

MGIC INVESTMENT CORP
Form 10-Q
November 07, 2016

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

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

For the quarterly period ended September 30, 2016

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

For the transition period from _____ to _____

Commission file number 1-10816

(Exact name of registrant as specified in its charter)

WISCONSIN

39-1486475

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

250 E. KILBOURN AVENUE

53202

MILWAUKEE, WISCONSIN

(Zip Code)

(Address of principal executive offices)

(414) 347-6480

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☒ 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	Accelerated filer	Non-accelerated filer	Smaller reporting	(Do not check if a smaller
filer <input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	company <input type="checkbox"/>	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 ☒

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	November 3, 2016	340,662,694

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 SEPTEMBER 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)	September 30, 2016	December 31, 2015
ASSETS		
Investment portfolio (notes 7 and 8):		
Securities, available-for-sale, at fair value:		
Fixed maturities (amortized cost, 2016 - \$4,602,457; 2015 - \$4,684,148)	\$ 4,718,625	\$ 4,657,561
Equity securities	7,218	5,645
Total investment portfolio	4,725,843	4,663,206
Cash and cash equivalents	274,743	181,120
Accrued investment income	42,310	40,224
Reinsurance recoverable on loss reserves (note 4)	46,863	44,487
Reinsurance recoverable on paid losses	4,632	3,319
Premiums receivable	47,421	48,469
Home office and equipment, net	32,009	30,095
Deferred insurance policy acquisition costs	17,408	15,241
Deferred income taxes, net (note 11)	602,142	762,080
Other assets	79,678	80,102
Total assets	\$ 5,873,049	\$ 5,868,343
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Loss reserves (note 12)	\$ 1,535,483	\$ 1,893,402
Unearned premiums	321,326	279,973
Federal Home Loan Bank advance (note 3)	155,000	—
Senior notes (note 3)	417,087	—
Convertible senior notes (note 3)	349,073	822,301
Convertible junior subordinated debentures (note 3)	256,872	389,522
Other liabilities	255,129	247,005
Total liabilities	3,289,970	3,632,203
Contingencies (note 5)		
Shareholders' equity (note 13):		
Common stock (one dollar par value, shares authorized 1,000,000; shares issued 2016 - 359,395; 2015 - 340,097; shares outstanding 2016 - 345,474; 2015 - 339,657)	359,395	340,097
Paid-in capital	1,779,911	1,670,238
Treasury stock at cost (shares 2016 - 13,921; 2015 - 440)	(111,459)	(3,362)
Accumulated other comprehensive income (loss), net of tax (note 9)	30,155	(60,880)
Retained earnings	525,077	290,047
Total shareholders' equity	2,583,079	2,236,140
Total liabilities and shareholders' equity	\$ 5,873,049	\$ 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 September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
(In thousands, except per share data)				
Revenues:				
Premiums written:				
Direct	\$283,618	\$273,803	\$831,022	\$800,619
Assumed	152	285	542	931
Ceded (note 4)	(33,446)	43,897	(99,944)	(22,334)
Net premiums written	250,324	317,985	731,620	779,216
Increase in unearned premiums, net	(12,948)	(78,751)	(41,447)	(109,186)
Net premiums earned	237,376	239,234	690,173	670,030
Investment income, net of expenses	27,515	25,939	82,572	75,815
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	5,092	640	8,984	27,133
Net realized investment gains	5,092	640	8,984	27,133
Other revenue	3,867	3,698	14,234	9,877
Total revenues	273,850	269,511	795,963	782,855
Losses and expenses:				
Losses incurred, net (note 12)	60,897	76,458	192,499	248,481
Change in premium deficiency reserve	—	—	—	(23,751)
Amortization of deferred policy acquisition costs	2,575	2,368	6,781	6,191
Other underwriting and operating expenses, net	37,870	46,075	112,995	121,152
Interest expense	13,536	17,362	40,481	52,097
Loss on debt extinguishment (note 3)	75,223	—	90,531	—
Total losses and expenses	190,101	142,263	443,287	404,170
Income before tax	83,749	127,248	352,676	378,685
Provision for (benefit from) income taxes (note 11)	27,131	(695,604)	117,646	(690,897)
Net income	\$56,618	\$822,852	\$235,030	\$1,069,582
Income per share (note 6)				
Basic	\$0.16	\$2.42	\$0.68	\$3.15
Diluted	\$0.14	\$1.78	\$0.58	\$2.35
Weighted average common shares outstanding - basic (note 6)	349,376	339,701	343,403	339,504
Weighted average common shares outstanding - diluted (note 6)	406,050	468,128	421,423	468,076

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		Nine Months Ended	
	September 30,		September 30,	
(In thousands)	2016	2015	2016	2015
Net income	\$56,618	\$822,852	\$235,030	\$1,069,582
Other comprehensive (loss) income, net of tax (note 9):				
Change in unrealized investment gains and losses (note 7)	(14,434)	95,295	92,731	51,212
Benefit plan adjustments	(241)	(7,355)	(722)	(8,447)
Foreign currency translation adjustment	(10)	(2,947)	(974)	(4,571)
Other comprehensive (loss) income, net of tax	(14,685)	84,993	91,035	38,194
Comprehensive income	\$41,933	\$907,845	\$326,065	\$1,107,776

See accompanying notes to consolidated financial statements

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

	Nine Months Ended September 30,	
(In thousands)	2016	2015
Common stock		
Balance, beginning of period	\$340,097	\$340,047
Net common stock issued under share-based compensation plans	985	44
Issuance of common stock (note 13)	18,313	—
Balance, end of period	359,395	340,091
Paid-in capital		
Balance, beginning of period	1,670,238	1,663,592
Net common stock issued under share-based compensation plans	(5,989)	(446)
Issuance of common stock (note 13)	113,146	—
Reissuance of treasury stock, net	—	(6,894)
Tax benefit from share-based compensation	100	2,113
Equity compensation	8,753	8,942
Reacquisition of convertible junior subordinated debentures-equity component (note 3)	(6,337)	—
Balance, end of period	1,779,911	1,667,307
Treasury stock		
Balance, beginning of period	(3,362)	(32,937)
Purchases of common stock (note 13)	(108,097)	—
Reissuance of treasury stock, net	—	29,575
Balance, end of period	(111,459)	(3,362)
Accumulated other comprehensive income (loss)		
Balance, beginning of period	(60,880)	(81,341)
Other comprehensive income (loss), net of tax (note 9)	91,035	38,194
Balance, end of period	30,155	(43,147)
Retained earnings (deficit)		
Balance, beginning of period	290,047	(852,458)
Net income	235,030	1,069,582
Reissuance of treasury stock, net	—	(29,494)
Balance, end of period	525,077	187,630
Total shareholders' equity	\$2,583,079	\$2,148,519

See accompanying notes to consolidated financial statements.

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

(In thousands)	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$ 235,030	\$ 1,069,582
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	44,324	38,361
Deferred tax expense (benefit)	111,191	(698,177)
Realized investment gains, net	(8,984)	(27,133)
Excess tax benefits related to share-based compensation	(100)	(2,113)
Loss on debt extinguishment	31,071	—
Payment of original issue discount-convertible junior subordinated debentures	(41,540)	—
Payment of original issue discount-convertible senior notes	(11,250)	—
Change in certain assets and liabilities:		
Accrued investment income	(2,086)	(6,343)
Prepaid insurance premium	95	47,436
Reinsurance recoverable on loss reserves	(2,376)	19,093
Reinsurance recoverable on paid losses	(1,313)	2,149
Premium receivable	1,048	5,863
Deferred insurance policy acquisition costs	(2,167)	(2,757)
Profit commission receivable	(2,005)	91,500
Loss reserves	(357,919)	(416,864)
Premium deficiency reserve	—	(23,751)
Unearned premiums	41,353	61,705
Return premium accrual	(12,800)	(6,400)
Income taxes payable - current	822	752
Other	9,235	(17,872)

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Net cash provided by operating activities	31,629	135,031
Cash flows from investing activities:		
Purchases of investments:		
Fixed maturities	(1,105,995)	(1,970,402)
Equity securities	(4,315)	(2,593)
Proceeds from sales of fixed maturities	718,894	1,527,680
Proceeds from maturity of fixed maturities	432,557	432,328
Proceeds from sale of equity securities	6,425	—
Net increase in payable for securities	3,376	48,120
Net decrease in restricted cash	—	17,212
Additions to property and equipment	(4,969)	(2,835)
Net cash provided by investing activities	45,973	49,510
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	573,094	—
Purchase of convertible senior notes	(363,778)	—
Purchase of convertible junior subordinated debentures-liability component	(91,110)	—
Purchase of convertible junior subordinated debentures-equity component	(9,750)	—
Purchase of common stock	(91,597)	—
Payment of debt issuance costs	(938)	—
Excess tax benefits related to share-based compensation	100	2,113
Net cash provided by financing activities	16,021	2,113
Net increase in cash and cash equivalents	93,623	186,654
Cash and cash equivalents at beginning of period	181,120	197,882
	\$ 274,743	\$ 384,536

Cash and cash equivalents
at end of period

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See accompanying notes to consolidated financial statements.

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 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 to 2015 amounts have been made in the accompanying financial statements to conform to the 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 updated guidance 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 as 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

Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued updated guidance that provides specific guidance on the presentation of certain cash flow items where there is currently diversity in practice, including, but not limited to, debt prepayment and debt issuance costs and proceeds from the settlement of insurance claims. The updated guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods and should be applied retrospectively unless impracticable. Early adoption is permitted including adoption in any interim period. We are currently evaluating the impacts the adoption of this guidance will have on our consolidated financial statements.

Measurement of Credit Losses on Financial Instruments

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

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. In contrast the current guidance requires excess tax benefits to

be 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

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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.

Note 3 – Debt

2016 debt transactions

During the first nine months of 2016, we completed a series of transactions that repositioned the maturity profile of our debt and lowered the number of potentially dilutive securities. These transactions are discussed below.

5.75% Senior Notes

In August 2016, we issued \$425 million aggregate principal amount of 5.75% Senior Notes (the “5.75% Notes”) due in 2023 and received net proceeds, after the deduction of underwriting fees, of \$418.1 million. Interest on the 5.75% Notes is payable semi-annually on February 15 and August 15 of each year, commencing on February 15, 2017. We have the option to redeem these notes, in whole or in part, at any time or from time to time prior to maturity at a redemption price equal to the greater of (i) 100% of the aggregate principal amount of the notes to be redeemed and (ii) the make-whole amount, which is the sum of the present values of the remaining scheduled payments of principal and interest discounted at the treasury rate defined in the notes plus 50 basis points, plus, in each case, accrued interest thereon to, but excluding, the redemption date. In addition to underwriting fees, we incurred approximately \$1.2 million of other expenses associated with the issuance of these notes.

The 5.75% Notes have covenants customary for securities of this nature, including customary events of default and further provide that the trustee or holders of at least 25% in aggregate principal amount of the outstanding 5.75% Notes may declare them immediately due and payable upon the occurrence of certain events of default after the expiration of the applicable grace period. In addition, in the case of an event of default arising from certain events of bankruptcy, insolvency or reorganization relating to the Company or any of its significant subsidiaries, the 5.75% Notes will become due and payable immediately. This description is not intended to be complete in all respects and is qualified in its entirety by the terms of the 5.75% Notes, including their covenants and events of default.

The net proceeds from the 5.75% Notes issuance were primarily used as (i) cash consideration to purchase a portion of our 2% Notes, and (ii) to repurchase the shares issued as partial consideration in the purchases of our 2% Notes, as further

described below. The remaining proceeds are being held for general corporate purposes.

2% Convertible Senior Notes

In the third quarter of 2016, we entered into privately negotiated agreements to purchase \$292.4 million in par value of our outstanding 2% Convertible Senior Notes (the “2% Notes”) due in 2020 at a purchase price of \$362.1 million, plus accrued interest. We funded the purchases with \$230.7 million in cash proceeds from the issuance of the 5.75% Notes and by issuing to certain sellers approximately 18.3 million shares of our common stock. The excess of the purchase price over carrying value is reflected as a loss on debt extinguishment on our consolidated statements of operations for the three and nine months ended September 30, 2016. The purchases of the 2% Notes reduced our potentially dilutive shares by approximately 42.1 million shares, without considering the shares issued in partial consideration in the purchase of the 2% Notes or the repurchase of shares to offset such shares issued. For more information about the share repurchases, see Note 13 - “Shareholders’ Equity.”

5% Convertible Senior Notes

During the first nine 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 carrying value is reflected as a loss on debt extinguishment on our consolidated statements of operations for the three and nine months ended September 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 nine months ended September 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 \$6.3 million related to the reacquisition of the equity component. For GAAP accounting purposes, the 9% Debentures owned by MGIC are considered retired and are eliminated in our consolidated financial statements and the underlying common stock

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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 of Chicago (“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 statements 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
5% Notes	\$333.5	\$ (2.0)	\$ 331.5
2% Notes	500.0	(9.2)	490.8
9% Debentures	389.5	—	389.5
Total long-term debt	\$1,223.0	\$ (11.2)	\$ 1,211.8

Long-term debt obligations

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

(In millions)	September 30, December 31,	
	2016	2015
FHLB Advance	\$ 155.0	\$ —
5% Notes ⁽¹⁾	145.0	333.5
2% Notes ^{(2) (3)}	207.6	500.0
5.75% Notes	425.0	—
9% Debentures ⁽⁴⁾	256.9	389.5
Long-term debt, par value	1,189.5	1,223.0
Less: Debt issuance costs	(11.5)	(11.2)
Long-term debt, carrying value	\$ 1,178.0	\$ 1,211.8

Convertible at any time prior to maturity at the holder’s option, at an initial conversion rate, which is subject to

(1) 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% 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.

Prior to April 10, 2017, the 2% 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

- (3) 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.

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

- (4) 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.

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The Convertible Senior Notes, Senior Notes and Convertible Junior Subordinated Debentures are obligations of our holding company, MGIC Investment Corporation, and not of its subsidiaries. As of September 30, 2016, we had approximately \$329 million in cash and investments at our holding company. The modified duration of the holding company investment portfolio, excluding cash and cash equivalents, was 1.6 years at September 30, 2016.

Interest payments on our debt obligations appear below.

	Nine Months Ended September 30,	
(In millions)	2016	2015
FHLB Advance	\$1.7	\$—
Senior Notes, interest at 5.375% per annum, due November 2015	—	1.7
5% Notes	6.9	8.6
2% Notes	7.0	5.0
9% Debentures	15.9	17.5
Total interest payments	\$31.5	\$32.8
Note 4 – Reinsurance		

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Premiums earned:				
Direct	\$270,718	\$252,951	\$789,671	\$738,870
Assumed	152	285	542	931
Ceded	(33,494)	(14,002)	(100,040)	(69,771)
Net premiums earned	\$237,376	\$239,234	\$690,173	\$670,030
Losses incurred:				
Direct	\$69,579	\$81,699	\$216,874	\$265,445
Assumed	241	425	681	1,191
Ceded	(8,923)	(5,666)	(25,056)	(18,155)
Net losses incurred	\$60,897	\$76,458	\$192,499	\$248,481

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 is 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. 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 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, resulting from an increase in our loss ratio, will reduce our profit commission. 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%.

Following is a summary of our quota share reinsurance agreements, excluding captive agreements, for the three and nine months ended September 30, 2016 and 2015.

	Three Months		Nine Months	
	Ended September		Ended September	
(In thousands)	30,		30,	
	2016	2015	2016	2015
2013 QSR Transaction				
Ceded premiums written, net of profit commission	n/a	\$(69,410)	n/a	\$(11,355)
Ceded premiums earned, net of profit commission	n/a	(11,568)	n/a	35,999
Ceded losses incurred	n/a	—	n/a	6,060
Ceding commissions ⁽¹⁾	n/a	(11,568)	n/a	10,235
Profit commission	n/a	11,568	n/a	62,525

2015 QSR Transaction (Effective July 1, 2015)

Ceded premiums written, net of profit commission ⁽²⁾	31,707	22,626	93,334	22,626
Ceded premiums earned, net of profit commission ⁽²⁾	31,707	22,626	93,334	22,626
Ceded losses incurred	7,432	4,236	22,015	4,236
Ceding commissions ⁽¹⁾	12,137	9,195	35,659	9,195
Profit commission	28,981	23,347	84,963	23,347

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

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The reinsurance recoverable on loss reserves related to our 2015 QSR Transaction was \$27 million as of September 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.

The reinsurance recoverable on loss reserves related to captive agreements was \$20 million as of September 30, 2016, which was supported by \$94 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. Each captive reinsurer is required to maintain a separate trust account to support its combined reinsured risk on all annual books. MGIC is the sole beneficiary of the trusts.

Note 5 – Litigation and Contingencies

Before paying 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 three quarters of 2016, curtailments reduced our average claim paid by approximately 6.7% and 5.4%, 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 4% 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 \$281 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 effect 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.

(In thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic earnings per share:				
Net income	\$56,618	\$822,852	\$235,030	\$1,069,582
Weighted average common shares outstanding	349,376	339,701	343,403	339,504
Basic income per share	\$0.16	\$2.42	\$0.68	\$3.15
Diluted earnings per share:				
Net income	\$56,618	\$822,852	\$235,030	\$1,069,582
Interest expense, net of tax ⁽¹⁾ :				
2% Convertible Senior Notes due 2020	1,324	1,982	5,288	5,946
5% Convertible Senior Notes due 2017	673	3,050	5,080	9,150
9% Convertible Junior Subordinated Debentures due 2063	—	5,697	—	17,090
Diluted income available to common shareholders	\$58,615	\$833,581	\$245,398	\$1,101,768
Weighted average shares - basic	349,376	339,701	343,403	339,504

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Effect of dilutive securities:

Unvested restricted stock units	1,395	1,983	1,428	2,128
2% Convertible Senior Notes due 2020	44,488	71,917	62,707	71,917
5% Convertible Senior Notes due 2017	10,791	25,674	13,885	25,674
9% Convertible Junior Subordinated Debentures due 2063	—	28,853	—	28,853
Weighted average shares - diluted	406,050	468,128	421,423	468,076
Diluted income per share	\$0.14	\$1.78	\$0.58	\$2.35

Antidilutive securities (in millions)

19.0 — 20.4 —

(1) 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 September 30, 2016 and December 31, 2015 are shown below.

September 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	\$41,735	\$ 562	\$ (41)	\$42,256
Obligations of U.S. states and political subdivisions	2,046,199	87,592	(1,122)	2,132,669
Corporate debt securities	1,720,839	33,409	(4,379)	1,749,869
Asset-backed securities	79,032	182	(32)	79,182
Residential mortgage-backed securities	245,876	616	(3,056)	243,436
Commercial mortgage-backed securities	347,630	3,563	(980)	350,213
Collateralized loan obligations	121,146	203	(349)	121,000
Total debt securities	4,602,457	126,127	(9,959)	4,718,625
Equity securities	7,094	127	(3)	7,218
Total investment portfolio	\$4,609,551	\$ 126,254	\$ (9,962)	\$4,725,843

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 September 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 September 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 FHLB Advance. As of September 30, 2016 that collateral is included in our total investment portfolio amount shown above with a total fair value of \$167.4 million.

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The amortized cost and fair values of debt securities at September 30, 2016, by contractual maturity, are shown in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Because most asset-backed and mortgage-backed securities and collateralized loan obligations provide for periodic payments throughout their lives, they are listed in separate categories.

September 30, 2016

(In thousands)	Amortized Cost	Fair Value
Due in one year or less	\$350,683	\$351,117
Due after one year through five years	1,166,094	1,184,500
Due after five years through ten years	1,148,505	1,177,837
Due after ten years	1,143,491	1,211,340
	\$3,808,773	\$3,924,794
Asset-backed securities	79,032	79,182
Residential mortgage-backed securities	245,876	243,436
Commercial mortgage-backed securities	347,630	350,213
Collateralized loan obligations	121,146	121,000
Total as of September 30, 2016	\$4,602,457	\$4,718,625

At September 30, 2016 and December 31, 2015, the investment portfolio had gross unrealized losses of \$10.0 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:

September 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	\$22,655	\$(41)	\$—	\$—	\$22,655	\$(41)
Obligations of U.S. states and political subdivisions	185,163	(815)	13,942	(307)	199,105	(1,122)
Corporate debt securities	200,500	(2,843)	41,424	(1,536)	241,924	(4,379)
Asset-backed securities	20	(32)	4,102	—	4,122	(32)
Residential mortgage-backed securities	3,204	(7)	186,494	(3,049)	189,698	(3,056)
Commercial mortgage-backed securities	84,048	(632)	38,992	(348)	123,040	(980)
Collateralized loan obligations	18,868	(186)	52,570	(163)	71,438	(349)
Equity securities	32	—	144	(3)	176	(3)
Total	\$514,490	\$(4,556)	\$337,668	\$(5,406)	\$852,158	\$(9,962)

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)

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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)

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The unrealized losses in all categories of our investments at September 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 268 and 303 securities in an unrealized loss position at September 30, 2016 and December 31, 2015, respectively.

During each of the three and nine months ended September 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 September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Realized investment gains (losses) on investments:				
Fixed maturities	\$1,511	\$638	\$5,397	\$27,123
Equity securities	3,581	2	3,587	10
Net realized investment gains	\$5,092	\$640	\$8,984	\$27,133
	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Realized investment gains (losses) on investments:				
Gains on sales	\$6,168	\$720	\$11,677	\$28,711
Losses on sales	(1,076)	(80)	(2,693)	(1,578)
Net realized investment gains	\$5,092	\$640	\$8,984	\$27,133

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.

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

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

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

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

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

Obligations of U.S. States & Political Subdivisions are evaluated by tracking, capturing, and analyzing quotes for active issues and trades reported via the Municipal Securities Rulemaking Board records. Daily briefings and reviews of current economic conditions, trading levels, spread relationships, and the slope of the yield curve provide further data for evaluation.

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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 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 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 3 years, credit ratings of AA+ or higher, and their balances reflect 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.

Fair value measurements for assets measured at fair value included the following as of September 30, 2016 and December 31, 2015:
September 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	\$42,256	\$ 8,755	\$33,501	\$ —
Obligations of U.S. states and political subdivisions	2,132,669	—	2,131,839	830
Corporate debt securities	1,749,869	—	1,749,869	—
Asset-backed securities	79,182	—	79,182	—
Residential mortgage-backed securities	243,436	—	243,436	—
Commercial mortgage-backed securities	350,213	—	350,213	—
Collateralized loan obligations	121,000	—	121,000	—
Total debt securities	4,718,625	8,755	4,709,040	830

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Equity securities ⁽¹⁾	7,218	2,950	—	4,268
Total investment portfolio	\$4,725,843	\$ 11,705	\$4,709,040	\$ 5,098
Real estate acquired ⁽²⁾	\$10,564	\$—	\$—	\$ 10,564

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

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

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December 31, 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⁾ 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 nine months of 2016.

For assets measured at fair value using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances for the three and nine months ended September 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 September 30, 2016

(In thousands)	Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
Balance at June 30, 2016	\$ 1,056	\$ 6,940	\$ 7,996	\$ 9,642
Total realized/unrealized gains (losses):				
Included in other comprehensive income	—	(3,519)	(3,519)	—
Included in earnings and reported as net realized investment gains, net	—	3,579	3,579	—
Included in earnings and reported as losses incurred, net	—	—	—	(501)
Purchases	—	1,167	1,167	8,938
Sales	(226)	(3,899)	(4,125)	(7,515)
Balance at September 30, 2016	\$ 830	\$ 4,268	\$ 5,098	\$ 10,564

Three Months Ended September 30, 2015

(In thousands)	Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
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Balance at June 30, 2015	\$ 1,634	\$ 321	\$ 1,955	\$7,995
Total realized/unrealized gains (losses):				
Included in earnings and reported as losses incurred, net	—	—	—	(1,031)
Purchases	—	2,535	2,535	9,632
Sales	(247)	—	(247)	(6,512)
Balance at September 30, 2015	\$ 1,387	\$ 2,856	\$ 4,243	\$10,084

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Nine Months Ended September 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	—	—	—	—
Included in earnings and reported as net realized investment gains, net	—	3,579	3,579	—
Included in earnings and reported as losses incurred, net	—	—	—	(143)
Purchases	—	4,258	4,258	27,953
Sales	(398)	(6,424)	(6,822)	(29,395)
Balance at September 30, 2016	\$ 830	\$ 4,268	\$ 5,098	\$ 10,564

Nine Months Ended September 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	—	—	—	(1,503)
Purchases	7	2,535	2,542	26,346
Sales	(466)	—	(466)	(27,417)
Balance at September 30, 2015	\$ 1,387	\$ 2,856	\$ 4,243	\$ 10,084

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

Financial Liabilities Not Measured at Fair Value

We incur financial liabilities in the normal course of our business. The following table presents the carrying value and fair value of our financial liabilities disclosed, but not carried, at fair value at September 30, 2016 and December 31, 2015. The fair values of our Convertible Senior Notes, 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.

(In thousands)	September 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial liabilities:				
FHLB Advance	\$ 155,000	\$ 159,302	n/a	n/a
5% Notes	144,629	148,904	331,546	345,616
2% Notes	204,444	261,530	490,755	701,955
5.75% Notes	417,087	442,531	n/a	n/a
9% Debentures	256,872	318,077	389,522	455,067
Total long-term debt	\$ 1,178,032	\$ 1,330,344	\$ 1,211,823	\$ 1,502,638

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Note 9 – Other Comprehensive Income

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Net unrealized holding (losses) gains arising during the period	\$(22,206)	\$27,271	\$142,852	\$(17,126)
Income tax benefit (expense)	7,772	(9,531)	(50,121)	5,955
Valuation allowance ⁽¹⁾	—	77,555	—	62,383
Net of taxes	(14,434)	95,295	92,731	51,212
Net changes in benefit plan assets and obligations	(370)	(546)	(1,110)	(1,638)
Income tax benefit	129	192	388	574
Valuation allowance ⁽¹⁾	—	(7,001)	—	(7,383)
Net of taxes	(241)	(7,355)	(722)	(8,447)
Net changes in unrealized foreign currency translation adjustment	(16)	(3,724)	(1,496)	(6,228)
Income tax benefit	6	1,306	522	2,186
Valuation allowance ⁽¹⁾	—	(529)	—	(529)
Net of taxes	(10)	(2,947)	(974)	(4,571)
Total other comprehensive (loss) income	(22,592)	23,001	140,246	(24,992)
Total income tax benefit (expense), net of valuation allowance	7,907	61,992	(49,211)	63,186
Total other comprehensive (loss) income, net of tax	\$(14,685)	\$84,993	\$91,035	\$38,194

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

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 nine months ended September 30, 2016 and 2015 are included in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Reclassification adjustment for net realized gains (losses) ⁽¹⁾	\$5,248	\$(1,120)	\$5,958	\$10,591
Income tax (expense) benefit	(1,837)	395	(1,963)	(3,697)
Valuation allowance ⁽²⁾	—	(413)	—	3,635
Net of taxes	3,411	(1,138)	3,995	10,529
Reclassification adjustment related to benefit plan assets and obligations ⁽³⁾	370	546	1,110	1,638
Income tax expense	(129)	(192)	(388)	(574)
Valuation allowance ⁽²⁾	—	192	—	574
Net of taxes	241	546	722	1,638
Reclassification adjustment related to foreign currency ⁽⁴⁾	—	—	1,467	—
Income tax expense	—	—	(513)	—
Net of taxes	—	—	954	—

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Total reclassifications	5,618	(574)	8,535	12,229
Total income tax expense, net of valuation allowance	(1,966)	(18)	(2,864) (62)
Total reclassifications, net of tax	\$3,652	\$ (592)	\$5,671	\$12,167

- (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.

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

(In thousands)	Nine Months Ended September 30, 2016			
	Net unrealized gains and losses on available-for-sale securities	Net benefit plan assets and obligations recognized 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	96,726	—	(20)	96,706
Less: Amounts reclassified from accumulated other comprehensive income (loss)	3,995	722	954	5,671
Balance at September 30, 2016, net of tax	\$75,583	\$ (45,374)	\$ (54)	\$ 30,155

Note 10 – Benefit Plans

The following tables provide the components of net periodic benefit cost for our pension, supplemental executive retirement and other postretirement benefit plans for three and nine months ended September 30, 2016 and 2015:

(In thousands)	Three Months Ended September 30,			
	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefit Plans	
	2016	2015	2016	2015
Service cost	\$2,283	\$2,564	\$188	\$208
Interest cost	3,976	3,962	176	174
Expected return on plan assets	(4,877)	(5,278)	(1,222)	(1,248)
Recognized net actuarial loss (gain)	1,464	1,372	—	(44)
Amortization of prior service cost	(172)	(211)	(1,662)	(1,661)
Net periodic benefit cost (benefit)	\$2,674	\$2,409	\$(2,520)	\$(2,571)

(In thousands)	Nine Months Ended September 30,			
	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefit Plans	
	2016	2015	2016	2015
Service cost	\$6,848	\$7,692	\$564	\$624
Interest cost	11,929	11,886	528	523
Expected return on plan assets	(14,631)	(15,832)	(3,665)	(3,743)
Recognized net actuarial loss (gain)	4,392	4,114	—	(132)
Amortization of prior service cost	(515)	(633)	(4,987)	(4,986)
Net periodic benefit cost (benefit)	\$8,023	\$7,227	\$(7,560)	\$(7,714)

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 September 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, 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 and we reversed the valuation allowance.

The effect of the change in valuation allowance on the provision for income taxes for three and nine months ended September 30, 2016 and 2015 was as follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
(In thousands)	2016	2015	2016	2015
Provision for income tax	\$27,131	\$43,694	\$117,646	\$131,568
Change in valuation allowance	—	(739,298)	—	(822,465)
Provision for (benefit from) income taxes	\$27,131	\$(695,604)	\$117,646	\$(690,897)

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The change in the valuation allowance that was included in other comprehensive income for the three and nine months ended September 30, 2015 was a decrease of \$70.0 million and \$54.5 million, respectively.

We have approximately \$1.6 billion of net operating loss (“NOL”) carryforwards on a regular tax basis and \$0.7 billion of NOL carryforwards for computing the alternative minimum tax as of September 30, 2016. Any unutilized carryforwards are scheduled to expire at the end of tax years 2030 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 September 30, 2016, there would also be interest related to these matters of approximately \$195.9 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 September 30, 2016, those state taxes and interest would approximate \$50.2 million. In addition, there could also be state tax penalties. Our total amount of unrecognized tax benefits as of September 30, 2016 is \$107.9 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 \$94.4 million. We recognize interest accrued and penalties related to unrecognized tax benefits in

income taxes. As of September 30, 2016 and December 31, 2015, we had accrued \$28.6 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 nine months ended September 30, 2016 and 2015:

(In thousands)	Nine months ended September 30,	
	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	292,090	338,611
Prior years ⁽¹⁾	(99,591)) (90,130)
Subtotal	192,499	248,481
Losses paid:		
Losses and LAE paid in respect of defaults related to:		
Current year	5,942	9,227
Prior years	549,706	652,465
Reinsurance terminations ⁽²⁾	(2,854)) (15,440)
Subtotal	552,794	646,252
Net reserve at end of period	1,488,620	1,941,195
Plus reinsurance recoverables	46,863	38,748
Reserve at end of period	\$1,535,483	\$1,979,943

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

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

⁽²⁾ 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 that occurred in prior years represents the actual claim rate and severity associated with those defaults resolved in the current year differing from the estimated liability at the prior year-end, as well as a re-estimation of amounts to be ultimately paid on defaults continuing from the end of the prior year. This re-estimation of the claim rate and severity is the result of our review of current trends in the default inventory, such as percentages of defaults that have resulted in a claim, the amount of the claims relative to the average loan exposure, changes in the relative level of defaults by geography and changes in average loan exposure.

Losses incurred on defaults that occurred in the current year decreased in the first nine 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 nine months of 2016 and 2015 is reflected in the following table.

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(In millions)	Nine months ended September 30,	
	2016	2015
Decrease in estimated claim rate on primary defaults	\$ (108)	\$ (95)
Increase in estimated severity on primary defaults	12	12
Change in estimates related to pool reserves, LAE reserves and reinsurance	(4)	(7)
Total prior year loss development ⁽¹⁾	\$ (100)	\$ (90)

(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.

For the nine months ended September 30, 2016 and 2015 we experienced favorable prior year loss reserve development. This development was, in part, due to the resolution of approximately 54% and 52% of the prior year default inventory during the nine months ended September 30, 2016 and 2015, respectively. During the first nine 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 nine months of 2015 were also favorably impacted by \$21 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 nine 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 nine months of 2016, our losses paid included \$52 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.

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The liability associated with our estimate of premiums to be refunded on expected claim payments is accrued for separately at September 30, 2016 and December 31, 2015 and approximated \$91 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 nine months ended September 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 September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Default inventory at beginning of period	52,558	66,357	62,633	79,901
New notices	17,607	19,509	50,418	55,856
Cures	(15,556)	(17,036)	(50,249)	(56,700)
Paid (including those charged to a deductible or captive)	(3,051)	(3,958)	(9,619)	(12,671)
Rescissions and denials	(125)	(230)	(477)	(623)
Other items removed from inventory	—	—	(1,273)	(1,121)
Default inventory at end of period	51,433	64,642	51,433	64,642

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 September 30, 2016 the percentage of loans in the inventory that have been in default for 12 or more consecutive months has declined compared with the prior year end and 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

	September 30, 2016		December 31, 2015		September 30, 2015	
3 months or less	12,333	24 %	13,053	21 %	13,991	22 %
4 - 11 months	12,648	25 %	15,763	25 %	14,703	23 %
12 months or more ⁽¹⁾	26,452	51 %	33,817	54 %	35,948	55 %
Total primary default inventory	51,433	100 %	62,633	100 %	64,642	100 %

Primary claims received inventory included in ending default inventory 1,636 3 % 2,769 4 % 2,982 5 %

Approximately 48%, 50%, and 50% of the primary default inventory in default for 12 consecutive months or more ⁽¹⁾ has been in default for at least 36 consecutive months as of September 30, 2016, December 31, 2015, and September 30, 2015, respectively.

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

	September 30, 2016	December 31, 2015	September 30, 2015
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3 payments or less	18,374	36	%	20,360	33	%	20,637	32	%
4 - 11 payments	12,282	24	%	15,092	24	%	14,890	23	%
12 payments or more	20,777	40	%	27,181	43	%	29,115	45	%
Total primary default inventory	51,433	100	%	62,633	100	%	64,642	100	%

Pool insurance default inventory decreased to 1,979 at September 30, 2016 from 2,739 at December 31, 2015. and 2,950 at September 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 September 30, 2016 and December 31, 2015

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the estimate of this liability totaled \$6 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 see Note 5 – “Litigation and Contingencies.”

Note 13 – Shareholders’ Equity

Capital transactions

As described in Note 3 - “Debt,” we entered into privately negotiated agreements to purchase, for cash, together with, in certain cases, shares of our common stock, \$292.4 million aggregate principal amount of our outstanding 2% Notes. We issued approximately 18.3 million shares of our common stock as partial consideration under these agreements. We have repurchased the shares issued as partial consideration for our 2% Notes repurchase. During the third quarter of 2016, we repurchased an aggregate of approximately 13.5 million shares of our common stock, of which approximately 2.1 million shares remained unsettled as of September 30, 2016, at a weighted average price per share of \$8.02, which includes commissions. The aggregate purchase price of the shares was \$108.1 million, which includes approximately \$16.5 million of cash settled after September 30, 2016. An additional 4.8 million shares were purchased in October 2016.

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 \$6.3 million as of September 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 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.

Note 14 – Stock-Based Compensation

We have incentive stock plans under which restricted stock units (“RSUs”) were granted to employees. We generally grant share-based compensation to employees 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):

	Nine months ended September 30,			
	2016		2015	
	Weighted		Weighted	
	Average		Average	
	Shares	Share	Shares	Share
	Granted	Fair	Granted	Fair
		Value		Value
RSUs subject to performance conditions	1,257	\$ 5.66	1,144	\$ 9.04
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).

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Based on our interpretation of the PMIERS, as of September 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 September 30, 2016, MGIC's risk-to-capital ratio was 11.1 to 1, below the maximum allowed by the jurisdictions with State Capital Requirements, and its policyholder position was \$1.4 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 September 30, 2016, the risk-to-capital ratio of our combined insurance operations (which includes a reinsurance affiliate) was 12.6 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 three quarters of 2016 MGIC received approval from the OCI to pay a \$16 million dividend to our holding company, which were paid in April, June, and September, 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.

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.

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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.

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OVERVIEW

Through our subsidiary MGIC, we are a leading provider of private mortgage insurance in the United States, as measured by \$180.1 billion of primary insurance in force at September 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 September 30,			Nine Months Ended September 30,		
(In millions, except per share data, unaudited)	2016	2015	Change	2016	2015	Change
Selected statement of operations data						
Total revenues	\$273.9	\$269.5	2 %	\$796.0	\$782.9	2 %
Losses incurred, net	60.9	76.5	(20)%	192.5	248.5	(23)%
Loss on debt extinguishment	75.2	—	N/M	90.5	—	N/M
Income before tax	83.7	127.2	(34)%	352.7	378.7	(7)%
Provision for (benefit from) income taxes	27.1	(695.6)	N/M	117.6	(690.9)	N/M
Net income	56.6	822.9	(93)%	235.0	1,069.6	(78)%
Diluted income per share	\$0.14	\$1.78	(92)%	\$0.58	\$2.35	(75)%

Non-GAAP Financial Measures ⁽¹⁾

Pretax operating income	\$153.9	\$126.6	22 %	\$434.2	\$351.6	23 %
Net operating income	102.2	83.1	23 %	288.0	229.5	25 %
Net operating income per diluted share	\$0.25	\$0.20	25 %	\$0.71	\$0.55	29 %

⁽¹⁾ See Explanation and Reconciliation of our use of Non-GAAP financial measures on pages 38-39.

Business Overview

Quarterly results

Net income for the third quarter 2016 was \$56.6 million, or \$0.14 per diluted share. Net income for the third quarter of 2015 was \$822.9 million, or \$1.78 per diluted share. The decline in our net income was primarily due to the tax benefit recognized upon reversal of our deferred tax asset valuation allowance in the third quarter of 2015 and the loss on debt extinguishment recorded in the third quarter of 2016 from our 2% Notes repurchases. The decline in net income was partially offset by a decrease in our losses incurred, net.

Total revenues were \$273.9 million, up 2% compared to the prior year. Net premiums earned of \$237.4 million decreased by 1% compared to the prior year period as we ceded more premiums in 2016 and the third quarter of 2015 included a non-recurring increase in net premiums earned due to commutation of our 2013 quota share reinsurance agreement (“2013 QSR Transaction”). The decrease in net premiums earned was offset in part by a higher level of premiums earned on single premium policies in 2016 due to increased cancellation activity and a reduction in premium refunds and related premium refund accrual compared to the prior year due to lower claim activity. Investment income, net of expenses, increased 6% compared with the prior year, reflecting a higher average investment yield over the period on our investment portfolio. Realized gains were \$5.1 million, up from \$0.6 million in the prior year.

Losses incurred, net were \$60.9 million, down 20% compared to the prior year driven by fewer new delinquency notices and a lower claim rate on the new notices received in the third quarter of 2016 compared to the prior year. The claim rate on new notices in the third quarter of 2016 was approximately 12% compared to 13% in the prior year.

Loss on debt extinguishment during the third quarter of 2016 reflects the repurchases of our 2% Notes at a cost that was in excess of our carrying value and a write-off of the unamortized debt issuance costs on the repurchased portion

of the notes. The repurchases were completed with funds from our 5.75% Notes issuance, and in certain cases, shares of our common stock. These transactions continued the repositioning of our debt maturity profile and reduced potentially dilutive shares.

See Note 3 - "Debt" to our consolidated financial statements for further discussion of the accounting for this transaction. Further, we will continue to assess opportunities to enhance our capital position, improve our debt profile, and reduce potential dilution from our outstanding convertible debt issuances, which could result in additional losses in 2016.

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The difference in Provision for (benefit from) income taxes reflects the change in our tax position. The third quarter of 2015 included a benefit from the reversal of our valuation allowance against our deferred tax assets, while the third quarter of 2016 results reflected a full tax provision.

Year to date results

Net income for the first nine months of 2016 was \$235.0 million, or \$0.58 per diluted share. Net income for the first nine months of 2015 was \$1.1 billion, or \$2.35 per diluted share. The decline in our net income was primarily due to the tax benefit recognized upon reversal of our deferred tax asset valuation allowance in the third quarter of 2015 and the loss on debt extinguishment resulting from our debt transactions completed during the first nine months of 2016. The decline in net income was partially offset by a decrease in our losses incurred, net.

Total revenues were \$796.0 million, up 2% compared to the same period in the prior year. Net premiums earned of \$690.2 million increased by 3% compared to the same period in the prior year due to a reduction in our premium refunds and related premium refund accrual and higher earned premiums on single premium policies due to increased cancellation activity compared to the prior year. These increases were offset in part by a higher level of premiums ceded in 2016. Investment income, net of expenses, increased 9% compared to the same period in the prior year, reflecting higher average portfolio yields over the period. Realized gains were \$9.0 million, down from \$27.1 million in the same period of the prior year. A substantial portion of our realized gains in 2015 were from fixed maturity security sales in the first quarter under favorable market conditions.

Losses incurred, net were \$192.5 million, down 22.5% compared to the same period in the prior year driven by fewer new delinquency notices received in the first nine months of 2016 compared to the same period of the prior year. There was also a higher level of favorable prior year loss development due to a lower claim rate on previously reported defaults and on our estimate of incurred but not reported losses (IBNR).

Loss on debt extinguishment during the first nine months of 2016 reflects the repurchases of a portion of our 5% Notes and 2% Notes, and MGIC's purchase of a portion of our 9% Debentures at costs that were in excess of our carrying values. In addition, the repurchases of the 5% Notes and 2% Notes included the write-off of unamortized debt issuance costs on the repurchased portions of those notes.

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 reduce potential dilution from our outstanding convertible debt issuances, which could result in additional losses in 2016.

The difference in Provision for (benefit from) income taxes reflects the change in our tax position. The first nine months of 2015 included a benefit from the reversal of our valuation allowance against our deferred tax assets in the third quarter

of 2015, while the first nine months of 2016 results reflected a full tax provision.

See "Results of Consolidated Operations" below for additional discussion of our results for the third quarter and first nine months of 2016 compared to the respective prior year periods.

Capital

GSEs

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.

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 September 30, 2016, MGIC’s Available Assets are \$4.7 billion and its Minimum Required Assets are \$4.1 billion. MGIC is in compliance with the PMIERs and eligible to insure loans purchased by the GSEs.

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

The GSEs 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.

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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 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 September 30, 2016, MGIC’s risk-to-capital ratio was 11.1 to 1, below the maximum allowed by the jurisdictions with State Capital Requirements, and its policyholder position was \$1.4 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 continue to evaluate the impact of the framework contained in the exposure draft, including the potential impact of certain items that have not yet been completely addressed by the framework which include: the treatment of ceded risk, minimum capital floors, and action level triggers. Currently we believe that the PMIERS contain the more restrictive capital requirements in most circumstances.

GSE Reform

The 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.”

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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 nine 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 \$479 million and \$405 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 7% and 6% of the modifications resulted in principal forgiveness in each of the first nine months of 2015 and 2016, respectively.

In 2015 and the first nine months of 2016, approximately 16% and 15%, 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 and September 2017, respectively, 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. As of September 30, 2016, approximately 11% of our primary insurance in force had benefited from HARP and was still in force.

As shown in the following table, as of September 30, 2016 approximately 20% of our primary risk in force has been modified.

Modifications

Policy year	HARP (1)	HAMP	Other
2003 Prior	11.1 %	19.2 %	16.0 %
2004	17.9 %	19.7 %	14.3 %
2005	24.7 %	20.7 %	13.9 %
2006	27.5 %	21.3 %	13.9 %
2007	38.2 %	20.2 %	8.8 %
2008	52.4 %	12.4 %	4.4 %
2009	27.4 %	1.8 %	1.4 %
2010 - Q3 2016	— %	0.1 %	— %
Total	10.9 %	5.9 %	3.2 %

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

As of September 30, 2016 based on loan count, the loans associated with 97.7% of HARP modifications, 77.7% of HAMP modifications and 73.2% 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.

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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.

• 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.

• Losses incurred, net

Losses incurred, net 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.

Other

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

Net realized investment gains (losses)

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.

Loss on debt extinguishment

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

Refer to “Explanation and reconciliation of our use of Non-GAAP financial measures” to understand how these items impact our evaluation of our fundamental financial performance.

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 premium rates reset to lower levels on a substantial portion of our monthly premium program after ten years, and increasing losses.

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

Non-GAAP financial measures

We believe that use of the Non-GAAP financial measures of pretax operating income (loss), net operating income (loss) and net operating income (loss) per diluted share facilitate the evaluation of the company's fundamental financial performance and provide relevant and meaningful information to investors about the ongoing operating results of the company. On a consolidated basis, these measures are not recognized in accordance with accounting principles generally accepted in the United States of America (GAAP) and should not be viewed as alternatives to GAAP measures of performance. The measures described below have been established to increase transparency for the purpose of evaluating the fundamental operating trends and enabling more meaningful comparisons with our competitors.

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

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

Net operating income (loss) per diluted share is calculated by dividing (i) net operating income (loss) adjusted for interest expense on convertible debt, share dilution from convertible debt, and the impact of stock-based compensation arrangements consistent with the accounting standard regarding earnings per share, whenever the impact is dilutive by (ii) diluted weighted average common shares outstanding.

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

Net realized investment gains (losses). The recognition of net realized investment gains or losses can vary (1) significantly across periods as the timing of individual securities sales is highly discretionary and is influenced by such factors as market opportunities, our tax and capital profile, and overall market cycles.

Trends in the profitability of our fundamental operating activities can be more clearly identified without the fluctuations of these realized gains and losses. We do not view them to be indicative of our fundamental operating activities. Therefore, these items are excluded from our calculation of net operating income (loss).

Gains and losses on debt extinguishment. Gains and losses on debt extinguishment result from discretionary activities that are undertaken to enhance our capital position, improve our debt profile, and reduce potential (2) dilution from our outstanding convertible debt issuances; therefore, these activities are not viewed as part of our fundamental operating activities and their results and are excluded from our calculation of net operating income (loss).

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

economic conditions. We do not view these impairment losses to be indicative of fundamental operating activities and we exclude them from our calculation of net operating income (loss).

Deferred tax asset valuation allowance. The recognition, or reversal, of a valuation allowance against deferred tax assets is subject to significant management judgment and the effects are recorded to the discrete accounting period when recognized or reversed. Such recognition or reversal may significantly impact the discrete accounting period (4) in which it is recorded; however recognition or reversal of a valuation allowance does not impact our cash position or operational activities. Therefore, we do not view the recognition, or reversal, of a valuation allowance against deferred tax assets to be indicative of fundamental operating activities and their effects are excluded from our calculation of net operating income (loss).

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Non-GAAP Reconciliations

Reconciliation of Income before tax to pretax operating income and calculation of Net operating income

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Income before tax per Statement of Operations	\$83,749	\$127,248	\$352,676	\$378,685
Adjustments:				
Net realized investment gains	(5,092)	(640)	(8,984)	(27,133)
Loss on debt extinguishment	75,223	—	90,531	—
Pretax operating income	153,880	126,608	434,223	351,552
Income taxes:				
Provision for income taxes ⁽¹⁾	51,677	43,470	146,188	122,071
Net operating income	\$102,203	\$83,138	\$288,035	\$229,481

⁽¹⁾ Income before tax within operating income is tax effected at our effective tax rate. The effective tax rate for the three and nine months ended September 30, 2015 excludes the effects of the change in our valuation allowance. Adjustments are tax effected at the Federal Statutory Rate of 35%.

Reconciliation of Net income to Net operating income

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Net income	\$56,618	\$822,852	\$235,030	\$1,069,582
Effect of change in deferred tax asset valuation allowance	—	(739,298)	—	(822,465)
Adjustments, net of tax ⁽¹⁾ :				
Net realized investment gains	(3,310)	(416)	(5,840)	(17,636)
Loss on debt extinguishment	48,895	—	58,845	—
Net operating income	\$102,203	\$83,138	\$288,035	\$229,481

⁽¹⁾ Adjustments are tax effected at the Federal Statutory Rate of 35%.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income per diluted share	\$0.14	\$1.78	\$0.58	\$2.35
Effect of change in deferred tax asset valuation allowance ⁽¹⁾	—	(1.58)	—	(1.76)
Net realized investment gains	(0.01)	—	(0.01)	(0.04)
Loss on debt extinguishment	0.12	—	0.14	—
Net operating income per diluted share	\$0.25	\$0.20	\$0.71	\$0.55

⁽¹⁾ The change in our deferred tax asset valuation allowance includes a \$698.1 million reduction to our tax provision for amounts to be realized in future periods, or \$1.49 per diluted share.

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New insurance written

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

Primary NIW by FICO score

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In billions)	2016	2015	2016	2015
740 and greater	\$8.7	\$7.1	\$20.5	\$19.3
700-739	3.5	3.1	9.0	8.3
660-699	1.6	1.7	4.5	4.4
659 and less	0.4	0.5	1.1	1.2
Total Primary	\$14.2	\$12.4	\$35.1	\$33.2
	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	

Percentage of primary NIW

Policy payment type:

Monthly premiums	82.0%	81.7%	79.8%	79.6%
Single premiums	17.7%	18.0%	19.9%	20.1%
Annual premiums	0.3%	0.3%	0.3%	0.3%

Type of mortgage:

Purchases	80.8%	87.9%	81.9%	80.6%
Refinances	19.2%	12.1%	18.1%	19.4%

LTV:

95.01% and above	6.0%	4.9%	5.5%	4.4%
90.01% to 95.00%	46.9%	51.4%	48.8%	50.4%
85.01% to 90.00%	31.9%	33.1%	31.8%	33.0%
80.01% to 85%	15.2%	10.6%	13.9%	12.2%

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, resulted in an increase in the percentage and volume of new insurance written resulting from purchase mortgage transactions during the first half of 2016 when compared to the same period in the prior year. While the volume of new insurance written resulting from purchase mortgage transactions increased in the third quarter of 2016 when compared to the same period in 2015, the percentage of our new insurance written represented by such transactions decreased year-over-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 refinance activity will remain elevated, which could cause the percentage of purchase transactions to decline but that will be highly dependent on the future level of mortgage interest rates.

Competition has been centered on pricing practices 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 nine months ended September 30, 2016 and 2015, the impact of our new insurance written and cancellations was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In billions)	2016	2015	2016	2015
NIW	\$14.2	\$12.4	\$35.1	\$33.2
Cancellations	(11.6)	(8.5)	(29.5)	(25.4)
Change in primary insurance in force	\$2.6	\$3.9	\$5.6	\$7.8

Direct primary insurance in force as of September 30, \$180.1 \$172.7

Direct primary risk in force as of September 30, \$46.8 \$45.0

Cancellation activity due to refinancing has historically been affected by the level of mortgage interest rates and the level of home price appreciation. Cancellations generally move inversely to the change in the direction of interest rates, although they generally lag a change in direction. Cancellations also include rescissions, policies cancelled due to claim payment, and policies cancelled when borrowers achieve the required amount of home equity.

Persistency

Persistency is the percentage of insurance remaining in force from one year prior. Our persistency rate was 78.3% at September 30, 2016 compared to 79.7% at December 31, 2015 and 80.0% at September 30, 2015. Since 2000, our year-end persistency ranged from a high of 84.7% at December 31, 2009 to a low of 47.1% at December 31, 2003.

Credit profile of primary risk in force

The proportion of our total primary risk in force written after 2008 has been steadily increasing in proportion to our total primary risk in force. The loans insured from our 2009 and later origination years possess significantly improved credit characteristics when compared to our 2005-2008 origination years. The loans we insured beginning in 2009, on average, have substantially higher FICO scores and lower LTVs than those insured in 2005-2008. The credit profile of our risk in force has also benefited from modification programs such as HARP. 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 under terms that generally provide the borrowers with a greater ability to pay and more financial flexibility to cover the loan obligations. The

following chart shows the composition of our primary risk in force as of September 30, 2016. As shown in the chart below, the aggregate of our 2009-2016 book years and our HARP modifications accounted for approximately 80% of our total primary risk in force at September 30, 2016.

Pool and other insurance

MGIC has written no new pool insurance since 2009, however, for a variety of reasons, including responding to capital market alternatives to private mortgage insurance and customer demands, MGIC may write pool risk in the future. Our direct pool risk in force was \$568 million (\$247 million on pool policies with aggregate loss limits and \$321 million on pool policies without aggregate loss limits) at September 30, 2016 compared to \$659 million (\$271 million on pool policies with aggregate loss limits and \$388 million on pool policies without aggregate loss limits) at December 31, 2015. If claim payments associated with a specific pool reach the aggregate loss limit, the remaining insurance in force within the pool would be cancelled and any remaining defaults under the pool would be removed from our default inventory.

In the third quarter of 2016 we participated in a GSE credit risk transfer transaction through an affiliate of MGIC. The transaction transfers risk via a pool structure for which we are providing credit insurance. Our level of participation in this transaction was immaterial to our financial statements and will remain immaterial to our financial statements in future periods. Any future participation in GSE credit risk transfer programs will be dependent on the terms of the transactions.

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RESULTS OF CONSOLIDATED OPERATIONS

The following section of the MD&A provides a comparative discussion of MGIC Investment Corporation's Results of Consolidated Operations for the three and nine months ended September 30, 2016 and 2015.

Revenue

(In millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	Change	2016	2015	Change
Net premiums written	\$250.3	\$318.0	(21)%	\$731.6	\$779.2	(6)%
Net premiums earned	\$237.4	\$239.2	(1)%	\$690.2	\$670.0	3 %
Investment income, net of expenses	27.5	25.9	6 %	82.6	75.8	9 %
Net realized investment gains	5.1	0.6	750 %	9.0	27.1	(67)%
Other revenue	3.9	3.7	5 %	14.2	9.9	43 %
Total revenues	\$273.9	\$269.5	2 %	\$796.0	\$782.9	2 %

Net premiums written and earned

Quarterly results

Net premiums written and earned each decreased from the prior year period, primarily due to the following:

• Net premiums written in the 2015 period included the return of unearned ceded premiums to us from reinsurers resulting from the commutation of our 2013 QSR Transaction.

• Net premiums earned decreased 1% as we ceded more earned premiums compared to the prior year and the third quarter of 2015 included a non-recurring increase in our profit commission due to the commutation of our 2013 QSR Transaction, which reduced the premiums we ceded in that period. The decline was offset in part by an increase in the premiums earned on single premium policies due to increased cancellation activity and a lower level of premium refunds and a reduction in our premium refund accrual due to lower claim activity.

Year to date results

Net premiums written decreased while net premiums earned increased from the prior year period primarily due to the following:

• Net premiums written in the 2015 period included the return of unearned ceded premiums to us from reinsurers resulting from the commutation of our 2013 QSR Transaction. Partially offsetting the impact of the commutation was an increase in new insurance written in the first nine months of 2016 compared to the prior year period.

• Net premiums earned increased 3% primarily due to a lower level of premium refunds and a reduction to our premium accrual due to lower claim activity, as well as an increase in the premiums earned on single premium policies due to increased cancellation activity and higher average insurance in force. These increases were offset in part by a higher amount of premiums ceded in 2016.

See "Overview - Factors Affecting Our Results" above for additional factors that influenced the amount of net premiums written and earned during the period.

Although we expect that our insurance in force will increase in 2016 compared to 2015, the ratio of net premiums earned divided by the weighted average primary insurance in force outstanding for the year (sometimes referred to as "premium yield" or "effective premium yield") is likely to decline in 2016 from 2015 levels.

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Our effective premium yield is primarily impacted by the following items; however the impact on our premium yield may will vary from period to period.

Description	<p>Explanation of impact on our premium yield</p> <p>Changing premium rates have decreased our premium yield in 2016 primarily due to the following factors.</p> <p>The books we wrote in 2009 and after were 70% of our insurance in force as of September 30, 2016 and these book years have a lower average premium rate than prior books due to several factors, including, lower risk characteristics on the 2009 and later books and competitive pricing in the industry in recent periods.</p>
Change in premium rates	<p>The monthly premium program used for the substantial majority of loans we insured provides for a set premium rate for the first ten years of the policy and a lower premium rate thereafter. The initial ten-year period is reset when the loan is refinanced under HARP.</p> <p>– As of September 30, 2016 approximately 4%, 7%, and 3% of our total primary risk in force (and insurance in force) was written in 2006, 2007, and 2008; respectively, was not refinanced under HARP and is subject to reset after ten years.</p> <p>Premium refunds upon claim payment or rescission decrease our premium yield. In 2016 compared to 2015, we have experienced lower levels of cancellations from claims and rescissions; therefore the negative impact on our effective premium yield has lessened in recent periods.</p>
Change in premium refunds and premium refund accruals (excluding most single premium policies)	<p>Generally, the level of premiums we refund and our premium refund accrual are highly variable from period to period. When a policy is cancelled for a reason other than rescission or claim payment, all premium that is non-refundable is immediately earned and any refundable premium is returned to the servicer or borrower.</p> <p>Non-refundable premium is primarily associated with our single premium policies, which is discussed below.</p> <p>– When a policy is rescinded, all previously collected premium is returned to the servicer.</p> <p>– When a policy is cancelled due to claim payment, we return any premium received since the date of default.</p>
Single premium policy persistency	<p>The recent decrease in single premium policy persistency has increased our premium yield, with an increasing impact in recent periods as single premiums have become a larger portion of our insurance in force and mortgage interest rates have remained low resulting in greater cancellations of policies.</p> <p>Generally, the premium on a single premium policy is not refundable and is earned over the estimated policy life. Therefore, if persistency is less than the estimated policy life assumption, the effective premium yield will increase.</p> <p>The use of reinsurance lowers our premium yield, however the magnitude of the impact varies from period to period due to the following considerations.</p> <p>The 2015 QSR Transaction increases the amount of our insurance in force covered by reinsurance and will result in an increase in the amount of premiums and losses ceded.</p>
Reinsurance	<p>– We cede 30% of earned and received premiums and losses incurred. The premiums we cede are reduced by a profit commission, which primarily varies by the level of losses we cede.</p> <p>*Our reinsurance affects premiums, underwriting expenses and losses incurred and should be analyzed by reviewing its total effect on our Statements of operations, as discussed below under “Reinsurance agreements.”</p>

Reinsurance agreements

Our reinsurance affects various lines of our statements of operations and therefore we believe it should be analyzed by reviewing its effect on our net income, described as follows.

¶ We cede a fixed percentage of premiums on insurance covered by the agreement.

We receive the benefit of a profit commission through a reduction in the premiums we cede. The profit commission varies directly and inversely with the level of losses on a “dollar for dollar” basis and is eliminated at levels of losses that we do not expect to occur. As a result, lower levels of losses result in a higher profit commission and less benefit from ceded losses; higher levels of losses result in more benefit from ceded losses and a lower profit commission (or for levels of losses we do not expect, its elimination).

¶ We receive the benefit of a ceding commission through a reduction in underwriting expenses equal to 20% of premiums ceded (before the effect of the profit commission).

¶ We cede a fixed percentage of losses incurred on insurance covered by the agreement.

The effects described above result in a net cost of the reinsurance, with respect to a covered loan, of 6% (but can be lower if losses are materially higher than we expect). This cost is derived by dividing the reduction in our pre-tax net income from such loans with reinsurance by our direct (that is, without reinsurance) premiums from such loan. Although the net cost of the reinsurance is generally constant at 6%, the effect of the reinsurance on the various components of pre-tax income discussed above will vary from period to period, depending on the level of ceded losses. The restructuring of the 2015 QSR Transaction caused volatility in our 2015 premium yield, which

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has continued in 2016, in part due to an increase in the amount of losses ceded as more of our insurance in force is covered, and fluctuations in our loss ratio, which impacts our profit commission. Because more of our insurance in force is covered under the 2015 QSR Transaction than was covered under the commuted 2013 QSR Transaction, the absolute dollar cost of the 2015 QSR Transaction will be modestly higher than the cost of the 2013 QSR Transaction.

The following table provides additional information related to our premiums written and earned and risk in force subject to reinsurance agreements for 2016 and 2015.

	As of and For the Nine Months Ended September 30,		
(Dollars in thousands)	2016	2015	
New insurance written subject to quota share reinsurance agreements	89	% 92	%
Insurance in force subject to quota share reinsurance agreements	75	% 72	%
Insurance in force subject to captive reinsurance agreements	2	% 3	%

2015 QSR Transaction

Ceded premiums written, net of profit commission	\$93,334	22,626	
% of direct premiums written	11	% 3	%
Ceded premiums earned, net of profit commission	\$93,334	22,626	
% of direct premiums earned	12	% 3	%
Ceding commissions	\$35,659	9,195	
Ceded risk in force	\$10,536,627	9,654,988	

2013 QSR Transaction

Ceded premiums written, net of profit commission	n/a	\$(11,355)	
% of direct premiums written	n/a	(1)%	
Ceded premiums earned, net of profit commission	n/a	\$35,999	
% of direct premiums earned	n/a	5	%
Ceding commissions	n/a	\$10,235	
Ceded risk in force	n/a	\$—	

Captives

Ceded premiums written	\$6,265	\$10,595	
% of direct premiums written	1	% 1	%
Ceded premiums earned	\$6,361	\$10,678	
% of direct premiums earned	1	% 1	%

As part of the settlement with the Consumer Financial Protection Bureau (“CFPB”) in 2013 and the Minnesota Department of Commerce (the “MN Department”) in 2015, MGIC has agreed to not enter into any new captive reinsurance agreements or reinsure any new loans under any existing captive reinsurance agreement for a period of ten years from the date of settlement. 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.

Investment income**Quarterly results**

Our investment portfolio generated net investment income of \$27.5 million in the third quarter, an increase of 6% from that reported for the same period in 2015. The increase in investment income was due to an increase in average portfolio yields over the period. The portfolio’s average pre-tax investment yield was 2.5% for three months ended September 30, 2016 compared to 2.4% for the three months ended September 30, 2015.

Year to date results

Our investment portfolio generated net investment income of \$82.6 million for the first nine months of 2016, an increase of 9% from that reported in the same period in 2015. The increase in investment income was due to an increase in average portfolio yields over the period. The portfolio's pre-tax investment yield averaged was 2.5% for the nine months ended September 30, 2016 compared to 2.4% for the nine months ended September 30, 2015.

Realized gains (losses) and other-than-temporary impairments

Quarterly results

Net realized gains for the third quarter of 2016 were \$5.1 million compared to \$0.6 million for the third quarter of 2015.

Year to date results

Net realized gains for the first nine months of 2016 were \$9.0 million compared to \$27.1 million in same period of 2015. Realized gains in 2016 were taken from both the fixed maturity and equity portfolio. Realized gains in 2015 were primarily taken from the fixed maturity portfolio as we sold securities to realize gains under favorable market conditions.

At September 30, 2016, the net unrealized gains in our investment portfolio were \$116.3 million, which included \$126.3 million of gross unrealized gains, partially offset by \$10.0 million of gross unrealized losses. At December 31, 2015, the net unrealized losses in our investment portfolio were \$26.6 million, which included \$67.8 million of gross unrealized losses, partially offset by \$41.3 million of gross unrealized gains.

Other revenue

Quarterly results

Other revenue for the third quarter of 2016 was \$3.9 million compared to \$3.7 million for the third quarter of 2015. The increase in other revenue was primarily due to an increase in contract underwriting fees.

Year to date results

Other revenue for the first nine months of 2016 was \$14.2 million compared to \$9.9 million in the same period of 2015. The increase in other revenue in the first nine months of 2016 compared to the prior year period was primarily due to the substantial liquidation of our Australian operations for which we recognized approximately \$4 million of gains related to changes in foreign currency exchange rates in the first quarter of 2016.

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Our remaining assets in Australia are minimal and are not expected to have a material impact on our future consolidated statements of operations upon final liquidation.

Losses incurred, net

As discussed in “Critical Accounting Policies” in our 10-K MD&A and consistent with industry practices, we establish loss reserves for future claims only for loans that are currently delinquent. The terms “delinquent” and “default” are used interchangeably by us. We consider a loan in default when it is two or more payments past due. Loss reserves are established based on estimating the number of loans in our default inventory 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 that could result in, among other things, greater losses on loans, and may affect borrower willingness to continue to make mortgage payments when the value of the home is below the mortgage balance. Our estimates are also affected by any agreements we enter into regarding our claims paying practices, such as the settlement agreements discussed in Note 5 – “Litigation and Contingencies” to our consolidated financial statements. Changes to our estimates could result in a material impact to our results of operations and capital position, even in a stable economic environment.

The loss ratio is the ratio, expressed as a percentage, of the sum of incurred losses and loss adjustment expenses to net premiums earned. All items included in the loss ratio computation are presented in our GAAP financial statements. The loss ratio does not reflect any effects due to changes in premium deficiency reserves. Management utilizes the loss ratio as one component to measure the profitability of our underwriting operations.

(In millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	Change	2016	2015	Change
Losses and LAE incurred in respect of defaults related to:						
Current year	\$95.6	\$115.0	(17)%	\$292.1	\$338.6	(14)%
Prior years	(34.7)	(38.5)	(10)%	(99.6)	(90.1)	11 %
Losses incurred, net	\$60.9	\$76.5	(20)%	\$192.5	\$248.5	(23)%
Loss Ratio	25.7 %	32.0 %		27.9 %	37.1 %	

Quarterly results

Losses incurred, net in the third quarter of 2016 decreased 20% as losses incurred on defaults that occurred in the current year declined compared to the same period in the prior year, offset in part by a lower level of favorable prior year reserve development.

Losses and LAE incurred on defaults that occurred in the current year declined due to:

-

a 10% reduction in new notices received as new notices received in the third quarter of 2016 were 17,607 compared to 19,509 in the same period of the prior year, and

- a lower claim rate applied to new notices received. The claim rate applied to new notices was approximately 12% in the third quarter of 2016 compared to approximately 13% in same period of the prior year.

Losses and LAE incurred on defaults that occurred in prior years reflects favorable prior years' development due to: a lower claim rate on previously reported defaults and on our IBNR in the third quarter of 2016 and a lower claim rate on previously reported defaults in the third quarter of 2015. The favorable development resulting from a decrease in our estimated claim rate was higher in the third quarter of 2015 compared to 2016, resulting in a decrease in the favorable impact on our losses incurred, net compared to the prior year.

The decline in the loss ratio compared to the prior year was primarily due to a lower level of losses incurred, net.

Year to date results

Losses incurred, net in the first nine months of 2016, decreased 23% as losses incurred on defaults that occurred in the current year declined and prior years favorable reserve development increased compared to the same period in the prior year.

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Losses and LAE incurred on defaults that occurred in the current year declined due to:
a 10% reduction in new notices received as new notices received in the first nine months of 2016 were 50,418 compared to 55,856 in the same period of the prior year.

The claim rate applied to new notices through the first nine months of both 2016 and 2015 was approximately 13%, but generally ranged from 12% to 13% quarter to quarter with notices received early in the year generally having a claim rate at the lower end of the range due to seasonal factors.

Losses and LAE incurred on defaults that occurred in prior years reflects favorable prior years' development due to: a lower claim rate on previously reported defaults and on our estimate of IBNR in the first nine months of 2016 and a lower claim rate on previously reported delinquencies in the first nine months of 2015. The first nine months of 2015 was also favorably impacted by \$21 million due to re-estimation of previously recorded reserves relating to disputes on our claims paying practices and adjustments to IBNR. The favorable claim rate development was modestly higher in the 2016 period compared to 2015.

The claim rate development was offset in part by adverse development in our claims severity estimates on previously reported defaults in each of the first nine months of 2016 and 2015 with the adverse impact being slightly higher in the 2016 period.

The decline in the loss ratio from the prior year period was due to a lower level of losses incurred, net, and a higher level of net premiums earned.

See "Claims severity" below for the recent quarters' changes in our claims severity estimates.

Historically, losses incurred have followed a seasonal trend in which the second half of the year has weaker credit performance than the first half, with higher new notice activity and a lower cure rate.

Loans insured in 2008 and prior continue to represent a substantial portion of our new notices received each quarter, with many new notices previously having been reported delinquent. For the first nine months of 2016, loans insured in 2008 and prior represented approximately 88% of the new notices received and 90% of those notices were previously delinquent. For the first nine months of 2015, loans insured in 2008 and prior represented approximately 93% of the new notices received and 88% of those notices were previously delinquent. As a result of this cycle in which loans default, cure, and re-default, along with the duration defaults may ultimately remain in our notice inventory, significant judgment is required in establishing the ultimate claim rate and it is expected to cause variability in our loss reserves in future periods.

Claims severity

The positive loss reserve development related to the claim rate on default notices received in prior years in the first nine months of 2016 and 2015 was partially offset by increases in our expected severity assumption on prior year notices. As shown in the following table, the average claim paid, expressed as a percentage of our exposure (the unpaid principal balance of the loan times our insurance coverage percentage), following periods of relative stability had increased in recent quarters prior to the second quarter of 2016. Our loss reserve estimates take into consideration trends over time, because the development of the delinquencies may vary from period to period without establishing a meaningful trend.

Note: Table excludes material settlements⁽¹⁾.

Period	Average exposure on claim paid	Average claim paid	% Paid to exposure	Average number of missed payments at claim received
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					date
Q3 2016	\$ 43,747	\$48,050	109.8	%	34
Q2 2016	43,709	47,953	109.7	%	35
Q1 2016	44,094	49,281	111.8	%	34
Q4 2015	44,342	49,134	110.8	%	35
Q3 2015	44,159	48,156	109.1	%	33
Q2 2015	44,683	48,587	108.7	%	34
Q1 2015	44,403	47,366	106.7	%	33
Q4 2014	44,321	46,714	105.4	%	32
Q3 2014	43,769	45,849	104.8	%	30
Q2 2014	43,402	45,531	104.9	%	30
Q1 2014	43,711	45,897	105.0	%	28
Q4 2013	44,923	47,072	104.8	%	26
Q3 2013	44,163	45,706	103.5	%	25
Q2 2013	43,990	45,340	103.1	%	24
Q1 2013	45,458	47,421	104.3	%	22

(1) - Settlements include amounts paid for claims paying practices and nonperforming loan (“NPL”) sales.

The average exposure (which, in the case of delinquent loans that have not been filed as claims, may change if different information is received from servicers) on items remaining in our default inventory at September 30, 2016 is \$44,790. The average number of missed payments on items remaining in our default inventory at September 30, 2016 is 20.

Factors that impact claim severity include the exposure on the loan, the amount of time between default and claim filing (which impacts the amount of interest and expenses) and curtailments. All else being equal, the longer the period between default and claim filing, the greater the severity. The majority of loans from 2005-2008 (which represent the majority of loans in the delinquent inventory) are covered by master policy terms that, except under certain circumstances, do not limit the

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number of years that an insured can include interest when filing a claim if they comply with their obligations under the terms of the master policy.

See Note 12 – “Loss Reserves” to our consolidated financial statements for a discussion of our losses incurred and claims paying practices.

The primary average claim paid can vary materially from period to period based upon a variety of factors, including the local market conditions, average loan amount, average coverage percentage, the amount of time between default and claim filing, and our loss mitigation efforts on loans for which claims are paid.

The primary average claim paid for the top 5 states (based on 2016 paid claims, excluding settlement amounts) for the three and nine months ended September 30, 2016 and 2015 appears in the following table.

Primary average claim paid

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Florida	58,540	59,409	61,065	58,299
New Jersey	82,061	75,956	81,949	72,543
Illinois	53,620	52,077	50,004	50,226
New York	84,634	66,863	73,150	68,792
Maryland	65,978	77,196	72,639	75,092
All other jurisdictions	40,400	41,272	40,824	40,949

All jurisdictions 48,050 48,156 48,449 47,614

Note: Jurisdictions in italics in the table above are those that predominately use a judicial foreclosure process, which generally increases the amount of time it takes for a foreclosure to be completed.

The primary average exposure of our primary risk in force at September 30, 2016, December 31, 2015 and September 30, 2015 and for the top 5 jurisdictions (based on 2016 paid claims, excluding settlement amounts) appears in the following table.

Primary average exposure

	September 30, 2016	December 31, 2015	September 30, 2015
Florida	\$ 49,714	\$ 49,095	\$ 48,817
New Jersey	63,146	62,496	62,417
Illinois	40,732	40,368	40,283
New York	51,845	50,964	50,856
Maryland	63,652	62,912	62,954
All other jurisdictions	46,160	44,887	44,526
All jurisdictions	\$ 46,983	\$ 45,820	\$ 45,494

The primary default inventory by policy year at September 30, 2016, December 31, 2015 and September 30, 2015 appears in the following table.

Primary default inventory by policy year

	September 30, 2016	December 31, 2015	September 30, 2015
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Policy year:

2004 and prior	11,753	14,599	15,376
2005	6,113	7,890	8,283
2006	9,698	11,853	12,320
2007	16,088	20,000	20,619
2008	4,236	5,418	5,527
2009	412	515	529
2010	213	274	285
2011	239	246	245
2012	357	388	384
2013	644	615	530
2014	1,008	672	485
2015	597	163	59
2016	75	—	—
Total primary default inventory	51,433	62,633	64,642

Our results of operations continue to be negatively impacted by the mortgage insurance we wrote during 2005 through 2008. Although uncertainty remains with respect to the ultimate losses we may experience on these books of business, as we continue to write new insurance on high-quality mortgages, those books have become a smaller percentage of our total portfolio, and we expect this trend to continue. Our 2005 through 2008 books of business represented approximately 27% and 32% of our total primary risk in force at September 30, 2016 and December 31, 2015, respectively. Approximately 37% and 36% of the remaining primary risk in force on our 2005-2008 books of business benefited from HARP as of September 30, 2016 and as of December 31, 2015, respectively.

On our primary business, the highest claim frequency years have typically been the third and fourth year after the year of loan origination. However, the pattern of claim frequency can be affected by many factors, including persistency and deteriorating economic conditions. Low persistency can accelerate the period in the life of a book during which the highest claim frequency occurs. Deteriorating economic conditions can result in increasing claims following a period of declining claims. As of September 30, 2016, 51% of our primary risk in force was written subsequent to December 31, 2013, 59% of our primary risk in force was written subsequent to December 31, 2012, and 65% of our primary risk in force was written subsequent to December 31, 2011.

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The primary default inventory for the top 15 jurisdictions (based on 2016 losses paid, excluding settlement amounts) at September 30, 2016, December 31, 2015 and September 30, 2015 appears in the following table.

Primary default inventory by jurisdiction

	September 30, 2016	December 31, 2015	September 30, 2015
Florida	4,372	5,903	6,387
New Jersey	2,756	3,498	3,601
Illinois	2,744	3,301	3,519
New York	3,269	3,901	4,037
Maryland	1,328	1,609	1,653
Pennsylvania	2,997	3,574	3,679
California	1,592	2,019	2,107
Ohio	2,637	3,209	3,169
Washington	811	1,049	1,093
Virginia	896	1,109	1,086
Puerto Rico	1,974	2,221	2,310
Michigan	1,522	1,877	1,975
Massachusetts	1,158	1,390	1,447
Connecticut	678	832	895
Georgia	1,861	2,225	2,255
All other jurisdictions	20,838	24,916	25,429
Total primary default inventory	51,433	62,633	64,642

Note: Jurisdictions in italics in the table above are those that predominately use a judicial foreclosure process, which generally increases the amount of time it takes for a foreclosure to be completed.

Information about net losses paid during the three and nine months ended September 30, 2016 and 2015 appears in the following table.

Net losses paid

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	2016	2015	2016	2015
Total primary (excluding settlements)	\$147	\$190	\$466	\$603
Rescission and NPL settlements ⁽¹⁾	1	—	52	10
Pool ⁽²⁾	14	17	42	52
Other	—	—	—	—
Direct losses paid	162	207	560	665
Reinsurance	(5)	(5)	(19)	(21)
Net losses paid	157	202	541	644
LAE	4	5	14	17
Net losses and LAE paid before terminations	161	207	555	661
Reinsurance terminations	(3)	(15)	(3)	(15)
Net losses and LAE paid	\$158	\$192	\$552	\$646

(1) See Note 12 - "Loss Reserves" for additional information on our settlements for claims paying practices and NPL sales.

(2) The three months ended September 30, 2016 and 2015 each include \$11 million and the nine months ended September 30, 2016 and 2015 each include \$32 million paid under the terms of the settlement with Freddie Mac.

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Primary claims paid for the top 15 jurisdictions (based on 2016 losses paid, excluding settlement amounts) and all other jurisdictions for the three and nine months ended September 30, 2016 and 2015 appears in the following table.

Paid losses by jurisdiction

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	2016	2015	2016	2015
Florida	\$19	\$36	69	\$125
New Jersey	14	13	45	31
Illinois	10	12	33	47
New York	11	8	27	22
Maryland	7	11	23	35
Pennsylvania	7	9	21	26
California	7	10	20	31
Ohio	6	7	16	21
Washington	4	8	13	20
Virginia	4	5	12	13
Puerto Rico	3	3	11	10
Michigan	3	4	11	13
Massachusetts	4	4	11	11
Connecticut	3	4	10	14
Georgia	3	4	10	15
All other jurisdictions	42	52	134	169
	147	190	466	603
Rescission and NPL settlements ⁽¹⁾	1	—	52	10
Other (Pool, LAE, Reinsurance)	10	2	34	33
Net losses and LAE paid	\$158	\$192	\$552	\$646

⁽¹⁾ See Note 12 - "Loss Reserves" for additional information on our settlements for claims paying practices and NPL sales.

We believe losses paid will continue to decline in the remainder of 2016 compared to the prior year.

The primary and pool loss reserves at September 30, 2016, December 31, 2015 and September 30, 2015 appear in the table below.

	September 30, December 31, September 30,		
Gross Reserves	2016	2015	2015
Primary:			
Direct loss reserves (in millions)	\$ 1,408	\$ 1,681	\$ 1,745
IBNR and LAE	85	126	132
Total primary loss reserves	\$ 1,493	\$ 1,807	\$ 1,877
Ending default inventory	51,433	62,633	64,642
Percentage of loans delinquent (default rate)	5.16 %	6.31 %	6.54 %
Average total primary loss reserves per default	\$ 29,027	\$ 28,859	\$ 29,032
Primary claims received inventory included in ending default inventory	1,636	2,769	2,982

Pool⁽¹⁾:

Direct loss reserves (in millions):

With aggregate loss limits	\$ 24	\$ 34	\$ 40
Without aggregate loss limits	8	9	9
Reserve related to Freddie Mac Settlement ⁽²⁾	10	42	52
Total pool direct loss reserves	\$ 42	\$ 85	\$ 101

Ending default inventory:

With aggregate loss limits	1,456	2,126	2,282
Without aggregate loss limits	523	613	668
Total pool ending default inventory	1,979	2,739	2,950

Pool claims received inventory included in ending default inventory	87	60	75
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Other gross reserves (in millions)	\$ —	\$ 1	\$ 2
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(1) Since a number of our pool policies include aggregate loss limits and/or deductibles, we do not disclose an average direct reserve per default for our pool business.

(2) See our Form 8-K filed with the Securities and Exchange Commission on November 30, 2012 for a discussion of our settlement with Freddie Mac regarding a pool policy.

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Underwriting and other expenses

(In millions)	Three Months Ended			Nine Months Ended		
	September 30,			September 30,		
	2016	2015	Change	2016	2015	Change
Other underwriting and operating expenses, net	\$37.9	\$46.1	(18)%	\$113.0	\$121.2	(7)%
Underwriting expense ratio ⁽¹⁾	14.7 %	14.4 %		15.1 %	15.2 %	

The underwriting expense ratio is the ratio, expressed as a percentage, of the underwriting and operating expenses, (1) net and amortization of deferred policy acquisition costs of our combined insurance operations (which excludes underwriting and operating expenses of our non-insurance operations) to net premiums written.

Quarterly results

Underwriting and other expenses decreased primarily due to the return of ceding commissions in 2015 to reinsurers as a result of commuting our 2013 QSR Transaction.

The increase in the underwriting expense ratio compared to the prior year was primarily due to an increase in compensation related expenses. The expense ratio for the third quarter of 2015 includes the impact of commuting our 2013 QSR Transaction, which had the effect of increasing the underwriting expense ratio in that period.

Year to date results

Underwriting and other expenses decreased primarily due to the return of ceding commissions in 2015 to reinsurers as a result of commuting our 2013 QSR Transaction.

The underwriting expense ratio was relatively stable compared to the prior year period.

Interest expense

(In millions)	Three Months Ended			Nine Months Ended		
	September 30,			September 30,		
	2016	2015	Change	2016	2015	Change
Interest expense	\$13.5	\$17.4	(22)%	\$40.5	\$52.1	(22)%

Quarterly & Year to date results

Interest expense decreased in both the three and nine months ended September 30, 2016 compared to the respective prior year periods reflecting the following:

Reductions to interest expense:

- maturity of our 5.375% Senior Notes in November of 2015,
- repurchase of \$188.5 million in par value of our 5% Notes in the first half of 2016,
- repurchase by MGIC of \$132.7 million in par value of our 9% Debentures, which are eliminated in consolidation, in the first quarter of 2016,
- repurchase of \$292.4 million in par value of our 2% Notes in the third quarter of 2016.

Increases to interest expense:

- MGIC borrowed \$155.0 million in the form of a fixed rate advance from the Federal Home Loan Bank in the first quarter of 2016, and
- we issued \$425 million aggregate principal of 5.75% Senior Notes in the third quarter of 2016.

See “Note 3 - Debt” for a further description of all of our 2016 debt transactions.

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Loss on debt extinguishment

	Three Months Ended September 30,			Nine Months Ended September 30,		
(In millions)	2016	2015	Change	2016	2015	Change
Loss on debt extinguishment	\$75.2	\$	—N/M	\$90.5	\$	—N/M

Quarterly results

Loss on debt extinguishment in the third quarter was driven by the repurchase of a portion of our 2% Notes in the third quarter of 2016 for which we paid consideration in excess of the carrying value of the notes repurchased. The loss also includes the write-off of unamortized debt issuance costs on the extinguished portion of the outstanding 2% Notes.

Year to date results

Loss on debt extinguishment during the first nine months was primarily due to the repurchase of a portion of our 2% Notes in the third quarter of 2016 for which we paid consideration in excess of the carrying value of the notes repurchased. The loss also includes the write-off of debt issuance costs on the extinguished portion of the outstanding 2% Notes. In addition, during the first half of 2016, we repurchased a portion of our 5% Notes and MGIC purchased a portion of our 9% Debentures, which were each completed at a cost in excess of the respective carrying values. The 9% Debentures held by MGIC are eliminated in consolidation.

See “Note 3 - Debt” for a further description of all of our 2016 debt transactions.

Income taxes

	Three Months Ended September 30,			Nine Months Ended September 30,		
(In millions, except rate)	2016	2015	Change	2016	2015	Change
Income before tax	\$83.7	\$127.2	(34)%	\$352.7	\$378.7	(7)%
Provision for (benefit from) income taxes	\$27.1	\$(695.6)	N/M	\$117.6	\$(690.9)	N/M
Effective tax provision (benefit) rate	32.4 %	(546.9)%	N/M	33.3 %	(182.4)%	N/M

Quarterly results

Income tax expense for the third quarter increased compared to the same period in the prior year. This change is primarily due to the reversal of our deferred tax valuation allowance in the third quarter of 2015 and because we were required to establish a full tax provision position in 2016. The difference between our statutory tax rate of 35% and our effective tax provision rate of 32.4% for the third quarter of 2016 was primarily due to the benefits of tax preferred securities. The difference between our statutory tax rate of 35% and our effective tax (benefit) rate of (546.9)% for the third quarter of 2015 was primarily due to the impact of the changes in our overall valuation allowance against our deferred tax assets.

Year to date results

Income tax expense for the first nine months of 2016 increased compared to the same period in the prior year. This change is primarily due to the reversal of our deferred tax valuation allowance in the third quarter of 2015 and because we were required to establish a full tax provision position in 2016. The difference between our statutory tax rate of 35% and our effective tax provision rate of 33.3% for the first nine months of 2016 was primarily due to the benefits of tax preferred securities. The difference between our statutory tax rate of 35% and our effective tax (benefit) rate of (182.4)% was primarily due to the impact of the changes in our overall valuation allowance against our deferred tax assets.

See Note 11 – “Income Taxes” to our consolidated financial statements for a discussion of our tax position.

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FINANCIAL CONDITION

Investments

Investment Portfolio 2016 Summary

Investments totaled \$4.73 billion as of September 30, 2016, increasing from \$4.66 billion as of December 31, 2015. Unrealized net capital gains totaled \$116.3 million as of September 30, 2016 compared to unrealized net capital losses of \$26.6 million as of December 31, 2015.

Net investment income was \$27.5 million in the third quarter of 2016, an increase of 6% from \$25.9 million in the third quarter of 2015, and \$82.6 million in the first nine months of 2016, an increase of 9% from \$75.8 million in the first nine months of 2015.

Net realized investment gains totaled \$5.1 million in the third quarter of 2016 compared to \$0.6 million in the third quarter of 2015 and \$9.0 million in the first nine months of 2016 compared to \$27.1 million in the first nine months of 2015.

Investment Portfolio Composition

As of September 30, 2016 and December 31, 2015, our investment portfolio was primarily made up of fixed maturity securities. Total investments increased by \$62.6 million during the first nine months of 2016 from the prior year end primarily due to increase in fair values, which was offset in part by the sale of investments to repurchase of a portion of our 5% Notes in the first half of 2016. At September 30, 2016, based on fair value, 99.7% of our fixed maturity securities were investment grade securities. The ratings shown in the following chart are provided by one or more of: Moody's, Standard & Poor's and Fitch Ratings. If three ratings are available the middle rating is utilized, otherwise the lowest rating is utilized. Approximately 2% of our investment portfolio, excluding cash and cash equivalents, is guaranteed by financial guarantors. As of September 30, 2016, less than 1% of our fixed maturity securities relied on financial guaranty insurance to elevate their rating.

The composition of our fixed maturity security ratings, based on fair value, at September 30, 2016, December 31, 2015 and September 30, 2015 is shown in the chart below.

Loss Reserves

Loss reserves are the primary liability on our balance sheet and they represent our estimated liability for losses and settlement expenses under MGIC's mortgage guaranty insurance policies, before considering offsetting reinsurance balances recoverable. The loss reserves can be split into two parts: (1) reserves representing estimates of losses and settlement expenses on known delinquencies and (2) IBNR reserves representing estimates of losses and settlement expenses on delinquencies that have occurred but have not yet been reported to us. Our gross liability for both is reduced by reinsurance balances recoverable on our estimated losses and settlement expenses to calculate a net reserve balance. The net reserve balance decreased by 19% to \$1.49 billion as of September 30, 2016, from \$1.85 billion as of December 31, 2015. Reinsurance balances recoverable on our estimated losses and settlement expenses, which serve to offset our loss reserves, were \$46.9 million and \$44.5 million as of September 30, 2016 and December 31, 2015, respectively. The overall decrease in our loss reserves during the first nine months of 2016 was due to a higher level of losses paid (\$552.8 million) relative to losses incurred (\$192.5 million).

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Debt

As shown in the table below, during the first nine months of 2016 we executed several transactions that reduced our aggregated principal amount of outstanding debt obligations by \$33.5 million.

2016 changes in long-term debt obligations

(in millions, except ratios)	Long-term debt, par value	Ratio of long-term debt to shareholders' equity	Transaction
Long-term debt at December 31, 2015	\$ 1,223.0	54.7%	
For the three months ended March 31, 2016:			
+ Advance from FHLB ⁽¹⁾	155.0		Secured Advance from FHLB to MGIC
– 9% Debentures repurchase ⁽¹⁾	(132.6)		Purchased by MGIC with funds from the Advance
– 5% Notes repurchase	(138.3)		Repurchased with holding company cash on hand
Long-term debt at March 31, 2016	\$ 1,107.1	47.2%	
For the three months ended June 30, 2016:			
– 5% Notes repurchase	(50.2)		Repurchased with holding company cash on hand
Long-term debt at June 30, 2016	\$ 1,056.9	42.1%	
For the three months ended September 30, 2016:			
+ 5.75% Notes issuance	425.0		Issued Senior Notes due 2023
– 2% Notes repurchase	(292.4)		Repurchased with funds from our 5.75% Notes issuance and issuance of common stock
Long-term debt at September 30, 2016	\$ 1,189.5	46.0%	

The borrowing from the FHLB and repurchase of our 9% Debentures were transactions executed by MGIC. The

⁽¹⁾ 9% Debentures are deemed extinguished on our consolidated financial statements, but remain outstanding as obligations owed by us to MGIC.

See Note 3 - “Debt” to our consolidated financial statements for the scheduled maturities of our outstanding debt and additional disclosures regarding our debt as of September 30, 2016.

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LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

We have three primary types of cash flows: (1) operating cash flows, which consist mainly of cash generated by our insurance operations and income earned on our investment portfolio, less amounts paid for claims, debt repurchase activity, interest expense and operating expenses, (2) investing cash flows related to the purchase, sale and maturity of investments and (3) financing cash flows generally from activities that impact our capital structure, such as changes in debt and shares outstanding. The following table summarizes our consolidated cash flows from operating, investing and financing activities:

	Nine Months Ended September 30,	
(In thousands)	2016	2015
Total cash provided by:		
Operating activities	31,629	135,031
Investing activities	45,973	49,510
Financing activities	16,021	2,113
Increase in cash and cash equivalents	\$93,623	\$186,654

Net cash provided by operating activities for the nine months ended September 30, 2016 decreased compared to the same period of 2015 primarily due to the commutation of our 2013 QSR transaction and corresponding settlement in the third quarter of 2015 for which we received return payment for written premiums previously ceded by us and received payment of our profit commission accrued during the term of the agreement. In addition, we repurchased a portion of our debt obligations during 2016 that included amounts paid for original issue discounts on the extinguished portion of the outstanding obligations. The decrease was offset in part by a lower level of losses paid in 2016.

Net cash from investing activities for the nine months ended September 30, 2016 decreased when compared to the same period of 2015, primarily due to a decrease in unsettled security purchase activity in 2016 compared to the prior year and changes in restricted cash in 2015. These decreases were offset in part by lower reinvestment of proceeds from sales and maturity of fixed maturity securities as a portion of the proceeds were utilized to fund debt repurchases in 2016. In addition, net proceeds from sales of equity securities increased in 2016.

Net cash provided by financing activities for the nine months ended September 30, 2016 includes the net proceeds from the issuance of our 5.75% Notes and the Advance from the FHLB, less amounts paid to purchase portions of our outstanding 5% and 2% Notes, our 9% Debentures, and to repurchase common stock issued as partial consideration of our 2% Notes repurchases. We also paid expenses associated with our 5.75% Notes issuance.

Capital Structure

Debt at Our Holding Company and Holding Company Capital Resources

The Convertible Senior Notes and Convertible Junior Subordinated Debentures are obligations of our holding company, MGIC Investment Corporation, and not of its subsidiaries. The payment of dividends from our insurance subsidiaries, which other than investment income and raising capital in the public markets is the principal source of our holding company cash inflow, is restricted by insurance regulation. MGIC is the principal source of dividend-paying capacity and Office of the Commissioner of Insurance of the State of Wisconsin (the "OCI") authorization is required for MGIC to pay dividends. In each of the first three quarters of 2016 MGIC received approval from the OCI to pay a \$16 million dividend to our holding company, which were paid in April, June, and September respectively, its first dividends since 2008. We expect to continue to receive quarterly dividends from MGIC; however, any additional dividends require approval from the OCI.

2016 Debt transactions:

•5.75% Senior Notes

In August 2016, we issued \$425 million of 5.75% Senior Notes due 2023 and received net proceeds of \$418.1 million. The following table outlines the use of funds received from the issuance through September 30, 2016.

	Cash proceeds (uses)
Issuance of 5.75% Senior Notes	\$418.1
Purchases of 2% Notes	
– cash consideration paid to sellers	(230.7)
– repurchases of common stock issued as consideration to certain sellers	(91.6)
Cash paid as of September 30, 2016	(322.3)
– repurchases of common stock issued as consideration to certain sellers, with settlement after September 30, 2016	(16.5)
Cash paid or committed to use as of September 30, 2016	(338.8)
Cash available for use as of September 30, 2016	\$ 79.3

In October 2016, we purchased the remaining 4.8 million shares issued as partial consideration for our 2% Notes repurchases at a weighted average price of \$8.08, resulting in additional cash use of approximately \$39 million. The funds remaining are being held for general corporate purposes.

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•2% Convertible Senior Notes

In August 2016, we purchased \$292.4 million in par value of our 2% Notes at a purchase price of \$362.1 million, plus accrued interest using a combination of net proceeds from our 5.75% Senior Notes issuance, together with, in certain cases, shares of MGIC Investment Corporation's common stock.

•5% Convertible Senior Notes

During the first nine months of 2016, we purchased \$188.5 million in par value of our 5% Notes at a purchase price of \$195.5 million, plus accrued interest using funds held at our holding company.

•9% Convertible Junior Subordinated Debentures

In February 2016, MGIC purchased \$132.7 million of par value of our 9% Debentures at a purchase price of \$150.7 million, plus accrued interest. The 9% Debentures are not extinguished; MGIC will hold them as an asset and will receive interest on them at the same time interest is paid to other holders of the 9% Debentures. In this regard, the 9% Debentures will continue to be a use of holding company liquidity. However, for GAAP accounting purposes, the 9% Debentures owned by MGIC will be considered retired and will be eliminated in our consolidated financial statements resulting in interest expense on the statement of operations that is lower than the cash payments due from our holding company.

We may from time to time continue to seek to acquire our debt obligations through cash purchases and/or exchanges for other securities. We may do this in open market purchases, privately negotiated acquisitions or other transactions. The amounts involved may be material.

Debt at our Holding Company

At September 30, 2016, we had approximately \$329 million in cash and investments at our holding company. As of September 30, 2016, our holding company's debt obligations were \$1,168 million in par value, which consisted of the following obligations:

\$425 million of 5.75% Senior Notes due 2023, with an annual interest cost of \$24 million;

\$145 million of 5% Convertible Senior Notes due 2017, with an annual interest cost of \$7 million;

\$208 million of 2% Convertible Senior Notes due 2020, with an annual interest cost of \$4 million;

\$390 million of 9% Convertible Junior Subordinated Debentures due 2063 (of which approximately \$133 million is held by MGIC), with an annual interest cost of \$35 million (of which approximately \$12 million is payable to MGIC). See "2016 Debt transactions" above for the accounting treatment of the debentures held by MGIC.

Subject to certain limitations and restrictions, holders of each of the convertible debt issues may convert their notes into shares of our common stock at their option prior to certain dates under the terms of their issuance, in which case our corresponding obligation will be eliminated.

See Note 8 – "Debt" to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2015 for additional information about our convertible debt, including our option to defer interest on our 9% Debentures. Any deferred interest compounds at the stated rate of 9%. The description in Note 8 - "Debt" to our consolidated financial statements in our Annual Report on Form 10-K is qualified in its entirety by the terms of the notes and debentures.

Debt at our subsidiaries

In February 2016, MGIC borrowed \$155.0 million in the form of a fixed rate advance from the 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.

Capital Contributions to Subsidiaries

We may also contribute funds to our insurance operations to comply with the PMIERS or the State Capital Requirements. See “Overview - Capital” above for a discussion of these requirements. See discussion of our non-insurance contract underwriting services in Note 5 – “Litigation and Contingencies” to our consolidated financial statements.

PMIERS

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 September 30, 2016, MGIC’s Available Assets are \$4.7 billion and its Minimum Required Assets are \$4.1 billion. MGIC is in compliance with the requirements of the PMIERS and eligible to insure loans purchased by the GSEs. Our Available Assets exclude approximately \$167.4 million of securities in our investment portfolio pledged under the terms of the Advance. The investment by MGIC in our 9% Debentures using funds from the Advance was not included in our Available Assets at the time of purchase, or in periods subsequent.

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Although we are in compliance with PMIERS as of September 30, 2016, our capital requirements under PMIERS may increase in the future because the GSEs have indicated that the tables of factors used to determine the 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. We plan to continuously comply with the existing PMIERS through our operational activities or through the contribution of funds from our holding company, subject to demands on the holding company's resources, as outlined above.

Risk-to-Capital

We compute our risk-to-capital ratio on a separate company statutory basis, as well as for our combined insurance operations. The risk-to-capital ratio is our net risk in force divided by our policyholders' position. Our net risk in force includes both primary and pool risk in force, and excludes risk on policies that are currently in default and for which loss reserves have been established. The risk amount includes pools of loans or bulk deals with contractual aggregate loss limits and in some cases without these limits. Policyholders' position consists primarily of statutory policyholders' surplus (which increases as a result of statutory net income and decreases as a result of statutory net loss and dividends paid), plus the statutory contingency reserve. The statutory contingency reserve is reported as a liability on the statutory balance sheet. A mortgage insurance company is required to make annual contributions to the contingency reserve of approximately 50% of net earned premiums. These contributions must generally be maintained for a period of ten years. However, with regulatory approval a mortgage insurance company may make early withdrawals from the contingency reserve when incurred losses exceed 35% of net earned premium in a calendar year.

MGIC's separate company risk-to-capital calculation appears in the table below.

(In millions, except ratio)	September 30, December 31,	
	2016	2015
Risk in force - net ⁽¹⁾	\$ 28,455	\$ 27,301
Statutory policyholders' surplus	\$ 1,495	\$ 1,574
Statutory contingency reserve	1,062	691
Statutory policyholders' position	\$ 2,557	\$ 2,265
Risk-to-capital	11.1:1	12.1:1

⁽¹⁾ Risk in force – net, as shown in the table above is net of reinsurance and exposure on policies currently in default for which loss reserves have been established.

Our combined insurance companies' risk-to-capital calculation appears in the table below.

(In millions, except ratio)	September 30, December 31,	
	2016	2015
Risk in force - net ⁽¹⁾	\$ 34,271	\$ 33,072
Statutory policyholders' surplus	\$ 1,496	\$ 1,608
Statutory contingency reserve	1,225	827
Statutory policyholders' position	\$ 2,721	\$ 2,435
Risk-to-capital	12.6:1	13.6:1

Risk in force – net, as shown in the table above, is net of reinsurance and exposure on policies currently in default

⁽¹⁾ (\$2.7 billion at September 30, 2016 and \$3.2 billion at December 31, 2015) for which loss reserves have been established.

The decrease in MGIC's and our combined insurance companies' risk-to-capital in the first nine months of 2016 reflects the percentage increase in our net risk in force more than offset by the percentage increase in our statutory policyholders' position in both calculations. Statutory policyholders' position increased in both calculations due to increases in our contingency reserves, which were partially offset by a decrease in surplus as the 9% Debentures held by MGIC are non-admitted assets. Our risk in force, net of reinsurance, increased in the first nine months of 2016, due to an increase in our insurance in force. Our 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.

For additional information regarding regulatory capital see Note 15 – “Capital Requirements” to our consolidated financial statements as well as our risk factor titled “State Capital requirements may prevent us from continuing to write new insurance on an uninterrupted basis.”

Financial Strength Ratings

The financial strength of MGIC, our principal mortgage insurance subsidiary, is as follows:

Rating Agency	Rating	Outlook
Moody's Investor Services	Baa3	Stable
Standard and Poor's Rating Services	BBB	Stable

For further information about the importance of MGIC's ratings, see our risk factor titled “Competition or changes in our relationships with our customers could reduce our revenues, reduce our premium yields and/or, or increase our losses.”

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At September 30, 2016, the approximate future payments under our contractual obligations of the type described in the table below are as follows:

Contractual Obligations

(In millions)	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt obligations	\$2,490.7	\$207.6	\$109.4	\$312.9	\$1,860.8
Operating lease obligations	2.9	0.7	1.1	1.0	0.1
Tax obligations	20.0	—	20.0	—	—
Purchase obligations	10.6	3.8	6.8	—	—
Pension, SERP and other post-retirement plans	274.9	23.8	46.9	55.2	149.0
Other long-term liabilities	1,535.5	721.7	614.2	199.6	—
Total	\$4,334.6	\$957.6	\$798.4	\$568.7	\$2,009.9

Our long-term debt obligations at September 30, 2016 include \$145 million of 5% Convertible Senior Notes due in 2017, \$208 million 2% Convertible Senior Notes due in 2020, \$425 million 5.75% Senior Notes due in 2023, \$155 million of a 1.91% FHLB advance due in 2023, and \$257 million in 9% Convertible Junior Subordinated Debentures due in 2063, including related interest, as discussed in Note 3 – “Debt” to our consolidated financial statements and under “Liquidity and Capital Resources” above. Our operating lease obligations include operating leases on certain office space, data processing equipment and autos, as discussed in Note 19 – “Leases” to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2015. Tax obligations primarily relate to our current dispute with the IRS, as discussed in Note 11 – “Income Taxes.” Purchase obligations consist primarily of agreements to purchase data processing hardware or services made in the normal course of business. See Note 13 – “Benefit Plans” to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2015 for a discussion of expected benefit payments under our benefit plans.

Our other long-term liabilities represent the loss reserves established to recognize the liability for losses and loss adjustment expenses related to defaults on insured mortgage loans. The timing of the future claim payments associated with the established loss reserves was determined primarily based on two key assumptions: the length of time it takes for a notice of default to develop into a received claim and the length of time it takes for a received claim to be ultimately paid. The future claim payment periods are estimated based on historical experience, and could emerge significantly different than this estimate. Due to the uncertain impact of certain factors, such as loss mitigation protocols established by servicers and changes in some state foreclosure laws it is difficult to estimate the amount and timing of future claim payments. See Note 12 – “Loss Reserves” to our consolidated financial statements. In accordance with GAAP for the mortgage insurance industry, we establish loss reserves only for loans in default. Because our reserving method does not take account of the impact of future losses that could occur from loans that are not delinquent, our obligation for ultimate losses that we expect to occur under our policies in force at any period end is not reflected in our financial statements or in the table above.

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Forward Looking Statements and Risk Factors

General: Our revenues and losses could be affected by the risk factors referred to under “Location of Risk Factors” below. These risk factors are an integral part of Management’s Discussion and Analysis.

These factors may also cause actual results to differ materially from the results contemplated by forward looking statements that we may make. Forward looking statements consist of statements which relate to matters other than historical fact. Among others, statements that include words such as we “believe,” “anticipate” or “expect,” or words of similar import, are forward looking statements. We are not undertaking any obligation to update any forward looking statements we may make even though these statements may be affected by events or circumstances occurring after the forward looking 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.

Location of Risk Factors: The risk factors are in Item 1 A of our Annual Report on Form 10-K for the year ended December 31, 2015, as supplemented by Part II, Item 1 A of our Quarterly Reports on Form 10-Q for the Quarters ended March 31, 2016 and June 30, 2016 and by Part II, Item 1 A of this Quarterly Report on Form 10-Q. The risk factors in the 10-K, as supplemented by these 10-Qs and through updating of various statistical and other information, are reproduced in Exhibit 99 to this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our investment portfolio is essentially a fixed maturity portfolio and is exposed to market risk. Important drivers of the market risk are credit spread risk and interest rate risk.

Credit spread risk is the risk that we will incur a loss due to adverse changes in credit spreads. Credit spread is the additional yield on fixed maturity securities above the risk-free rate (typically referenced as the yield on U.S. Treasury securities) that market participants require to compensate them for assuming credit, liquidity and/or prepayment risks.

We manage credit risk via our investment policy guidelines which primarily place our investments in investment grade securities and limit the amount of our credit exposure to any one issue, issuer and type of instrument. Guideline and investment portfolio detail is available in "Business – Section C, Investment Portfolio" in Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2015.

Interest rate risk is the risk that we will incur a loss due to adverse changes in interest rates relative to the characteristics of our interest bearing assets.

One of the measures used to quantify interest rate risk exposure is modified duration. Modified duration measures the price sensitivity of the assets to the changes in spreads. At September 30, 2016, the modified duration of our fixed income investment portfolio was 4.8 years, which means that an instantaneous parallel shift in the yield curve of 100 basis points would result in a change of 4.8% in the fair value of our fixed income portfolio. For an upward shift in the yield curve, the fair value of our portfolio would decrease and for a downward shift in the yield curve, the fair value would increase. See Note 7 – “Investments” to our consolidated financial statements for additional disclosure surrounding our investment portfolio.

Item 4. Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as

amended), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our principal executive officer and principal financial officer concluded that such controls and procedures were effective as of the end of such period. There was no change in our internal control over financial reporting that occurred during the third quarter of 2016 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1 A. Risk Factors

With the exception of the changes described and set forth below, there have been no material changes in our risk factors from the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 as supplemented by Part II, Item I A of our Quarterly Reports on Form 10-Q for the Quarters ended March 31, 2016 and June 30, 2016. The risk factors in the 10-K, as supplemented by those 10-Qs and this 10-Q, and through updating of various statistical and other information, are reproduced in their entirety in Exhibit 99 to this Quarterly Report on Form 10-Q.

We are involved in legal proceedings and are subject to the risk of additional legal proceedings in the future. 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 three quarters of 2016, curtailments reduced our average claim paid by approximately 6.7% and 5.4%, 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 4% 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 \$281 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.

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.

Our holding company debt obligations materially exceed our holding company cash and investments.

At September 30, 2016, we had approximately \$329 million in cash and investments at our holding company and our holding company's debt obligations were \$1,168 million in aggregate principal amount, consisting of \$145 million of 5% Notes, \$208 million of 2% Notes, \$425 million of 5.75% Senior Notes due in 2023 ("5.75% Notes"), and \$390 million of 9% Debentures (of which approximately \$133 million was purchased by and is held by MGIC, and is eliminated on the consolidated balance sheet). Annual debt service on the outstanding holding company debt as of September 30, 2016, is approximately \$71 million (of which approximately \$12 million will be paid to MGIC

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and will be eliminated on the consolidated income statement). For more information about the purchase by MGIC of a portion of our outstanding 9% Convertible Junior Subordinated Debentures, see "Management's Discussion and Analysis – Debt at Our Holding Company and Holding Company Capital Resources" in our Annual Report on Form 10-K filed with the SEC on February 26, 2016. We completed a public offering of the 5.75% Notes in August 2016. We used a portion of the net proceeds from the offering, together with, in certain cases, shares of our common stock, to purchase approximately \$292 million aggregate principal amount of the 2% Notes. In the third quarter of 2016, we used a portion of the net proceeds of the offering to purchase shares of our common stock to offset a portion of the shares used as partial consideration in the purchase of the 2% Notes. In October 2016, we purchased the remaining 4.8 million shares used as partial consideration for our 2% Notes repurchases. The funds remaining are being held for general corporate purposes. We may continue to purchase our debt securities in the future.

The Convertible Senior Notes, Senior Notes and Convertible Junior Subordinated Debentures are obligations of our holding company, MGIC Investment Corporation, and not of its subsidiaries. The payment of dividends from our insurance subsidiaries which, other than investment income and raising capital in the public markets, is the principal source of our holding company cash inflow, is restricted by insurance regulation. MGIC is the principal source of dividend-paying capacity and OCI authorization is required for MGIC to pay dividends. In each of April, June and September of 2016, MGIC paid \$16 million dividends to our holding company, its first dividends since 2008, and we expect to continue to receive quarterly dividends. If any additional capital contributions to our subsidiaries were required, such contributions would decrease our holding company cash and investments. As described in our Current Report on Form 8-K filed on February 11, 2016, MGIC borrowed \$155 million from the Federal Home Loan Bank of Chicago. This is an obligation of MGIC and not of our holding company.

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Item 2. Unregistered Sale of Equity Securities and Use of Proceeds

Unregistered sales of equity securities

We entered into privately negotiated agreements with certain holders of the 2% Convertible Senior Notes due 2020 (the “2% Notes”) to repurchase approximately \$292.4 million aggregate principal amount of the outstanding 2% Notes (the “2020 Convertible Purchases”). These agreements include those agreements that were disclosed in a Current Report on Form 8-K that the Company filed with the SEC on August 4, 2016. The total consideration paid by the Company in the 2020 Convertible Purchases consists of approximately \$230.7 million in cash and 18,313,482 shares of the Company’s common stock.

The exemption claimed for the issuance of shares of common stock in the repurchase transactions described above is Section 3(a)(9) of the Securities Act of 1933, as amended.

In the second and third quarters of 2016, we repurchased shares of its common stock to offset the shares used as partial consideration in the 2020 Convertible Purchases. See “Share repurchases” below.

Share repurchases

The following table sets forth information regarding repurchases made by or on behalf of us of our common stock during the three months ended September 30, 2016.

Period Beginning	Period Ending	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
July 1, 2016	July 31, 2016	—	\$ —	—	—
August 1, 2016	August 31, 2016	2,476,948	\$ 8.04	2,476,948	15,836,534
September 1, 2016	September 30, 2016	11,003,693	\$ 8.01	11,003,693	4,832,841
		13,480,641	\$ 8.02	13,480,641	

On August 5, 2016 we completed our public offering (the “Offering”) of \$425 million aggregate principal amount of our 5.75% Senior Notes due 2023 (the “Notes”). In our Prospectus Supplement for the Offering filed on August 4, 2016 with the SEC, we announced our intention to use the net proceeds from the Offering, together with, in certain cases, shares of our common stock, to fund the 2020 Convertible Purchases and also to purchase shares of our common stock to offset the shares issued as partial consideration in the 2020 Convertible Purchases.

(b) The repurchase plan had no expiration date, however the 18,313,482 shares issued as partial consideration in the 2020 Convertible Purchases had been repurchased as of October 2016.

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Item 6. Exhibits

The accompanying Index to Exhibits is incorporated by reference in answer to this portion of this Item, and except as otherwise indicated in the next sentence, the Exhibits listed in such Index are filed as part of this Form 10-Q. Exhibit 32 is not filed as part of this Form 10-Q but accompanies this Form 10-Q.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, on November 7, 2016.

MGIC INVESTMENT CORPORATION

/s/ Timothy J. Mattke
Timothy J. Mattke
Executive Vice President and
Chief Financial Officer

/s/ Julie K. Sperber
Julie K. Sperber
Vice President, Controller and Chief Accounting Officer

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INDEX TO EXHIBITS

(Part II, Item 6)

Exhibit Number	Description of Exhibit
4.8	Third Supplemental Indenture, dated as of August 5, 2016, between MGIC Investment Corporation and U.S. Bank National Association (as successor to Bank One Trust Company, National Association), as Trustee, under the Indenture, dated as of October 15, 2000, between the Company and the Trustee (incorporated by reference to Exhibit 4.1 to the Company's Form 8 K filed August 5, 2016)
12	Ratio of Earnings to Fixed Charges
31.1	Certification of CEO under Section 302 of Sarbanes-Oxley Act of 2002
31.2	Certification of CFO under Section 302 of Sarbanes-Oxley Act of 2002
32	Certification of CEO and CFO under Section 906 of Sarbanes-Oxley Act of 2002 (as indicated in Item 6 of Part II, this Exhibit is not being "filed")
99	Risk Factors included in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015, as supplemented by Part II, Item 1A of our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2016, June 30, 2016, and September 30, 2016, and through updating of various statistical and other information
101	The following financial information from MGIC Investment Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015, (ii) Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2015, (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016 and 2015, (iv) Consolidated Statements of Shareholders' Equity for the nine months ended September 30, 2016 and 2015, (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015, and (vi) the Notes to Consolidated Financial Statements.