

NMI Holdings, Inc.
Form 10-Q
November 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended September 30, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from _____ to _____

Commission file number 001-36174

NMI Holdings, Inc.

(Exact name of registrant as specified in
its charter)

DELAWARE

(State or other jurisdiction of incorporation or
organization)

45-4914248

(I.R.S. Employer Identification No.)

2100 Powell Street, Emeryville, CA

(Address of principal executive offices)

94608

(Zip Code)

(855) 530-6642

(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 NO

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 NO

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 Accelerated filer Non-accelerated filer Smaller reporting company
(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 NO

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The number of shares of common stock, \$0.01 par value per share, of the registrant outstanding on November 6, 2014 was 58,363,334 shares.

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CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This report contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the U.S. Private Securities Litigation Reform Act of 1995. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions or future events or performance are not historical facts and may be forward looking. These statements are often, but not always, made through the use of words or phrases such as "anticipate," "believes," "can," "could," "may," "predicts," "potential," "should," "will," "estimate," "plans," "projects," "contemplates," "expects," "intends" or words of similar meaning and include, but are not limited to, statements regarding the outlook for our future business and financial performance. All forward looking statements are necessarily only estimates of future results, and actual results may differ materially from expectations. Further, any forward looking statement speaks only as of the date on which it is made and we undertake no obligation to update or revise any forward looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. We have based these forward looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, operating results, business strategy and financial needs. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward looking statements including, but not limited to:

- our limited operating history;
- retention of our existing certificates of authority in each state and Washington D.C. and our ability to remain a mortgage insurer in good standing in each state and Washington D.C.;
- changes in the business practices of the GSEs, including adoption and implementation of their proposed new mortgage insurer eligibility requirements or decisions to decrease or discontinue the use of mortgage insurance;
- our ability to remain a qualified mortgage insurer under the requirements imposed by the GSEs;
- actions of existing competitors and potential market entry by new competitors;
- changes to laws and regulations, including changes to the GSEs' role in the secondary mortgage market or other changes that could affect the residential mortgage industry generally or mortgage insurance in particular;
- changes in general economic, market and political conditions and policies, interest rates, inflation and investment results or other conditions that affect the housing market or the markets for home mortgages or mortgage insurance;
- changes in the regulatory environment;
- our ability to implement our business strategy, including our ability to write mortgage insurance on high quality low down payment residential mortgage loans, implement successfully and on a timely basis, complex infrastructure, systems, procedures, and internal controls to support our business and regulatory and reporting requirements of the insurance industry;
- our ability to attract and retain a diverse customer base, including the largest mortgage originators;
- failure of risk management or investment strategy;
- claims exceeding our reserves or amounts we had expected to experience;
- failure to maintain, improve and continue to develop necessary information technology systems or the failure of technology providers to perform;
- ability to recruit, train and retain key personnel; and
- emergence of claim and coverage issues.

For more information regarding these risks and uncertainties as well as certain additional risks that we face, you should refer to the Risk Factors detailed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2013 and in our subsequent quarterly and other reports, including Part II, Item 1A, "Risk Factors," Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report on Form 10-Q, including the exhibits hereto, filed from time to time with the U.S. Securities and Exchange Commission (the "SEC").

Unless expressly indicated or the context requires otherwise, the terms "we", "our", "us" and "Company" in this document refer to NMI Holdings, Inc., a Delaware corporation, and its wholly owned subsidiaries on a consolidated basis.

PART I

Item 1. Financial Statements and Supplementary Data

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NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2014	December 31, 2013
Assets		
Investments, available-for-sale, at fair value:		
Fixed maturities (amortized cost of \$310,270 and \$416,135 as of September 30, 2014 and December 31, 2013, respectively)	\$308,564	\$409,088
Total investments	308,564	409,088
Cash and cash equivalents	137,485	55,929
Accrued investment income	1,293	2,001
Premiums receivable	402	19
Prepaid expenses	1,097	1,519
Deferred policy acquisition costs, net	1,651	90
Goodwill and other indefinite lived intangible assets	3,634	3,634
Software and equipment, net	10,777	8,876
Other assets	675	63
Total Assets	\$465,578	\$481,219
Liabilities		
Unearned premiums	\$13,440	\$1,446
Reserve for insurance claims and claim expenses	2	—
Accounts payable and accrued expenses	13,691	10,052
Warrant liability, at fair value	3,312	6,371
Current tax payable	602	—
Deferred tax liability	133	133
Total Liabilities	31,180	18,002
Commitments and contingencies		
Shareholders' Equity		
Common stock - Class A shares, \$0.01 par value, 58,363,334 and 58,052,480 shares issued and outstanding as of September 30, 2014 and December 31, 2013, respectively (250,000,000 shares authorized)	584	581
Additional paid-in capital	560,605	553,707
Accumulated other comprehensive loss, net of tax	(3,882	) (7,047
Accumulated deficit	(122,909	) (84,024
Total Shareholders' Equity	434,398	463,217
Total Liabilities and Shareholders' Equity	\$465,578	\$481,219
See accompanying notes to consolidated financial statements.		

NMI HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues	(In Thousands, except for share data)			
Premiums written				
Direct	\$9,661	\$482	\$19,890	\$483
Net premiums written	9,661	482	19,890	483
Increase in unearned premiums	(5,761	) —	(11,993) —
Net premiums earned	3,900	482	7,897	483
Net investment income	1,342	1,519	4,299	3,336
Net realized investment gains (losses)	134	(308	) 134	172
Gain (loss) from change in fair value of warrant liability	1,240	468	3,009	(610
Gain from settlement of warrants	—	—	37	—
Total Revenues	6,616	2,161	15,376	3,381
Expenses				
Insurance claims and claims expenses	(26	) —	2	—
Amortization of deferred policy acquisition costs	47	—	108	—
Other underwriting and operating expenses	17,848	16,034	55,725	45,480
Total Expenses	17,869	16,034	55,835	45,480
Loss before income taxes	(11,253	) (13,873	) (40,459	) (42,099
Income tax benefit	(277	) —	(1,574) —
Net Loss	(10,976	) (13,873	) (38,885	) (42,099
Other Comprehensive (Loss) Income, net of tax				
Net unrealized holding (losses) gains for the period included in accumulated other comprehensive loss, net of tax benefit of (\$488) and \$0 for the three months ended September 30, 2014 and 2013, respectively, and tax expense of \$2,176 and \$0 for the nine months ended September 30, 2014 and 2013, respectively	(709	) 2,283	3,165	(7,040
Other Comprehensive (Loss) Income, net of tax	(709	) 2,283	3,165	(7,040
Total Comprehensive Loss	\$(11,685	) \$(11,590	) \$(35,720	) \$(49,139
Loss per share				
Basic and diluted loss per share	\$(0.19	) \$(0.25	) \$(0.67	) \$(0.76
Weighted average common shares outstanding	58,363,334	55,637,480	58,239,251	55,589,674

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
	Class A	Class B				
	(In Thousands)					
Balance, January 1, 2013	\$553	\$2	\$517,032	\$ 1	\$(28,840)	\$488,748
Common stock Class A shares issued under stock plans, net of shares withheld for employee taxes	1	—	(1,579)	)—	—	(1,578)
Common stock Class A shares issued related to initial public offering (net of expenses of \$3,483)	25	—	27,887	—	—	27,912
Conversion of Class B shares of common stock into Class A shares of common stock	2	(2))—	—	—	—
Share-based compensation expense	—	—	10,367	—	—	10,367
Change in unrealized investment gains/losses, net of tax of \$0	—	—	—	(7,048)	)—	(7,048)
Net loss	—	—	—	—	(55,184)	(55,184)
Balance, December 31, 2013	\$581	\$—	\$553,707	\$(7,047)	\$(84,024)	\$463,217
Balance, January 1, 2014	\$581	\$—	\$553,707	\$(7,047)	\$(84,024)	\$463,217
Common stock Class A shares issued related to warrants	*	—	13	—	—	13
Common stock Class A shares issued under stock plans, net of shares withheld from employee taxes	3	—	11	—	—	14
Share-based compensation expense	—	—	6,874	—	—	6,874
Change in unrealized investment gains/losses, net of tax of \$2,176	—	—	—	3,165	—	3,165
Net loss	—	—	—	—	(38,885)	(38,885)
Balance, September 30, 2014	\$584	\$—	\$560,605	\$(3,882)	\$(122,909)	\$434,398

* During the first nine months of 2014, we issued 1,115 common shares with a par value of \$0.01 related to the exercise of warrants, which is not identifiable in this schedule due to rounding.

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	For the Nine Months Ended September 30,	
	2014	2013
Cash Flows From Operating Activities	(In Thousands)	
Net loss	\$(38,885	) \$(42,099
Adjustments to reconcile net loss to net cash used in operating activities:		
Net realized investment gains	(134	) (172
(Gain) loss from change in fair value of warrant liability	(3,009	) 610
Gain from settlement of warrants	(37) —
Depreciation and other amortization	6,603	5,410
Share-based compensation expense	6,874	8,827
Benefit for taxes on current year unrealized gains	(1,574) —
Changes in operating assets and liabilities:		
Accrued investment income	708	(1,834
Premiums receivable	(383) —
Prepaid expenses	422	(636
Deferred policy acquisition costs, net	(1,561	) (4
Other assets	(612	) 49
Unearned premiums	11,993	—
Reserve for insurance claims and claims expenses	2	—
Accounts payable and accrued expenses	3	568
Net Cash Used in Operating Activities	(19,590	) (29,281
Cash Flows From Investing Activities		
Purchase of short-term investments	—	(510
Purchase of fixed-maturity investments, available-for-sale	(4,359	) (559,752
Proceeds from maturity of short-term investments	—	5,375
Proceeds from redemptions, maturities and sale of fixed-maturity investments, available-for-sale	112,132	139,384
Purchase of software and equipment	(6,641	) (5,396
Net Cash Provided by (Used in) Investing Activities	101,132	(420,899
Cash Flows From Financing Activities		
Issuance of common stock	1,086	—
Taxes paid related to net share settlement of equity awards	(1,072	) (1,578
Net Cash Provided by (Used in) Financing Activities	14	(1,578
Net Increase (Decrease) in Cash and Cash Equivalents	81,556	(451,758
Cash and Cash Equivalents, beginning of period	55,929	485,855
Cash and Cash Equivalents, end of period	\$137,485	\$34,097
See accompanying notes to consolidated financial statements.		

NMI HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Organization and Basis of Presentation

NMI Holdings, Inc. ("NMIH"), a Delaware corporation, was formed in May 2011 with the intention of providing private mortgage guaranty insurance through a wholly owned insurance subsidiary. From May 2011 through March 2013, our activities were limited to raising capital, seeking to acquire the assets and approvals necessary to become a private mortgage guaranty insurance provider and hiring personnel. We are licensed in all 50 states and Washington D.C. In April 2013, we, through our primary insurance subsidiary, National Mortgage Insurance Corporation ("NMIC"), wrote our first mortgage guaranty insurance policy. As of September 30, 2014, we had \$1.8 billion of primary insurance in force ("IIF") and \$4.8 billion of pool IIF, with \$435.7 million of primary risk-in-force ("RIF") and \$93.1 million of pool RIF.

On November 30, 2011, we entered into an agreement with MAC Financial Ltd. to acquire MAC Financial Holding Corporation and its subsidiaries, which were renamed NMIC, National Mortgage Reinsurance Inc One ("Re One") and National Mortgage Reinsurance Inc Two ("Re Two"), for \$8.5 million in cash, common stock and warrants plus the assumption of \$1.3 million in liabilities ("MAC Acquisition"). In addition, we incurred \$0.1 million in deferred tax liabilities as a result of the acquisition of certain indefinite-lived intangibles. The MAC Acquisition was completed in April 2012. On September 30, 2013, we merged MAC Financial Holding Corporation into NMIH, with NMIH surviving the merger. Also on September 30, 2013, we merged Re Two into NMIC with NMIC surviving the merger. The accompanying consolidated financial statements include the accounts of NMIH and its wholly owned subsidiaries, NMIC and Re One.

In April 2012, we offered and sold 55.0 million shares of common stock at an issue price of \$10.00 per share in a private placement ("Private Placement"). Gross proceeds from the Private Placement were \$550.0 million. Net proceeds from the Private Placement, after an approximate 7% underwriting fee and other offering expenses, were approximately \$510 million.

NMIC was approved as an eligible mortgage guaranty insurer by Freddie Mac and Fannie Mae (collectively the "GSEs") on January 15, 2013 and January 16, 2013, respectively, which approvals require NMIC to continue meeting certain conditions, which include an agreement to maintain minimum capital of \$150 million at NMIC and that NMIC not exceed a risk-to-capital ratio of 15:1 for its first three years. NMIC is currently in compliance with these requirements.

In November 2013, we completed an initial public offering of 2.4 million shares of our common stock (the "IPO") and our common stock began trading on the NASDAQ Global Market ("NASDAQ") on November 8, 2013, under the symbol "NMIH." For a further discussion see "Note 2, Common Stock Offerings."

On March 26, 2014, NMIH contributed \$20 million in cash to NMIC to support its minimum surplus requirement as part of GSE Approval. On September 18, 2014, NMIH contributed an additional \$70 million in cash to NMIC.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, which include the results of NMIH and its wholly owned subsidiaries, have been prepared in accordance with the instructions to Form 10-Q as prescribed by the SEC for interim reporting and include all of the other information and disclosures required by accounting principles generally accepted in the U.S. ("GAAP"). Our accounts are maintained in U.S. dollars. These statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2013 included in our Annual Report on Form 10-K. All intercompany transactions have been eliminated. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities as of the balance sheet date. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates. The results of operations for the interim period may not be indicative of the results that may be expected for the full year ending December 31, 2014.

Basic net loss per share is based on the weighted-average number of common shares outstanding, while diluted net loss per share is based on the weighted-average number of common shares outstanding and common stock equivalents that would be issuable upon the exercise of stock options, other stock-based compensation arrangements, and the

dilutive effect of outstanding warrants. As a result of our net losses for the three months ended September 30, 2014 and September 30, 2013, 5.9 million and 5.3 million shares of our common stock equivalents that we issued as of each respective period under stock-based compensation arrangements and warrants were not included in the calculation of diluted net loss per share as of such dates because they were anti-dilutive.

NMI HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Deferred Policy Acquisition Costs

Costs directly associated with the successful acquisition of mortgage guaranty insurance policies, consisting of certain selling expenses and other policy issuance and underwriting expenses, are initially deferred and reported as deferred policy acquisition costs ("DAC"). For each book year of business, these costs are amortized to expense in proportion to estimated gross profits over the estimated life of the policies. We recorded net DAC of \$1.7 million at September 30, 2014 and \$90.2 thousand at December 31, 2013.

Premium Deficiency Reserves

We consider whether a premium deficiency exists at each fiscal quarter using best estimate assumptions as of the testing date. Per Financial Accounting Standards Board Accounting Standards Codification ("ASC") 944, a premium deficiency reserve shall be recognized if the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs, and maintenance costs exceeds related unearned premiums and anticipated investment income. We have determined that no premium deficiency reserves were necessary for the three months ended September 30, 2014 or for the year ended December 31, 2013.

Reclassifications

Certain items in the financial statements as of December 31, 2013 and for the three months ended September 30, 2013 have been reclassified to conform to the current period's presentation. There was no effect on net income or shareholders' equity previously reported.

Subsequent Events

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

2. Common Stock Offerings

We entered into a purchase/placement agreement that closed in April 2012, pursuant to which we offered and sold an aggregate of 55,000,000 of our Class A common shares, resulting in gross proceeds of \$550.0 million and net proceeds of approximately \$510 million after an approximate 7% underwriting fee and other offering expenses. On November 8, 2013, we completed an initial public offering of 2.4 million shares of common stock, and our common stock began trading on the NASDAQ under the symbol "NMIH". Net proceeds from the offering were approximately \$28 million, after an approximate 6% underwriting fee and other offering expenses and reimbursements pursuant to the underwriting agreement.

3. Investments

We have designated our investment portfolio as available-for-sale and report it at fair value. The related unrealized gains and losses are, after considering the related tax expense or benefit, recognized as a component of accumulated other comprehensive loss in shareholders' equity. Net realized investment gains and losses are reported in income based upon specific identification of securities sold. Prior to the third quarter of 2014, our investment portfolio consisted of A rated securities or better. During the third quarter, we made the decision to invest 10-15% of the investment portfolio in BBB securities. As of September 30, 2014 approximately 1% of the investment portfolio was invested in BBB securities, and we will invest additional amounts of the portfolio in the future as we believe appropriate.

Fair Values and Gross Unrealized Gains and Losses on Investments

	Amortized Cost (In Thousands)	Gross Unrealized Gains	Losses	Fair Value
As of September 30, 2014				
U.S. Treasury securities and obligations of U.S. government agencies	\$84,445	\$20	\$(791)	) \$83,674
Municipal bonds	12,011	22	(54)	) 11,979
Corporate debt securities	156,875	476	(1,279)	) 156,072
Asset-backed securities	56,939	217	(317)	) 56,839
Total Investments	\$310,270	\$735	\$(2,441)	) \$308,564

NMI HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	Amortized Cost (In Thousands)	Gross Unrealized Gains	Losses	Fair Value
As of December 31, 2013				
U.S. Treasury securities and obligations of U.S. government agencies	\$108,067	\$—	\$(1,461	) \$106,606
Municipal bonds	12,017	1	(85	) 11,933
Corporate debt securities	221,899	157	(4,799	) 217,257
Asset-backed securities	74,152	114	(974	) 73,292
Total Investments	\$416,135	\$272	\$(7,319	) \$409,088

Scheduled Maturities

The amortized cost and fair values of available for sale securities at September 30, 2014 and December 31, 2013, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Because most asset-backed securities provide for periodic payments throughout their lives, they are listed below in separate categories.

As of September 30, 2014	Amortized Cost (In Thousands)	Fair Value
Due in one year or less	\$4,114	\$4,134
Due after one through five years	206,384	205,054
Due after five through ten years	28,795	28,450
Due after ten years	14,038	14,087
Asset-backed securities	56,939	56,839
Total Investments	\$310,270	\$308,564

As of December 31, 2013	Amortized Cost (In Thousands)	Fair Value
Due in one year or less	\$—	\$—
Due after one through five years	260,855	257,501
Due after five through ten years	65,687	63,440
Due after ten years	15,441	14,855
Asset-backed securities	74,152	73,292
Total Investments	\$416,135	\$409,088

Net Realized Investment Gains (Losses) on Investments

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In Thousands)			
Corporate debt securities	\$292	\$(207	) \$292	\$309
U.S. Treasury securities and obligations of U.S. government agencies	(58	) (72	) (58	) (87
Asset-backed securities	(100	) (29	) (100	) (50
Total Net Realized Investment Gains	\$134	\$(308	) \$134	\$172

NMI HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Aging of Unrealized Losses

At September 30, 2014, the investment portfolio had gross unrealized losses of \$2.4 million, \$2.2 million of which has been in an unrealized loss position for a period of 12 months or greater. We did not consider these securities to be other-than-temporarily impaired as of September 30, 2014. We based our conclusion that these investments were not other-than-temporarily impaired at September 30, 2014 on the following facts: (i) the unrealized losses were primarily caused by interest rate movements since the purchase date; (ii) we do not intend to sell these investments; and (iii) we do not believe that it is more likely than not that we will be required to sell these investments before recovery of our amortized cost basis, which may not occur until maturity. For those securities in an unrealized loss position, the length of time the securities were in such a position is as follows:

	Less Than 12 Months			12 Months or Greater			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
As of September 30, 2014	(Dollars in Thousands)								
U.S. Treasury securities and obligations of U.S. government agencies	4	\$7,199	\$(13)	15	\$65,454	\$(778)	19	\$72,653	\$(791)
Municipal bonds	1	3,234	(16)	1	1,712	(38)	2	4,946	(54)
Corporate debt securities	15	37,097	(155)	25	71,059	(1,124)	40	108,156	(1,279)
Assets-backed securities	6	20,865	(100)	5	16,763	(217)	11	37,628	(317)
Total Investments	26	\$68,395	\$(284)	46	\$154,988	\$(2,157)	72	\$223,383	\$(2,441)
As of December 31, 2013	(Dollars in Thousands)								
U.S. Treasury securities and obligations of U.S. government agencies	19	\$106,606	\$(1,461)	—	\$—	\$—	19	\$106,606	\$(1,461)
Municipal bonds	2	4,915	(85)	—	—	—	2	4,915	(85)
Corporate debt securities	47	187,714	(4,799)	—	—	—	47	187,714	(4,799)
Assets-backed securities	11	58,225	(974)	—	—	—	11	58,225	(974)
Total Investments	79	\$357,460	\$(7,319)	—	\$—	\$—	79	\$357,460	\$(7,319)

Net investment income is comprised of the following:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Fixed maturities	\$1,480	\$1,651	\$4,711	\$3,663
Cash equivalents	—	—	—	2
Investment income	1,480	1,651	4,711	3,665
Investment expenses	(138)	(132)	(412)	(329)

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Net Investment Income	\$1,342	\$1,519	\$4,299	\$3,336
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As of September 30, 2014 and December 31, 2013, there were approximately \$7.0 million of cash and investments in the form of U.S. Treasury securities on deposit with various state insurance departments to satisfy regulatory requirements.

4. Fair Value of Financial Instruments

The following describes the valuation techniques used by us to determine the fair value of financial instruments held at September 30, 2014 and December 31, 2013:

We established a fair value hierarchy by prioritizing the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1

NMI HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under this standard are described below:

Level 1 - Unadjusted quoted prices for identical assets or liabilities in active markets that are accessible at the measurement date for identical assets or liabilities;

Level 2 - Prices or valuations based on observable inputs other than quoted prices in active markets for identical assets and liabilities; and

Level 3 - Unobservable inputs that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The level of market activity used to determine the fair value hierarchy is based on the availability of observable inputs market participants would use to price an asset or a liability, including market value price observations.

Assets classified as Level 1 and Level 2

To determine the fair value of securities available-for-sale in Level 1 and Level 2 of the fair value hierarchy, independent pricing sources have been utilized. One price is provided per security based on observable market data.

To ensure securities are appropriately classified in the fair value hierarchy, we review the pricing techniques and methodologies of the independent pricing sources and believe that their policies adequately consider market activity, either based on specific transactions for the issue valued or based on modeling of securities with similar credit quality, duration, yield and structure that were recently traded. A variety of inputs are utilized by the independent pricing sources including benchmark yields, reported trades, non-binding broker/dealer quotes, issuer spreads, two sided markets, benchmark securities, bids, offers and reference data including data published in market research publications. Inputs may be weighted differently for any security, and not all inputs are used for each security evaluation. Market indicators, industry and economic events are also considered. This information is evaluated using a multidimensional pricing model. Quality controls are performed by the independent pricing sources throughout this process, which include reviewing tolerance reports, trading information and data changes, and directional moves compared to market moves. This model combines all inputs to arrive at a value assigned to each security. We have not made any adjustments to the prices obtained from the independent pricing sources.

Liabilities classified as Level 3

The warrants outstanding are valued using a Black-Scholes option-pricing model in combination with a binomial model and Monte Carlo simulation used to value the pricing protection features within the warrants. Variables in the model include the risk-free rate of return, dividend yield, expected life and expected volatility of our stock price. ASC 825, Disclosures about Fair Value of Financial Instruments, requires all entities to disclose the fair value of their financial instruments, both assets and liabilities recognized and not recognized in the balance sheet, for which it is practicable to estimate fair value.

NMI HOLDINGS, INC.

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The following is a list of those assets and liabilities that are measured at fair value by hierarchy level as of September 30, 2014 and December 31, 2013:

Assets and Liabilities at Fair Value	Fair Value Measurements Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Other Significant Unobservable Inputs (Level 3)	
As of September 30, 2014	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	\$38,747	\$44,927	\$—	\$83,674
Municipal bonds	—	11,979	—	11,979
Corporate debt securities	—	156,072	—	156,072
Asset-backed securities	—	56,839	—	56,839
Cash and cash equivalents	137,485	—	—	137,485
Total Assets	\$176,232	\$269,817	\$—	\$446,049
Warrant liability	\$—	\$—	\$3,312	\$3,312
Total Liabilities	\$—	\$—	\$3,312	\$3,312

Assets and Liabilities at Fair Value	Fair Value Measurements Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Other Significant Unobservable Inputs (Level 3)	
As of December 31, 2013	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	\$49,484	\$57,122	\$—	\$106,606
Municipal bonds	—	11,933	—	11,933
Corporate debt securities	—	217,257	—	217,257
Asset-backed securities	—	73,292	—	73,292
Cash and cash equivalents	55,929	—	—	55,929
Total Assets	\$105,413	\$359,604	\$—	\$465,017
Warrant liability	\$—	\$—	\$6,371	\$6,371
Total Liabilities	\$—	\$—	\$6,371	\$6,371

The following is a roll-forward of Level 3 liabilities measured at fair value for the nine months ended September 30, 2014 and the year ended December 31, 2013:

Level 3 Instruments Only	Warrant Liability
Nine Months Ended September 30, 2014	(In Thousands)
Balance, January 1, 2014	\$6,371
Change in fair value of warrant liability included in earnings	(3,009)
Gain on settlement of warrants	(37)
Issuance of common stock on warrant exercise	(13)
Balance, September 30, 2014	\$3,312
Level 3 Instruments Only	Warrant Liability
Year Ended December 31, 2013	(In Thousands)
Balance, January 1, 2013	\$4,842
Change in fair value of warrant liability included in earnings	1,529
Balance, December 31, 2013	\$6,371

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We revalue the warrant liability quarterly using a Black-Scholes option-pricing model, in combination with a binomial model and a Monte-Carlo simulation model, which is used to value the pricing protection features within the warrant. As of September 30, 2014 the assumptions used in the option pricing model were as follows: a common stock price as of September 30, 2014 of \$8.65, risk free interest rate of 2.16%, expected life of 6.74 years, expected volatility of 39.0%, and a dividend yield of 0%. The change in fair value is primarily attributable to a decline in the price of our common stock from December 31, 2013 to September 30, 2014.

The carrying value of other selected assets on our consolidated balance sheet approximates fair value.

5. Reserves for Insurance Claims and Claims Expenses

We establish claim reserves to recognize the estimated liability for insurance claims and claim expenses related to defaults on insured mortgage loans. Our method, consistent with industry practice, is to establish claim reserves only for loans in default. Our claim reserves also include amounts we expect to incur for claims and claim adjustment expenses from defaults that we estimate to have occurred, but which have not yet been reported to us ("IBNR"). We received our first notice of default ("NOD") within our primary insurance book in the second quarter of 2014, which subsequently cured during the third quarter of 2014. Therefore, we currently do not have any reserves related to reported NODs. We have, however, established a small IBNR reserve for the three and nine months ended September 30, 2014. For the year ended December 31, 2013 we had no claim or IBNR reserves. Additionally, we entered into a pool insurance transaction with Fannie Mae, effective September 1, 2013. We would only establish claim or IBNR reserves for this pool transaction, if we expect claims to exceed the transaction's deductible, which represents the amount of claims absorbed by Fannie Mae before we are obligated to pay any claims under the policy. At September 30, 2014, nine loans in the pool were past due by 60 days or more. These nine loans represent approximately \$766 thousand in RIF. Due to the size of the deductible (\$10.3 million), the low level of NODs reported through September 30, 2014 and the high quality of the loans (all loans are less than 80% LTV), we have not established any pool reserves for claims or IBNR for the three and nine months ended September 30, 2014 or for the year ended December 31, 2013.

The following table provides a reconciliation of the beginning and ending reserve balances for insurance claims and claims expenses for the nine months ended September 30, 2014 and 2013:

	For the Nine Months Ended September 30,	
	2014	2013
	(In Thousands)	
Reserve at beginning of period	\$—	\$—
Claims incurred:		
Claims and Claim expenses incurred:		
Current year	2	—
Prior years	—	—
Total claims incurred	2	—
Claims paid:		
Claims and Claim Expenses paid:		
Current year	—	—
Prior years	—	—
Total claims paid	—	—
Reserve at end of period	\$2	\$—

NMI HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

6. Software and Equipment

Software and equipment includes capitalized software purchased in connection with the MAC Acquisition which had a fair value of \$5.0 million at the date of acquisition, as well as software we have developed. Software and equipment, net of accumulated amortization and depreciation, as of September 30, 2014 and December 31, 2013 consist of the following:

	As of September 30, 2014	As of December 31, 2013
	(In Thousands)	
Software	\$19,836	\$14,140
Equipment	626	542
Leasehold improvements	1,003	141
Subtotal	21,465	14,823
Accumulated amortization and depreciation	(10,688)	(5,947)
Software and equipment, net	\$10,777	\$8,876

Amortization and depreciation expense for the three and nine months ended September 30, 2014 and 2013 was \$1.8 million, \$4.7 million, \$2.0 million and \$3.9 million, respectively.

7. Intangible Assets and Goodwill

Intangible assets and goodwill consist of identifiable intangible assets and goodwill purchased in connection with the MAC Acquisition. Intangible assets and goodwill, net, as of September 30, 2014 and December 31, 2013, consist of the following:

As of September 30, 2014 and December 31, 2013	(In Thousands)	Expected Lives
Goodwill	\$3,244	Indefinite
State licenses	260	Indefinite
GSE applications	130	Indefinite
Total Intangible Assets and Goodwill	\$3,634	

We test goodwill and intangibles for impairment in the third and fourth quarter, respectively, of every year, or more frequently if we believe indicators of impairment exist. We have not identified any impairments of goodwill or impairments of indefinite-lived intangibles as of September 30, 2014.

8. Income Taxes

We are a U.S. taxpayer and are subject to a statutory U.S. federal corporate income tax rate of 35%. Our holding company files a consolidated U.S. federal and various state income tax returns on behalf of itself and its subsidiaries. Our effective income tax rate on our pre-tax loss was 2.5% for the three months ended September 30, 2014, compared to 0.0% for the comparable 2013 period. Our effective income tax rate on our pre-tax loss was 3.9% for the nine months ended September 30, 2014, compared to 0.0% for the comparable 2013 period.

The income tax benefit of \$1.6 million for the nine months ended September 30, 2014 is related to the tax effects of unrealized gains credited to other comprehensive income ("OCI"). Generally, the amount of tax expense or benefit allocated to continuing operations is determined without regard to the tax effects of other categories of income or loss, such as OCI. However, an exception to the general rule is provided in ASC 740-20-45-7 when there is a pre-tax loss from continuing operations and there are items charged or credited to other categories, including OCI, in the current year. The intra-period tax allocation rules related to items charged or credited directly to OCI can result in disproportionate tax effects that remain in OCI until certain events occur. As a result of a reduction in unrealized losses credited directly to OCI during the nine months ended September 30, 2014, approximately \$2.2 million of tax provision expense has been netted with current year unrealized gains in OCI, and \$1.6 million of tax provision benefit was allocated to the income tax provision for continuing operations. Other benefits from income taxes were eliminated or reduced by the recognition of a full valuation allowance which was recorded to reflect the amount of the deferred taxes that may not be realized.

As of September 30, 2014 and December 31, 2013, we have a net deferred tax liability of \$0.1 million as a result of the acquisition of indefinite-lived intangibles in the MAC Acquisition for which no benefit has been reflected in the acquired net operating loss carry forwards. The tax liability incurred at the acquisition is recorded as an increase in goodwill.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

9. Share Based Compensation

A summary of option activity under our 2012 Stock Incentive Plan during the nine months ended September 30, 2014 and September 30, 2013 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value per Share
	(Shares in Thousands)		
Options outstanding at December 31, 2013	3,062	\$10.31	\$3.98
Options granted	780	12.03	4.85
Options exercised	(109	) 10.00	3.85
Options forfeited	(87	) 11.35	4.47
Options outstanding at September 30, 2014	3,646	\$10.66	\$4.16
	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value per Share
	(Shares in Thousands)		
Options outstanding at December 31, 2012	2,547	\$10.00	\$3.86
Options granted	532	11.78	4.57
Options forfeited	(15	) 10.00	3.84
Options outstanding at September 30, 2013	3,064	\$10.31	\$3.98

As of September 30, 2014, there were 109 thousand options exercised and 1.6 million options were fully vested and exercisable. The weighted average exercise price for the fully vested and exercisable options was \$10.22. The remaining weighted average contractual life of options fully vested and exercisable as of September 30, 2014 was 7.5 years. The aggregate intrinsic value for fully vested and exercisable options was \$0 as of September 30, 2014. The fair value of option grants to employees is determined based on a Black-Scholes simulation model at the date of grant. A summary of restricted stock unit ("RSU") activity in the plan during the nine months ended September 30, 2014 and September 30, 2013 is as follows:

	Shares	Weighted Average Grant Date Fair Value per Share
	(Shares in Thousands)	
Non-vested restricted stock units at December 31, 2013	1,242	\$7.75
Restricted stock units granted	373	11.52
Restricted stock units vested	(295	) 8.23
Restricted stock units forfeited	(45	) 9.90
Non-vested restricted stock units at September 30, 2014	1,275	\$8.66
	Shares	Weighted Average Grant Date Fair Value per Share
	(Shares in Thousands)	
Non-vested restricted stock units at December 31, 2012	1,429	\$7.35
Restricted stock units granted	82	11.75
Restricted stock units vested	(262) 6.79
Restricted stock units forfeited	—	—

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Non-vested restricted stock units at September 30, 2013	1,249	\$7.76
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At September 30, 2014, the 1.3 million shares of non-vested RSUs consisted of 0.6 million shares that are subject to both a market and service condition and 0.7 million shares that are subject only to service conditions. The non-vested RSUs subject to both a market and service condition vest in one-half increments upon the achievement of certain market price goals and continued service. Non-vested RSUs subject only to a service condition vest over a service period ranging from 1 to 3 years. The fair value of RSUs subject to market and service conditions is determined based on a Monte Carlo simulation model at the date of grant. The fair value of RSUs subject only to service conditions are valued at our stock price on the date of grant less the present value of anticipated dividends, which is \$0.

On May 8, 2014 we held our annual shareholder meeting. Our shareholders voted to approve our 2014 Omnibus Incentive Plan, which authorizes us to make 4 million shares of our class A common stock available for grant. These shares may be either authorized but unissued shares or treasury shares. On September 19, 2014, we filed a registration statement on SEC Form S-8 to register the shares authorized under the 2014 Omnibus Incentive Plan.

10. Warrants

We issued 992,000 warrants to FBR Capital Markets and Co. ("FBR") and the former stockholders of MAC Financial Ltd., upon the completion of our Private Placement and in conjunction with the MAC Acquisition, respectively. Each warrant gave the holder thereof the right to purchase one share of common stock at an exercise price equal to \$10.00. The warrants were issued with an aggregate fair value of \$5.1 million.

Upon exercise of these warrants, the amounts will be reclassified from warrant liability to additional paid-in capital. During the first quarter of 2014, 7,790 warrants were exercised and we issued 1,115 Class A common shares via a cashless exercise. Upon exercise we reclassified the fair value of the warrants from warrant liability to additional paid in capital and recognized a gain of approximately \$37 thousand. No warrants were exercised during the second or third quarters of 2014.

We account for these warrants to purchase our common shares in accordance with ASC 470-20, Debt with Conversion and Other Options and ASC 815-40, Derivatives and Hedging - Contracts in Entity's Own Equity.

11. Litigation

Effective July 1, 2014, we entered into a settlement agreement (the "Settlement Agreement") with Arch U.S. MI Services, Inc. ("Arch"), Germaine J. Marks and Truitte D. Todd, in their capacities as, respectively, Receiver and Special Deputy Receiver of PMI Mortgage Insurance Co., in Rehabilitation (collectively, the "Receiver") and PMI Mortgage Insurance Co., in Rehabilitation ("PMI"), to settle the complaint filed on August 8, 2012 by the Receiver against NMIH, NMIC and certain employees of the Company (collectively the "Defendants"), in California Superior Court, Alameda County (the "PMI Complaint"). Pursuant to the terms of an Asset Purchase Agreement, dated February 7, 2013, between Arch and PMI, PMI transferred and assigned to Arch all causes of action pursued in the PMI Complaint. Pursuant to the terms of the Settlement Agreement, the Company and its insurance carriers made a settlement payment in favor of Arch, and Arch released the Defendants from all claims alleged in the PMI Complaint. On July 28, 2014, the Court dismissed the PMI Complaint with prejudice. The Company's portion of the settlement payment was recorded in the Company's financial statements in the second quarter of 2014.

12. Statutory Information

Our insurance subsidiaries, NMIC and Re One, file financial statements in conformity with statutory basis accounting principles ("SAP") prescribed or permitted by the Wisconsin Office of the Commissioner of Insurance ("Wisconsin OCI"). NMIC's principal regulator is the Wisconsin OCI. Prescribed SAP includes state laws, regulations and general administrative rules, as well as a variety of publications of the National Association of Insurance Commissioners ("NAIC"). The Wisconsin 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 and for determining its solvency under Wisconsin insurance laws.

NMIC and Re One's combined statutory net loss, statutory surplus and contingency reserve as of and for the nine months ended September 30, 2014 and for the year ended December 31, 2013 were as follows:

September 30, 2014	December 31, 2013
(In Thousands)	

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Statutory net loss	\$ (36,217)	\$ (33,307)
Statutory surplus	243,481		189,698	
Contingency reserve	6,262		2,314	

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Under applicable Wisconsin law, as well as that of 15 other states, a mortgage guaranty insurer must maintain a minimum amount of statutory capital relative to the risk-in-force (risk-to-capital ratio or "RTC ratio") in order for the mortgage guaranty insurer to continue to write new business. While formulations of minimum capital may vary in each jurisdiction that has such a requirement, the most common measure applied allows for a maximum permitted RTC ratio of 25 to 1. Wisconsin and certain other states, including California and Illinois, apply a substantially similar requirement referred to as minimum policyholders position. Our operation plan filed with the Wisconsin OCI and other state insurance departments in connection with NMIC's applications for licensure includes the expectation that NMIH will downstream additional capital if needed so that NMIC does not exceed risk-to-capital ratios agreed to with those states. NMIC may in the future seek state insurance department approvals, as needed, of an amendment to our business plan to increase this ratio to the Wisconsin regulatory minimum of 25 to 1. In addition, under the terms of our conditional approvals from the GSEs we are required to operate at a risk-to-capital ratio not to exceed 15:1 for our first three years of operations.

Certain states limit the amount of risk a mortgage guaranty insurer may retain on a single loan to 25% of the indebtedness to the insured and, as a result, the portion of such insurance in excess of 25% must be reinsured. NMIC and Re One have entered into a primary excess share reinsurance agreement, effective August 1, 2012, and a facultative pool reinsurance agreement, effective September 1, 2013, under which NMIC cedes premiums, loss reserves and claims to Re One on an excess share basis for any primary or pool policy which offers coverage greater than 25% on any loan insured thereunder. NMIC will use reinsurance provided by Re One solely for purposes of compliance with these state statutory coverage limits. Currently, NMIC has no other reinsurance agreements. During April 2013, NMIC began writing its first mortgage insurance policies and ceding premium and risk to Re One the following month.

As of September 30, 2013, NMIC had 22 policies in force totaling approximately \$1.2 million of RIF, resulting in a RTC ratio of 0.5:1. As of September 30, 2014, NMIC had \$467 million in total RIF with a RTC ratio of 1.9:1, significantly below the GSE and state imposed financial requirements. The risk-to-capital calculation for each of our insurance subsidiaries, as well as our combined risk-to-capital calculation, as of September 30, 2014, is presented below.

As of September 30, 2014	NMIC (In Thousands)	Re One	Combined
Primary risk-in-force			
Direct	\$435,722	\$—	\$435,722
Assumed	—	37,258	37,258
Ceded	(37,258)	) —	(37,258)
Total primary risk-in-force	398,464	37,258	435,722
Pool risk-in-force ⁽¹⁾			
Direct	93,090	—	93,090
Assumed	—	24,705	24,705
Ceded	(24,705)	) —	(24,705)
Total pool risk-in-force	68,385	24,705	93,090
Total risk-in-force	466,849	61,963	528,812
Statutory policyholders' surplus	234,261	9,220	243,481
Statutory contingency reserve	5,409	853	6,262
Total statutory policyholders' position	\$239,670	\$10,073	\$249,743
Risk-to-Capital ⁽²⁾	1.9:1	6.2:1	2.1:1

⁽¹⁾ Pool risk-in-force as shown in the table above is equal to the aggregate stop loss less a deductible.

⁽²⁾ Represents total risk-in-force divided by statutory policyholders' position which is the metric by which the majority of state insurance regulators will assess our capital adequacy. Additionally, pursuant to the 2013 Fannie

Mae pool agreement, we are required to maintain the greater of (a) the risk-to-capital requirements outlined in Fannie Mae's January 2013 approval letter or (b) a risk-to-capital ratio of 18:1 on primary business plus statutory capital equal to the amount of net risk-in-force of the pool.

NMIH is not subject to any limitations on its ability to pay dividends except those generally applicable to corporations that are incorporated in Delaware, such as NMIH. Delaware corporation law provides that dividends are only payable out of a corporation's

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capital surplus or (subject to certain limitations) recent net profits. As of December 31, 2013, NMIH's capital surplus was approximately \$463 million. NMIH assets, excluding investment in NMIC and Re One, were approximately \$276 million at December 31, 2013 and were unencumbered by any debt or other subsidiary commitments or obligations. The insurance subsidiaries are both mono-line mortgage guaranty insurance companies, and the assets of each are dedicated only to the support of direct risk and obligations of each mortgage insurance entity. NMIC only writes direct mortgage guaranty insurance business and assumes no business from any other entity. Re One only assumes business from NMIC to allow NMIC to comply with statutory risk requirements. Neither NMIC nor Re One have subsidiaries, and therefore do not have subsidiary risks and obligations that compete for its resources.

The GSEs and state insurance regulators may restrict our insurance subsidiaries' ability to pay dividends to NMIH. In addition to the restrictions imposed during the GSE Approval and state licensing processes, the ability of our insurance subsidiaries to pay dividends to NMIH is limited by insurance laws of the State of Wisconsin and certain other states. Wisconsin law provides that an insurance company may pay out dividends without the prior approval of the Wisconsin OCI ("ordinary dividends") in an amount, when added to other shareholder distributions made in the prior 12 months, not to exceed the lesser of (a) 10% of the insurer's surplus as regards to policyholders as of the prior December 31, or (b) its net income (excluding realized capital gains) for the twelve month period ending December 31 of the immediately preceding calendar year. In determining net income, an insurer may carry forward net income from the previous calendar years that has not already been paid out as a dividend. Dividends that exceed this amount are "extraordinary dividends," which require prior approval of the Wisconsin OCI. As of December 31, 2013, the amount of restricted net assets held by our consolidated insurance subsidiaries totaled approximately \$193 million of NMIH's consolidated net assets of \$463 million. The amount of restricted assets used to determine any dividend to NMIH, once all restrictions expire, would be computed under SAP which may differ from the amount of restricted assets computed under GAAP. Since inception, NMIC has not paid any dividends to NMIH. As NMIC had a statutory net loss for the year ended December 31, 2013, NMIC cannot pay any dividends to NMIH through December 31, 2014, without the prior approval of the Wisconsin OCI. Additionally, NMIC will not be permitted to pay dividends to NMIH until after December 31, 2015 as a condition of GSE Approval or until January 2016 under agreements with various state insurance regulators.

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

The following analysis should be read in conjunction with our unaudited consolidated financial statements and the notes thereto included in this report and our audited financial statements, notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K for the year ended December 31, 2013, for a more complete understanding of our financial position and results of operations. In addition, investors should review the "Cautionary Note Regarding Forward-Looking Statements" above and the "Risk Factors" detailed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2013, as subsequently updated in Item 1A of Part II of our Quarterly Reports on Form 10-Q filed in 2014 for a discussion of those risks and uncertainties that have the potential to affect our business, financial condition, results of operations, cash flows or prospects in a material and adverse manner. Our results of operations for interim periods are not necessarily indicative of results to be expected for the full year or for any other period.

Overview

We were incorporated in May 2011 and, through our subsidiaries, provide private mortgage guaranty insurance (which we refer to as "mortgage insurance" or "MI"). Our primary insurance subsidiary, National Mortgage Insurance Corporation ("NMIC"), is a qualified MI provider on loans purchased by Fannie Mae and Freddie Mac (collectively the "GSEs") and is currently licensed in all 50 states and D.C. to issue mortgage guaranty insurance. Our reinsurance subsidiary, National Mortgage Reinsurance Inc One ("Re One"), solely provides reinsurance to NMIC on certain loans insured by NMIC, as described in Note 12, Statutory Information, above. On November 8, 2013, we filed a final prospectus announcing the sale of 2.1 million shares of common stock through our IPO. Following our IPO, and to meet our obligations under certain Registration Rights Agreements to which we are a party, we filed a final prospectus on December 9, 2013 registering 51,101,434 Class A common shares that had previously been issued during our Private Placement.

MI protects mortgage lenders from all or a portion of default-related losses on residential mortgage loans made to home buyers who generally make down payments of less than 20% of the home's purchase price. By protecting lenders and investors from credit losses, we help facilitate the availability of mortgages to prospective, primarily first-time, U.S. home buyers, thus promoting homeownership while protecting lenders and investors against potential losses related to a borrower's default. MI also facilitates the sale of these mortgage loans in the secondary mortgage market, most of which are sold to Fannie Mae and Freddie Mac. We are one of seven companies in the U.S. who offer MI. Our business strategy is to become a leading national MI company with our principal focus on writing insurance on high quality, low down payment residential mortgages in the United States.

The MI industry is a highly regulated, capital intensive industry. Other challenges to entry include the need for a customer-integrated operating platform capable of issuing and servicing mortgage insurance policies, the competitive positions and established customer relationships of existing mortgage insurance providers, and in order to conduct MI business nationwide, the need to obtain and maintain insurance licenses in all 50 states and D.C. Additionally, the resource commitment required by mortgage originators, and larger lenders in particular, to connect to a new mortgage insurance platform, such as ours, is significant, and absent a critical need, such as the capital constraints in the MI industry during the financial crisis, they have historically, in our view, been reluctant to make such an investment. We were formed at a time when the severe dislocation in the MI industry caused by the financial crisis created a need for newly capitalized mortgage insurers and this has facilitated our efforts to establish relationships with lenders.

Following our formation, we focused our efforts on organizational development, capital raising and other start-up related activities. Our efforts to build our MI business have included, among other things, securing GSE approval, obtaining insurance licenses in all 50 states and D.C., building an executive management team and hiring other key officers and directors and staff, building our operating processes, and designing and developing our business and technology applications and environment and infrastructure. In 2014, we continue to make progress achieving our goals, through the addition of new customers and the attainment of our goal of becoming licensed nationwide by obtaining a certificate of authority in Wyoming in April 2014. Since we began writing MI in April 2013, we have become a fully operational MI company, with \$1.8 billion of primary IIF and \$4.8 billion of pool IIF as of September 30, 2014 compared to \$161.7 million of primary IIF and \$5.1 billion of pool IIF as of December 31, 2013. As of September 30, 2014, the Company had primary RIF of \$435.7 million compared to primary RIF of \$36.5

million as of December 31, 2013. Pool RIF as of September 30, 2014 and December 31, 2013 was \$93.1 million. NMIC primarily differentiates itself from its competitors by underwriting all loans it insures either prior to or post close, which permits us to provide loan originators and aggregators with 12-month rescission relief protection, thereby giving our customers consistent confidence of coverage. We have established risk management controls throughout our organization that we believe will support our continued financial strength. As a newly capitalized mortgage insurer, we have the ability to write new business without the burden of risky legacy exposures and believe our current capital supports our current business writing strategy, while staying within the regulatory guidelines imposed by state insurance departments and the GSEs.

On July 10, 2014, the Federal Housing Finance Agency ("FHFA") released for public comment the proposed private mortgage insurer eligibility requirements ("PMIERS"). The draft PMIERS represent the standards by which private mortgage insurers are eligible to provide mortgage insurance on loans owned or guaranteed by the GSEs. We believe that the proposed eligibility requirements for private mortgage insurers will help restore confidence in an industry affected by the recent housing crisis. We also believe a strong and financially sustainable private mortgage insurance industry is a key component of a healthy residential mortgage market and that NMIC is well positioned under the PMIERS to continue to serve the growing demand for private MI. The public comment period for the PMIERS closed on September 8, 2014, and we, along with other industry participants, provided comments to the FHFA, which are publicly available on the FHFA's website. Our comments, the FHFA's website and information contained on or accessible through the FHFA's website are not incorporated by reference into this report. We believe NMIC will fully comply with the new financial requirements within the transition time period.

Our headquarters are located in Emeryville, California and our website is www.nationalmi.com. Our website and the information contained on or accessible through our website are not incorporated by reference into this report.

Conditions and Trends Impacting Our Business

We discuss below the following conditions and trends that have impacted or are expected to impact our business.

- Customer Development
- New Insurance Written ("NIW"), Insurance in Force and Risk in Force
- Consolidated Results of Operations
- Holding Company Liquidity and Capital Resources
- Capital Position of Our Insurance Subsidiaries
- Consolidated Investment Portfolio and Other Factors that Impact Our Consolidated Results
- Proposed PMIERS
- GSE Approval Conditions and GSE Reform
- Competition
- Other Items

Customer Development

We organize our sales and marketing efforts based on our national and regional customer segmentation. Our sales strategy is focused on attracting as customers mortgage originators in the United States that fall into two distinct categories, which we refer to as "National Accounts" and "Regional Accounts," discussed below. Since April 2013, we have increased our customer base to include some of the largest loan originators in the U.S., and we expect to continue to acquire new national and regional account customers. In addition to adding new customers, we believe our existing customers will allocate more of their business to us for placement of our MI.

We define National Accounts as the most significant residential mortgage originators as determined by volume of their own originations as well as volume of insured business they may acquire from other originators through their correspondent channels. These National Accounts generally originate loans through their retail channels as well as purchase loans originated by other entities, primarily mortgage originators who we would classify as Regional Accounts, as described below. National Accounts may sell their loans to the GSEs or private label secondary markets or securitize the loans themselves. We currently classify approximately 40 mortgage originators and/or aggregators as National Accounts.

The Regional Accounts originate mortgage loans on a local or regional level throughout the country. Some of these Regional Accounts have origination platforms across multiple regions; however, their primary lending focus is local. They sell the majority of their originations to National Accounts, but Regional Accounts may also retain loans in their portfolios or sell portions of their production directly to the GSEs.

During the nine months ended September 30, 2014, we received NIW from 189 National and Regional Accounts. The table below shows the number of our customers generating NIW within each of the last six completed fiscal quarters and during the nine months ended September 30, 2014.

New Insurance Written, Insurance in Force and Risk in Force

NMIC began writing MI in April 2013. Primary insurance may be written on a flow basis, in which loans are insured in individual, loan-by-loan transactions, or may be written on a bulk basis, in which each loan in a portfolio of loans is individually insured in a single, bulk transaction. MI may also be written in a pool policy, where a group of loans (or pool) are insured under a single contract. Pool insurance may have a stated aggregate loss limit for a pool of loans and may also have a deductible under which no losses are paid by the insurer until losses on the pool of loans exceed the deductible.

During the three months ended September 30, 2014, we had primary NIW of \$974.9 million, compared to primary NIW of \$429.9 million during the three months ended June 30, 2014. We have not written any new pool insurance in 2014. Our total NIW of \$5.3 billion for the year ended December 31, 2013 consisted almost entirely of pool insurance written under our Fannie Mae pool agreement, which comprised \$5.2 billion of the total NIW.

As of September 30, 2014, NMIC had primary IIF of \$1.8 billion and pool IIF of \$4.8 billion and total RIF of \$528.8 million, consisting of \$435.7 million of primary RIF, representing insurance on 7,628 loans, and pool RIF of \$93.1 million, representing insurance on approximately 21,000 loans. As of December 31, 2013, NMIC had primary IIF of \$161.7 million and pool IIF of \$5.1 billion and total RIF of \$129.6 million, consisting of primary RIF of \$36.5 million and pool RIF of \$93.1 million. We expect NMIC's primary IIF and RIF to significantly increase over the coming months.

Fannie Mae Pool Transaction

Effective September 1, 2013, NMIC entered into an agreement with Fannie Mae, pursuant to which NMIC initially insured approximately 22,000 loans with IIF of \$5.2 billion (as of September 1, 2013). We receive monthly premiums from Fannie Mae for this transaction, which are recorded as written and earned in the month received. The agreement has a term of 10 years from September 1, 2013, the coverage effective date.

The RIF to NMIC is \$93.1 million, which represents the difference between a deductible payable by Fannie Mae on initial losses and a stop loss above which losses are borne by Fannie Mae. NMIC provides this same level of risk coverage over the term

of the agreement. We are bound to counter-party requirements contained in the agreement that specify the amount of capital NMIC will need to maintain to support the agreement until the new PMIERS are effective, discussed below in "Proposed PMIERS." The capital we are required to maintain under the pool agreement is specified as the greater of the following:

a. the amount of capital required in our January 2013 approval letter from Fannie Mae (\$150 million); or

b. the sum of:

i. 5.6% of net primary RIF, plus;

ii. for pool insurance, the lesser of

1. 5.6% of the RIF under the pool transaction, based upon loan level coverage, before application of the aggregate stop loss and deductible, or;

2. the aggregate stop loss amount, net of any deductible, for the pool transaction.

Although our GSE approval letters require that NMIC hold at least \$150 million of capital in total to support both pool and primary risk, the capital we are required to maintain under this pool agreement just to support the pool risk (under b.ii.) will decline over the 10-year term of the agreement as the loans in the pool amortize or as loans pay off. The amount calculated under ii.2. is equivalent to \$93.1 million and remains the same over the term of the transaction. The current loan level RIF of the pool, as of September 30, 2014, is \$1.64 billion, which, when multiplied by 5.6% per the calculation under b.ii.1, produces a capital requirement of \$91.9 million. We expect that as the loans in the pool amortize or as loans pay off, the capital required in b.ii.1 will continue to decline below the \$93.1 million, which is constant and set at the effective date of the transaction, and as a result the amount of capital required under b.ii. will continue to decline. If the draft PMIERS (discussed below) were put into place today, we expect that the amount of capital we would have to hold to support this particular pool transaction would be \$44.1 million, a significant reduction from the current capital requirement of \$91.9 million under b.ii above.

Insurance Portfolio

We underwrite every loan we insure, including loans submitted through our delegated channel. We believe the prevailing standard of other companies in the MI industry has been to conduct partial quality assurance testing of delegated underwritten loans. We believe the industry's practice has exacerbated the negative impact of the recent mortgage crisis on legacy mortgage insurers because their partial quality control reviews did not adequately prevent the issuance of mortgage insurance through their delegated channels on ineligible, poor quality loans. Our pricing policies also help mitigate credit risk in the form of higher premium rates for loan features or borrower characteristics associated with historically higher default rates.

As part of this underwriting, we utilize certain risk principles that form the basis of how we originate primary NIW. First, we manage our portfolio credit risk by using several loan eligibility matrices which prescribe the maximum loan-to-value ("LTV") ratio, minimum borrower credit score, maximum loan size, property type and occupancy status of loans that we will insure. Our loan eligibility matrices, as well as all of our detailed underwriting guidelines, are contained in our Underwriting Guideline Manual that is publicly available on our website. Our eligibility criteria and underwriting guidelines are designed to mitigate the layered risk inherent in a single insurance policy. "Layered risk" refers to the accumulation of borrower, loan risk and property risk. For example, we have higher credit score and lower maximum allowed LTV requirements for riskier property types, such as investor properties, compared to owner-occupied properties.

We monitor the concentrations of the various risk attributes in our insurance portfolio. Our primary IIF and RIF as of September 30, 2014 were made up of approximately 66% and 65%, respectively, of credit scores at or above 740. Generally, insuring loans made to borrowers with higher credit scores tends to result in a lower frequency of claims. Additionally, as of September 30, 2014, we believe our insurance portfolio is comprised of loans that are full documentation loans, and less than 1% of our RIF is above 95% LTV. As we continue to increase our insurance writings, we expect to continue to seek out and insure high credit quality mortgages. Since we recently began writing MI in April 2013, our portfolio does not yet reflect our expected distribution of LTVs, borrower credit scores, loan sizes, property types and occupancy statuses of loans that we expect to insure, as well as the concentrations within states and metropolitan statistical areas. We believe we will move toward our expected distribution of these risk

attributes in our insurance portfolio as we continue to write more business.

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Overview of NIW, IIF and RIF

A significant portion of our NIW in the first nine months of 2014 was comprised of single premium policies. Our single premium policies are currently written in two ways: single premium policies written on a loan by loan basis (“Single”) and single premium policies written on individual loans that are aggregated and delivered by the lender in a single transaction (“Aggregated Single”). Prior to writing Aggregated Single policies, the lender solicits single premium bids from us and other private MI companies. Because of the lower acquisition cost, the competitive bidding process and traditionally higher FICO scores associated with these policies, Aggregated Single policies have lower premiums than our Single premium policies.

While our single premium policies (including Single and Aggregated Single) currently represent the majority of our NIW and IIF, we expect the mix of our policy types could change meaningfully in future quarters. Our current long term expectation is for our total single premium policies (including Single and Aggregated Single) to collectively represent ten to twenty percent of our NIW and IIF as we expand our customer base and our business develops. Lender-paid single premiums are non-refundable and fully earned upon cancellation.

The tables on the following pages provide information on our current IIF by different metrics for the periods presented, including weighted average premiums (in basis points), FICO distributions, LTVs, premiums written and earned, average loan sizes and geographic distribution.

The table below shows NIW, IIF, RIF, policies in force, the weighted-average coverage and loans in default, by quarter, for the last five quarters, for our primary book.

Primary	For the Three Months Ended					
	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	
	(Dollars in Thousands)					
New insurance written	\$974,910	\$429,944	\$354,313	\$157,568	\$3,560	
Insurance in force ⁽¹⁾	\$1,812,956	\$939,753	\$514,796	\$161,731	\$4,604	
Risk in force ⁽¹⁾	\$435,722	\$220,949	\$115,467	\$36,516	\$1,196	
Policies in force ⁽¹⁾	7,628	3,865	2,072	653	22	
Weighted-average coverage ⁽²⁾	24.0	% 23.5	% 22.4	% 22.6	% 26.0	%
Loans in default (count)	—	1	—	—	—	
Risk in force on defaulted loans	\$—	\$100	\$—	\$—	\$—	

⁽¹⁾ Reported as of the end of the period.

⁽²⁾ End of period RIF divided by IIF.

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The table below shows primary and pool IIF, NIW and premiums written and earned by policy type.

Primary and Pool

	As of and for the Three Months Ended September 30, 2014				As of and for the Three Months Ended June 30, 2014			
	IIF	NIW	Premiums Written	Premiums Earned	IIF	NIW	Premiums Written	Premiums Earned
	(In Thousands)							
Monthly Single	\$690,081	\$423,625	\$883	\$883	\$277,490	\$206,767	\$301	\$301
Aggregated Single	257,557	132,973	2,771	353	125,056	97,037	2,086	224
Total Primary	865,318	418,312	4,666	1,323	537,207	126,140	1,292	196
Pool	1,812,956	974,910	8,320	2,559	939,753	429,944	3,679	721
Total	4,822,061	—	1,341	1,341	4,936,751	—	1,372	1,372
	\$6,635,017	\$974,910	\$9,661	\$3,900	\$5,876,504	\$429,944	\$5,051	\$2,093

	As of and for the Three Months Ended March 31, 2014				As of and for the Three Months Ended December 31, 2013			
	IIF	NIW	Premiums Written	Premiums Earned	IIF	NIW	Premiums Written	Premiums Earned
	(In Thousands)							
Monthly Single	\$73,734	\$50,136	\$99	\$99	\$24,558	\$20,395	\$25	\$25
Aggregated Single	28,020	26,518	535	56	1,790	1,790	47	7
Total Primary	413,042	277,659	3,150	355	135,383	135,383	1,572	166
Pool	514,796	354,313	3,784	510	161,731	157,568	1,644	198
Total	5,028,677	—	1,394	1,394	5,089,517	—	1,414	1,414
	\$5,543,473	\$354,313	\$5,178	\$1,904	\$5,251,248	\$157,568	\$3,058	\$1,612

	As of and for the Three Months ended September 30, 2013			
	IIF	NIW	Premiums Written	Premiums Earned
	(In Thousands)			
Monthly Single	\$4,604	\$3,560	\$6	\$6
Aggregated Single	—	—	—	—
Total Primary	4,604	3,560	6	6
Pool	5,171,664	5,171,664	476	476
Total	\$5,176,268	\$5,175,224	\$482	\$482

The tables below show the initial weighted average premium, in basis points, the weighted average FICO and the weighted average LTV, by policy type, for the quarter in which the policy was originated.

Weighted Average Premium

	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
	(Shown in Basis Points)				
Monthly	59	58	56	64	66

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Single	208	215	205	251	—
Aggregated Single	112	102	113	116	—

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Weighted Average FICO

	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Monthly	746	747	749	747	762
Single	747	746	752	735	—
Aggregated Single	760	758	759	759	—

Weighted Average LTV

	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Monthly	92	% 93	% 92	% 93	% 92
Single	92	93	92	92	—
Aggregated Single	89	90	90	90	—

The table below reflects our total NIW, IIF and RIF by FICO as of September 30, 2014.

Total Portfolio	NIW	IIF	RIF
	(Dollars in Thousands)		
	As of September 30, 2014		
>= 740	\$		