MGIC INVESTMENT CORP
Form 10-Q
August 01, 2016

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, 2016
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

MGIC INVESTMENT CORPORATION
(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
(Address of principal executive offices)	(Zip Code)

(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" and "smaller reporting 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)

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 29, 2016	340,641,277

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, 2016

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands)	June 30, 2016	December 31, 2015
ASSETS		
Investment portfolio (notes 7 and 8):		
Securities, available-for-sale, at fair value:		
Fixed maturities (amortized cost, 2016 - $4,421,363; 2015 - $4,684,148)	$4,556,202	$4,657,561
Equity securities	9,876	5,645
Total investment portfolio	4,566,078	4,663,206
Cash and cash equivalents	300,974	181,120
Accrued investment income	39,709	40,224
Reinsurance recoverable on loss reserves (note 4)	45,215	44,487
Reinsurance recoverable on paid losses	4,773	3,319
Premiums receivable	46,602	48,469
Home office and equipment, net	30,800	30,095
Deferred insurance policy acquisition costs	16,680	15,241
Deferred income taxes, net (note 11)	617,266	762,080
Other assets	76,689	80,102
Total assets	$5,744,786	$5,868,343
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Loss reserves (note 12)	$1,632,333	$1,893,402
Unearned premiums	308,424	279,973
Federal Home Loan Bank advance (note 3)	155,000	—
Convertible senior notes (note 3)	636,324	822,301
Convertible junior subordinated debentures (note 3)	256,872	389,522
Other liabilities	244,154	247,005
Total liabilities	3,233,107	3,632,203
Contingencies (note 5)		
Shareholders' equity (note 13):		
Common stock (one dollar par value, shares authorized 1,000,000; shares issued 2016 - 341,076; 2015 - 340,097; shares outstanding 2016 - 340,636; 2015 - 339,657)	341,076	340,097
Paid-in capital	1,660,666	1,670,238
Treasury stock at cost (shares - 440)	(3,362)	(3,362)
Accumulated other comprehensive income (loss), net of tax (note 9)	44,840	(60,880)
Retained earnings	468,459	290,047
Total shareholders' equity	2,511,679	2,236,140
Total liabilities and shareholders' equity	$5,744,786	$5,868,343

See accompanying notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share data)	2016	2015	2016	2015
Revenues:				
Premiums written:				
Direct	$282,113	$261,404	$547,404	$526,816
Assumed	182	308	390	646
Ceded (note 4)	(32,280)	(34,937)	(66,498)	(66,231)
Net premiums written	250,015	226,775	481,296	461,231
Increase in unearned premiums, net	(18,559)	(13,267)	(28,499)	(30,435)
Net premiums earned	231,456	213,508	452,797	430,796
Investment income, net of expenses	27,248	25,756	55,057	49,876
Net realized investment gains (losses):				
Total other-than-temporary impairment losses	—	—	—	—
Portion of losses recognized in comprehensive income, before taxes	—	—	—	—
Net impairment losses recognized in earnings	—	—	—	—
Other realized investment gains	836	166	3,892	26,493
Net realized investment gains	836	166	3,892	26,493
Other revenue	3,994	3,699	10,367	6,179
Total revenues	263,534	243,129	522,113	513,344
Losses and expenses:				
Losses incurred, net (note 12)	46,590	90,238	131,602	172,023
Change in premium deficiency reserve	—	(17,333)	—	(23,751)
Amortization of deferred policy acquisition costs	2,245	2,046	4,206	3,803
Other underwriting and operating expenses, net	35,348	35,829	75,125	75,097
Interest expense	12,244	17,373	26,945	34,735
Loss on debt extinguishment (note 3)	1,868	—	15,308	—
Total losses and expenses	98,295	128,153	253,186	261,907
Income before tax	165,239	114,976	268,927	251,437
Provision for income taxes (note 11)	56,018	1,322	90,515	4,707
Net income	$109,221	$113,654	$178,412	$246,730
Income per share (note 6)				
Basic	$0.32	$0.33	$0.52	$0.73
Diluted	$0.26	$0.28	$0.43	$0.60
Weighted average common shares outstanding - basic (note 6)	340,678	339,705	340,411	339,406
Weighted average common shares outstanding - diluted (note 6)	446,139	439,127	450,354	439,200

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)	2016	2015	2016	2015
Net income	$109,221	$113,654	$178,412	$246,730
Other comprehensive income (loss), net of tax (note 9):				
Change in unrealized investment gains and losses (note 7)	56,338	(63,646)	107,165	(44,083)
Benefit plan adjustments	(173)	(392)	(481)	(1,092)
Foreign currency translation adjustment	11	390	(964)	(1,624)
Other comprehensive income (loss), net of tax	56,176	(63,648)	105,720	(46,799)
Comprehensive income	$165,397	$50,006	$284,132	$199,931

See accompanying notes to consolidated financial statements

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

	Six Months Ended June 30,	
(In thousands)	2016	2015
Common stock		
Balance, beginning of period	$340,097	$340,047
Net common stock issued under share-based compensation plans	979	32
Balance, end of period	341,076	340,079
Paid-in capital		
Balance, beginning of period	1,670,238	1,663,592
Net common stock issued under share-based compensation plans	(5,954)	(32)
Reissuance of treasury stock, net	—	(7,181)
Tax benefit from share-based compensation	115	2,568
Equity compensation	6,017	5,984
Reacquisition of convertible junior subordinated debentures-equity component (note 3)	(9,750)	—
Balance, end of period	1,660,666	1,664,931
Treasury stock		
Balance, beginning of period	(3,362)	(32,937)
Reissuance of treasury stock, net	—	29,575
Balance, end of period	(3,362)	(3,362)
Accumulated other comprehensive income (loss)		
Balance, beginning of period	(60,880)	(81,341)
Other comprehensive income (loss), net of tax (note 9)	105,720	(46,799)
Balance, end of period	44,840	(128,140)
Retained earnings (deficit)		
Balance, beginning of period	290,047	(852,458)
Net income	178,412	246,730
Reissuance of treasury stock, net	—	(29,496)
Balance, end of period	468,459	(635,224)
Total shareholders' equity	$2,511,679	$1,238,284

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)	2016	2015
Cash flows from operating activities:		
Net income	$178,412	$246,730
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	28,477	23,938
Deferred tax expense (benefit)	88,157	(13)
Realized investment gains, net	(3,892)	(26,493)
Excess tax benefits related to share-based compensation	(115)	(2,568)
Payment of original issue discount-convertible junior subordinated debentures	(41,540)	—
Change in certain assets and liabilities:		
Accrued investment income	515	(4,043)
Prepaid insurance premium	48	(10,462)
Reinsurance recoverable on loss reserves	(728)	4,385
Reinsurance recoverable on paid losses	(1,454)	506
Premium receivable	1,867	4,974
Deferred insurance policy acquisition costs	(1,439)	(1,920)
Profit commission receivable	(2,793)	(50,957)
Loss reserves	(261,069)	(286,046)
Premium deficiency reserve	—	(23,751)
Unearned premiums	28,451	40,874
Return premium accrual	(7,300)	(3,500)
Income taxes payable - current	523	526
Other	(13,063)	27,929
Net cash used in operating activities	(6,943)	(59,891)
Cash flows from investing activities:		
Purchases of investments:		
Fixed maturities	(723,409)	(1,499,319)
Equity securities	(3,128)	(39)
Proceeds from sales of fixed maturities	649,776	1,218,688
Proceeds from maturity of fixed maturities	313,484	298,618
Proceeds from sale of equity securities	2,525	—
Net increase in payable for securities	24,519	41,762
Net decrease in restricted cash	—	17,212
Additions to property and equipment	(2,724)	(1,711)
Net cash provided by investing activities	261,043	75,211
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	155,000	—
Purchase of convertible senior notes	(188,501)	—
Purchase of convertible junior subordinated debentures-liability component	(91,110)	—
Purchase of convertible junior subordinated debentures-equity component	(9,750)	—
Excess tax benefits related to share-based compensation	115	2,568
Net cash (used in) provided by financing activities	(134,246)	2,568

Net increase in cash and cash equivalents	119,854	17,888
Cash and cash equivalents at beginning of period	181,120	197,882
Cash and cash equivalents at end of period	$300,974	$215,770

See accompanying notes to consolidated financial statements.

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016
(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 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, 2015 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, 2016.

Reclassifications

Certain reclassifications have been made in the accompanying financial statements to 2015 amounts to conform to 2016 presentation. See Note 2 - "New Accounting Pronouncements" for a discussion of our adoption of accounting guidance related to the presentation of debt issuance costs in the first quarter of 2016, with retrospective application to prior periods.

Subsequent events

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

Note 2 – New Accounting Pronouncements

Adopted Accounting Standards

Presentation of Debt Issuance Costs

In April 2015, the Financial Accounting Standards Board ("FASB") issued updated guidance related to the presentation of debt issuance costs. The new standard requires the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred charge, consistent with the treatment of debt discounts. The updated guidance was effective for reporting periods beginning after December 15, 2015. The adoption of this guidance as of March 31, 2016 has been applied retrospectively to prior periods. See Note 3 - "Debt" for the reclassification made to our consolidated balance sheet as of December 31, 2015. The adoption of this

guidance had no impact on our statements of operations or retained earnings.

Accounting for Share-Based Compensation When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

In June 2014, the FASB issued updated guidance to resolve diversity in practice concerning employee share-based compensation that contains performance targets that could be achieved after the requisite service period. No explicit guidance on how to account for these types of performance share-based compensation awards existed prior to this update. The updated guidance requires that a performance target that affects vesting and that can be achieved after the requisite service period be treated as a performance condition. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which service has been rendered. If the performance target becomes probable of being achieved before the end of the service period, the remaining unrecognized compensation cost for which requisite service has not yet been rendered is recognized prospectively over the remaining service period. The total amount of compensation cost recognized during and after the service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The updated guidance was effective for reporting periods after December 15, 2015. The adoption of this guidance as of March 31, 2016, with application to awards granted in 2016, is not expected to have a material impact on our consolidated financial statements.

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Prospective Accounting Standards

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 its 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. For most financial instruments in scope, recognition of credit losses will generally accelerate as entities will effectively recognize losses when the instruments are originated or purchased. 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.

Improvements to Employee Share-Based Compensation Accounting

In March 2016, the 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 as opposed to excess tax benefits being recognized in paid-in capital under the current guidance. 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 withholding requirements will be applied on a modified retrospective approach. The updated guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those

annual periods. Early adoption is permitted in any interim or annual period. We are currently evaluating the impacts the adoption of this guidance will have on our consolidated financial statements.

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. 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.

Disclosures about Short-Duration Contracts

In May 2015, the FASB issued updated guidance requiring expanded disclosures for insurance entities that issue short-duration contracts. The expanded disclosures are designed to provide additional insight into an insurance entity's ability to underwrite and anticipate costs associated with claims. The disclosures include information about incurred and paid claims development, on a net of reinsurance basis, for the number of years claims incurred typically remain outstanding, not to exceed ten years. Each period presented in the disclosure about claims development that precedes the current reporting periods is considered supplementary information. The expanded disclosures also include more transparent information about significant changes in methodologies and assumptions used to estimate claims, and the timing, frequency, and severity of claims. The disclosures required by this update are effective for annual periods beginning after December 31, 2015, and interim periods within annual periods beginning after December 31, 2016, and is to be applied retrospectively. We are evaluating the applicability and impact, if any, of the new disclosure requirements.

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Note 3 – Debt

2016 debt transactions

During the first half of 2016, market conditions allowed us to complete a series of transactions that repositioned the maturity profile of our debt and lowered our interest expense. These transactions, including the amounts and accounting impacts, are discussed below.

5% Convertible Senior Notes

During the first six months of 2016, we purchased $188.5 million in par value of our 5% Convertible Senior Notes (the "5% Notes") due in 2017 at a purchase price of $195.5 million, plus accrued interest using funds held at our holding company. The excess of the purchase price over par value is reflected as a loss on debt extinguishment and outstanding debt issuance costs on the purchased debt were recognized as interest expense on our consolidated statement of operations for the three and six months ended June 30, 2016. The purchases of the 5% Notes reduced our potentially dilutive shares by approximately 14.0 million shares.

9% Convertible Junior Subordinated Debentures

In February 2016, MGIC purchased $132.7 million of par value of our 9% Convertible Junior Subordinated Debentures (the "9% Debentures") due in 2063 at a purchase price of $150.7 million, plus accrued interest. The 9% Debentures include a conversion feature that allows us, at our option, to make a cash payment to converting holders in lieu of issuing shares of common stock upon conversion of the 9% Debentures. The accounting standards applicable to extinguishment of debt with a cash conversion feature require the consideration paid to be allocated between the extinguishment of the liability component and reacquisition of the equity component. 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. In addition, our shareholders' equity was separately reduced by $9.8 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.

Federal Home Loan Bank Advance

In February 2016, MGIC borrowed $155.0 million in the form of a fixed rate advance from the Federal Home Loan Bank ("FHLB") (the "Advance") to provide funds used to purchase the 9% Debentures. Interest on the Advance is payable monthly at an annual rate, fixed for the term of the Advance, of 1.91%. The principal of the Advance matures

on February 10, 2023. MGIC may prepay the Advance at any time. Such prepayment would be below par if interest rates have risen after the Advance was originated, or above par if interest rates have declined. The Advance is secured by eligible collateral whose market value must be maintained at 102% of the principal balance of the Advance. MGIC provided eligible collateral from its investment portfolio.

Accounting standard update

As of March 31, 2016 we adopted the accounting update related to the presentation of debt issuance costs in the financial statements. The change in accounting guidance has been applied retrospectively to prior periods. As a result, a reclassification of approximately $11.2 million of debt issuance costs was made on our December 31, 2015 balance sheet, resulting in a reduction to other assets and a reduction to long-term debt; there was no impact on our consolidated statement of operations or retained earnings.

The impact of the reclassification of debt issuance costs on our outstanding debt obligations as of December 31, 2015 is as follows.

(In millions)	December 31, 2015 As previously reported	Adjustment	As Adjusted
Convertible Senior Notes, interest at 5% per annum, due May 2017	$333.5	$ (2.0)	$331.5
Convertible Senior Notes, interest at 2% per annum, due April 2020	500.0	(9.2)	490.8
Convertible Junior Subordinated Debentures, interest at 9% per annum, due April 2063	389.5	—	389.5
Total long-term debt	$1,223.0	$ (11.2)	$1,211.8

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The principal amounts of our debt obligations and their aggregate carrying value as of June 30, 2016 and December 31, 2015 were as follows.

(In millions)	June 30, 2016	December 31, 2015
FHLB Advance, interest at 1.91% per annum, due February 2023	$155.0	$ —
Convertible Senior Notes, interest at 5% per annum, due May 2017 [1]	145.0	333.5
Convertible Senior Notes, interest at 2% per annum, due April 2020 [2] [3]	500.0	500.0
Convertible Junior Subordinated Debentures, interest at 9% per annum, due April 2063 [4]	256.9	389.5
Long-term debt, par value	1,056.9	1,223.0
Less: Debt issuance costs on convertible senior notes	(8.7)	(11.2)
Long-term debt, carrying value	$1,048.2	$ 1,211.8

(1) Convertible at any time prior to maturity at the holder's option, at an initial conversion rate, which is subject to adjustment, of 74.4186 shares per $1,000 principal amount, representing an initial conversion price of approximately $13.44 per share.

(2) Prior to January 1, 2020, the 2% Convertible Senior Notes are convertible only upon satisfaction of one or more conditions. One such condition is that during any calendar quarter commencing after March 31, 2014, the last reported sale price of our common stock for each of at least 20 trading days during the 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter be greater than or equal to 130% of the applicable conversion price on each applicable trading day. The 2% Notes are convertible at an initial conversion rate, which is subject to adjustment, of 143.8332 shares per $1,000 principal amount, representing an initial conversion price of approximately $6.95 per share. 130% of such conversion price is $9.03. On or after January 1, 2020, holders may convert their notes irrespective of satisfaction of the conditions.

(3) Prior to April 10, 2017, the notes will not be redeemable. On any business day on or after April 10, 2017 we may redeem for cash all or part of the notes, at our option, at a redemption rate equal to 100% of the principal amount of the notes being redeemed, plus any accrued and unpaid interest, if the closing sale price of our

common stock exceeds 130% of the then prevailing conversion price of the notes for each of at least 20 of the 30 consecutive trading days preceding notice of the redemption.

(4) 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 Convertible Senior Notes and Convertible Junior Subordinated Debentures are obligations of our holding company, MGIC Investment Corporation, and not of its subsidiaries. As of June 30, 2016, we had approximately $217 million in cash and investments at our holding company. The net unrealized gains on our holding company investment portfolio were approximately $0.5 million as of June 30, 2016. The modified duration of the holding company investment portfolio, excluding cash and cash equivalents, was 1.4 years at June 30, 2016.
Interest payments on our debt obligations appear below.

	Six Months Ended June 30,

(In millions)	2016	2015
FHLB Advance, interest at 1.91% per annum, due February 2023	$0.9	$—
Senior Notes, interest at 5.375% per annum, due November 2015	—	1.7
Convertible Senior Notes, interest at 5% per annum, due May 2017	6.9	8.6
Convertible Senior Notes, interest at 2% per annum, due April 2020	5.0	5.0
Convertible Junior Subordinated Debentures, interest at 9% per annum, due April 2063	15.9	17.5
Total interest payments	$28.7	$32.8

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Note 4 – Reinsurance

The effect of all reinsurance agreements on premiums earned and losses incurred is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2016	2015	2016	2015
Premiums earned:				
Direct	$263,566	$240,171	$518,953	$485,919
Assumed	182	308	390	646
Ceded	(32,292)	(26,971)	(66,546)	(55,769)
Net premiums earned	$231,456	$213,508	$452,797	$430,796
Losses incurred:				
Direct	$54,863	$95,710	$147,295	$183,746
Assumed	339	198	440	766
Ceded	(8,612)	(5,670)	(16,133)	(12,489)
Net losses incurred	$46,590	$90,238	$131,602	$172,023

Quota share reinsurance

Effective July 1, 2015, we entered into a quota share reinsurance agreement (“2015 QSR Transaction”) and commuted our prior 2013 quota share reinsurance agreement (“2013 QSR Transaction”). The group of unaffiliated reinsurers are the same under our 2015 QSR Transaction as our prior 2013 QSR Transaction and 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 provides coverage on policies that were in the 2013 QSR Transaction; additional qualifying in force policies as of the agreement effective date which either had no history of defaults, or where a single default had been cured for twelve or more months at the agreement effective date; and all qualifying new insurance written through December 31, 2016. The agreement cedes losses incurred and premiums on or after the effective date through December 31, 2024, at which time the agreement expires.

The 2015 QSR Transaction increased the amount of our insurance in force covered by reinsurance and will result in an increase in the amount of premiums and losses ceded. A higher level of losses ceded will reduce our profit commission and in turn will reduce our premium yield. 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 private mortgage insurer eligibility requirements (“PMIERs”) of Fannie Mae and Freddie Mac (collectively, the “GSEs”) for the risk ceded in any required calculation period. The structure of the 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 2015 QSR Transaction, we will receive a profit commission provided that the loss ratio on the loans covered under the agreement remains below 60%.

A summary of our quota share reinsurance agreements, excluding captive agreements, for the three and six months ended June 30, 2016 and 2015 appears as follows.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2016	2015	2016	2015
2013 QSR Transaction				
Ceded premiums written, net of profit commission	n/a	$30,919	n/a	$58,055
Ceded premiums earned, net of profit commission	n/a	22,954	n/a	47,567

Ceded losses incurred	n/a	1,187	n/a	6,060
Ceding commissions [1]	n/a	11,681	n/a	21,803
Profit commission	n/a	27,483	n/a	50,957
2015 QSR Transaction (Effective July 1, 2015)				
Ceded premiums written, net of profit commission [2]	$29,961	n/a	$61,627	n/a
Ceded premiums earned, net of profit commission [2]	29,961	n/a	61,627	n/a
Ceded losses incurred	6,070	n/a	14,583	n/a
Ceding commissions [1]	11,946	n/a	23,522	n/a
Profit commission	29,767	n/a	55,982	n/a

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

(2) Effective July 1, 2015 premiums are ceded on an earned and received basis as defined in our 2015 QSR Transaction.

Under the terms of the 2015 QSR Transaction, reinsurance premiums, ceding commission and profit commission are settled net on a quarterly basis. The reinsurance premium due after deducting the related ceding commission and profit commission is reported within “Other liabilities” on the consolidated balance sheets.

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The reinsurance recoverable on loss reserves related to our 2015 QSR Transaction was $22 million as of June 30, 2016 and $11 million as of December 31, 2015. 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 (the "MN Department") 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.

Captive agreements were generally written on an annual book of business and 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, and the trust accounts are made up of capital deposits by the captive reinsurers, premium deposits by MGIC, and investment income earned. The reinsurance recoverable on loss reserves related to captive agreements was $23 million as of June 30, 2016, which was supported by $109 million of trust assets, while as of December 31, 2015, the reinsurance recoverable on loss reserves related to captive agreements was $34 million, which was supported by $137 million of trust assets.

Note 5 – Litigation and Contingencies

Before paying a claim, we review the loan and servicing files to determine the appropriateness of the claim amount. 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 2015 and the first half of 2016, curtailments reduced our average claim paid by approximately 6.7% and 5.5%, respectively.

When reviewing the loan file associated with a claim, 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 recent quarters, approximately 5% of claims received in a quarter have been resolved by rescissions, down from the peak of approximately 28% in the first half of 2009. 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 curtail claims or rescind coverage, 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.

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. Under ASC 450-20, an estimated loss from such discussions and proceedings is accrued for only if we determine that the loss is probable and can be reasonably estimated. In such cases, 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 $193 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.

For MGIC, while these proceedings in the aggregate have not resulted in material liability, were there to be future proceedings under these laws, there can be no assurance that the outcome 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.

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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. Beginning in the second half of 2009, our subsidiary experienced an increase in claims for contract underwriting remedies, which continued throughout 2012. The underwriting remedy expense for 2015 was approximately $1 million, but may increase in the future.

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 common shares outstanding during the reporting period. Diluted EPS includes the components of basic EPS and also gives effect to dilutive common equivalent shares outstanding during the reporting period. We calculate diluted EPS using the treasury stock method for unvested restricted stock, and the if-converted method for convertible debt instruments. For unvested restricted stock, assumed proceeds under the treasury stock method would include unamortized compensation expense and windfall tax benefits or shortfalls. The determination of potentially issuable shares from our convertible debt instruments does not consider 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. In addition, interest expense, net of tax, related to dilutive convertible debt instruments is added back to earnings in calculating diluted EPS.

The following table reconciles the numerators and denominators used to calculate basic and diluted EPS and also indicates the number of antidilutive securities.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share data)	2016	2015	2016	2015
Basic earnings per share:				
Net income	$109,221	$113,654	$178,412	$246,730
Weighted average common shares outstanding	340,678	339,705	340,411	339,406
Basic income per share	$0.32	$0.33	$0.52	$0.73
Diluted earnings per share:				
Net income	$109,221	$113,654	$178,412	$246,730
Interest expense, net of tax [(1)]:				
2% Convertible Senior Notes due 2020	1,982	3,049	3,964	6,098
5% Convertible Senior Notes due 2017	1,728	4,692	4,406	9,384
9% Convertible Junior Subordinated Debentures due 2063	3,757	—	8,379	—
Diluted income available to common shareholders	$116,688	$121,395	$195,161	$262,212
Weighted average shares - basic	340,678	339,705	340,411	339,406
Effect of dilutive securities:				
Unvested restricted stock units	1,209	1,831	1,444	2,203
2% Convertible Senior Notes due 2020	71,917	71,917	71,917	71,917

5% Convertible Senior Notes due 2017	13,307	25,674	15,449	25,674
9% Convertible Junior Subordinated Debentures due 2063	19,028	—	21,133	—
Weighted average shares - diluted	446,139	439,127	450,354	439,200
Diluted income per share	$0.26	$0.28	$0.43	$0.60
Antidilutive securities (in millions)	—	28.9	—	28.9

(1) Due to the valuation allowance recorded against deferred tax assets, the three and six months ended June 30, 2015 were not tax effected. The three and six months ended June 30, 2016 have been tax effected at a rate of 35%.

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Note 7 – Investments

The amortized cost, gross unrealized gains and losses and fair value of the investment portfolio at June 30, 2016 and December 31, 2015 are shown below.

June 30, 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	$ 59,860	$ 2,276	$ (806)	$ 61,330
Obligations of U.S. states and political subdivisions	1,968,194	109,789	(531)	2,077,452
Corporate debt securities	1,704,917	31,769	(6,721)	1,729,965
Asset-backed securities	104,221	236	(50)	104,407
Residential mortgage-backed securities	241,314	600	(3,574)	238,340
Commercial mortgage-backed securities	281,502	3,547	(891)	284,158
Collateralized loan obligations	61,355	44	(849)	60,550
Total debt securities	4,421,363	148,261	(13,422)	4,556,202
Equity securities	6,228	3,651	(3)	9,876
Total investment portfolio	$ 4,427,591	$ 151,912	$ (13,425)	$ 4,566,078

December 31, 2015

(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	$ 160,393	$ 2,133	$ (1,942)	$ 160,584
Obligations of U.S. states and political subdivisions	1,766,407	33,410	(7,290)	1,792,527
Corporate debt securities	2,046,697	2,836	(44,770)	2,004,763
Asset-backed securities	116,764	56	(203)	116,617
Residential mortgage-backed securities	265,879	161	(8,392)	257,648
Commercial mortgage-backed securities	237,304	162	(3,975)	233,491
Collateralized loan obligations	61,345	3	(1,148)	60,200
Debt securities issued by foreign sovereign governments	29,359	2,474	(102)	31,731
Total debt securities	4,684,148	41,235	(67,822)	4,657,561
Equity securities	5,625	38	(18)	5,645
Total investment portfolio	$ 4,689,773	$ 41,273	$ (67,840)	$ 4,663,206

(1) At June 30, 2016 and December 31, 2015, there were no other-than-temporary impairment losses recorded in other comprehensive income.

During the first quarter of 2016, we substantially liquidated our Australian entities and repatriated most assets, including proceeds from the monetization of our Australian investment portfolio. As of June 30, 2016 we held no investments in foreign sovereign governments.

As discussed in Note 3 - “Debt” we are required to maintain collateral of at least 102% of the outstanding principal balance of the Advance. As of June 30, 2016 we pledged eligible collateral with a total fair value of $166.6 million.

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The amortized cost and fair values of debt securities at June 30, 2016, by contractual maturity, are shown below. 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 below in separate categories.

June 30, 2016		
(In thousands)	Amortized Cost	Fair Value
Due in one year or less	$272,706	$273,365
Due after one year through five years	1,143,174	1,163,590
Due after five years through ten years	1,128,998	1,156,648
Due after ten years	1,188,093	1,275,144
	$3,732,971	$3,868,747
Asset-backed securities	104,221	104,407
Residential mortgage-backed securities	241,314	238,340
Commercial mortgage-backed securities	281,502	284,158
Collateralized loan obligations	61,355	60,550
Total as of June 30, 2016	$4,421,363	$4,556,202

At June 30, 2016 and December 31, 2015, the investment portfolio had gross unrealized losses of $13.4 million and $67.8 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, 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	$8,996	$(806)	$—	$—	$8,996	$(806)
Obligations of U.S. states and political subdivisions	30,347	(303)	15,842	(228)	46,189	(531)
Corporate debt securities	110,610	(2,341)	167,209	(4,381)	277,819	(6,722)
Asset-backed securities	13,440	(45)	8,047	(5)	21,487	(50)
Residential mortgage-backed securities	2,383	(68)	203,939	(3,505)	206,322	(3,573)
Commercial mortgage-backed securities	33,169	(553)	38,382	(338)	71,551	(891)
Collateralized loan obligations	—	—	52,050	(849)	52,050	(849)
Equity securities	—	—	154	(3)	154	(3)
Total	$198,945	$(4,116)	$485,623	$(9,309)	$684,568	$(13,425)

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December 31, 2015	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	$60,548	$(1,467)	$1,923	$(475)	$62,471	$(1,942)
Obligations of U.S. states and political subdivisions	417,615	(6,404)	37,014	(886)	454,629	(7,290)
Corporate debt securities	1,470,628	(38,519)	114,982	(6,251)	1,585,610	(44,770)
Asset-backed securities	86,604	(173)	5,546	(30)	92,150	(203)
Residential mortgage-backed securities	35,064	(312)	209,882	(8,080)	244,946	(8,392)
Commercial mortgage-backed securities	134,488	(2,361)	69,927	(1,614)	204,415	(3,975)
Collateralized loan obligations	—	—	51,750	(1,148)	51,750	(1,148)
Debt securities issued by foreign sovereign governments	4,463	(102)	—	—	4,463	(102)
Equity securities	355	(8)	171	(10)	526	(18)
Total	$2,209,765	$(49,346)	$491,195	$(18,494)	$2,700,960	$(67,840)

The unrealized losses in all categories of our investments at June 30, 2016 and December 31, 2015 were primarily caused by the difference in interest rates at each respective period, compared to interest rates at the time of purchase. There were 211 and 303 securities in an unrealized loss position at June 30, 2016 and December 31, 2015, respectively.

During each of the three and six months ended June 30, 2016 and 2015 there were no other-than-temporary impairments ("OTTI") recognized. The net realized investment gains on the investment portfolio are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2016	2015	2016	2015
Realized investment gains (losses) on investments:				
Fixed maturities	$831	$161	$3,886	$26,485
Equity securities	5	5	6	8
Net realized investment gains	$836	$166	$3,892	$26,493

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2016	2015	2016	2015
Realized investment gains (losses) on investments:				
Gains on sales	$1,404	$785	$5,509	$27,991
Losses on sales	(568)	(619)	(1,617)	(1,498)
Net realized investment gains	$836	$166	$3,892	$26,493

Note 8 – Fair Value Measurements

Our estimates of fair value for financial assets and financial liabilities are based on the framework established in the fair value accounting guidance. The framework is based on the inputs used in valuation, gives the highest priority to quoted prices in active markets and requires that observable inputs be used in the valuations when available.

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.

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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 include 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 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, equity securities, and Australian government and semi government securities.

Level 2 - Quoted prices for similar instruments in active markets; 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 financial instrument. The observable inputs are used in valuation models to calculate the fair value of the financial instruments. Financial assets utilizing Level 2 inputs primarily include obligations of U.S. government corporations and agencies, corporate bonds, mortgage-backed securities, and most municipal bonds.

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

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

Residential Mortgage-Backed Securities 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 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. Evaluation utilizes regular reviews of the inputs for securities covered, including executed trades, broker quotes, credit information, collateral attributes and/or cash flow waterfall as applicable.

Asset-Backed Securities 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 market color as available are used, resulting in tranche-specific spreads.

Level 3 - Valuations derived from valuation techniques in which one or more significant inputs or value drivers are unobservable or from par values for certain 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 include certain equity securities that can only be redeemed or sold at their par value and only to the security issuer and certain state premium tax credit investments. The state premium tax credit investments have an average maturity of less than 2 years, credit ratings of AA+ or higher, and their balance reflects their 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.

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Fair value measurements for assets measured at fair value included the following as of June 30, 2016 and December 31, 2015:

June 30, 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	$61,330	$14,678	$46,652	$ —
Obligations of U.S. states and political subdivisions	2,077,452	—	2,076,396	1,056
Corporate debt securities	1,729,965	—	1,729,965	—
Asset-backed securities	104,407	—	104,407	—
Residential mortgage-backed securities	238,340	—	238,340	—
Commercial mortgage-backed securities	284,158	—	284,158	—
Collateralized loan obligations	60,550	—	60,550	—
Total debt securities	4,556,202	14,678	4,540,468	1,056
Equity securities [1]	9,876	2,936	—	6,940
Total investment portfolio	$4,566,078	$17,614	$4,540,468	$ 7,996
Real estate acquired [2]	$9,642	$—	$—	$ 9,642

December 31, 2015

(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	$160,584	$46,197	$114,387	$ —
Obligations of U.S. states and political subdivisions	1,792,527	—	1,791,299	1,228
Corporate debt securities	2,004,763	—	2,004,763	—
Asset-backed securities	116,617	—	116,617	—
Residential mortgage-backed securities	257,648	—	257,648	—
Commercial mortgage-backed securities	233,491	—	233,491	—
Collateralized loan obligations	60,200	—	60,200	—
Debt securities issued by foreign sovereign governments	31,731	31,731	—	—
Total debt securities	4,657,561	77,928	4,578,405	1,228
Equity securities [1]	5,645	2,790	—	2,855
Total investment portfolio	$4,663,206	$80,718	$4,578,405	$ 4,083
Real estate acquired [2]	$12,149	$—	$—	$ 12,149

[1] Certain 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.

There were no transfers of securities between Level 1 and Level 2 during the first six months of 2016.

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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, 2016 and 2015 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, 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

Three Months Ended June 30, 2015

(In thousands)	Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
Balance at March 31, 2015	$ 1,791	$ 321	$ 2,112	$ 10,897
Total realized/unrealized gains (losses):				
Included in earnings and reported as losses incurred, net	—	—	—	31
Purchases	—	—	—	5,917
Sales	(157)	—	(157)	(8,850)
Balance at June 30, 2015	$ 1,634	$ 321	$ 1,955	$ 7,995

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

Six Months Ended June 30, 2015

(In thousands)	Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
Balance at December 31, 2014	$ 1,846	$ 321	$ 2,167	$ 12,658
Total realized/unrealized gains (losses):				
Included in earnings and reported as losses incurred, net	—	—	—	(472)
Purchases	7	—	7	16,714
Sales	(219)	—	(219)	(20,905)
Balance at June 30, 2015	$ 1,634	$ 321	$ 1,955	$ 7,995

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.”

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Financial Liabilities Not Measured at Fair Value

We incur financial liabilities in the normal course of our business. The following tables present the carrying value and fair value of our financial liabilities disclosed, but not carried, at fair value at June 30, 2016 and December 31, 2015. The fair values of our Convertible Senior Notes and Convertible Junior Subordinated Debentures were based on observable market prices and the fair value of the Federal Home Loan Bank Advance was estimated using discounted cash flows on current incremental borrowing rates for similar borrowing arrangements, and in all cases they are categorized as Level 2.

June 30, 2016

(In thousands)	Carrying Value	Fair Value
Financial liabilities:		
FHLB Advance due 2023	$155,000	$160,025
Convertible Senior Notes due 2017	144,470	150,070
Convertible Senior Notes due 2020	491,854	554,670
Convertible Junior Subordinated Debentures due 2063	256,872	285,244
Total Debt	$1,048,196	$1,150,009

December 31, 2015

(In thousands)	Carrying Value	Fair Value
Financial liabilities:		
Convertible Senior Notes due 2017	$331,546	$345,616
Convertible Senior Notes due 2020	490,755	701,955
Convertible Junior Subordinated Debentures due 2063	389,522	455,067
Total Debt	$1,211,823	$1,502,638

Note 9 – Other Comprehensive Income

The pretax components of our other comprehensive income (loss) and the related income tax (expense) benefit for the three and six months ended June 30, 2016 and 2015 are included in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2016	2015	2016	2015
Net unrealized holding gains (losses) arising during the period	$86,674	$(64,118)	$165,058	$(44,397)
Income tax (expense) benefit	(30,336)	22,362	(57,893)	15,486
Valuation allowance [1]	—	(21,890)	—	(15,172)
Net of taxes	56,338	(63,646)	107,165	(44,083)
Net changes in benefit plan assets and obligations	(266)	(392)	(740)	(1,092)
Income tax benefit	93	137	259	382
Valuation allowance [1]	—	(137)	—	(382)
Net of taxes	(173)	(392)	(481)	(1,092)
Net changes in unrealized foreign currency translation adjustment	16	598	(1,480)	(2,504)
Income tax (expense) benefit	(5)	(208)	516	880
Net of taxes	11	390	(964)	(1,624)
Total other comprehensive income (loss)	86,424	(63,912)	162,838	(47,993)
Total income tax (expense) benefit, net of valuation allowance	(30,248)	264	(57,118)	1,194

Total other comprehensive income (loss), net of tax	$56,176	$(63,648)	$105,720	$(46,799)

(1) See Note 11 – "Income Taxes" for a discussion of the valuation allowance recorded against deferred tax assets.

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The pretax and related income tax (expense) benefit components of the amounts reclassified from our accumulated other comprehensive loss to our consolidated statements of operations for the three and six months ended June 30, 2016 and 2015 are included in the following table.

(In thousands)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Reclassification adjustment for net realized gains (losses) [1]	$98	$477	$710	$11,711
Income tax expense	(34)	(161)	(126)	(4,092)
Valuation allowance [2]	—	122	—	4,048
Net of taxes	64	438	584	11,667
Reclassification adjustment related to benefit plan assets and obligations [3]	266	392	740	1,092
Income tax expense	(93)	(137)	(259)	(382)
Valuation allowance [2]	—	137	—	382
Net of taxes	173	392	481	1,092
Reclassification adjustment related to foreign currency [4]	—	—	1,467	—
Income tax expense	—	—	(513)	—
Net of taxes	—	—	954	—
Total reclassifications	364	869	2,917	12,803
Total income tax expense, net of valuation allowance	(127)	(39)	(898)	(44)
Total reclassifications, net of tax	$237	$830	$2,019	$12,759

[1] Increases (decreases) Net realized investment gains on the consolidated statements of operations.
[2] See Note 11 – "Income Taxes" for a discussion of the valuation allowance recorded against deferred tax assets.
[3] Decreases (increases) Other underwriting and operating expenses, net on the consolidated statements of operations.
[4] Increases (decreases) Other revenue on the consolidated statements of operations.

Changes in our accumulated other comprehensive income (loss), including amounts reclassified from other comprehensive income (loss), for the six months ended June 30, 2016 are included in the table below.

(In thousands)	Six Months Ended June 30, 2016			
	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 accumulated other comprehensive income (loss)
Balance at December 31, 2015, net of tax	$(17,148)	$ (44,652)	$ 920	$ (60,880)
Other comprehensive income (loss) before reclassifications	107,749	—	(10)	107,739
Less: Amounts reclassified from accumulated other comprehensive income (loss)	584	481	954	2,019
Balance at June 30, 2016, net of tax	$90,017	$ (45,133)	$ (44)	$ 44,840

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Note 10 – Benefit Plans

The following tables provide the components of net periodic benefit cost for the pension, supplemental executive retirement and other postretirement benefit plans:

	Three Months Ended June 30,			
(In thousands)	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	2016	2015	2016	2015
Service cost	$2,402	$2,680	$201	$214
Interest cost	4,024	4,016	180	171
Expected return on plan assets	(4,865)	(5,259)	(1,221)	(1,247)
Recognized net actuarial loss (gain)	1,567	1,533	—	(53)
Amortization of prior service cost	(171)	(211)	(1,663)	(1,663)
Net periodic benefit cost (benefit)	$2,957	$2,759	$(2,503)	$(2,578)

	Six Months Ended June 30,			
(In thousands)	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	2016	2015	2016	2015
Service cost	$4,565	$5,128	$376	$416
Interest cost	7,953	7,924	352	349
Expected return on plan assets	(9,754)	(10,554)	(2,443)	(2,495)
Recognized net actuarial loss (gain)	2,928	2,742	—	(88)
Amortization of prior service cost	(343)	(422)	(3,325)	(3,325)
Net periodic benefit cost (benefit)	$5,349	$4,818	$(5,040)	$(5,143)

We currently intend to make contributions totaling $11.4 million to our qualified pension plan and supplemental executive retirement plan in 2016, of which $2.6 million has been contributed through June 30, 2016.

Note 11 – Income Taxes

Valuation Allowance

We review the need to maintain a deferred tax asset valuation allowance on a quarterly basis. We analyze many factors, among which are the severity and frequency of operating losses, our capacity for the carryback or carryforward of any losses, the existence and current level of taxable operating income, operating results on a three year cumulative basis, the expected occurrence of future income or loss, the expiration dates of the loss carryforwards, the cyclical nature of our operating results, and available tax planning strategies. Based on our analysis, we reduced our benefit from income tax through the recognition of a valuation allowance from the first quarter of 2009 through the second quarter of 2015. In the third quarter of 2015, based on our analysis, we concluded that it was more likely than not that our deferred tax assets would be fully realizable and that the valuation allowance was no longer necessary. Therefore, we reversed the valuation allowance.

The effect of the change in valuation allowance on the provision for income taxes was as follows:

	Three months ended June 30,		Six months ended June 30,	
(In thousands)	2016	2015	2016	2015
Provision for income tax	$56,018	$39,991	$90,515	$87,874
Change in valuation allowance	—	(38,669)	—	(83,167)
Provision for income taxes	$56,018	$1,322	$90,515	$4,707

The change in the valuation allowance that was included in other comprehensive income for the three and six months ended June 30, 2015 was an increase of $22.0 million and $15.6 million, respectively.

We have approximately $1.7 billion of net operating loss ("NOL") carryforwards on a regular tax basis and $0.8 billion of NOL carryforwards for computing the alternative minimum tax as of June 30, 2016. Any unutilized carryforwards are scheduled to expire at the end of tax years 2029 through 2033.

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, 2016, there would also be interest related to these matters of approximately $191.2 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.
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 has filed an answer to our petition which continues 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. Litigation to resolve our dispute with the IRS could be lengthy and costly in terms of legal fees and related expenses. We can provide no assurance regarding the outcome of any such litigation or whether a compromised settlement with the IRS will ultimately be reached and finalized. 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, 2016, those state taxes and interest would approximate $49.7 million. In addition, there could also be state tax penalties. Our total amount of unrecognized tax benefits as of June 30, 2016 is $107.6 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. We continue to believe that our previously recorded tax provisions and liabilities are appropriate. However, we would need to make appropriate 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 – “Capital Requirements.”

The total amount of the unrecognized tax benefits, related to our aforementioned REMIC issue that would affect our effective tax rate is $94.2 million. We recognize interest

accrued and penalties related to unrecognized tax benefits in income taxes. As of June 30, 2016 and December 31, 2015, we had accrued $28.3 million and $27.8 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 defaulted 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. 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 borrower 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.

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The following table provides a reconciliation of beginning and ending loss reserves for the six months ended June 30, 2016 and 2015:

	Six months ended June 30,	
(In thousands)	2016	2015
Reserve at beginning of period	$1,893,402	$2,396,807
Less reinsurance recoverable	44,487	57,841
Net reserve at beginning of period	1,848,915	2,338,966
Losses incurred:		
Losses and LAE incurred in respect of defaults related to:		
Current year	196,543	223,564
Prior years [1]	(64,941)	(51,541)
Subtotal	131,602	172,023
Losses paid:		
Losses and LAE paid in respect of defaults related to:		
Current year	1,396	2,382
Prior years	392,007	451,317
Reinsurance terminations [2]	(4)	(15)
Subtotal	393,399	453,684
Net reserve at end of period	1,587,118	2,057,305
Plus reinsurance recoverables	45,215	53,456
Reserve at end of period	$1,632,333	$2,110,761

(1) A negative number for prior year losses incurred indicates a redundancy of prior year loss reserves.

(2) In a termination or commutation, the reinsurance agreement is cancelled, with no future premium ceded and funds for any incurred but unpaid losses transferred to us. The transferred funds result in an increase in our investment portfolio (including cash and cash equivalents) and a decrease in net losses paid (reduction in losses incurred). In addition, there is an offsetting decrease in the reinsurance recoverable (increase in losses incurred), and thus there is no net impact to losses incurred.

The "Losses incurred" section of the table above 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 received 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 estimated claim rate and estimated 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 received in the current year decreased in the first six months of 2016 compared to the same period in 2015, primarily due to a decrease in the number of new defaults, net of related cures.

The prior year development of the reserves in the first six months of 2016 and 2015 is reflected in the following table.

Six months ended June 30,

(In millions)	2016			2015		
Decrease in estimated claim rate on primary defaults	$	(76	)	$	(59	)
Increase in estimated severity on primary defaults	17			15		
Change in estimates related to pool reserves, LAE reserves and reinsurance	(6		)	(8		)
Total prior year loss development [1]	$	(65	)	$	(52	)

(1) A negative number for prior year loss development indicates a redundancy of prior year loss reserves, and a positive number indicates a deficiency of prior year loss reserves.

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For the six months ended June 30, 2016 and 2015 we experienced favorable prior year loss reserve development. This development was, in part, due to the resolution of approximately 43% and 41% of the prior year default inventory during the six months ended June 30, 2016 and 2015, respectively. During the first six months of 2016, we experienced improved cure rates on prior year defaults, which was offset in part by an increase in severity on the prior year defaults. In addition to the resolution of defaults, the first six months of 2015 were also favorably impacted by $20 million due to re-estimation of previously recorded reserves relating to disputes on our claims paying practices and adjustments to incurred but not reported losses (IBNR). The favorable development in the first six months of 2015 was offset, in part, by an increase in the severity on prior year defaults remaining in the delinquent inventory.

The “Losses paid” section of the table above 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 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 half of 2016, our losses paid included $51 million associated with settlements for claims paying practices and nonperforming loan sales. These settlements reduced our delinquent inventory by 1,273 notices. These settlements had no material impact on our losses incurred, net.

The liability associated with our estimate of premiums to be refunded on expected claim payments is accrued for separately at June 30, 2016 and December 31, 2015 and approximated $97 million and $102 million, respectively. This liability was included in “Other liabilities” on our consolidated balance sheets.

Delinquent inventory

A rollforward of our primary default inventory for the three and six months ended June 30, 2016 and 2015 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 number of business days in a month and transfers of servicing between loan servicers.

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Default inventory at beginning of period	55,590	72,236	62,633	79,901
New notices	16,080	17,451	32,811	36,347
Cures	(15,640)	(17,897)	(34,693)	(39,664)
Paids (including those charged to a deductible or captive)	(3,195)	(4,140)	(6,568)	(8,713)
Rescissions and denials	(142)	(172)	(352)	(393)
Other items removed from inventory	(135)	(1,121)	(1,273)	(1,121)
Default inventory at end of period	52,558	66,357	52,558	66,357

The decrease in the primary default inventory experienced during 2016 and 2015 was generally across all markets and primarily in book years 2008 and prior. As of June 30, 2016 the percentage of loans in the inventory that have been in default for 12 or more consecutive months remained consistent compared with the prior year end and declined compared to one year prior, as shown in the following table. Historically as a default ages it becomes more likely to result in a claim. The percentage of loans that have been in default for 12 or more consecutive months and the number of loans in our primary claims received inventory have been affected by our suspended rescissions and the resolution of certain of those rescissions discussed below and in Note 5 – “Litigation and Contingencies.”

Consecutive months in default	June 30, 2016			December 31, 2015			June 30, 2015		
3 months or less	11,547	22	%	13,053	21	%	12,545	19	%
4 - 11 months	12,680	24	%	15,763	25	%	15,487	23	%
12 months or more [(1)]	28,331	54	%	33,817	54	%	38,325	58	%
Total primary default inventory	52,558	100	%	62,633	100	%	66,357	100	%
Primary claims received inventory included in ending default inventory	1,829	3	%	2,769	4	%	3,440	5	%

(1) Approximately 49%, 50%, and 51% 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, 2016, December 31, 2015, and June 30, 2015, respectively.

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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, 2016		December 31, 2015		June 30, 2015	
3 payments or less	17,299	33 %	20,360	33 %	19,274	29 %
4 - 11 payments	12,746	24 %	15,092	24 %	15,710	24 %
12 payments or more	22,513	43 %	27,181	43 %	31,373	47 %
Total primary default inventory	52,558	100%	62,633	100%	66,357	100%

Pool insurance default inventory decreased to 2,024 at June 30, 2016 from 2,739 at December 31, 2015. The pool insurance default inventory was 3,129 at June 30, 2015.

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. At June 30, 2016 and December 31, 2015 the estimate of this liability totaled $5 million and $7 million, respectively. This liability was 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, including settlements that we believe are probable, as defined in ASC 450-20, see Note 5 – “Litigation and Contingencies.”

Note 13 – Shareholders’ Equity

Capital transactions

As described in Note 3 - “Debt” the purchase of a portion of our 9% Debentures by MGIC, and corresponding elimination of the purchased 9% Debentures in consolidation, resulted in a reduction to our consolidated shareholders’ equity of approximately $9.8 million as of June 30, 2016. This reduction represents the allocated portion of the consideration paid to reacquire the equity component of the 9% Debentures. The reduction was recognized in paid-in capital and was less than the amount ascribed to paid-in capital at original issuance of the 9% Debentures.

Shareholders Rights Agreement

Our Amended and Restated Shareholders Rights Agreement dated July 23, 2015, which was approved by shareholders, (the “Agreement”) 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 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.

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Note 14 – Stock-Based Compensation

We have incentive stock plans under which restricted stock units (“RSUs”) were granted to employees. Our annual grant of share-based compensation to employees takes place during the first quarter of each fiscal year. 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 incentive 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,			
	2016		2015	
	Shares Granted	Weighted Average Share Fair Value	Shares Granted	Weighted Average Share Fair Value
RSUs subject to performance conditions	1,257	$ 5.66	1,114	$ 8.99
RSUs subject only to service conditions	433	5.67	410	8.99

Note 15 – Capital Requirements

Capital - GSEs

Substantially all of our insurance written since 2008 has been for loans purchased by the GSEs. The PMIERs of the GSEs include financial requirements that 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, 2016, 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.

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” and, together with the GSE Financial Requirements, the “Financial 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, 2016, MGIC’s risk-to-capital ratio was 11.6 to 1, below the maximum allowed by the jurisdictions with State Capital Requirements, and its policyholder position was $1.3 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 transaction 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 agreement, 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, 2016, the risk-to-capital ratio of our combined insurance operations (which includes a reinsurance affiliate) was 13.2 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.

In each of the first and second quarter of 2016 MGIC received approval from the OCI to pay a $16 million dividend to our holding company, which were paid in April and June, respectively, its first dividends since 2008. Any additional dividends paid by MGIC to our holding company in 2016 would require OCI approval under the adjusted statutory net income regulations discussed below.

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MGIC is subject to statutory regulations as to payment of dividends. The maximum amount of dividends that MGIC may pay in any 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 a change in underwriting deduction. As a result, in periods in which MGIC is increasing contingency reserves, statutory net income is lowered. For the year ended December 31, 2015, MGIC's statutory net income was reduced by $444 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

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.

OVERVIEW

Through our subsidiary MGIC, we are a leading provider of private mortgage insurance in the United States, as measured by $177.5 billion of primary insurance in force at June 30, 2016. As used below, "we" and "our" refer to MGIC Investment Corporation's consolidated operations. The discussion below 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, 2015. We refer to this Discussion as the "10-K MD&A."

Financial performance of MGIC Investment Corporation

	Three Months Ended June 30,			Six Months Ended June 30,		
(In millions, except per share data)	2016	2015	Change	2016	2015	Change
Selected statement of operations data (unaudited)						
Total revenues	$263.5	$243.1	8 %	$522.1	$513.3	2 %
Losses incurred, net	46.6	90.2	(48)%	131.6	172.0	(23)%
Loss on debt extinguishment	1.9	—	N/M	15.3	—	N/M
Income before tax	165.2	115.0	44 %	268.9	251.4	7 %
Provision for taxes	56.0	1.3	N/M	90.5	4.7	N/M
Net income	109.2	113.7	(4)%	178.4	246.7	(28)%
Diluted earnings per share	$0.26	$0.28	(7)%	$0.43	$0.60	(28)%

Business Overview

Net income for the three and six months ended June 30, 2016 decreased by 4% and 28%, respectively, compared to the prior year, primarily due to effects in 2016 of the recognition of a full tax provision as well as losses from debt repurchase activity. The impact of these items on our net income for the three and six months ended June 30, 2016 compared to the prior year was partially offset by a reduction in our losses incurred, net, and higher revenues.

Total revenues for the three and six months ended June 30, 2016 increased 8% and 2%, respectively, compared to the prior year, driven by an increase in net premiums earned and higher investment income. Net premiums earned of $231.5 million and $452.8 million, for the three and six months ended June 30, 2016, respectively, increased by 8% and 5% compared to the respective prior year periods due to a decrease in our premium refund estimates and an increase in earned premiums on single premium policies due to increased cancellation activity. Investment income, net of expenses, increased 6% and 10%, respectively, compared with the prior year, reflecting a higher investment yield on our investment portfolio. For the six months ended June 30, 2016, these increases were partially offset by lower realized investment gains compared to the prior year, reflecting the higher investment sales activity in the first quarter of 2015 under favorable market conditions.

Losses incurred, net for the three and six months ended June 30, 2016 decreased by 48% and 23%, respectively, compared to the prior year, driven by higher favorable prior year primary loss reserve development resulting from a decrease in the claim rate on items remaining in the default inventory from the respective prior year end, as well as

fewer new notices in each of the second quarter and first six months of 2016 compared to the prior year periods. Through the first six months of 2016, the claim rate on new notices was approximately 13%, which is relatively consistent with the prior year period.

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Loss on debt extinguishment during the three and six months ended June 30, 2016 reflects the repurchases we executed in the first half of 2016 to reposition the maturity profile of our debt and reduce potentially dilutive shares. We purchased a portion of our outstanding debt at amounts above our carrying value for our 5% Convertible Senior Notes (5% Notes) and above fair value of the liability component for our Convertible Junior Subordinated Debentures (9% Debentures), resulting in the recognition of losses. See Note 3 - "Debt" to our consolidated financial statements for further discussion of the accounting for these transactions. Further, we will continue to assess opportunities to enhance our capital position, improve our debt profile and liquidity, and reduce potential dilution through additional debt transactions, which could result in additional losses in 2016.

The difference in Provision for taxes in the three and six months ended June 30, 2016 compared with the prior year reflects the change in our tax position; 2015 included a valuation allowance against our deferred tax assets while 2016 did not. Because there is no longer a valuation allowance our 2016 results reflected a full tax provision.
See "Results of Consolidated Operations" below for additional discussion of our results for the second quarter and first six months of 2016 compared to the prior year periods.

For a number of years, substantially all of the loans we insured have been sold to Fannie Mae and Freddie Mac (the "GSEs"), which have been in conservatorship since late 2008. When the conservatorship will end and what role, if any, the GSEs will play in the secondary mortgage market post-conservatorship will be determined by Congress. The scope of the FHA's large market presence may also change in connection with the determination of the future 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." While we strongly believe private mortgage insurance should be an integral part of credit enhancement in a future mortgage market, its role in that market cannot be predicted.

Capital

GSEs

We must comply with the Private Mortgage Eligibility Requirements (the "PMIERs") of the GSEs to be eligible to insure loans purchased by them. 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" (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, 2016, MGIC's Available Assets are $4.7 billion and its Minimum Required Assets are $4.2 billion. MGIC is in compliance with the requirements of 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 may reduce the amount of credit they allow under the PMIERs for the risk ceded under our quota share reinsurance transaction. The GSEs' ongoing approval of that transaction is subject to several conditions and the transaction will be reviewed under the PMIERs at least annually by the GSEs. For more information about the transaction, see Note 4 - "Reinsurance" to our consolidated financial statements.
- The GSEs could make the PMIERs more onerous in the future; in this regard, the PMIERs provide that the tables of 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 will provide notice 180 days prior to the effective date of table updates. In addition, the GSEs may amend the PMIERs at any time.
-

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 additional capital be needed by MGIC in the future, additional 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 GSE loans increased under the PMIERs over what state regulation currently requires, our reinsurance transaction mitigates the negative effect of the PMIERs on our returns. In this regard, see the first bullet point above.

State Regulations

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

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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, 2016, MGIC's risk-to-capital ratio was 11.6:1 to 1, below the maximum allowed by the jurisdictions with State Capital Requirements, and its policyholder position was $1.3 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 transaction 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 agreement, 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 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.

GSE Reform

The Federal Housing Finance Agency ("FHFA") is the conservator of the GSEs 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. The financial reform legislation that was passed in July 2010 (the "Dodd-Frank Act") required the U.S. Department of the Treasury to report its recommendations regarding options for ending the conservatorship

of the GSEs. This report did not provide any definitive timeline for GSE reform; however, it did recommend using a combination of federal housing policy changes to wind down the GSEs, shrink the government's footprint in housing finance (including FHA insurance), and help bring private capital back to the mortgage market. Since then, members of Congress introduced several bills intended to change the business practices of the GSEs and the FHA; however, no legislation has been enacted. 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 Modification and Other Similar Programs

Our operating results continue to be impacted by the Home Affordable Modification Program ("HAMP") and the GSEs' Home Affordable Refinance Program ("HARP"). During the first six months of each of 2015 and 2016, we were notified of modifications that cured delinquencies that had they become paid claims would have resulted in approximately $335 million and $262 million, respectively, of estimated claim payments. Based on information that is provided to us, most of the modifications resulted in reduced payments from interest rate and/or amortization period adjustments. Approximately 8% and 5% of the modifications resulted in principal forgiveness in each of the first half of 2015 and 2016, respectively.

In 2015 and the first half of 2016, approximately 16% and 14%, respectively, of our primary cures were the result of modifications, with HAMP accounting for approximately 66% and 64% of the modifications in each of those periods, respectively. Although the HAMP and HARP programs have been extended through December 2016, we believe that we have realized the majority of the benefits from them because the number of loans insured by us that we are aware are entering those programs has decreased significantly.

HARP allows borrowers who are not delinquent but who may not otherwise be able to refinance their loans under the current GSE underwriting standards, to refinance their loans. We allow HARP refinances on loans that we insure, regardless of whether the loan meets our current underwriting standards, and we account for the refinance as a loan modification (even where there is a new lender) rather than new insurance written.

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As of June 30, 2016, approximately 12% of our primary insurance in force had benefited from HARP and was still in force.

As shown in the following table, as of June 30, 2016 approximately 21% of our primary risk in force has been modified.

Modifications

Policy year	HARP (1)	HAMP	Other
2003 and Prior	11.1%	18.5 %	15.6%
2004	17.9%	18.8 %	13.8%
2005	24.4%	19.7 %	13.6%
2006	27.4%	20.7 %	13.6%
2007	37.9%	19.9 %	8.6 %
2008	52.0%	12.2 %	4.3 %
2009	26.1%	1.6 %	1.2 %
2010 - Q2 2016	—	—	—
Total	11.6%	6.2 %	3.4 %

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

As of June 30, 2016 based on loan count, the loans associated with 97.8% of HARP modifications, 78.1% of HAMP modifications and 74.0% of other modifications remaining in our inventory were current.

Eligibility under certain loan modification programs can adversely affect us by creating an incentive for borrowers who are able to make their mortgage payments to become delinquent in an attempt to obtain the benefits of a modification. New notices of delinquency increase our incurred losses.

Over the past several years, the average time it takes to receive a claim associated with a defaulted loan 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. Unless a loan is cured during a foreclosure delay, at the completion of the foreclosure, additional interest and expenses may be due to the lender from the borrower. See "Results of Consolidated Operations - Losses incurred, net" for additional discussion on our loss severity.

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:

- New insurance written, which increases insurance in force, and is the aggregate principal amount of the mortgages that are insured during a period. Many factors affect new insurance written, 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. New insurance written does not include loans previously insured by us which are modified, including loans refinanced under HARP.

- Cancellations, which reduce insurance in force. 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 became insured and the terms on which mortgage credit is available. Generally, single premium policies are not refundable; therefore, if a single premium policy is cancelled, because the loan is repaid, the remaining unearned premium is earned immediately. Cancellations also include rescissions, which require us to return any premiums received related to the rescinded policy, and policies cancelled due to claim payment, which require us to return any premium received from the date of default. Finally, cancellations are affected by home price appreciation, which can give homeowners the right to cancel the mortgage insurance on their loans.

- Premium rates, which are affected by product type, competitive pressures, the risk characteristics of the loans insured, the percentage of coverage on the loans, and in some cases the age of the insurance policy. The substantial majority of our monthly mortgage insurance premiums are under a premium plan in 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 declines because 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 to begin as of the date of the HARP transaction. The remainder of our monthly premiums are under a premium plan in which premiums are determined by a fixed percentage of the loan’s amortizing balance over the life of the policy.

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- 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 insurance in force 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, new insurance written 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.

- Investment income

Our investment portfolio is composed principally of investment grade fixed maturity 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 net premiums received, 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. From time to time we may elect to realize gains through sales of securities that are trading above our cost basis. 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 maturity securities is affected by the coupon rate of the security compared to the yield of comparable securities at the time of sale.

- 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. 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 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.

- 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.

- Changes in housing values, which affect our ability to mitigate our losses through sales of properties with delinquent mortgages as well as borrower willingness to continue to make mortgage payments when the value of the home is below the mortgage balance.

- The rate at which we rescind policies or curtail claims. Our estimated loss reserves reflect mitigation from rescissions of policies, curtailments, and denials of claims. We collectively refer to such rescissions and denials as “rescissions” and variations of this term.

- 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 (percentage of insurance remaining in force from one year prior), the condition of the economy, including unemployment and housing prices, and other factors can affect this pattern. For example, a weak economy or housing price 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 “Results of Consolidated Operations - Reinsurance agreements” below.

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• 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 “Results of Consolidated Operations - Reinsurance agreements” below.

• 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.

Mortgage Insurance Earnings and Cash Flow Cycle

In our industry, a “book” is the group of loans insured in a particular calendar year. In general, the majority of any underwriting profit (premium revenue minus losses) 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 modest underwriting profit or 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 revenues, as the number of insured loans decreases (primarily due to loan prepayments), and increasing losses.

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MORTGAGE INSURANCE PORTFOLIO
New insurance written

The amount of our primary new insurance written during the three and six months ended June 30, 2016 and 2015 was as follows:

Primary NIW by FICO score

	Three Months Ended June 30,		Six Months Ended June 30,	
(In billions)	2016	2015	2016	2015
740 and greater	$7.3	$7.0	$11.9	$12.2
700-739	3.3	2.9	5.4	5.2
660-699	1.6	1.5	2.9	2.7
659 and less	0.4	0.4	0.7	0.7
Total Primary	$12.6	$11.8	$20.9	$20.8

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Percentage of primary NIW				
Policy payment type:				
Monthly premiums	78.5%	79.9%	78.3%	78.4%
Single premiums	21.2%	19.8%	21.4%	21.3%
Annual premiums	0.3 %	0.3 %	0.3 %	0.3 %
Type of mortgage:				
Purchases	83.1%	80.1%	82.7%	76.3%
Refinances	16.9%	19.9%	17.3%	23.7%
LTV:				
95.01% and above	5.4 %	4.8 %	5.1 %	4.1 %
90.01% to 95.00%	49.7%	50.6%	50.1%	49.8%
85.01% to 90.00%	31.4%	32.8%	31.8%	33.0%
80.01% to 85%	13.5%	11.8%	13.0%	13.1%

Conditions and Trends impacting our NIW

- New insurance written continues to have strong underlying credit characteristics as from our perspective lenders maintain high underwriting standards.
- An improved employment environment and what we view as solid housing market fundamentals, such as household formations, increased home sales and low interest rates, have resulted in an increase in the percentage and volume of new insurance written resulting from purchase mortgage transactions during both the second quarter and the first half of 2016 when compared to the same periods in the prior year. Since mortgage interest rates are expected to remain low and housing market fundamentals are expected to remain stable to modestly improving most forecasts are calling for an increase in purchase activity in future periods. Increasing purchase activity is generally a net positive as we estimate that our industry's market share is approximately 3-4 times higher for purchase loans compared to refinances. However, these same forecasts for low mortgage rates are predicting an increase in the volume of refinances in the

second half of 2016, which could cause the percentage of purchase transactions to decline but that will be highly dependent on the future level of mortgage interest rates.

- Competitive pricing practices within the private mortgage insurance industry remain in the market, including: (i) reductions to standard filed rates on borrower-paid policies, (ii) use by certain competitors of a spectrum of filed rates to allow for formulaic, risk-based pricing; and (iii) use of customized rates (discounted from published rates) on lender-paid single premium policies.

In response to the competitive dynamics in the market, we revised our filed premium rates effective April 2016. In general, the revisions decreased our filed premium rates on some higher-FICO score loans and increased our filed premium rates on some lower-FICO loans. In addition to the revisions of our filed rates, we continue to use the authority set forth in our rate filings to negotiate customized lender-paid single premium policy rates on a selective basis.

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Insurance in force and risk in force

The amount of our insurance in force and risk in force is impacted by the amount of new insurance written and cancellations of primary insurance in force during the period. For the three and six months ended June 30, 2016 and 2015, the impact of our new insurance written and cancellations was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In billions)	2016	2015	2016	2015
NIW	$12.6	$11.8	$20.9	$20.8
Cancellations	(10.1)	(9.1)	(17.9)	(16.9)
Change in primary insurance in force	$2.5	$		