of our 9% Debentures at a purchase price of $150.7 million. The purchase of the 9% Debentures resulted in an $8.3 million loss on debt extinguishment on the consolidated statement of operations for the six months ended June 30, 2016, which represents the difference between the fair value and the carrying value of the liability component on the purchase date. Our shareholders' equity was separately reduced by $6.3 million related to the reacquisition of the equity component. For GAAP accounting purposes, the 9% Debentures owned by MGIC are considered retired and are eliminated in our consolidated financial statements and the underlying common stock equivalents, approximately 9.8 million shares, are not included in the computation of diluted shares.

Debt obligations
The par value of our long-term debt obligations and their aggregate carrying values as of June 30, 2017 and December 31, 2016 were as follows.

(In millions)	June 30, 2017	December 31, 2016
FHLB Advance	$155.0	$ 155.0
5% Notes	—	145.0
2% Notes	—	207.6
5.75% Notes	425.0	425.0
9% Debentures[1]	256.9	256.9
Long-term debt, par value	836.9	1,189.5
Debt issuance costs	(7.0)	(10.8)
Long-term debt, carrying value	$829.9	$ 1,178.7

(1) Convertible at any time prior to maturity at the holder's option, at an initial conversion rate, which is subject to adjustment, of 74.0741 shares per $1,000 principal amount, representing an initial conversion price of approximately $13.50 per share.

If a holder elects to convert their debentures, deferred interest owed on the debentures being converted is also converted into shares of our common stock. The conversion rate for any deferred interest is based on the average price that our shares traded at during a 5-day period immediately prior to the election to convert. In lieu of issuing shares of common stock upon conversion of the debentures, we may, at our option, make a cash payment to converting holders for all or some of the shares of our common stock otherwise issuable upon conversion.

The 5.75% Senior Notes due 2023 ("5.75% Notes") and 9% Convertible Junior Subordinated Debentures due in 2063 ("9% Debentures") are obligations of our holding company, MGIC Investment Corporation, and not of its subsidiaries. The Federal Home Loan Bank Advance (the "FHLB Advance") is an obligation of MGIC.

Interest payments on our debt obligations appear below.

(In millions)	Six Months Ended June 30, 2017	2016
Revolving credit facility	$0.5	$—
FHLB Advance	1.5	0.9
5% Notes	3.6	6.9
2% Notes	2.1	5.0
5.75% Notes	12.9	—
9% Debentures	11.6	15.9
Total interest payments	$32.2	$28.7

Note 4. Reinsurance

The reinsurance agreements we have entered into are discussed below. The effect of all of our reinsurance agreements on premiums earned and losses incurred is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2017	2016	2017	2016
Premiums earned:				
Direct	$261,180	$263,566	$520,608	$518,953
Assumed	62	182	160	390
Ceded	(30,106)	(32,292)	(60,529)	(66,546)
Net premiums earned	$231,136	$231,456	$460,239	$452,797
Losses incurred:				
Direct	$31,396	$54,863	$63,809	$147,295
Assumed	61	339	166	440
Ceded	(4,118)	(8,612)	(9,017)	(16,133)
Losses incurred, net	$27,339	$46,590	$54,958	$131,602

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Quota share reinsurance

In March 2017, we entered into a quota share reinsurance agreement (“2017 QSR Transaction”) with an effective date of January 1, 2017 with a group of unaffiliated reinsurers, each with a financial strength rating of A- or better by Standard and Poor’s, A.M. Best or both. We utilize quota share reinsurance to manage our exposure to losses resulting from our mortgage guaranty insurance policies and to provide reinsurance capital credit under the PMIERs. Our 2017 QSR Transaction provides coverage on new business written January 1, 2017 through December 29, 2017 that meets certain eligibility requirements. Under the agreement we cede losses incurred and premiums on or after the effective date through December 31, 2028, at which time the agreement expires. Early termination of the agreement can be elected by us effective December 31, 2021 for a fee, or under specified scenarios for no fee upon prior written notice including if we will receive less than 90% of the full credit amount under the PMIERs for the risk ceded in any required calculation period.

Our 2015 quota share reinsurance agreement (“2015 QSR Transaction”), which became effective on July 1, 2015, covers eligible risk in force written before 2017. The group of unaffiliated reinsurers under our 2015 QSR Transaction each has an insurer financial strength rating of A- or better by Standard and Poor’s Rating Services, A.M. Best or both. The 2015 QSR Transaction cedes losses incurred and premiums through December 31, 2024, at which time the agreement expires. Early termination of the agreement can be elected by us effective December 31, 2018 for a fee, or under specified scenarios for no fee upon prior written notice, including if we will receive less than 90% of the full credit amount under the PMIERs for the risk ceded in any required calculation period.

The structure of both the 2017 QSR Transaction and 2015 QSR Transaction is a 30% quota share for all policies covered, with a 20% ceding commission as well as a profit commission. Generally, under the QSR Transactions, we will receive a profit commission provided that the loss ratio on the loans covered under the agreement remains below 60%.

Following is a summary of our quota share reinsurance agreements, excluding captive agreements discussed below, for the three and six months ended June 30, 2017 and 2016.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2017	2016	2017	2016
Ceded premiums written and earned, net of profit commission (1)	$28,917	$29,961	$57,812	$61,627
Ceded losses incurred	4,424	6,070	9,111	14,583
Ceding commissions (2)	12,248	11,946	24,251	23,522
Profit commission	32,325	29,767	63,442	55,982

(1) Under our QSR Transactions, premiums are ceded on an earned and received basis as defined in the agreements.

(2) Ceding commissions are reported within Other underwriting and operating expenses, net on the consolidated statements of operations.

Under the terms of QSR Transactions, ceded premiums, ceding commission and profit commission are settled net on a quarterly basis. The ceded premium due after deducting the related ceding commission and profit commission is reported within “Other liabilities” on the consolidated balance sheets.

The reinsurance recoverable on loss reserves related to our QSR Transactions was $33.1 million as of June 30, 2017 and $31.8 million as of December 31, 2016. The reinsurance recoverable balance is secured by funds on deposit from the reinsurers which are based on the funding requirements of PMIERs that address ceded risk.

Captive reinsurance

In the past, MGIC also obtained captive reinsurance. In a captive reinsurance arrangement, the reinsurer is affiliated with the lender for whom MGIC provides mortgage insurance. As part of our settlement with the Consumer Financial Protection Bureau ("CFPB") in 2013 and with the Minnesota Department of Commerce in 2015, MGIC has agreed to not enter into any new captive reinsurance agreement or reinsure any new loans under any existing captive reinsurance agreement for a period of ten years subsequent to the respective settlements. In accordance with the CFPB settlement, all of our active captive arrangements were placed into run-off. In addition, the GSEs will not approve any future reinsurance or risk sharing transaction with a mortgage enterprise or an affiliate of a mortgage enterprise.

The reinsurance recoverable on loss reserves related to captive agreements was $12.0 million as of June 30, 2017, which was supported by $86.0 million of trust assets, while as of December 31, 2016, the reinsurance recoverable on loss reserves related to captive agreements was $19.0 million, which was supported by $91.0 million of trust assets. Each captive reinsurer is required to maintain a separate trust account to support its combined reinsured risk on all annual books. MGIC is the sole beneficiary of the trusts.

Note 5. Litigation and Contingencies

Before paying an insurance claim, we review the loan and servicing files to determine the appropriateness of the claim amount. When reviewing the files, we may determine that we have the right to rescind coverage on the loan. In our SEC reports, we refer to insurance rescissions and denials of claims collectively as "rescissions" and variations of that term. In addition, all of our insurance policies provide that we can reduce or deny a claim if the servicer did not comply with its obligations under our insurance policy. We call such reduction of claims “curtailments.” In recent quarters, an immaterial percentage of claims received in a quarter have been resolved by rescissions. In each of 2016 and the first half of 2017, curtailments reduced our average claim paid by approximately 5.5%.

Our loss reserving methodology incorporates our estimates of future rescissions, curtailments, and reversals of rescissions and curtailments. A variance between ultimate actual rescission, curtailment and reversal rates and our estimates, as a result of the outcome of litigation, settlements or other factors, could materially affect our losses.

When the insured disputes our right to rescind coverage or curtail claims, we generally engage in discussions in an attempt to settle the dispute. If we are unable to reach a settlement, the outcome of a dispute ultimately would be determined by legal proceedings.

Under ASC 450-20, until a liability associated with settlement discussions or legal proceedings becomes probable and can be reasonably estimated, we consider our claim payment or rescission resolved for financial reporting purposes and do not accrue an estimated loss. Where we have determined that a loss is probable and can be reasonably estimated, we have recorded our best estimate of our probable loss. If we are not able to implement settlements we consider probable, we intend to defend MGIC vigorously against any related legal proceedings.

In addition to matters for which we have recorded a probable loss, we are involved in other discussions and/or proceedings with insureds with respect to our claims paying practices. Although it is reasonably possible that when these matters are resolved we will not prevail in all cases, we are unable to make a reasonable estimate or range of estimates of the potential liability. We estimate the maximum exposure associated with matters where a loss is reasonably possible to be approximately $291 million, although we believe (but can give no assurance that) we will ultimately resolve these matters for significantly less than this amount. This estimate of our maximum exposure does not include interest or consequential or exemplary damages.
Mortgage insurers, including MGIC, have been involved in litigation and regulatory actions related to alleged violations of the anti-referral fee provisions of the Real Estate Settlement Procedures Act, which is commonly known as RESPA, and the notice provisions of the Fair Credit Reporting Act, which is commonly known as FCRA. While these proceedings in the aggregate have not resulted in material liability for MGIC, there can be no assurance that the outcome of future proceedings, if any, under these laws would not have a material adverse affect on us. In addition, various regulators, including the CFPB, state insurance

commissioners and state attorneys general may bring other actions seeking various forms of relief in connection with alleged violations of RESPA. The insurance law provisions of many states prohibit paying for the referral of insurance business and provide various mechanisms to enforce this prohibition. While we believe our practices are in conformity with applicable laws and regulations, it is not possible to predict the eventual scope, duration or outcome of any such reviews or investigations nor is it possible to predict their effect on us or the mortgage insurance industry.

Through a non-insurance subsidiary, we utilize our underwriting skills to provide an outsourced underwriting service to our customers known as contract underwriting. As part of the contract underwriting activities, that subsidiary is responsible for the quality of the underwriting decisions in accordance with the terms of the contract underwriting agreements with customers. That subsidiary may be required to provide certain remedies to its customers if certain standards relating to the quality of our underwriting work are not met, and we have an established reserve for such future obligations. Claims for remedies may be made a number of years after the underwriting work was performed. The underwriting remedy expense for 2016 and the first half of 2017 was immaterial to our consolidated financial statements.

In addition to the matters described above, we are involved in other legal proceedings in the ordinary course of business. In our opinion, based on the facts known at this time, the ultimate resolution of these ordinary course legal proceedings will not have a material adverse effect on our financial position or results of operations.

See Note 11 – “Income Taxes” for a description of federal income tax contingencies.

Note 6. Earnings per Share
Basic earnings per share (“EPS”) is calculated by dividing net income by the weighted average number of shares of common stock outstanding. Diluted EPS includes the components of basic EPS and also gives effect to dilutive common stock equivalents. We calculate diluted EPS using the treasury stock method and if-converted method. Under the if-converted method, diluted EPS reflects the potential dilution that could occur if our convertible debt instruments result in the issuance of common stock. The determination of potentially issuable shares does not consider the satisfaction of the conversion requirements and the shares are included in the determination of diluted EPS as of the beginning of the period, if dilutive. During the quarter ended June 30, 2017, we had several debt issuances that could result in contingently issuable shares and consider each potential issuance of shares separately to reflect the maximum potential dilution. Nonetheless, our dilutive common stock equivalents may not reflect all of the contingently issuable shares that could be required to be

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issued upon any debt conversion. For purposes of calculating basic and diluted EPS, vested restricted stock and restricted stock units ("RSUs") are considered outstanding.

The following table reconciles the numerators and denominators used to calculate basic and diluted EPS.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share data)	2017	2016	2017	2016
Basic earnings per share:				
Net income	$118,622	$109,221	$208,420	$178,412
Weighted average common shares outstanding - basic	366,918	340,678	354,035	340,411
Basic earnings per share	$0.32	$0.32	$0.59	$0.52
Diluted earnings per share:				
Net income	$118,622	$109,221	$208,420	$178,412
Interest expense, net of tax [1]:				
2% Notes	84	1,982	907	3,964
5% Notes	427	1,728	1,709	4,406
9% Debentures	3,757	3,757	7,514	8,379
Diluted income available to common shareholders	$122,890	$116,688	$218,550	$195,161
Weighted average common shares outstanding - basic	366,918	340,678	354,035	340,411
Effect of dilutive securities:				
Unvested RSUs	1,140	1,209	1,314	1,444
2% Notes	3,827	71,917	16,771	71,917
5% Notes	3,557	13,307	7,154	15,449
9% Debentures	19,028	19,028	19,028	21,133
Weighted average common shares outstanding - diluted	394,470	446,139	398,302	450,354
Diluted earnings per share	$0.31	$0.26	$0.55	$0.43

[1] Tax effected at a rate of 35%.

Note 7. Investments

The amortized cost, gross unrealized gains and losses and fair value of the investment portfolio at June 30, 2017 and December 31, 2016 are shown below.

June 30, 2017

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses [1]	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$64,043	$ 364	$ (478)	$63,929
Obligations of U.S. states and political subdivisions	2,131,471	42,983	(9,165)	2,165,289
Corporate debt securities	1,823,823	12,699	(8,897)	1,827,625
ABS	21,988	10	(11)	21,987
RMBS	209,874	78	(7,612)	202,340
CMBS	310,997	1,548	(5,467)	307,078
CLOs	112,769	332	(138)	112,963
Total debt securities	4,674,965	58,014	(31,768)	4,701,211
Equity securities	7,183	41	(15)	7,209
Total investment portfolio	$4,682,148	$ 58,055	$ (31,783)	$4,708,420

December 31, 2016

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses [1]	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$73,847	$ 407	$ (724)	$73,530
Obligations of U.S. states and political subdivisions	2,147,458	20,983	(25,425)	2,143,016
Corporate debt securities	1,756,461	6,059	(18,610)	1,743,910
ABS	59,519	74	(28)	59,565
RMBS	231,733	102	(7,626)	224,209
CMBS	327,042	769	(7,994)	319,817
CLOs	121,151	226	(202)	121,175
Total debt securities	4,717,211	28,620	(60,609)	4,685,222
Equity securities	7,144	8	(24)	7,128
Total investment portfolio	$4,724,355	$ 28,628	$ (60,633)	$4,692,350

(1) At June 30, 2017 and December 31, 2016, there were no other-than-temporary impairment losses recorded in other comprehensive income.

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The FHLB Advance is secured by eligible collateral whose fair value must be maintained at 102% of the outstanding principal balance. As of June 30, 2017 that collateral is included in our total investment portfolio amount shown above with a total fair value of $165.9 million.

The amortized cost and fair values of debt securities at June 30, 2017, by contractual maturity, are shown in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Because most asset-backed and mortgage-backed securities and collateralized loan obligations provide for periodic payments throughout their lives, they are listed in separate categories.

June 30, 2017

(In thousands)	Amortized Cost	Fair Value
Due in one year or less	$341,831	$342,028
Due after one year through five years	1,356,023	1,362,799
Due after five years through ten years	1,026,851	1,030,223
Due after ten years	1,294,632	1,321,793
	$4,019,337	$4,056,843
ABS	21,988	21,987
RMBS	209,874	202,340
CMBS	310,997	307,078
CLOs	112,769	112,963
Total as of June 30, 2017	$4,674,965	$4,701,211

At June 30, 2017 and December 31, 2016, the investment portfolio had gross unrealized losses of $31.8 million and $60.6 million, respectively. For those securities in an unrealized loss position, the length of time the securities were in such a position, as measured by their month-end fair values, is as follows:

June 30, 2017	Less Than 12 Months		12 Months or Greater		Total	
(In thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$52,769	$(471)	$993	$(7)	$53,762	$(478)
Obligations of U.S. states and political subdivisions	622,767	(8,595)	17,400	(570)	640,167	(9,165)
Corporate debt securities	649,134	(7,664)	27,241	(1,233)	676,375	(8,897)
ABS	3,362	(11)	—	—	3,362	(11)
RMBS	43,815	(885)	155,030	(6,727)	198,845	(7,612)
CMBS	172,505	(5,439)	7,237	(28)	179,742	(5,467)
CLOs	7,275	(138)	—	—	7,275	(138)
Equity securities	455	(7)	139	(8)	594	(15)
Total	$1,552,082	$(23,210)	$208,040	$(8,573)	$1,760,122	$(31,783)

December 31, 2016	Less Than 12 Months		12 Months or Greater		Total	
(In thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$48,642	$(724)	$—	$—	$48,642	$(724)
Obligations of U.S. states and political subdivisions	1,136,676	(24,918)	13,681	(507)	1,150,357	(25,425)

Corporate debt securities	915,777	(16,771)	35,769	(1,839)	951,546	(18,610)
ABS	3,366	(28)	656	—	4,022	(28)
RMBS	46,493	(857)	171,326	(6,769)	217,819	(7,626)
CMBS	205,545	(7,529)	38,587	(465)	244,132	(7,994)
CLOs	13,278	(73)	34,760	(129)	48,038	(202)
Equity securities	568	(15)	137	(9)	705	(24)
Total	$2,370,345	$(50,915)	$294,916	$(9,718)	$2,665,261	$(60,633)

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The unrealized losses in all categories of our investments at June 30, 2017 and December 31, 2016 were primarily caused by the difference in interest rates at each respective period, compared to interest rates at the time of purchase. There were 404 and 607 securities in an unrealized loss position at June 30, 2017 and December 31, 2016, respectively.

During each of the three and six months ended June 30, 2017 and 2016 there were no other-than-temporary impairments ("OTTI") recognized. The net realized investment gains (losses) on the investment portfolio are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2017	2016	2017	2016
Realized investment gains (losses) on investments:				
Fixed maturities	$(52)	$831	$(177)	$3,886
Equity securities	10	5	13	6
Net realized investments (losses) gains	$(42)	$836	$(164)	$3,892

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2017	2016	2017	2016
Realized investment gains (losses) on investments:				
Gains on sales	$644	$1,404	$829	$5,509
Losses on sales	(686)	(568)	(993)	(1,617)
Net realized investments (losses) gains	$(42)	$836	$(164)	$3,892

Note 8. Fair Value Measurements

Under the authoritative guidance, fair value is disclosed using a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value and categorizes assets and liabilities into Levels 1, 2, and 3 based on inputs available to determine their fair values. To determine the fair value of securities available-for-sale in Level 1 and Level 2 of the fair value hierarchy, independent pricing sources have been utilized. One price is provided per security based on observable market data. To ensure securities are appropriately classified in the fair value hierarchy, we review the pricing techniques and methodologies of the independent pricing sources and believe that their policies adequately consider market activity, either based on specific transactions for the issue valued or based on modeling of securities with similar credit quality, duration, yield and structure that were recently traded. A variety of inputs are utilized by the independent pricing sources including benchmark yields, reported

trades, non-binding broker/dealer quotes, issuer spreads, two sided markets, benchmark securities, bids, offers and reference data including data published in market research publications. Inputs may be weighted differently for any security, and not all inputs are used for each security evaluation.

Market indicators, industry and economic events are also considered. This information is evaluated using a multidimensional pricing model. This model combines all inputs to arrive at a value assigned to each security. Quality controls are performed by the independent pricing sources throughout this process, which include reviewing tolerance reports, trading information, data changes, and directional moves compared to market moves. In addition, on a quarterly basis, we perform quality controls over values received from the pricing sources which also includes reviewing tolerance reports, trading information, data changes, and directional moves compared to market moves. We have not made any adjustments to the prices obtained from the independent pricing sources.

In accordance with fair value accounting guidance, we applied the following fair value hierarchy in order to measure fair value for assets and liabilities:

Level 1 - Quoted prices for identical instruments in active markets that we can access. Financial assets utilizing Level 1 inputs primarily include U.S. Treasury securities and equity securities.

Level 2 - Quoted prices for similar instruments in active markets that we can access; quoted prices for identical or similar instruments in markets that are not active; and inputs, other than quoted prices, that are observable in the marketplace for the instrument. The observable inputs are used in valuation models to calculate the fair value of the instruments. Financial assets utilizing Level 2 inputs primarily include obligations of U.S. government corporations and agencies, corporate bonds, mortgage-backed securities, asset-backed securities, and most municipal bonds.

The independent pricing sources utilize these approaches to determine the fair value of the instruments in Level 2 of the fair value hierarchy based on type of instrument:

Corporate Debt & U.S. Government and Agency Bonds are evaluated by surveying the dealer community, obtaining relevant trade data, benchmark quotes and spreads and incorporating this information into the evaluation process.

Obligations of U.S. States & Political Subdivisions are evaluated by tracking, capturing, and analyzing quotes for active issues and trades reported via the Municipal Securities Rulemaking Board records. Daily briefings and reviews of current economic conditions, trading

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levels, spread relationships, and the slope of the yield curve provide further data for evaluation.

Residential Mortgage-Backed Securities (“RMBS”) are evaluated by monitoring interest rate movements, and other pertinent data daily. Incoming market data is enriched to derive spread, yield and/or price data as appropriate, enabling known data points to be extrapolated for valuation application across a range of related securities.

Commercial Mortgage-Backed Securities (“CMBS”) are evaluated using valuation techniques that reflect market participants’ assumptions and maximize the use of relevant observable inputs including quoted prices for similar assets, benchmark yield curves and market corroborated inputs. The inputs for securities covered, including executed trades, broker quotes, credit information, collateral attributes and/or cash flow waterfall as applicable, are regularly reviewed as part of the evaluation.

Asset-Backed Securities (“ABS”) are evaluated using spreads and other information solicited from market buy- and sell-side sources, including primary and secondary dealers, portfolio managers, and research analysts. Cash flows are generated for each tranche, benchmark yields are determined, and deal collateral performance and tranche level attributes including trade activity, bids, and offer are applied, resulting in tranche-specific prices.

Collateralized loan obligations ("CLO") are evaluated by manager rating, seniority in the capital structure, assumptions about prepayment, default and recovery and their impact on cash flow generation. Loan level net asset values are determined and aggregated for tranches and as a final step, prices are checked against available recent trade activity.

Level 3 - Valuations derived from valuation techniques in which one or more significant inputs or value drivers are unobservable or from par values for equity securities restricted in their ability to be redeemed or sold. The inputs used to derive the fair value of Level 3 securities reflect our own assumptions about the assumptions a market participant would use in pricing an asset or liability. Financial assets utilizing Level 3 inputs primarily include equity securities that can only be redeemed or sold at their par value and only to the security issuer and a state premium tax credit investment. The state premium tax credit investment has a maturity of less than 2 years, a credit rating of AAA, and its balance reflects its remaining scheduled payments discounted at an average annual rate of 7.1%. Our non-financial assets that are classified as Level 3 securities consist of real estate acquired through claim settlement. The fair value of real estate acquired is the lower of our acquisition cost or a percentage of the appraised value. The percentage applied to the appraised value is based upon our historical sales experience adjusted for current trends.

Fair value measurements for assets measured at fair value included the following as of June 30, 2017 and December 31, 2016:

June 30, 2017

(In thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$63,929	$ 13,342	$ 50,587	$ —

Obligations of U.S. states and political subdivisions	2,165,289	—	2,164,712	577
Corporate debt securities	1,827,625	—	1,827,625	—
ABS	21,987	—	21,987	—
RMBS	202,340	—	202,340	—
CMBS	307,078	—	307,078	—
CLOs	112,963	—	112,963	—
Total debt securities	4,701,211	13,342	4,687,292	577
Equity securities [1]	7,209	2,941	—	4,268
Total investment portfolio	$4,708,420	$16,283	$4,687,292	$ 4,845
Real estate acquired [2]	$10,271	$—	$—	$ 10,271

(1) Equity securities in Level 3 are carried at cost, which approximates fair value.

(2) Real estate acquired through claim settlement, which is held for sale, is reported in Other assets on the consolidated balance sheets.

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December 31, 2016

(In thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$73,530	$30,690	$42,840	$ —
Obligations of U.S. states and political subdivisions	2,143,016	—	2,142,325	691
Corporate debt securities	1,743,910	—	1,743,910	—
ABS	59,565	—	59,565	—
RMBS	224,209	—	224,209	—
CMBS	319,817	—	319,817	—
CLOs	121,175	—	121,175	—
Total debt securities	4,685,222	30,690	4,653,841	691
Equity securities (1)	7,128	2,860	—	4,268
Total investment portfolio	$4,692,350	$33,550	$4,653,841	$ 4,959
Real estate acquired (2)	$11,748	$—	$—	$ 11,748

(1) Equity securities in Level 3 are carried at cost, which approximates fair value.

(2) Real estate acquired through claim settlement, which is held for sale, is reported in Other assets on the consolidated balance sheets.

For assets measured at fair value using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances for the three and six months ended June 30, 2017 and 2016 is shown in the following tables. There were no transfers into or out of Level 3 in those periods and there were no losses included in earnings for those periods attributable to the change in unrealized losses on assets still held at the end of the applicable period.

Three Months Ended June 30, 2017

(In thousands)	Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
Balance at March 31, 2017	$ 683	$ 4,268	$ 4,951	$10,730
Total realized/unrealized gains (losses):				
Included in earnings and reported as losses incurred, net	—	—	—	(63)
Purchases	—	—	—	9,421
Sales	(106)	—	(106)	(9,817)
Balance at June 30, 2017	$ 577	$ 4,268	$ 4,845	$10,271

Three Months Ended June 30, 2016

(In thousands)	Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
Balance at March 31, 2016	$ 1,192	$ 3,421	$ 4,613	$12,849
Total realized/unrealized gains (losses):				
Included in other comprehensive income	—	3,519	3,519	—
Included in earnings and reported as losses incurred, net	—	—	—	651
Purchases	—	—	—	6,748
Sales	(136)	—	(136)	(10,606)

Balance at June 30, 2016	$ 1,056	$ 6,940	$ 7,996	$9,642

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Six Months Ended June 30, 2017

(In thousands)	Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
Balance at December 31, 2016	$ 691	$ 4,268	$ 4,959	$ 11,748
Total realized/unrealized gains (losses):				
Included in earnings and reported as losses incurred, net	—	—	—	(226)
Purchases	—	—	—	18,104
Sales	(114)	—	(114)	(19,355)
Balance at June 30, 2017	$ 577	$ 4,268	$ 4,845	$ 10,271

Six Months Ended June 30, 2016

(In thousands)	Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
Balance at December 31, 2015	$ 1,228	$ 2,855	$ 4,083	$ 12,149
Total realized/unrealized gains (losses):				
Included in other comprehensive income	—	3,519	3,519	—
Included in earnings and reported as losses incurred, net	—	—	—	358
Purchases	—	3,091	3,091	19,015
Sales	(172)	(2,525)	(2,697)	(21,880)
Balance at June 30, 2016	$ 1,056	$ 6,940	$ 7,996	$ 9,642

Authoritative guidance over disclosures about the fair value of financial instruments requires additional disclosure for financial instruments not measured at fair value. Certain financial instruments, including insurance contracts, are excluded from these fair value disclosure requirements. The carrying values of cash and cash equivalents (Level 1) and accrued investment income (Level 2) approximated their fair values. Additional fair value disclosures related to our investment portfolio are included in Note 7 – "Investments."

Financial Liabilities Not Measured at Fair Value

We incur financial liabilities in the normal course of our business. The following table presents the carrying value and fair value of our financial liabilities disclosed, but not carried, at fair value at June 30, 2017 and December 31, 2016. The fair values of our 5% Notes, 2% Notes, 5.75% Notes, and 9% Debentures were based on observable market prices. The fair value of the FHLB Advance was estimated using discounted cash flows on current incremental borrowing rates for similar borrowing arrangements. In all cases the fair values of the financial liabilities below are categorized as Level 2.

	June 30, 2017		December 31, 2016	
(In thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial liabilities:				
FHLB Advance	155,000	154,140	$ 155,000	$ 151,905
5% Notes	—	—	144,789	147,679
2% Notes	—	—	204,672	308,605
5.75% Notes	417,983	457,878	417,406	445,987
9% Debentures	256,872	338,190	256,872	323,040
Total financial liabilities	$ 829,855	$ 950,208	$ 1,178,739	$ 1,377,216

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Note 9. Other Comprehensive Income

The pretax and related income tax (expense) benefit components of our other comprehensive income (loss) for the three and six months ended June 30, 2017 and 2016 are included in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2017	2016	2017	2016
Net unrealized investment gains arising during the period	$39,614	$86,674	$58,261	$165,058
Income tax expense	(13,865)	(30,336)	(20,391)	(57,893)
Net of taxes	25,749	56,338	37,870	107,165
Net changes in benefit plan assets and obligations	(220)	(266)	(454)	(740)
Income tax benefit	78	93	159	259
Net of taxes	(142)	(173)	(295)	(481)
Net changes in unrealized foreign currency translation adjustment	—	16	45	(1,480)
Income tax (expense) benefit	—	(5)	(14)	516
Net of taxes	—	11	31	(964)
Total other comprehensive income	39,394	86,424	57,852	162,838
Total income tax expense	(13,787)	(30,248)	(20,246)	(57,118)
Total other comprehensive income, net of tax	$25,607	$56,176	$37,606	$105,720

The pretax and related income tax (expense) benefit components of the amounts reclassified from our accumulated other comprehensive loss ("AOCL") to our consolidated statements of operations for the three and six months ended June 30, 2017 and 2016 are included in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2017	2016	2017	2016
Reclassification adjustment for net realized (losses) gains (1)	$(1,392)	$98	$(2,139)	$710
Income tax benefit (expense)	487	(34)	748	(126)
Net of taxes	(905)	64	(1,391)	584
Reclassification adjustment related to benefit plan assets and obligations (2)	220	266	454	740
Income tax expense	(78)	(93)	(159)	(259)
Net of taxes	142	173	295	481
Reclassification adjustment related to foreign currency (3)	—	—	—	1,467
Income tax expense	—	—	—	(513)
Net of taxes	—	—	—	954
Total reclassifications	(1,172)	364	(1,685)	2,917
Total income tax benefit (expense)	409	(127)	589	(898)
Total reclassifications, net of tax	$(763)	$237	$(1,096)	$2,019

(1) Increases (decreases) Net realized investment (losses) gains on the consolidated statements of operations.
(2) Decreases (increases) Other underwriting and operating expenses, net on the consolidated statements of operations.
(3) Increases (decreases) Other revenue on the consolidated statements of operations.

A rollforward of AOCL for the six months ended June 30, 2017, including amounts reclassified from AOCL, are included in the table below.

	Six Months Ended June 30, 2017			
(In thousands)	Net unrealized gains and losses on available-for-sale securities	Net benefit plan assets and obligations recognized in shareholders' equity	Net unrealized foreign currency translation	Total AOCL
Balance, December 31, 2016, net of tax	$(20,797)	$ (54,272)	$ (31)	$(75,100)
Other comprehensive income before reclassifications	36,479	—	31	36,510
Less: Amounts reclassified from AOCL	(1,391)	295	—	(1,096)
Balance, June 30, 2017, net of tax	$17,073	$ (54,567)	$ —	$(37,494)

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Note 10. Benefit Plans

The following tables provide the components of net periodic benefit cost for our pension, supplemental executive retirement and other postretirement benefit plans for three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30,			
	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefit Plans	
(In thousands)	2017	2016	2017	2016
Service cost	$2,484	$2,402	$220	$201
Interest cost	3,879	4,024	186	180
Expected return on plan assets	(5,013)	(4,865)	(1,312)	(1,221)
Recognized net actuarial loss	1,549	1,567	—	—
Amortization of prior service cost	(106)	(171)	(1,663)	(1,663)
Net periodic benefit cost (benefit)	$2,793	$2,957	$(2,569)	$(2,503)

	Six Months Ended June 30,			
	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefit Plans	
(In thousands)	2017	2016	2017	2016
Service cost	$4,778	$4,565	$407	$376
Interest cost	7,737	7,953	353	352
Expected return on plan assets	(10,049)	(9,754)	(2,624)	(2,443)
Recognized net actuarial loss	3,084	2,928	—	—
Amortization of prior service cost	(213)	(343)	(3,325)	(3,325)
Net periodic benefit cost (benefit)	$5,337	$5,349	$(5,189)	$(5,040)

We currently intend to make contributions totaling $9.4 million to our qualified pension plan and supplemental executive retirement plan in 2017.

Note 11. Income Taxes

We have approximately $1.2 billion of net operating loss (“NOL”) carryforwards on a regular tax basis and $0.3 billion of NOL carryforwards for computing the alternative minimum tax as of June 30, 2017. Any unutilized carryforwards are scheduled to expire at the end of tax years 2031 through 2033.

We evaluate the realizability of our deferred tax assets including our NOL carryforwards on a quarterly basis. Based on our analysis, we have concluded that all of our deferred tax assets are fully realizable and therefore no valuation allowance existed at June 30, 2017 and December 31, 2016.

Tax Contingencies

As previously disclosed, the Internal Revenue Service (“IRS”) completed examinations of our federal income tax returns for the years 2000 through 2007 and issued proposed assessments for taxes, interest and penalties related to our treatment of the flow-through income and loss from an investment in a portfolio of residual interests of Real Estate Mortgage Investment Conduits (“REMICs”). The IRS indicated that it did not believe that, for various reasons, we had established sufficient tax basis in the REMIC residual interests to deduct the losses from taxable income. We appealed these assessments within the IRS and in August 2010, we reached a tentative settlement agreement with the IRS which was not finalized.

In 2014, we received Notices of Deficiency (commonly referred to as "90 day letters") covering the 2000-2007 tax years. The Notices of Deficiency reflect taxes and penalties related to the REMIC matters of $197.5 million and at June 30, 2017, there would also be interest related to these matters of approximately $195.7 million. In 2007, we made a payment of $65.2 million to the United States Department of the Treasury which will reduce any amounts we would ultimately owe. The Notices of Deficiency also reflect additional amounts due of $261.4 million, which are primarily associated with the disallowance of the carryback of the 2009 net operating loss to the 2004-2007 tax years. We believe the IRS included the carryback adjustments as a precaution to keep open the statute of limitations on collection of the tax that was refunded when this loss was carried back, and not because the IRS actually intends to disallow the carryback permanently. Depending on the outcome of this matter, additional state income taxes and state interest may become due when a final resolution is reached. As of June 30, 2017, those state taxes and interest would approximate $82.4 million. In addition, there could also be state tax penalties. Our total amount of unrecognized tax benefits as of June 30, 2017 is $140.8 million, which represents the tax benefits generated by the REMIC portfolio included in our tax returns that we have not taken benefit for in our financial statements, including any related interest.

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We filed a petition with the U.S. Tax Court contesting most of the IRS' proposed adjustments reflected in the Notices of Deficiency and the IRS filed an answer to our petition which continued to assert their claim. The case has twice been scheduled for trial and in each instance, the parties jointly filed, and the U.S. Tax Court approved (most recently in February 2016), motions for continuance to postpone the trial date. Also in February 2016, the U.S. Tax Court approved a joint motion to consolidate for trial, briefing and opinion, our case with similar cases of Radian Group, Inc., as successor to Enhance Financial Services Group, Inc., et al. The parties informed the Tax Court in January 2017 that they had reached a basis for settlement of the major issues in the case and in June 2017 that there was only one remaining unresolved secondary issue (a factual determination arising from the 2002-2004 audit that is unrelated to the REMIC matter which the parties continue to work toward resolving). Any agreed settlement terms will ultimately be subject to review by the Joint Committee on Taxation ("JCT") before a settlement can be completed and there is no assurance that a settlement will be completed. Based on information that we currently have regarding the status of our ongoing dispute, we recorded a provision for additional taxes and interest of $27.8 million in the first half of 2017.

Should a settlement not be completed, ongoing litigation to resolve our dispute with the IRS could be lengthy and costly in terms of legal fees and related expenses. We would need to make further adjustments, which could be material, to our tax provision and liabilities if our view of the probability of success in this matter changes, and the ultimate resolution of this matter could have a material negative impact on our effective tax rate, results of operations, cash flows, available assets and statutory capital. In this regard, see Note 15 - “Statutory Information.”

The total amount of the unrecognized tax benefits, related to our aforementioned REMIC issue that would affect our effective tax rate is $119.1 million. We recognize interest accrued and penalties related to unrecognized tax benefits in income taxes. As of June 30, 2017 and December 31, 2016, we had accrued $49.9 million and $28.9 million, respectively, for the payment of interest.

Note 12. Loss Reserves

We establish reserves to recognize the estimated liability for losses and loss adjustment expenses (“LAE”) related to defaults on insured mortgage loans. Loss reserves are established by estimating the number of loans in our inventory of delinquent loans that will result in a claim payment, which is referred to as the claim rate, and further estimating the amount of the claim payment, which is referred to as claim severity.

Estimation of losses is inherently judgmental. The conditions that affect the claim rate and claim severity include the current and future state of the domestic

economy, including unemployment and the current and future strength of local housing markets; exposure on insured loans; the amount of time between default and claim filing; and curtailments and rescissions. The actual amount of the claim payments may be substantially different than our loss reserve estimates. Our estimates could be adversely affected by several factors, including a deterioration of regional or national economic conditions, including unemployment, leading to a reduction in borrowers’ income and thus their ability to make mortgage payments, and a drop in housing values which may affect borrower willingness to continue to make mortgage payments when the value of the home is below the mortgage balance. Changes to our estimates could result in a material impact to our results of operations and capital position, even in a stable economic environment.

The “Losses incurred” section of the table below shows losses incurred on defaults that occurred in the current year and in prior years. The amount of losses incurred relating to defaults that occurred in the current year represents the estimated amount to be ultimately paid on such defaults. The amount of losses incurred relating to defaults that occurred in prior years represents the actual claim rate and severity associated with those defaults resolved in the current year differing from the estimated liability at the prior year-end, as well as a re-estimation of amounts to be ultimately paid on defaults continuing from the end of the prior year. This re-estimation of the claim rate and severity is the result of our review of current trends in the default inventory, such as percentages of defaults that have resulted in a claim, the amount of the claims relative to the average loan exposure, changes in the relative level of defaults by geography and changes in average loan exposure.

Losses incurred on defaults that occurred in the current year decreased in the first six months of 2017 compared to the same period in 2016, primarily due to a decrease in the estimated claim rate on recently reported defaults and a decrease in the number of new defaults, net of related cures.

For the six months ended June 30, 2017 and 2016 we experienced favorable prior year loss reserve development. This development was, in part, due to the resolution of approximately 48% and 43% of the prior year default inventory during the six months ended June 30, 2017 and 2016, respectively. During the first six months of 2017 and 2016, we experienced improved cure rates on prior year defaults, which were offset in part by an increase in severity on the prior year defaults in both periods.

The “Losses paid” section of the table below shows the breakdown between claims paid on new default notices in the current year and claims paid on defaults from prior years. Until a few years ago, it took, on average, approximately twelve months for a default that is not cured to develop into a paid claim. Over the past several years, the average time

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it takes to receive a claim associated with a default has increased. This is, in part, due to new loss mitigation protocols established by servicers and to changes in some state foreclosure laws that may include, for example, a requirement for additional review and/or mediation processes. It is difficult to estimate how long it may take for current and future defaults that do not cure to develop into paid claims.

During the first six months of 2017 and 2016, our losses paid included amounts paid in connection with disputes concerning our claims paying practices and settlements of coverage on pools of non-performing loans ("NPLs"). The impacts of the settlements were as follows:

- 2017 - Items removed from inventory totaled 1,128 notices with an amount paid of $45 million.
- 2016 - Items removed from inventory totaled 1,273 notices with an amount paid of $51 million.

The liability associated with our estimate of premiums to be refunded on expected claim payments is accrued for separately at June 30, 2017 and December 31, 2016 and approximated $74 million and $85 million, respectively. This liability was included in "Other liabilities" on our consolidated balance sheets.

The following table provides a reconciliation of beginning and ending loss reserves as of and for the six months ended June 30, 2017 and 2016:

	Six months ended June 30,	
(In thousands)	2017	2016
Reserve at beginning of period	$1,438,813	$1,893,402
Less reinsurance recoverable	50,493	44,487
Net reserve at beginning of period	1,388,320	1,848,915
Losses incurred:		
Losses and LAE incurred in respect of default notices received in:		
Current year	158,906	196,543
Prior years (1)	(103,948)	(64,941)
Total losses incurred	54,958	131,602
Losses paid:		
Losses and LAE paid in respect of default notices received in:		
Current year	2,125	1,396
Prior years	298,847	392,007
Reinsurance terminations	—	(4)
Total losses paid	300,972	393,399
Net reserve at end of period	1,142,306	1,587,118
Plus reinsurance recoverables	44,783	45,215
Reserve at end of period	$1,187,089	$1,632,333

(1) A negative number for prior year losses incurred indicates a redundancy of prior year loss reserves. See the following table for more information about prior year loss development.

The prior year development of the reserves in the first six months of 2017 and 2016 is reflected in the following table.

	Six months ended June 30,	
(In millions)	2017	2016
Decrease in estimated claim rate on primary defaults	$ (104)	$ (76)

Increase in estimated severity on primary defaults	2		17	
Change in estimates related to pool reserves, LAE reserves and reinsurance	(2	)	(6	)
Total prior year loss development [1]	$ (104	)	$ (65	)

[1] A negative number for prior year loss development indicates a redundancy of prior year loss reserves.

Default inventory

A rollforward of our primary default inventory for the three and six months ended June 30, 2017 and 2016 appears in the following table. The information concerning new notices and cures is compiled from monthly reports received from loan servicers. The level of new notice and cure activity reported in a particular month can be influenced by, among other things, the date on which a servicer generates its report, the accuracy of the data provided by servicers, the number of business days in a month, transfers of servicing between loan servicers and whether all servicers have provided the reports in a given month.

	Three months ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Default inventory at beginning of period	45,349	55,590	50,282	62,633
New notices	14,463	16,080	29,402	32,811
Cures	(14,708)	(15,640)	(31,836)	(34,693)
Paids (including those charged to a deductible or captive)	(2,573)	(3,195)	(5,208)	(6,568)
Rescissions and denials	(100)	(142)	(195)	(352)
Other items removed from inventory	(1,114)	(135)	(1,128)	(1,273)
Default inventory at end of period	41,317	52,558	41,317	52,558

The decrease in the primary default inventory experienced during 2017 and 2016 was generally across all markets and primarily in book years 2008 and prior. Historically as a default ages it becomes more likely to result in a claim.

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Consecutive months in default

	June 30, 2017			December 31, 2016			June 30, 2016		
3 months or less	10,299	25	%	12,194	24	%	11,547	22	%
4 - 11 months	11,018	27	%	13,450	27	%	12,680	24	%
12 months or more (1) (2)	20,000	48	%	24,638	49	%	28,331	54	%
Total primary default inventory	41,317	100	%	50,282	100	%	52,558	100	%
Primary claims received inventory included in ending default inventory:									
	1,258	3	%	1,385	3	%	1,829	3	%

(1) Approximately 46%, 47%, and 49% of the primary default inventory in default for 12 consecutive months or more has been in default for at least 36 consecutive months as of June 30, 2017, December 31, 2016, and June 30, 2016, respectively.

(2) The majority of items removed from our default inventory under NPL settlements during the six months ended June 30, 2017 were in default for 12 consecutive months or more as of December 31, 2016.

The number of months a loan is in the default inventory can differ from the number of payments that the borrower has not made or is considered delinquent. These differences typically result from a borrower making monthly payments that do not result in the loan becoming fully current. The number of payments that a borrower is delinquent is shown in the table below.

Number of payments delinquent

	June 30, 2017			December 31, 2016			June 30, 2016		
3 payments or less	15,858	38	%	18,419	36	%	17,299	33	%
4 - 11 payments	10,560	26	%	12,892	26	%	12,746	24	%
12 payments or more (1)	14,899	36	%	18,971	38	%	22,513	43	%
Total primary default inventory	41,317	100	%	50,282	100	%	52,558	100	%

(1) The majority of items removed from our default inventory under NPL settlements during the six months ended June 30, 2017 had 12 or more payments delinquent as of December 31, 2016.

Pool insurance default inventory decreased to 1,511 at June 30, 2017 from 1,883 at December 31, 2016, and 2,024 at June 30, 2016.

Claims paying practices

Our loss reserving methodology incorporates our estimates of future rescissions. A variance between ultimate actual rescission rates and our estimates, as a result of the outcome of litigation, settlements or other factors, could materially affect our losses.

The liability associated with our estimate of premiums to be refunded on expected future rescissions is accrued for separately and is included in “Other liabilities” on our consolidated balance sheets.

For information about discussions and legal proceedings with customers with respect to our claims paying practices see Note 5 – “Litigation and Contingencies.”

Note 13. Shareholders’ Equity

Change in accounting principle

As described in Note 2 - “New Accounting Pronouncements,” during the first quarter of 2017 we adopted the updated guidance of “Improvements to Employee Share-Based Compensation Accounting.” The adoption of this guidance resulted in an immaterial cumulative effect adjustment to our 2017 beginning retained earnings.

2% Notes
As described in Note 3 - "Debt," on March 21, 2017, we issued an irrevocable notice of redemption in respect of our outstanding 2% Notes, with a redemption date of April 21, 2017. Subsequent to our notice of redemption, in April, holders of approximately $202.5 million of the outstanding principal amount exercised their rights to convert their notes into shares of our common stock. As a result, we issued approximately 29.1 million shares of our common stock, of which 18.7 million shares were reissued from our treasury stock and 10.4 million were newly issued shares. The conversions of the notes increased our shareholders' equity by the carrying value of the notes, which included outstanding debt issuance costs, at the time of conversion.

Shareholders Rights Agreement
Our Amended and Restated Rights Agreement dated July 23, 2015 seeks to diminish the risk that our ability to use our NOLs to reduce potential future federal income tax obligations may become substantially limited and to deter certain abusive takeover practices. The benefit of the NOLs would be substantially limited, and the timing of the usage of the NOLs could be substantially delayed, if we were to experience an "ownership change" as defined by Section 382 of the Internal Revenue Code.

Under the Agreement each outstanding share of our Common Stock is accompanied by one Right. The "Distribution Date" occurs on the earlier of ten days after a public announcement that a person has become an "Acquiring Person," or ten business days after a person

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announces or begins a tender offer in which consummation of such offer would result in a person becoming an "Acquiring Person." An "Acquiring Person" is any person that becomes, by itself or together with its affiliates and associates, a beneficial owner of 5% or more of the shares of our Common Stock then outstanding, but excludes, among others, certain exempt and grandfathered persons as defined in the Agreement. The Rights are not exercisable until the Distribution Date. Each Right will initially entitle shareholders to buy one-tenth of one share of our Common Stock at a Purchase Price of $45 per full share (equivalent to $4.50 for each one-tenth share), subject to adjustment. Each exercisable Right (subject to certain limitations) will entitle its holder to purchase, at the Rights' then-current Purchase Price, a number of our shares of Common Stock (or if after the Shares Acquisition Date, we are acquired in a business combination, common shares of the acquiror) having a market value at the time equal to twice the Purchase Price. The Rights will expire on August 1, 2018, or earlier as described in the Agreement. The Rights are redeemable at a price of $0.001 per Right at any time prior to the time a person becomes an Acquiring Person. Other than certain amendments, the Board of Directors may amend the Rights in any respect without the consent of the holders of the Rights.

Note 14. Share-Based Compensation

We have certain share-based compensation plans. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period which generally corresponds to the vesting period. Awards under our plans generally vest over periods ranging from one to three years.

The number of shares granted to employees and the weighted average fair value per share during the periods presented were (shares in thousands):

	Six months ended June 30,			
	2017		2016	
	Shares Granted	Weighted Average Share Fair Value	Shares Granted	Weighted Average Share Fair Value
RSUs subject to performance conditions	1,237	$ 10.41	1,257	$ 5.66
RSUs subject only to service conditions	395	10.41	433	5.67

Note 15. Statutory Information

Statutory Capital Requirements

The insurance laws of 16 jurisdictions, including Wisconsin, our domiciliary state, require a mortgage insurer to maintain a minimum amount of statutory capital relative to the risk in force (or a similar measure) in order for the mortgage insurer to continue to write new business. We refer to these requirements as the "State Capital Requirements." While they vary among jurisdictions, the most common State Capital Requirements allow for a maximum risk-to-capital ratio of 25 to 1. A risk-to-capital ratio will increase if (i) the percentage decrease in capital exceeds the percentage decrease in insured risk, or (ii) the percentage increase in capital is less than the percentage increase in insured risk. Wisconsin does not regulate capital by using a risk-to-capital measure but instead requires a minimum policyholder position ("MPP"). The "policyholder position" of a mortgage insurer is its net worth or surplus, contingency reserve and a portion of the reserves for unearned premiums.

At June 30, 2017, MGIC's risk-to-capital ratio was 10.2 to 1, below the maximum allowed by the jurisdictions with State Capital Requirements, and its policyholder position was $1.8 billion above the required MPP of $1.1 billion. In calculating our risk-to-capital ratio and MPP, we are allowed full credit for the risk ceded under our reinsurance transactions with a group of unaffiliated reinsurers. It is possible that under the revised State Capital Requirements discussed below, MGIC will not be allowed full credit for the risk ceded to the reinsurers. If MGIC is not allowed an agreed level of credit under either the State Capital Requirements or the financial requirements of the PMIERs, MGIC may terminate the reinsurance transactions, without penalty. At this time, we expect MGIC to continue to comply with the current State Capital Requirements; however, you should read the rest of these financial statement footnotes for information about matters that could negatively affect such compliance.

At June 30, 2017, the risk-to-capital ratio of our combined insurance operations (which includes a reinsurance affiliate) was 11.3 to 1. Reinsurance agreements with an affiliate permit MGIC to write insurance with a higher coverage percentage than it could on its own under certain state-specific requirements. A higher risk-to-capital ratio on a combined basis may indicate that, in order for MGIC to continue to utilize reinsurance agreements with its affiliate, additional capital contributions to the reinsurance affiliate could be needed.

We ask the Commissioner of Insurance of the State of Wisconsin (the “OCI”) not to object before MGIC pays dividends. In the second quarter of 2017, MGIC paid a $30 million dividend to our holding company. MGIC is subject to statutory regulations as to payment of dividends. The maximum amount of dividends that MGIC may pay in any

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twelve-month period without regulatory approval by the OCI is the lesser of adjusted statutory net income or 10% of statutory policyholders' surplus as of the preceding calendar year end. Adjusted statutory net income is defined for this purpose to be the greater of statutory net income, net of realized investment gains, for the calendar year preceding the date of the dividend or statutory net income, net of realized investment gains, for the three calendar years preceding the date of the dividend less dividends paid within the first two of the preceding three calendar years. The OCI recognizes only statutory accounting practices prescribed or permitted by the State of Wisconsin for determining and reporting the financial condition and results of operations of an insurance company. The OCI has adopted certain prescribed accounting practices that differ from those found in other states. Specifically, Wisconsin domiciled companies record changes in the contingency reserves through the income statement as changes in underwriting deductions. As a result, in periods in which MGIC is increasing contingency reserves, statutory net income is lowered. For the year ended December 31, 2016, MGIC's statutory net income was reduced by $490 million to account for the increase in contingency reserves.

The NAIC previously announced that it plans to revise the minimum capital and surplus requirements for mortgage insurers that are provided for in its Mortgage Guaranty Insurance Model Act. In May 2016, a working group of state regulators released an exposure draft of a risk-based capital framework to establish capital requirements for mortgage insurers, although no date has been established by which the NAIC must propose revisions to the capital requirements. We are currently evaluating the impact of the framework contained in the exposure draft, including the potential impact of certain items that have not yet been completely addressed by the framework which include: the treatment of ceded risk, minimum capital floors, and action level triggers.

While MGIC currently meets the State Capital Requirements of Wisconsin and all other jurisdictions, it could be prevented from writing new business in the future in all jurisdictions if it fails to meet the State Capital Requirements of Wisconsin, or it could be prevented from writing new business in another jurisdiction if it fails to meet the State Capital Requirements of that jurisdiction, and in each case MGIC does not obtain a waiver of such requirements. It is possible that regulatory action by one or more jurisdictions, including those that do not have specific State Capital Requirements, may prevent MGIC from continuing to write new insurance in such jurisdictions.

If we are unable to write business in all jurisdictions, lenders may be unwilling to procure insurance from us anywhere. In addition, a lender's assessment of the future ability of our insurance operations to meet the State Capital Requirements or the PMIERs may affect its willingness to procure insurance from us. A possible future failure by MGIC to meet the State Capital Requirements or the PMIERs will not necessarily mean that MGIC lacks sufficient resources to pay claims on its insurance liabilities. While we believe MGIC has sufficient claims paying resources to meet its claim obligations on its insurance in force on a timely basis, you should read the rest of these financial statement footnotes for information about matters that could negatively affect MGIC's claims paying resources.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Introduction

The following is management’s discussion and analysis of the financial condition and results of operations of MGIC Investment Corporation for the second quarter and first six months of 2017. As used below, “we” and “our” refer to MGIC Investment Corporation’s consolidated operations. This form 10-Q should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the year ended December 31, 2016. See the “Glossary of terms and acronyms” for definitions and descriptions of terms used throughout this MD&A.

Forward Looking and Other Statements

As discussed under “Forward Looking Statements and Risk Factors” below, actual results may differ materially from the results contemplated by forward looking statements. We are not undertaking any obligation to update any forward looking statements or other statements we may make in the following discussion or elsewhere in this document even though these statements may be affected by events or circumstances occurring after the forward looking statements or other statements were made. Therefore no reader of this document should rely on these statements being current as of any time other than the time at which this document was filed with the Securities and Exchange Commission.

Through our subsidiary MGIC, we are a leading provider of PMI in the United States, as measured by $187.3 billion of primary IIF at June 30, 2017.

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Overview

Summary Financial Results of MGIC Investment Corporation

(In millions, except per share data, unaudited)	Three Months Ended June 30, 2017	2016	% Change	Six Months Ended June 30, 2017	2016	% Change
Selected statement of operations data						
Total revenues	$263.3	$263.5	—	$524.2	$522.1	—
Losses incurred, net	27.3	46.6	(41)	55.0	131.6	(58)
Loss on debt extinguishment	0.1	1.9	N/M	0.1	15.3	N/M
Income before tax	180.6	165.2	9	354.6	268.9	32
Provision for income taxes	62.0	56.0	11	146.2	90.5	62
Net income	118.6	109.2	9	208.4	178.4	17
Diluted income per share	$0.31	$0.26	19	$0.55	$0.43	28
Non-GAAP Financial Measures [1]						
Adjusted pre-tax operating income	$180.7	$166.3	9	$354.8	$280.3	27
Adjusted net operating income	119.3	110.0	8	236.4	186.2	27
Adjusted net operating income per diluted share	$0.31	$0.26	19	$0.62	$0.44	41

[1] See “Explanation and Reconciliation of our use of Non-GAAP Financial Measures.”

SUMMARY OF SECOND QUARTER AND YEAR TO DATE 2017 RESULTS

Comparative quarterly results

We recorded second quarter 2017 net income of $118.6 million, or $0.31 per diluted share. Net income increased by $9.4 million compared with net income of $109.2 million in the prior year, primarily due to lower losses incurred, net. In addition to the increase in net income, our diluted weighted average shares outstanding decreased from the prior year, resulting in a 19% increase in diluted income per share.

Adjusted net operating income for the second quarter 2017 was $119.3 million (Q2 2016: $110.0 million) and adjusted net operating income per diluted share was $0.31 (Q2 2016: $0.26). The 8% increase in adjusted net operating income was driven primarily by lower losses incurred, net. In addition to the increase in adjusted net operating income, our diluted weighted average shares outstanding decreased from the prior year, resulting in a 19% increase in adjusted net operating income per diluted share.

The decrease in our diluted weighted average shares during the three months ended June 30, 2017 was primarily due to the repayment at maturity of our 5% Notes on May 1, 2017.

Losses incurred, net were $27.3 million, down 41% compared to the prior year. New delinquency notices in the second quarter were 10% lower than the prior year and the claim rate applied to the new notices was approximately 11%, down from approximately 13% in the prior year. Our estimated claim rate on new notices reflects the current economic environment and anticipated cure activity on the notices received.

The increase in our provision for income taxes in the second quarter of 2017 as compared to the same period in the prior year was primarily due to an increase in our income before tax.

In June 2017, MGIC paid a dividend of $30 million to our holding company and we expect to continue to pay quarterly dividends through the remainder of the year.

Comparative year to date results

We recorded net income of $208.4 million, or $0.55 per diluted share during the first six months 2017. Net income increased by $30.0 million compared with net income of $178.4 million in the same period of 2016, primarily due to lower losses incurred, net and lower losses from debt extinguishment activity in the current year period, partially offset by an increase in our effective tax rate due to an additional provision related to our IRS litigation recorded in the first half of 2017. In addition to the increase in net income, our diluted weighted average shares outstanding decreased from the prior year, resulting in a 28% increase in diluted income per share.

Adjusted net operating income for the first six months of 2017 was $236.4 million (2016: $186.2 million) and adjusted net operating income per diluted share was $0.62 (2016: $0.44). The 27% increase in adjusted net operating income was driven primarily by lower losses incurred, net. In addition to the increase in adjusted net operating income, our weighted average shares outstanding decreased from the prior year, resulting in a 41% increase in adjusted net operating income per diluted share.

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The decrease in our diluted weighted average shares during the six months ended June 30, 2017 was primarily due to the repayment at maturity of our 5% Notes on May 1, 2017.

Losses incurred, net were $55.0 million down 58% compared to the prior year. New delinquency notices in the first half of 2017 were 10% lower than the prior year and the claim rate applied to the new notices was approximately 11%, down from approximately 13% in the prior year.

Loss on debt extinguishment in the prior year reflects the repurchases of a portion of our outstanding debt at amounts above our carrying value for our 5% Notes and above fair value of the liability component for our 9% Debentures.

The increase in our provision for income taxes for the first six months of 2017 as compared to the prior year was the result of an increase in our income before tax and an additional provision recorded for the expected settlement of our IRS litigation as more fully described in Note 11 - "Income Taxes" to our consolidated financial statements. Excluding the additional provision and interest related to our IRS litigation, the effective tax rate was approximately 33.4% in the first six months of 2017, compared to 33.5% in the prior year period.

See "Consolidated Results of Operations" below for additional discussion of our results for the three and six months ended June 30, 2017 compared to the respective prior year periods.

CAPITAL

The following debt transactions were completed during the second quarter of 2017:

- 2% Notes - In April, holders of approximately $202.5 million of the outstanding principal amount of the notes exercised their rights to convert their notes to shares of our common stock and we issued approximately 29.1 million shares of our common stock, which included newly issued shares and the reissuance of treasury stock. The remaining $5.1 million of outstanding principal amount of the notes was redeemed for cash. The conversions and cash redemptions eliminated our debt obligation for the 2% Notes and the conversions increased our shareholders' equity by the carrying value of the converted notes, including outstanding debt issuance costs. The notes redeemed for cash eliminated approximately 0.7 million potentially dilutive shares. These shares had previously been included in our calculation of diluted weighted average shares and diluted EPS up to the date of the notes redemption.
- 5% Notes - On May 1, 2017, our 5% Notes matured and were repaid with $145 million of holding company cash. The repayment of our 5% Notes eliminated approximately 10.8 million potentially dilutive shares. These shares were included in our calculation of diluted weighted average shares and diluted EPS up to the date of the notes repayment.
- Revolving credit facility - In March, we borrowed $150 million on our revolving credit facility to fund, as necessary, the redemption price of our 2% Notes. In April, we repaid the amount borrowed because most holders of our 2% Notes elected to convert their notes.

The above debt transactions allowed us to lower our long-term debt to shareholders' equity ratio. As of June 30, 2017, our ratio of long-term debt to shareholders' equity was approximately 28%, down from approximately 47% as of December 31, 2016. While the repayment at maturity of our 5% Notes, partial redemption of our 2% Notes, and the repayment of the amount borrowed on our revolving credit facility reduced the cash and investments at our holding company during the second quarter, we expect to provide additional liquidity to our holding company during 2017 through quarterly dividends from MGIC.

GSEs

We must comply with the PMIERs to be eligible to insure loans purchased by the GSEs. The PMIERs include financial requirements, as well as business, quality control and certain transaction approval requirements. The financial requirements of the PMIERs require a mortgage insurer's Available Assets to equal or exceed its Minimum

Required Assets. Based on our interpretation of the PMIERs, as of June 30, 2017, MGIC's Available Assets totaled approximately $4.7 billion, an excess of approximately $815 million over its Minimum Required Assets of approximately $3.8 billion. MGIC is in compliance with the PMIERs and eligible to insure loans purchased by the GSEs.

If MGIC ceases to be eligible to insure loans purchased by one or both of the GSEs, it would significantly reduce the volume of our new business writings. Factors that may negatively impact MGIC's ability to continue to comply with the financial requirements of the PMIERs include the following:

- The GSEs could make the PMIERs more onerous in the future; in this regard, the PMIERs provide that the factors that determine Minimum Required Assets will be updated every two years and may be updated more frequently to reflect changes in macroeconomic conditions or loan performance. The GSEs have informed us that they currently do not expect any updates to be effective before the fourth quarter of 2018 and we expect the GSEs will provide notice 180 days prior to the effective date of such updates. The GSEs may amend the PMIERs at any time.
- The GSEs may reduce the amount of credit they allow under the PMIERs for the risk ceded under our quota share reinsurance transactions. The GSEs' ongoing approval of those transactions is subject to several conditions and the transactions will be reviewed under the PMIERs at

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least annually by the GSEs. For more information about the transactions, see Note 4 - "Reinsurance" to our consolidated financial statements.

- Our future operating results may be negatively impacted by the matters discussed in our risk factors. Such matters could decrease our revenues, increase our losses or require the use of assets, thereby creating a shortfall in Available Assets.
- Should capital be needed by MGIC in the future, capital contributions from our holding company may not be available due to competing demands on holding company resources, including for repayment of debt.

While on an overall basis, the amount of Available Assets MGIC must hold in order to continue to insure loans purchased by the GSEs increased under the PMIERs over what state regulation currently requires, our reinsurance transactions mitigate the negative effect of the PMIERs on our returns. In this regard, see the second bullet point above.

State Regulations
The insurance laws of 16 jurisdictions, including Wisconsin, MGIC's domiciliary state, require a mortgage insurer to maintain a minimum amount of statutory capital relative to its risk in force (or a similar measure) in order for the mortgage insurer to continue to write new business. We refer to these requirements as the "State Capital Requirements." While they vary among jurisdictions, the most common State Capital Requirements allow for a maximum risk-to-capital ratio of 25 to 1. A risk-to-capital ratio will increase if (i) the percentage decrease in capital exceeds the percentage decrease in insured risk, or (ii) the percentage increase in capital is less than the percentage increase in insured risk. Wisconsin does not regulate capital by using a risk-to-capital measure but instead requires an MPP.

At June 30, 2017, MGIC's risk-to-capital ratio was 10.2 to 1, below the maximum allowed by the jurisdictions with State Capital Requirements, and its policyholder position was $1.8 billion above the required MPP of $1.1 billion. In calculating our risk-to-capital ratio and MPP, we are allowed full credit for the risk ceded under our reinsurance transactions with a group of unaffiliated reinsurers. It is possible that under the revised State Capital Requirements discussed below, MGIC will not be allowed full credit for the risk ceded to the reinsurers. If MGIC is not allowed an agreed level of credit under either the State Capital Requirements or the PMIERs, MGIC may terminate the reinsurance transactions, without penalty. At this time, we expect MGIC to continue to comply with the current State Capital Requirements; however, refer to our risk factor titled "State capital requirements may prevent us from continuing to write new insurance on an uninterrupted basis" for more information about matters that could negatively affect such compliance.

The NAIC plans to revise the minimum capital and surplus requirements for mortgage insurers that are provided for in its Mortgage Guaranty Insurance Model Act. In May 2016, a working group of state regulators released an exposure draft of a risk-based capital framework to establish capital requirements for mortgage insurers, although no date has been established by which the NAIC must propose revisions to the capital requirements. We continue to evaluate the impact of the framework contained in the exposure draft, including the potential impact of certain items that have not yet been completely addressed by the framework which include: the treatment of ceded risk, minimum capital floors, and action level triggers. Currently we believe that the PMIERs contain the more restrictive capital requirements in most circumstances.

GSE REFORM
The FHFA has been the conservator of the GSEs since 2008 and has the authority to control and direct their operations. The increased role that the federal government has assumed in the residential housing finance system through the GSE conservatorship may increase the likelihood that the business practices of the GSEs change in ways that have a material adverse effect on us and that the charters of the GSEs are changed by new federal legislation. In the past, members of Congress have introduced several bills intended to change the business practices of the GSEs and

the FHA; however, no legislation has been enacted. The Administration has indicated that the conservatorship of the GSEs should end; however, it is unclear whether and when that would occur and how that would impact us. As a result of the matters referred to above, it is uncertain what role the GSEs, FHA and private capital, including private mortgage insurance, will play in the residential housing finance system in the future or the impact of any such changes on our business. In addition, the timing of the impact of any resulting changes on our business is uncertain. Most meaningful changes would require Congressional action to implement and it is difficult to estimate when Congressional action would be final and how long any associated phase-in period may last.

For additional information about the business practices of the GSEs, see our risk factor titled “Changes in the business practices of the GSEs, federal legislation that changes their charters or a restructuring of the GSEs could reduce our revenues or increase our losses.”

LOAN MODIFICATIONS AND OTHER SIMILAR PROGRAMS

The federal government, including through the U.S. Department of the Treasury and the GSEs, and several lenders have modification and refinance programs to make loans more affordable to borrowers with the goal of reducing the number of foreclosures. These programs have included HAMP, which expired at the end of 2016, and HARP, which is scheduled to expire at the end of September 2017. The

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GSEs have introduced the "Flex Modification" program to replace HAMP effective in October 2017. Until it becomes effective, loan servicers must still evaluate borrowers for other GSE modification programs.
During 2016 and the first half of 2017, we were notified of modifications that cured delinquencies that had they become paid claims would have resulted in approximately $0.5 billion and $0.2 billion, respectively, of estimated claim payments. These levels are down from a high of $3.2 billion in 2010.

We cannot determine the total benefit we may derive from loan modification programs, particularly given the uncertainty around the re-default rates for defaulted loans that have been modified. Our loss reserves do not account for potential re-defaults of current loans.

As shown in the following table, as of June 30, 2017 approximately 18% of our primary RIF has been modified.

Policy year	HARP Modifications [1]		HAMP & Other Modifications	
2003 and prior	11.1	%	38.3	%
2004	18.8	%	38.7	%
2005	25.4	%	37.9	%
2006	28.7	%	37.4	%
2007	39.7	%	30.2	%
2008	54.5	%	17.9	%
2009	32.6	%	4.5	%
2010 - Q2 2017	—	%	0.2	%
Total	9.3	%	8.2	%

(1) Includes proprietary programs that are substantially the same as HARP.

As of June 30, 2017 based on loan count, the loans associated with 97.8% of HARP modifications and 78.1% of HAMP and other modifications were current.

FACTORS AFFECTING OUR RESULTS
Our results of operations are affected by:

Premiums written and earned
Premiums written and earned in a year are influenced by:

- NIW, which increases IIF, is the aggregate principal amount of the mortgages that are insured during a period. Many factors affect NIW, including the volume of low down payment home mortgage originations and competition to provide credit enhancement on those mortgages, including competition from the FHA, the VA, other mortgage insurers, GSE programs that may reduce or eliminate the demand for mortgage insurance and other alternatives to mortgage insurance. NIW does not include loans previously insured by us that are modified, such as loans modified under HARP.

- Cancellations, which reduce IIF. Cancellations due to refinancings are affected by the level of current mortgage interest rates compared to the mortgage coupon rates throughout the in force book, current home values compared to values when the loans in the in force book were insured and the terms on which mortgage credit is available. Home price appreciation can give homeowners the right to cancel mortgage insurance on their loans if sufficient home equity is achieved. Cancellations also result from policy rescissions, which require us to return any premiums received on the rescinded policies and claim payments, which require us to return any premium received on the related policies from the date of default on the insured loans. Cancellations of single premium policies, which are generally non-refundable, results in immediate recognition of any remaining unearned premium.

- Premium rates, which are affected by product type, competitive pressures, the risk characteristics of the insured loans and the percentage of coverage on the insured loans. The substantial majority of our monthly and annual mortgage insurance premiums are under premium plans for which, for the first ten years of the policy, the amount of premium is determined by multiplying the initial premium rate by the original loan balance; thereafter, the premium resets and a lower premium rate is used for the remaining life of the policy. However, for loans that have utilized HARP, the initial ten-year period resets as of the date of the HARP transaction. The remainder of our monthly and annual premiums are under premium plans for which premiums are determined by a fixed percentage of the loan's amortizing balance over the life of the policy.

- Premiums ceded, net of a profit commission, under reinsurance agreements. See Note 4 - "Reinsurance" to our consolidated financial statements for a discussion of our reinsurance agreements.

Premiums are generated by the insurance that is in force during all or a portion of the period. A change in the average IIF in the current period compared to an earlier period is a factor that will increase (when the average in force is higher) or reduce (when it is lower) premiums written and earned in the current period, although this effect may be enhanced (or mitigated) by differences in the average premium rate between the two periods as well as by premiums that are returned or expected to be returned in connection with claim payments and rescissions, and premiums ceded under reinsurance agreements. Also, NIW and cancellations during a period will generally have a greater effect on premiums written and earned in subsequent periods than in the period in which these events occur.

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Investment income

Our investment portfolio is composed principally of investment grade fixed income securities. The principal factors that influence investment income are the size of the portfolio and its yield. As measured by amortized cost (which excludes changes in fair value, such as from changes in interest rates), the size of the investment portfolio is mainly a function of cash generated from (or used in) operations, such as NPW, investment income, net claim payments and expenses, and cash provided by (or used for) non-operating activities, such as debt or stock issuances or repurchases.

Losses incurred

Losses incurred are the current expense that reflects estimated payments that will ultimately be made as a result of delinquencies on insured loans. As explained under “Critical Accounting Policies” in our 10-K MD&A, except in the case of a premium deficiency reserve, we recognize an estimate of this expense only for delinquent loans. The level of new delinquencies has historically followed a seasonal pattern, with new delinquencies in the first part of the year lower than new delinquencies in the latter part of the year, though this pattern can be affected by the state of the economy and local housing markets. Losses incurred are generally affected by:

- The state of the economy, including unemployment and housing values, each of which affects the likelihood that loans will become delinquent and whether loans that are delinquent cure their delinquency.

- The product mix of the in force book, with loans having higher risk characteristics generally resulting in higher delinquencies and claims.

- The size of loans insured, with higher average loan amounts tending to increase losses incurred.

- The percentage of coverage on insured loans, with deeper average coverage tending to increase incurred losses.

- The rate at which we rescind policies or curtail claims. Our estimated loss reserves incorporate our estimates of future rescissions of policies and curtailments of claims, and reversals of rescissions and curtailments. We collectively refer to such rescissions and denials as “rescissions” and variations of this term. We call reductions to or denials of claims “curtailments.”

- The distribution of claims over the life of a book. Historically, the first few years after loans are originated are a period of relatively low claims, with claims increasing substantially for several years subsequent and then declining, although persistency, the condition of the economy, including unemployment and housing prices, and other factors can affect this pattern. For example, a weak economy or housing value declines can lead to

claims from older books increasing, continuing at stable levels or experiencing a lower rate of decline. See further information under “Mortgage Insurance Earnings and Cash Flow Cycle” below.

- Losses ceded under reinsurance agreements. See Note 4 - “Reinsurance” to our consolidated financial statements for a discussion of our reinsurance agreements.

Underwriting and other expenses

The majority of our operating expenses are fixed, with some variability due to contract underwriting volume. Contract underwriting generates fee income included in “Other revenue.” Underwriting and other expenses are net of any ceding commission associated with our reinsurance agreements. See Note 4 - “Reinsurance” to our consolidated financial statements for a discussion of our reinsurance agreements.

Interest expense

Interest expense reflects the interest associated with our outstanding debt obligations. For information about our outstanding debt obligations, see Note 3 - "Debt" to our consolidated financial statements and under "Liquidity and Capital Resources" below.

Other

Certain activities that we do not consider being part of our fundamental operating activities, may also impact our results of operations and are described below.

Net realized investment gains (losses)

Realized gains and losses are a function of the difference between the amount received on the sale of a security and the security's cost basis, as well as any "other than temporary" impairments ("OTTI") recognized in earnings. The amount received on the sale of fixed income securities is affected by the coupon rate of the security compared to the yield of comparable securities at the time of sale.

Loss on debt extinguishment

At times, we may undertake activities to enhance our capital position, improve our debt profile and/or reduce potential dilution from our outstanding convertible debt. Extinguishing our outstanding debt obligations early through these discretionary activities may result in losses primarily driven by the payment of consideration in excess of our carrying value and the write off of unamortized debt issuance costs on the extinguished portion of the debt.

Refer to "Explanation and reconciliation of our use of Non-GAAP financial measures" below to understand how these items impact our evaluation of our core financial performance.

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MORTGAGE INSURANCE EARNINGS AND CASH FLOW CYCLE

In general, the majority of any underwriting profit that a book generates occurs in the early years of the book, with the largest portion of any underwriting profit realized in the first year following the year the book was written. Subsequent years of a book generally result in either less underwriting profit or in underwriting losses. This pattern of results typically occurs because relatively few of the claims that a book will ultimately experience typically occur in the first few years of the book, when premium revenue is highest, while subsequent years are affected by declining premium revenue, as the number of insured loans decreases (primarily due to loan prepayments) and increasing losses. The typical pattern is also a function of premium rates generally resetting to lower levels after ten years.

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EXPLANATION AND RECONCILIATION OF OUR USE OF NON-GAAP FINANCIAL MEASURES

Non-GAAP financial measures
We believe that use of the Non-GAAP measures of adjusted pre-tax operating income (loss), adjusted net operating income (loss) and adjusted net operating income (loss) per diluted share facilitate the evaluation of the company's core financial performance thereby providing relevant information to investors. These measures are not recognized in accordance with GAAP and should not be viewed as alternatives to GAAP measures of performance.

Adjusted pre-tax operating income (loss) is defined as GAAP income (loss) before tax, excluding the effects of net realized investment gains (losses), gain (loss) on debt extinguishment, net impairment losses recognized in income (loss) and infrequent or unusual non-operating items where applicable.

Adjusted net operating income (loss) is defined as GAAP net income (loss) excluding the after-tax effects of net realized investment gains (losses), gain (loss) on debt extinguishment, net impairment losses recognized in income (loss), and infrequent or unusual non-operating items where applicable. The amounts of adjustments to GAAP income (loss) before tax are generally tax effected using a federal statutory tax rate of 35%.

Adjusted net operating income (loss) per diluted share is calculated in a manner consistent with the accounting standard regarding earnings per share by dividing (i) adjusted net operating income (loss) after making adjustments for interest expense on convertible debt, whenever the impact is dilutive by (ii) diluted weighted average common shares outstanding, which reflects share dilution from unvested restricted stock units and from convertible debt when dilutive under the “if-converted” method.

Although pretax operating income (loss) and net operating income (loss) exclude certain items that have occurred in the past and are expected to occur in the future, the excluded items are: (1) not viewed as part of the operating performance of our primary activities; or (2) impacted by both discretionary and other economic factors and are not necessarily indicative of operating trends. These adjustments, along with the reasons for their treatment, are described below. Other companies may calculate these measures differently, and, therefore, their measures may not be comparable to those used by us.

(1) Net realized investment gains (losses). The recognition of net realized investment gains or losses can vary significantly across periods as the timing of individual

securities sales is highly discretionary and is influenced by such factors as market opportunities, our tax and capital profile, and overall market cycles.

Trends in the profitability of our fundamental operating activities can be more clearly identified without the fluctuations of these realized gains and losses.

(2) Gains and losses on debt extinguishment. Gains and losses on debt extinguishment result from discretionary activities that are undertaken to enhance our capital position, improve our debt profile, and/or reduce potential dilution from our outstanding convertible debt.

(3) Net impairment losses recognized in earnings. The recognition of net impairment losses on investments can vary significantly in both size and timing, depending on market credit cycles, individual issuer performance, and general economic conditions.

(4) Infrequent or unusual non-operating items. In 2017, this adjustment reflects income tax expense related to our IRS dispute, which is related to past transactions which are non-recurring in nature and are not part of our primary operating activities.

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Non-GAAP Reconciliations

Reconciliation of Income before tax / Net income to Adjusted pre-tax operating income / Adjusted net operating income

	Three Months Ended June 30,					
	2017			2016		
(In thousands, except per share amounts)	Pre-tax	Tax provision (benefit)	Net (after-tax)	Pre-tax	Tax provision (benefit)	Net (after-tax)
Income before tax / Net income	$180,616	$61,994	$118,622	$165,239	$56,018	$109,221
Adjustments:						
Additional income tax provision related to IRS litigation	—	(559)	559	—	(152)	152
Net realized investment losses (gains)	42	15	27	(836)	(293)	(543)
Loss on debt extinguishment	65	23	42	1,868	654	1,214
Adjusted pre-tax operating income / Adjusted net operating income	$180,723	$61,473	$119,250	$166,271	$56,227	$110,044

Reconciliation of Net income per diluted share to Adjusted net operating income per diluted share

Weighted average diluted shares outstanding	394,470	446,139
Net income per diluted share	$0.31	$0.26
Additional income tax provision related to IRS litigation	—	—
Net realized investment losses (gains)	—	—
Loss on debt extinguishment	—	—
Adjusted net operating income per diluted share	$0.31	$0.26

Reconciliation of Income before tax / Net income to Adjusted pre-tax operating income / Adjusted net operating income

	Six Months Ended June 30,					
	2017			2016		
(In thousands, except per share amounts)	Pre-tax	Tax provision (benefit)	Net (after-tax)	Pre-tax	Tax provision (benefit)	Net (after-tax)
Income before tax / Net income	$354,573	$146,153	$208,420	$268,927	$90,515	$178,412
Adjustments:						
Additional income tax provision related to IRS litigation	—	(27,783)	27,783	—	(341)	341
Net realized investment losses (gains)	164	57	107	(3,892)	(1,362)	(2,530)
Loss on debt extinguishment	65	23	42	15,308	5,358	9,950
Adjusted pre-tax operating income / Adjusted net operating income	$354,802	$118,450	$236,352	$280,343	$94,170	$186,173

Reconciliation of Net income per diluted share to Adjusted net operating income per diluted share

Weighted average diluted shares outstanding	398,302	450,354

Net income per diluted share	$0.55	$0.43
Additional income tax provision related to IRS litigation	0.07	—
Net realized investment losses (gains)	—	(0.01)
Loss on debt extinguishment	—	0.02
Adjusted net operating income per diluted share	$0.62	$0.44

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Mortgage Insurance Portfolio

NEW INSURANCE WRITTEN
According to Inside Mortgage Finance and GSE estimates, total mortgage originations for the second quarter and first six months of 2017 decreased from the respective prior year periods due to a decline in refinance originations that was somewhat offset by an increase in purchase originations. Total mortgage originations in the second quarter of 2017 are estimated to have been higher than the first quarter primarily due to seasonal factors. PMI market share of total mortgage originations is generally influenced by the mix of purchase and refinance originations as PMI market share is 3-4 times higher for purchase originations than refinance originations. PMI market share is also impacted by the market share of total originations for FHA, VA, and USDA.

NIW for the second quarter of 2017 was $12.9 billion (Q2 2016: $12.6 billion) and for the first half of 2017 was $22.2 billion (YTD 2016: $20.9 billion) and continued to have what we believe are favorable risk characteristics (see tables 01 and 02). The percentage of purchase mortgages insured increased in the three and six months ended June 30, 2017 compared to the same periods of the prior year because the level of refinance transactions declined as mortgage interest rates in the current year were generally higher than those in the latter half of 2016, and the prior year periods experienced declining mortgage interest rates (see table 04).