

MGIC

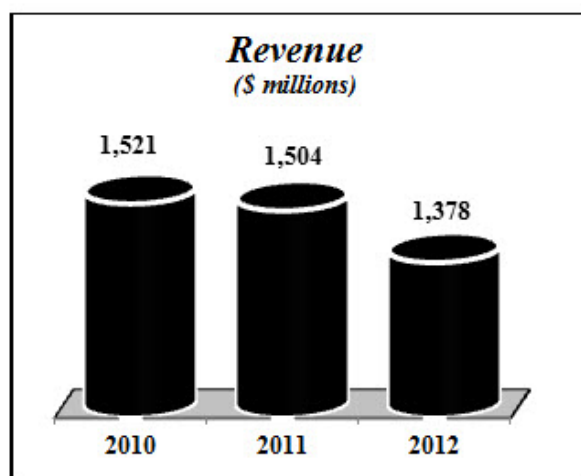
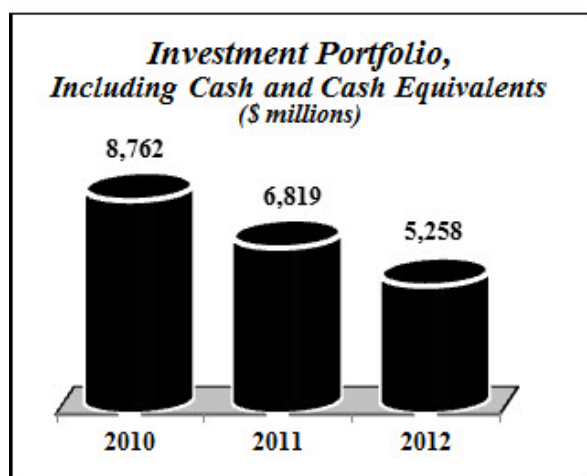
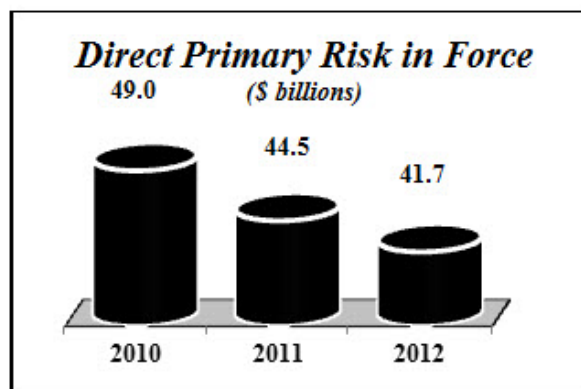
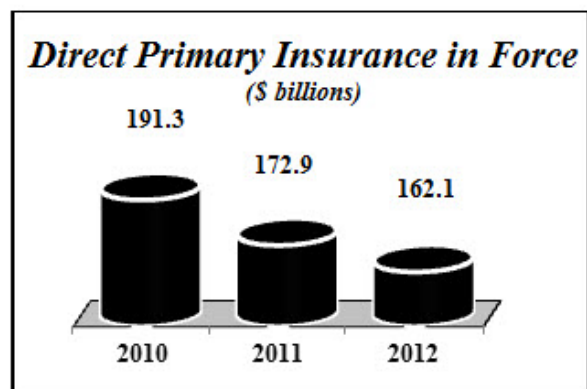
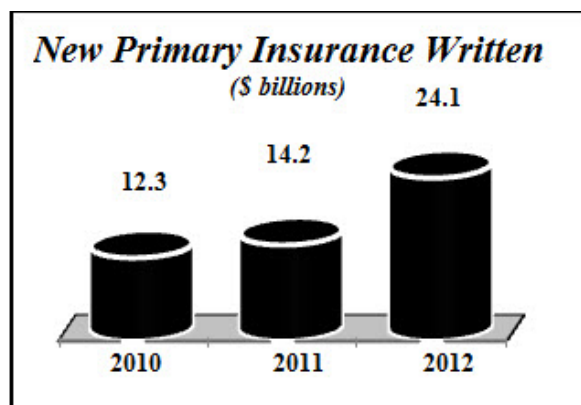
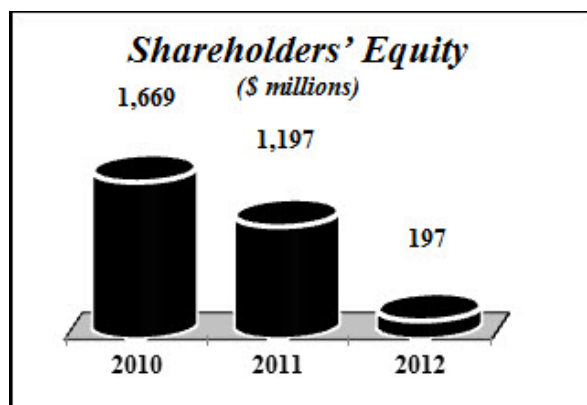


MGIC Investment Corporation
Annual Report

2012

Financial Summary

	<u>2010</u>	<u>2011</u>	<u>2012</u>
Net loss (\$ millions)	(363.7)	(485.9)	(927.1)
Diluted loss per share (\$)	(2.06)	(2.42)	(4.59)



Fellow Shareholders



2012 was a year in which we experienced disappointing financial results but accomplished numerous operational goals which improved our position for future earnings. In addition, with the housing market finally showing signs of life, and the success of the capital raise discussed below, MGIC is in an excellent position to take advantage of the improving housing market.

New household formations, after averaging about 500,000 per year from 2008 through 2010, grew to 1.1 million in 2011 and 1.2 million in 2012. This is a key statistic for MGIC as new household formations often give rise to first time home buyers who typically lack the funds to afford a 20% down payment.

Interest rates at near record low levels and the current level of home prices combine to make housing the most affordable it has been in decades. The housing market is very active: as of December 2012, there is only a four month supply of houses, down from a high of 12 months in 2010. National mortgage delinquency rates fell to 7.1% in the fourth quarter of 2012 from a high of 10.1% two years ago. And home prices rose, up 7.3% in 2012, which helped decrease the number of underwater mortgages to 6.6 million at December 31, 2012, down from 10.5 million a year ago. All of these factors bode well for MGIC.

In 2012, our industry continued to regain market share from the FHA and recently the FHA announced another price increase, which will be effective April 1, 2013. In fact, MGIC insurance is now a less expensive alternative to FHA at all FICO scores above 680. We estimate the private MI industry's market share at approximately 10% in the 4th quarter of 2012, up from approximately 6% a year ago. Within our industry, MGIC's reported market share was approximately 18% for the full year. We estimate that approximately 75% of the private mortgage insurance market in 2012 was comprised of the more profitable monthly premium plans and, within that segment, we estimate our market share was 21% in the fourth quarter of 2012. The \$24 billion of new insurance we wrote in 2012 represents a 70% increase from 2011.

The new business written since mid-2008 now accounts for approximately 33% of our risk in force and we expect the business from the most troubled years (2005 through mid-2008) to be less than 50% of our primary risk in force by the end of 2013. This new business augments our existing claims paying ability as each \$20 billion of new insurance we write is expected to add approximately \$400 million of premiums in excess of losses over its estimated life. The profitability of the new business is perhaps best captured by the fact that after four years of seasoning, the 2009 book of business has an incurred loss ratio of approximately 13%, after three years of seasoning, the 2010 book of business has an incurred loss ratio of less than 6% and, after two years of seasoning, the 2011 book has an incurred loss ratio of approximately 3%. We are in a "golden age" of credit quality that I expect to continue for some time, given the changes made after the lessons learned from the books of business written at the peak of the market and the impact that the definition of "qualified mortgage" is expected to have in reinforcing future quality.

On the credit front, while the cure rate on delinquent mortgages did not recover as fast as we had expected, the number of new notices of delinquency decreased 21%, year over year. The primary delinquent inventory declined by 20% in 2012 and paid claims declined by 11%. During 2012, we approved mortgage modifications under the US Treasury's HARP program, enabling 59,000 borrowers (representing \$11.2 billion of insurance in force) to lower their monthly payment obligation and improve their ability to continue making their mortgage payments. Since the inception of the program, approximately 11% of our primary insurance in force (nearly 100,000 borrowers with mortgage balances totaling \$18.7 billion) has benefited from HARP or similar refinance programs and more than 98% of the related borrowers are current. Additionally, approximately 11% of the insurance in force has been modified through HAMP or other loan modification programs, thus helping these borrowers to avoid a foreclosure and MGIC avoid a claim payment.

Fellow Shareholders

In the fourth quarter of 2012, we booked the financial impact of the Freddie Mac dispute, which we settled, and the expected financial impact of the Countrywide dispute, which we have made substantial progress towards resolving. These contingencies were major overhangs to our company and our stock. I am delighted one is now behind us and, while there can never be any guaranty, the other is well on its way to resolution.

Finally, while not a 2012 event, I would be remiss if I did not mention the March 2013 concurrent offerings of common stock and convertible senior notes that raised net proceeds of more than \$1.1 billion. We have already transferred \$800 million of them to MGIC, thereby reducing its risk-to-capital ratio so that it is within regulatory requirements and further increasing its claims paying ability. The result is that we have strengthened MGIC's competitiveness to take advantage of the expanding opportunities in our industry. MGIC's long-established market presence, combined with its strong national sales and underwriting organizations, make us a formidable presence for our competition, particularly in the more profitable monthly premium segment of the market. The additional capital will also improve our holding company liquidity.

So in summary, our company is in an excellent position to participate in the improving housing market. And, unlike new entrants to our business, we are an established company with a tenured sales and underwriting organization. Returns on the monthly premium business are very strong and should continue to be so, given the outstanding credit quality of our recent new business. We believe that the capital and operating strategy that we have put in place positions our company well for a better future.

Thank you for your support.

Respectfully,



Curt S. Culver
Chairman and Chief Executive Officer

The factors discussed under "Risk Factors" following the "Management's Discussion and Analysis" in this Annual Report may cause actual results to differ materially from the results contemplated by forward looking statements made in the foregoing letter. Forward looking statements consist of statements which relate to matters other than historical fact, including matters that inherently refer to future events. Statements in the letter that include words such as "may," "could," "expect," "believe" or "will" or words of similar import, are forward looking statements.

Five-Year Summary of Financial Information

	Year Ended December 31,				
	2012	2011	2010	2009	2008
Summary of Operations	(In thousands, except per share data)				
Revenues:					
Net premiums written	\$ 1,017,832	\$ 1,064,380	\$ 1,101,795	\$ 1,243,027	\$ 1,466,047
Net premiums earned	\$ 1,033,170	\$ 1,123,835	\$ 1,168,747	\$ 1,302,341	\$ 1,393,180
Investment income, net	121,640	201,270	247,253	304,678	308,517
Realized investment gains (losses), net, including net impairment losses	195,409	142,715	92,937	51,934	(12,486)
Other revenue	28,145	36,459	11,588	49,573	32,315
Total revenues	<u>1,378,364</u>	<u>1,504,279</u>	<u>1,520,525</u>	<u>1,708,526</u>	<u>1,721,526</u>
Losses and expenses:					
Losses incurred, net	2,067,253	1,714,707	1,607,541	3,379,444	3,071,501
Change in premium deficiency reserve	(61,036)	(44,150)	(51,347)	(261,150)	(756,505)
Underwriting and other expenses	201,447	214,750	225,142	239,612	271,314
Reinsurance fee	-	-	-	26,407	1,781
Interest expense	99,344	103,271	98,589	89,266	81,074
Total losses and expenses	<u>2,307,008</u>	<u>1,988,578</u>	<u>1,879,925</u>	<u>3,473,579</u>	<u>2,669,165</u>
Loss before tax and joint ventures	(928,644)	(484,299)	(359,400)	(1,765,053)	(947,639)
(Benefit from) provision for income taxes	(1,565)	1,593	4,335	(442,776)	(397,798)
Income from joint ventures, net of tax (1)	-	-	-	-	24,486
Net loss	<u>\$ (927,079)</u>	<u>\$ (485,892)</u>	<u>\$ (363,735)</u>	<u>\$ (1,322,277)</u>	<u>\$ (525,355)</u>
Weighted average common shares outstanding	201,892	201,019	176,406	124,209	113,962
Diluted loss per share	\$ (4.59)	\$ (2.42)	\$ (2.06)	\$ (10.65)	\$ (4.61)
Dividends per share	\$ -	\$ -	\$ -	\$ -	\$ 0.075
Balance sheet data					
Total investments	\$ 4,230,275	\$ 5,823,647	\$ 7,458,282	\$ 7,254,465	\$ 7,045,536
Cash and cash equivalents	1,027,625	995,799	1,304,154	1,185,739	1,097,334
Total assets	5,574,324	7,216,230	9,333,642	9,404,419	9,146,734
Loss reserves	4,056,843	4,557,512	5,884,171	6,704,990	4,775,552
Premium deficiency reserve	73,781	134,817	178,967	193,186	454,336
Short- and long-term debt	99,910	170,515	376,329	377,098	698,446
Convertible senior notes	345,000	345,000	345,000	-	-
Convertible junior debentures	379,609	344,422	315,626	291,785	272,465
Shareholders' equity	196,940	1,196,815	1,669,055	1,302,581	2,434,233
Book value per share	0.97	5.95	8.33	10.41	19.46

Five-Year Summary of Financial Information (cont.)

	Year Ended December 31,				
	2012	2011	2010	2009	2008
New primary insurance written					
(\$ millions)	\$ 24,125	\$ 14,234	\$ 12,257	\$ 19,942	\$ 48,230
New primary risk written					
(\$ millions)	5,949	3,525	2,944	4,149	11,669
New pool risk written					
(\$ millions)	-	-	-	4	145
Insurance in force (at year-end)					
(\$ millions)					
Direct primary insurance.....	162,082	172,873	191,250	212,182	226,955
Direct primary risk	41,735	44,462	48,979	54,343	58,981
Direct pool risk					
With aggregate loss limits	439	674	1,154	1,478	1,752
Without aggregate loss limits ..	879	1,177	1,532	1,951	2,521
Primary loans in default ratios					
Policies in force	1,006,346	1,090,086	1,228,315	1,360,456	1,472,757
Loans in default	139,845	175,639	214,724	250,440	182,188
Percentage of loans in default	13.90%	16.11%	17.48%	18.41%	12.37%
Percentage of loans in default —					
bulk	32.10%	35.33%	37.36%	40.87%	32.64%
Insurance operating ratios					
(GAAP) (2)					
Loss ratio	200.1%	152.6%	137.5%	259.5%	220.4%
Underwriting expense ratio	15.2%	16.0%	16.3%	15.1%	14.2%
Combined ratio.....	215.3%	168.6%	153.8%	274.6%	234.6%
Risk-to-capital ratio (statutory)					
Mortgage Guaranty Insurance					
Corporation	44.7:1	20.3:1	19.8:1	19.4:1	12.9:1
MGIC Indemnity Corporation....	1.2:1	-	-	-	-
Combined insurance companies..	47.8:1	22.2:1	23.2:1	22.1:1	14.7:1

(1) For many years ending in 2008, we had a significant investment in a less than majority owned joint venture, Sherman Financial Group LLC, or “Sherman.” In August 2008, we sold our entire interest in Sherman to Sherman. Beginning in the fourth quarter of 2008, our results of operations are no longer affected by any joint venture results.

(2) The loss ratio is the ratio, expressed as a percentage, of the sum of incurred losses and loss adjustment expenses to net premiums earned. The expense ratio is the ratio, expressed as a percentage, of the combined insurance operations underwriting expenses to net premiums written.

Management's Discussion and Analysis of Financial Condition and Results of Operations

We have reproduced below the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" that appeared in our Annual Report on Form 10-K for the year ended December 31, 2012, which was filed with the SEC on March 1, 2013. Except for various cross-references, we have not changed what appears below from what was in our Form 10-K. As a result, the Management's Discussion and Analysis and Risk Factors are not updated to reflect any events or changes in circumstances that have occurred since our Annual Report on Form 10-K was filed with the SEC. Our Risk Factors are an integral part of Management's Discussion and Analysis and appear immediately after it.

Overview

Through our subsidiaries Mortgage Guaranty Insurance Corporation ("MGIC") and MGIC Indemnity Corporation ("MIC"), we are the largest private mortgage insurer in the United States, as measured by \$162.1 billion of primary insurance in force at December 31, 2012. For our rank based on new insurance written in 2012, see Item 1, "Our Products and Services—Sales and Marketing and Competition" in our Annual Report on Form 10-K for the year ended December 31, 2012.

As used below, "we" and "our" refer to MGIC Investment Corporation's consolidated operations. In the discussion below, we classify, in accordance with industry practice, as "full documentation" loans approved by GSE and other automated underwriting systems under "doc waiver" programs that do not require verification of borrower income. For additional information about such loans, see footnote (3) to the composition of primary default inventory table under "Results of Consolidated Operations—Losses—Losses Incurred" below. The discussion of our business in this document generally does not apply to our Australian operations which have historically been immaterial. The results of our operations in Australia are included in the consolidated results disclosed. For additional information about our Australian operations, see our risk factor titled "Our Australian operations may suffer significant losses" below and "Overview—Australia" below.

Forward Looking and Other Statements

As discussed under "Forward Looking Statements and Risk Factors" in this Annual Report, 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.

Outlook

At this time, we are facing the following particularly significant challenges:

- Whether we may continue to write insurance on new residential mortgage loans due to actions our regulators or the GSEs could take based upon our capital position or based upon their projections of future deterioration in our capital position. This challenge is discussed under "Capital" below.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

- Whether private mortgage insurance will remain a significant credit enhancement alternative for low down payment single family mortgages. A definition of "qualified residential mortgages" ("QRM") that significantly impacts the volume of low down payment mortgages available to be insured or a possible restructuring or change in the charters of the GSEs could significantly affect our business. If final rules implementing Basel III do not consider mortgage insurance when calculating a loan's risk weighting, the incentive for banking organizations to purchase mortgage insurance for loans held for investment may be reduced. For additional information about this challenge, see "Qualified Residential Mortgages" and "GSE Reform" below and our risk factor titled "The implementation of the Basel III capital accord, or other changes to our customers' capital requirements, may discourage the use of mortgage insurance" below.

Capital

Insurance regulators

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 "Capital Requirements." New insurance written in the jurisdictions that have Capital Requirements represented approximately 50% of new insurance written in 2011 and 2012. While formulations of minimum capital vary among jurisdictions, the most common formulation allows for a maximum risk-to-capital ratio of 25 to 1.

At December 31, 2012, MGIC's risk-to-capital ratio was 44.7 to 1, exceeding the maximum allowed by many jurisdictions. We expect MGIC's risk-to-capital ratio to increase above its December 31, 2012 level. At December 31, 2012, the risk-to-capital ratio of our combined insurance operations (which includes reinsurance affiliates) was 47.8 to 1.

Although MGIC does not meet the Capital Requirements of Wisconsin, the Office of the Commissioner of Insurance of the State of Wisconsin ("OCI") has waived them until December 31, 2013. In place of the Capital Requirements, the OCI Order containing the waiver of Capital Requirements (the "OCI Order") provides that MGIC can write new business as long as it maintains regulatory capital that the OCI determines is reasonably in excess of a level that would constitute a financially hazardous condition. See Note 1 – "Nature of Business – Capital" to our consolidated financial statements for a description of the OCI Order and other state waivers of capital requirements.

MGIC's failure to meet the Capital Requirements to insure new business does not necessarily mean that MGIC does not have sufficient resources to pay claims on its insurance liabilities. While we believe that MGIC has sufficient claims paying resources to meet its claim obligations on its insurance in force on a timely basis, we cannot assure you that the events that led to MGIC failing to meet Capital Requirements would not also result in it not having sufficient claims paying resources. Furthermore, our estimates of MGIC's claims paying resources and claim obligations are based on various assumptions. These assumptions include the timing of the receipt of claims on loans in our delinquency inventory and future claims that we anticipate will ultimately be received, our anticipated rescission activity, premiums, housing values and unemployment rates. These assumptions are subject to inherent uncertainty and require judgment by management.

As part of our longstanding plan to write new business in MIC, a direct subsidiary of MGIC, MGIC has made capital contributions to MIC. As of December 31, 2012, MIC had statutory capital of \$448 million. In the third quarter of 2012, we began writing new mortgage insurance in MIC on the same policy terms as MGIC, in those jurisdictions where we did not have active waivers of Capital Requirements for MGIC. We project MIC can write 100% of our new insurance for at least five years if MGIC is unable to

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

write new business. This projection is based on the 18:1 risk-to-capital limitation prescribed by Freddie Mac's approval of MIC and assumes the mix and level of new insurance written in the future would be the same as we wrote in 2012. It also assumes MIC's eligibility would extend throughout this period. Approximately 19% of new insurance written in 2011 and 2012 was from jurisdictions in which MIC is currently writing business. If we had to write substantially more of our business in MIC and our levels of new insurance written were to increase materially, MIC may require additional capital to stay below Freddie Mac's prescribed risk-to-capital limit or a waiver of Freddie Mac's risk-to-capital limitation may be required. See Note 1 – "Nature of Business – Capital" to our consolidated financial statements for a discussion of our approvals from the GSEs to utilize MIC.

GSEs

The GSEs have approved MGIC as an eligible mortgage insurer, under remediation plans, even though our insurer financial strength (IFS) rating is below the published GSE minimum. The GSEs may change the requirements under our remediation plans or fail to renew, when they expire, their approvals of MIC as an eligible insurer. These possibilities could result from changes imposed on the GSEs by their regulator or due to an actual or GSE-projected deterioration in our capital position. For additional information about this challenge see our risk factors titled "We may not continue to meet the GSEs' mortgage insurer eligibility requirements," "Capital requirements may prevent us from continuing to write new insurance on an uninterrupted basis" and "We have reported losses for the last five years, expect to continue to report annual net losses, and cannot assure you when we will return to profitability" below.

Qualified Residential Mortgages

The financial reform legislation that was passed in July 2010 (the "Dodd-Frank Act" or "Dodd-Frank") requires a securitizer to retain at least 5% of the risk associated with mortgage loans that are securitized, and in some cases the retained risk may be allocated between the securitizer and the lender that originated the loan. This risk retention requirement does not apply to mortgage loans that are Qualified Residential Mortgages ("QRMs") or that are insured by the FHA or another federal agency. In March 2011, federal regulators requested public comments on a proposed risk retention rule that includes a definition of QRM. The proposed definition of QRM contains many underwriting requirements, including a maximum loan-to-value ratio ("LTV") of 80% on a home purchase transaction, a prohibition on seller contributions toward a borrower's down payment or closing costs, and certain limits on a borrower's debt-to-income ratio. The LTV is to be calculated without including mortgage insurance. None of our new risk written in 2012 was on loans that qualify as QRMs under the March 2011 proposed rules.

The regulators also requested public comments regarding an alternative QRM definition, the underwriting requirements of which would allow loans with a maximum LTV of 90% and higher debt-to-income ratios than allowed under the proposed QRM definition, and that may consider mortgage insurance in determining whether the LTV requirement is met. We estimate that approximately 22% of our new risk written in 2012 was on loans that would have met the alternative QRM definition. The regulators also requested that the public comments include information that may be used to assess whether mortgage insurance reduces the risk of default. We submitted a comment letter, including studies to the effect that mortgage insurance reduces the risk of default. Under the proposed rule, because of the capital support provided by the U.S. Government, the GSEs satisfy the Dodd-Frank risk-retention requirements while they are in conservatorship. Therefore, under the proposed rule, lenders that originate loans that are sold to the GSEs while they are in conservatorship would not be required to retain risk associated with those loans. The public comment period for the proposed rule expired on August 1, 2011. At this time we do not know when a final rule will be issued, although it was not expected that the final QRM rule would be issued until the final rule defining Qualified Mortgages (QMs) (discussed below) was issued. The Consumer Financial Protection Bureau ("CFPB") issued the final QM rule on January 10, 2013.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

Depending on, among other things, (a) the final definition of QRM and its requirements for LTV, seller contributions and debt-to-income ratio, (b) to what extent, if any, the presence of mortgage insurance would allow for a higher LTV in the definition of QRM, and (c) whether lenders choose mortgage insurance for non-QRM loans, the amount of new insurance that we write may be materially adversely affected. For other factors that could decrease the demand for mortgage insurance, see our risk factors titled "If the volume of low down payment home mortgage originations declines, the amount of insurance that we write could decline, which would reduce our revenues" and "The implementation of the Basel III capital accord, or other changes to our customers' capital requirements, may discourage the use of mortgage insurance" below.

As noted above, on January 10, 2013, the CFPB issued the final rule defining QM, in order to implement laws requiring lenders to consider a borrower's ability to repay a home loan before extending credit. The QM rule, which becomes effective in January 2014, prohibits loans with certain features, such as negative amortization, points and fees in excess of 3% of the loan amount, and terms exceeding 30 years, from being considered QMs. The rule also establishes general underwriting criteria for QMs including that a borrower have a total debt-to-income ratio of less than or equal to 43%. The rule provides a temporary category of QMs that have more flexible underwriting requirements so long as they satisfy the general product feature requirements of QMs and so long as they meet the underwriting requirements of the GSEs or those of the U.S. Department of Housing and Urban Development, Department of Veterans Affairs or Rural Housing Service (collectively, "Other Federal Agencies"). The temporary category of QMs that meet the underwriting requirements of the GSEs or the Other Federal Agencies will phase out when the GSEs or the Other Federal Agencies issue their own qualified mortgage rules, if the GSEs' conservatorship ends, and in any case after seven years. We expect that most lenders will be reluctant to make loans that do not qualify as QMs because they will not be entitled to the presumptions about compliance with the ability-to-pay requirements. Given the credit characteristics presented to us, we estimate that 99% of our new risk written in 2012 was for mortgages that would have met the QM definition and 91% of our new risk written in 2012 was for mortgages that would have met the QM definition even without the temporary category allowed for mortgages that meet the GSEs' underwriting requirements. In making these estimates, we have not considered the limitation on points and fees because the information is not available to us. We do not believe such limitation would materially affect the percentage of our new risk written meeting the QM definition. The QM rule is scheduled to become effective in January 2014.

GSE Reform

The 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 mortgage market 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. In addition, these factors may increase the likelihood that the charters of the GSEs are changed by new federal legislation. 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 was released in February 2011 and while it does not provide any definitive timeline for GSE reform, it does recommend using a combination of federal housing policy changes to wind down the GSEs, shrink the government's footprint in housing finance, and help bring private capital back to the mortgage market. In 2012, Members of Congress introduced several bills intended to scale back the GSEs, however, no legislation was 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 domestic residential housing finance system in the future or the impact of any such changes on our business. In addition, the timing of the impact 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.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Loan Modification and Other Similar Programs

Beginning in the fourth quarter of 2008, the federal government, including through the Federal Deposit Insurance Corporation and the GSEs, and several lenders have adopted programs to modify loans to make them more affordable to borrowers with the goal of reducing the number of foreclosures. During 2010, 2011 and 2012, we were notified of modifications that cured delinquencies that had they become paid claims would have resulted in approximately \$3.2 billion, \$1.8 billion and \$1.2 billion, respectively, of estimated claim payments. As noted below, we cannot predict with a high degree of confidence what the ultimate re-default rate on these modifications will be. Although the recent re-default rate has been lower, for internal reporting purposes, we assume approximately 50% of these modifications will ultimately re-default, and those re-defaults may result in future claim payments. Because modifications cure the defaults with respect to the previously defaulted loans, our loss reserves do not account for potential re-defaults unless at the time the reserve is established, the re-default has already occurred. Based on information that is provided to us, most of the modifications resulted in reduced payments from interest rate and/or amortization period adjustments; less than 5% resulted in principal forgiveness.

One loan modification program is the Home Affordable Modification Program ("HAMP"). Some of HAMP's eligibility criteria relate to the borrower's current income and non-mortgage debt payments. Because the GSEs and servicers do not share such information with us, we cannot determine with certainty the number of loans in our delinquent inventory that are eligible to participate in HAMP. We believe that it could take several months from the time a borrower has made all of the payments during HAMP's three month "trial modification" period for the loan to be reported to us as a cured delinquency.

We rely on information provided to us by the GSEs and servicers. We do not receive all of the information from such sources that is required to determine with certainty the number of loans that are participating in, or have successfully completed, HAMP. We are aware of approximately 9,300 loans in our primary delinquent inventory at December 31, 2012 for which the HAMP trial period has begun and which trial periods have not been reported to us as completed or cancelled. Through December 31, 2012 approximately 44,400 delinquent primary loans have cured their delinquency after entering HAMP and are not in default. In 2011 and 2012, approximately 18% and 17%, respectively, of our primary cures were the result of a modification, with HAMP accounting for approximately 70% of those modifications in each year. By comparison, in 2010, approximately 27% of our primary cures were the result of a modification, with HAMP accounting for approximately 60% of those modifications. We believe that we have realized the majority of the benefits from HAMP because the number of loans insured by us that we are aware are entering HAMP trial modification periods has decreased significantly since 2010. Recent announcements by the U.S. Treasury have extended the end date of the HAMP program through 2013, expanded the eligibility criteria of HAMP and increased lenders' incentives to modify loans through principal forgiveness. Approximately 66% of the loans in our primary delinquent inventory are guaranteed by the GSEs. The GSEs have informed us that they already use expanded criteria (beyond the HAMP guidelines) for determining eligibility for loan modification and currently do not offer principal forgiveness. Therefore, we currently expect new loan modifications will continue to only modestly mitigate our losses in 2013.

In 2009, the GSEs began offering the Home Affordable Refinance Program ("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. We allow the 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. To incent lenders to allow more current borrowers to refinance their loans, in October 2011, the GSEs and their regulator, FHFA, announced an expansion of HARP. The expansion includes, among other changes, releasing certain representations in certain circumstances benefitting the GSEs. We have agreed to allow these additional HARP refinances, including releasing the insured in certain circumstances from certain

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

rescission rights we would have under our policy. While an expansion of HARP may result in fewer delinquent loans and claims in the future, our ability to rescind coverage will be limited in certain circumstances. We are unable to predict what net impact these changes may have on our incurred or paid losses. Approximately 11% of our primary insurance in force has benefitted from HARP and is still in force.

The effect on us of loan modifications depends on how many modified loans subsequently re-default, which in turn can be affected by changes in housing values. Re-defaults can result in losses for us that could be greater than we would have paid had the loan not been modified. At this point, we cannot predict with a high degree of confidence what the ultimate re-default rate will be. In addition, because we do not have information in our database for all of the parameters used to determine which loans are eligible for modification programs, our estimates of the number of loans qualifying for modification programs are inherently uncertain. If legislation is enacted to permit a portion of a borrower's mortgage loan balance to be reduced in bankruptcy and if the borrower re-defaults after such reduction, then the amount we would be responsible to cover would be calculated after adding back the reduction. Unless a lender has obtained our prior approval, if a borrower's mortgage loan balance is reduced outside the bankruptcy context, including in association with a loan modification, and if the borrower re-defaults after such reduction, then under the terms of our policy the amount we would be responsible to cover would be calculated net of the reduction.

Eligibility under certain loan modification programs can also 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.

In response to the significant increase in the number of foreclosures that began in 2009, various government entities and private parties have from time to time enacted foreclosure (or equivalent) moratoriums and suspensions (which we collectively refer to as moratoriums). In October 2010, a number of mortgage servicers temporarily halted some or all of the foreclosures they were processing after discovering deficiencies in their foreclosure processes and those of their service providers. In response to the deficiencies, some states changed their foreclosure laws to require additional review and verification of the accuracy of foreclosure filings. Some states also added requirements to the foreclosure process, including mediation processes and requirements to file new affidavits. Certain state courts have issued rulings calling into question the validity of some existing foreclosure practices. These actions halted or significantly delayed foreclosures. Furthermore five of the nation's largest mortgage servicers agreed to implement new servicing and foreclosure practices as part of a settlement announced in February 2012, with the federal government and the attorneys general of 49 states.

Past moratoriums or delays were designed to afford time to determine whether loans could be modified and did not stop the accrual of interest or affect other expenses on a loan, and we cannot predict whether any future moratorium or lengthened timeframes would do so. Therefore, unless a loan is cured during a moratorium or delay, at the completion of a foreclosure, additional interest and expenses may be due to the lender from the borrower. In some circumstances, our paid claim amount may include some additional interest and expenses. For moratoriums or delays resulting from investigations into servicers and other parties' actions in foreclosure proceedings, our willingness to pay additional interest and expenses may be different, subject to the terms of our mortgage insurance policies. The various moratoriums and extended timeframes may temporarily delay our receipt of claims and may increase the length of time a loan remains in our delinquent loan inventory.

We do not know what effect improprieties that may have occurred in a particular foreclosure have on the validity of that foreclosure, once it was completed and the property transferred to the lender. Under our policy, in general, completion of a foreclosure is a condition precedent to the filing of a claim. Beginning in 2011 and from time to time, various courts have ruled that servicers did not provide sufficient evidence

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that they were the holders of the mortgages and therefore they lacked authority to foreclose. Some courts in other jurisdictions have considered similar issues and reached similar conclusions, but other courts have reached different conclusions. These decisions have not had a direct impact on our claims processes or rescissions.

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, other mortgage insurers, GSE programs that may reduce or eliminate the demand for mortgage insurance and other alternatives to mortgage insurance. In addition, new insurance written can be influenced by a lender's assessment of the financial strength of our insurance operations. New insurance written does not include loans previously insured by us which are modified, such as loans modified under the Home Affordable Refinance Program.
- 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. Refinancings are also affected by 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. Cancellations also include rescissions, which require us to return any premiums received related to the rescinded policy, and policies cancelled due to claim payment, which require us to return any premium received from the date of default. Finally, cancellations are affected by home price appreciation, which can give homeowners the right to cancel the mortgage insurance on their loans.
- Premium rates, which are affected by the risk characteristics of the loans insured and the percentage of coverage on the loans.
- Premiums ceded to reinsurance subsidiaries of certain mortgage lenders ("captives") and risk sharing arrangements with the GSEs.

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 to captives or the GSEs. 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 comprised almost entirely of investment grade fixed income securities. The principal factors that influence investment income are the size of the portfolio and its yield. As

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measured by amortized cost (which excludes changes in fair market 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 earnings, net claim payments and expenses, less cash provided by (or used for) non-operating activities, such as debt or stock issuances or repurchases or dividend payments. Realized gains and losses are a function of the difference between the amount received on the sale of a security and the security's amortized cost, as well as any "other than temporary" impairments recognized in earnings. The amount received on the sale of fixed income securities is affected by the coupon rate of the security compared to the yield of comparable securities at the time of sale.

- Losses incurred

Losses incurred are the current expense that reflects estimated payments that will ultimately be made as a result of delinquencies on insured loans. As explained under "Critical Accounting Policies" below, 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. Our estimated loss reserves reflect mitigation from rescissions of policies 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 two 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.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

- Changes in premium deficiency reserve

Each quarter, we re-estimate the premium deficiency reserve on the remaining Wall Street bulk insurance in force. The premium deficiency reserve primarily changes from quarter to quarter as a result of two factors. First, it changes as the actual premiums, losses and expenses that were previously estimated are recognized. Each period such items are reflected in our financial statements as earned premium, losses incurred and expenses. The difference between the amount and timing of actual earned premiums, losses incurred and expenses and our previous estimates used to establish the premium deficiency reserve has an effect (either positive or negative) on that period's results. Second, the premium deficiency reserve changes as our assumptions relating to the present value of expected future premiums, losses and expenses on the remaining Wall Street bulk insurance in force change. Changes to these assumptions also have an effect on that period's results.

- 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."

- Interest expense

Interest expense reflects the interest associated with our outstanding debt obligations. The principal amount of our long-term debt obligations at December 31, 2012 is comprised of \$100.1 million of 5.375% Senior Notes due in November 2015, \$345 million of 5% Convertible Senior Notes due in 2017 and \$389.5 million of 9% Convertible Junior Subordinated Debentures due in 2063 (interest on these debentures accrues and compounds even if we defer the payment of interest), as discussed in Note 3 – "Debt" to our consolidated financial statements and under "Liquidity and Capital Resources" below. At December 31, 2012, the convertible debentures are reflected as a liability on our consolidated balance sheet at the current amortized value of \$379.6 million, with the unamortized discount reflected in equity.

Mortgage Insurance Earnings and Cash Flow Cycle

In our industry, a "book" is the group of loans insured in a particular calendar year. In general, the majority of any underwriting profit (premium revenue minus losses) that a book generates occurs in the early years of the book, with the largest portion of any underwriting profit realized in the first year following the year the book was written. Subsequent years of a book generally result in modest underwriting profit or underwriting losses. This pattern of results typically occurs because relatively few of the claims that a book will ultimately experience typically occur in the first few years of the book, when premium revenue is highest, while subsequent years are affected by declining premium revenues, as the number of insured loans decreases (primarily due to loan prepayments), and increasing losses.

Australia

We began international operations in Australia, where we started to write business in June 2007. Since 2008, we are no longer writing new business in Australia and we have reduced our headcount. At December 31, 2012 our equity value in our Australian operations was approximately \$150 million and our risk in force in Australia was approximately \$0.7 billion. In Australia, mortgage insurance is a single premium product that covers the entire loan balance. As a result, our Australian risk in force represents the entire amount of the loans that we have insured. However, the mortgage insurance we provide only covers the unpaid loan balance after the sale of the underlying property.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

Summary of 2012 Results

Our results of operations for 2012 were principally affected by the factors referred to below.

- Net premiums written and earned

Net premiums written and earned during 2012 decreased when compared to 2011. The decrease was due to our lower average insurance in force as well as an increase in return premium on claims paid, somewhat offset by a decrease in premiums ceded to captives and a decrease in return premium due to a lower amount of rescissions.

- Investment income

Investment income in 2012 was lower when compared to 2011 due to a decrease in our average invested assets as we continue to meet our claim obligations, as well as a decrease in our average investment yield.

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

Net realized gains for 2012 included \$197.7 million in net realized gains on the sale of fixed income investments, slightly offset by \$2.3 million in other-than-temporary impairment ("OTTI") losses. Net realized gains for 2011 included \$143.4 million in net realized gains on the sale of fixed income investments, slightly offset by \$0.7 million in OTTI losses. The gross unrealized gains on our investment portfolio were \$46.8 million at December 31, 2012.

- Other revenue

Other revenue for 2012 decreased compared to 2011 primarily due to a decrease in gains on the repurchase of Senior Notes, slightly offset by an increase in contract underwriting fees. We recognized gains of \$17.8 million on repurchases in 2012, compared to gains of \$27.7 million in 2011.

- Losses incurred

Losses incurred for 2012 increased compared to 2011 primarily due to a \$267.5 million settlement related to the Freddie Mac pool policy, approximately \$100 million for probable rescission settlement agreements, and a larger increase in the claim rate as a result of lower cure rate trends, partially offset by a decrease in estimated severity. The primary default inventory decreased by 35,794 delinquencies in 2012, compared to a decrease of 39,085 in 2011. See Note 20 – "Litigation and Contingencies" to our consolidated financial statements for a discussion of our settlement with Freddie Mac as well as our probable settlement agreements.

- Change in premium deficiency reserve

During 2012 the premium deficiency reserve on Wall Street bulk transactions declined by \$61 million from \$135 million, as of December 31, 2011, to \$74 million as of December 31, 2012. The decrease in the premium deficiency reserve represents the net result of actual premiums, losses and expenses as well as a change in net assumptions for the period. The change in net assumptions for 2012 is primarily related to higher estimated ultimate losses. The \$74 million premium deficiency reserve as of December 31, 2012 reflects the present value of expected future losses and expenses that exceeds the present value of expected future premiums and already established loss reserves.

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- Underwriting and other expenses

Underwriting and other expenses for 2012 decreased when compared to 2011. The decrease primarily reflects our reduction in headcount.

- Interest expense

Interest expense for 2012 decreased when compared to 2011. The decrease is primarily due to lower interest on our Senior Notes due to repayments and repurchases, partially offset by an increase in amortization on our junior debentures.

- Benefit from income taxes

The effective tax rate benefit on our pre-tax loss was (0.2%) in 2012, compared to the effective tax rate provision of 0.3% in 2011. During those periods, the benefit from income taxes was eliminated or reduced by the recognition of a valuation allowance.

Results of Consolidated Operations

New insurance written

The amount of our primary new insurance written during the years ended December 31, 2012, 2011 and 2010 was as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Total Primary NIW (In billions)	\$ 24.1	\$ 14.2	\$ 12.3
Refinance volume as a % of primary NIW	36%	29%	32%

The increase in new insurance written in 2012, compared to 2011, was partially due to larger origination volume as well as a modest increase in the private mortgage insurance industry's market share. Our industry continues to regain market share from the FHA but the pace of that recovery is slower than we expected given the continued differences in underwriting guidelines, loan level price adjustments by the GSEs and the secondary market benefits associated with government insured loans versus loans insured by the private sector. The increase in new insurance written in 2011, compared to 2010, was partially due to a modest increase in the private mortgage insurance industry market share.

As discussed in Note 1 – "Nature of Business-Capital" to our consolidated financial statements, PMI and RMIC ceased writing business in 2011. Based on public disclosures, these competitors approximated slightly more than 20% of the private mortgage insurance industry volume in the first half of 2011. Most of the market share of these two former competitors has gone to other mortgage insurers and not to us because, among other reasons, some competitors have materially lower premiums than we do on single premium policies, one of these competitors also uses a risk weighted pricing model that typically results in lower premiums than we charge on certain loans and several of these competitors have streamlined their underwriting to be closely aligned with that of the GSEs. We continuously monitor the competitive landscape and make adjustments to our pricing and underwriting guidelines as warranted.

The FHA substantially increased its market share beginning in 2008, and beginning in 2011, that market share began to gradually decline. We believe that the FHA's market share increased, in part, because private mortgage insurers tightened their underwriting guidelines (which led to increased utilization of the FHA's programs) and because of increases in the amount of loan level delivery fees that

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

the GSEs assess on loans (which result in higher costs to borrowers). In addition, federal legislation and programs provided the FHA with greater flexibility in establishing new products and increased the FHA's competitive position against private mortgage insurers. We believe that the FHA's current premium pricing, when compared to our current credit-tiered premium pricing (and considering the effects of GSE pricing changes), has allowed us to be more competitive with the FHA than in the recent past for loans with high FICO credit scores. We cannot predict, however, the FHA's share of new insurance written in the future due to, among other factors, different loan eligibility terms between the FHA and the GSEs; future increases in guarantee fees charged by the GSEs; changes to the FHA's annual premiums; and the total profitability that may be realized by mortgage lenders from securitizing loans through Ginnie Mae when compared to securitizing loans through Fannie Mae or Freddie Mac. Our level of new insurance written could also be affected by other items, including those noted in our Risk Factors below.

From time to time, in response to market conditions, we change the types of loans that we insure and the guidelines under which we insure them. In addition, we make exceptions to our underwriting guidelines on a loan-by-loan basis and for certain customer programs. Together, the number of loans for which exceptions were made accounted for fewer than 5% of the loans we insured in 2011 and fewer than 2% of the loans we insured in 2012. A large percentage of the exceptions were made for loans with debt-to-income ratios slightly above our guidelines or financial reserves slightly below our guidelines. While the debt-to-income ratio contained in our guidelines exceeds the general requirements of the QM definition, it is within the underwriting guidelines of the GSEs. The rule containing the QM definition provides a temporary category of QMs that have more flexible underwriting requirements so long as they satisfy the general product feature requirements of QMs and so long as they meet the underwriting requirements of certain agencies, including the GSEs. For more information, see our risk factor titled "The amount of insurance we write could be adversely affected if the definition of Qualified Residential Mortgage results in a reduction of the number of low down payment loans available to be insured or if lenders and investors select alternatives to private mortgage insurance" below. Beginning in September 2009, we have made changes to our underwriting guidelines that have allowed certain loans to be eligible for insurance that were not eligible prior to those changes and we expect to continue to make changes in appropriate circumstances in the future. As noted in our risk factor titled "Competition or changes in our relationships with our customers could reduce our revenues or increase our losses," below, in the first quarter of 2012, we made changes to streamline our underwriting guidelines and lowered our premium rates on loans with credit scores of 760 or higher. Our underwriting guidelines are available on our website at <http://www.mgic.com/underwriting/index.html>

During the second quarter of 2012, we began writing a portion of our new insurance under an endorsement to our master policy (the "Gold Cert Endorsement"). If a borrower makes payments for three years, our Gold Cert Endorsement limits our ability to rescind coverage except under certain circumstances, including where we prove the lender had knowledge of inaccurate information in the loan file. In addition, our Gold Cert Endorsement limits our ability to rescind on loans for which the borrower makes payments on time for one year with his own funds, if we are provided with certain documents shortly after we insure the loan and we fail to discover that the loan was ineligible for our insurance. We believe the limitations on our rights to rescind coverage under the Gold Cert Endorsement will materially reduce rescissions on such loans. Currently, less than 3% of our insurance in force was written under our Gold Cert Endorsement. However, we estimate that approximately 33% of our new insurance written in the fourth quarter of 2012, and 41% of our new insurance written in December 2012, was written under this endorsement.

The endorsement is filed as Exhibit 99.7 to our quarterly report on Form 10-Q for the quarter ended March 31, 2012 (filed with the SEC on May 10, 2012). Availability of the endorsement is subject to approval in specified jurisdictions. We expect that eventually a significant portion of our new insurance written will have rescission terms equivalent to those in this endorsement. Our level of new insurance written could also be affected by other items, including those noted in our Risk Factors below.

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Cancellations, insurance in force and risk in force

New insurance written and cancellations of primary insurance in force during the years ended December 31, 2012, 2011 and 2010 were as follows:

	<u>2012</u>	<u>2011</u> (In billions)	<u>2010</u>
NIW	\$ 24.1	\$ 14.2	\$ 12.3
Cancellations	<u>(34.9)</u>	<u>(32.6)</u>	<u>(33.2)</u>
Change in primary insurance in force	<u>\$ (10.8)</u>	<u>\$ (18.4)</u>	<u>\$ (20.9)</u>
Direct primary insurance in force as of December 31,	\$ 162.1	\$ 172.9	\$ 191.3
Direct primary risk in force as of December 31,	\$ 41.7	\$ 44.5	\$ 49.0

Cancellation activity 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 and policies cancelled due to claim payment. Since 2009, cancellations due to rescissions and claim payments have comprised a significant amount of our cancellations.

Our persistency rate was 79.8% at December 31, 2012 compared to 82.9% at December 31, 2011 and 84.4% at December 31, 2010. These persistency rates reflect the more restrictive credit policies of lenders (which make it more difficult for homeowners to refinance loans), as well as declines in housing values. During the 1990s, our year-end persistency ranged from a high of 87.4% at December 31, 1990 to a low of 68.1% at December 31, 1998. 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.

Bulk transactions

We ceased writing Wall Street bulk business in the fourth quarter of 2007. In addition, we wrote no new business through the bulk channel since the second quarter of 2008. We expect the volume of any future business written through the bulk channel will be insignificant. Wall Street bulk transactions, as of December 31, 2012, included approximately 70,000 loans with insurance in force of approximately \$10.7 billion and risk in force of approximately \$3.2 billion, which is approximately 72% of our bulk risk in force.

In bulk transactions, the individual loans in the insured portfolio are generally insured to specified levels of coverage. Some of our bulk transactions (approximately 5% of our bulk risk in force) contain aggregate loss limits on the insured portfolio. If claim payments associated with a specific bulk portfolio reach the aggregate loss limit, the remaining insurance in force within the deal may be cancelled and any remaining defaults under the deal are removed from our default inventory.

Pool insurance

We are currently not issuing new commitments for pool insurance and expect that the volume of any future pool business will be insignificant.

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Our direct pool risk in force was \$1.3 billion (\$0.4 billion on pool policies with aggregate loss limits and \$0.9 billion on pool policies without aggregate loss limits) at December 31, 2012 compared to \$1.9 billion (\$0.7 billion on pool policies with aggregate loss limits and \$1.2 billion on pool policies without aggregate loss limits) at December 31, 2011. 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 are removed from our default inventory.

See Note 20 – “Litigation and Contingencies” for discussions regarding our settlement of the pool insurance dispute with Freddie Mac.

Net premiums written and earned

Net premiums written and earned during 2012 decreased when compared to 2011. The decrease was due to our lower average insurance in force as well as an increase in return premium on claims paid, somewhat offset by a decrease in premiums ceded to captives and a decrease in return premium due to a lower amount of rescissions.

Net premiums written and earned during 2011 decreased when compared to 2010. The decrease was due to our lower average insurance in force, somewhat offset by lower levels of premium refunds related to rescissions and the continued decline of premiums ceded to captives.

We expect our average insurance in force to continue to decline in 2013 because our expected new insurance written levels are not expected to exceed our cancellation activity. We expect our premium yields (net premiums written or earned, expressed on an annual basis, divided by the average insurance in force) for 2013 to decline slightly from the level experienced during 2012.

Risk sharing arrangements

For the year ended December 31, 2012, approximately 4% of our flow new insurance written was subject to arrangements with captives, compared to 5% for the year ended December 31, 2011. We expect the percentage of new insurance written subject to risk sharing arrangements to also approximate 4% in 2013.

Effective January 1, 2009, we are no longer ceding new business under excess of loss reinsurance treaties with lender captive reinsurers. Loans reinsured through December 31, 2008 under excess of loss agreements will run off pursuant to the terms of the particular captive arrangement. New business will continue to be ceded under quota share reinsurance arrangements, limited to a 25% cede rate. Beginning in 2009, many of our captive arrangements have either been terminated or placed into run-off. See Note 11 – “Reinsurance” to our consolidated financial statements for a description of these risk sharing arrangements and the related reinsurance recoverables.

We anticipate that our ceded premiums related to risk sharing agreements will continue to decline in 2013 for the reasons discussed above.

In 2012 the captive arrangements reduced our losses incurred by approximately \$56 million, compared to a \$65 million captive reduction in 2011. We anticipate that the reduction in losses incurred will continue to be lower in 2013, as some of our captive arrangements were terminated in 2011 and 2012 and many of the active captives have reached, or will reach in 2013, their maximum potential liability under the terms of the contracts. See our risk factor titled “We are involved in legal proceedings and are subject to the risk of additional legal proceedings in the future” below for a discussion of requests or subpoenas for information regarding captive mortgage reinsurance arrangements.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

Investment income

Investment income in 2012 was lower when compared to 2011 due to a decrease in our average invested assets as we continue to meet our claim obligations as well as a decrease in the average investment yield. Our average investment yield has declined as we have elected to realize gains in our investment portfolio as discussed under "Realized gains and other-than-temporary impairments" below. The average maturity of our investments has continued to decrease, as discussed under "Liquidity and Capital Resources" below. The portfolio's average pre-tax investment yield was 1.7% at December 31, 2012 and 2.8% at December 31, 2011.

We continue to expect a decline in investment income in 2013, compared to 2012, as the average amortized cost of invested assets decreases due to claim payments exceeding premiums received in future periods. See further discussion under "Liquidity and Capital Resources" below.

Investment income for 2011 decreased when compared to 2010 due to a decrease in the average investment yield. The decrease in the average investment yield was caused both by decreases in prevailing interest rates and a decrease in the average maturity of our investments. The portfolio's average pre-tax investment yield was 3.1% at December 31, 2010.

Realized gains and other-than-temporary impairments

Net realized gains for 2012 included \$197.7 million in net realized gains on the sale of fixed income investments, slightly offset by \$2.3 million in OTTI losses. Net realized gains for 2011 included \$143.4 million in net realized gains on the sale of fixed income investments, slightly offset by \$0.7 million in OTTI losses. We elected to realize these gains, by selling certain securities, given the favorable market conditions experienced in 2011 and 2012. We then reinvested the funds taking into account our anticipated future claim payment obligations. We also continue to reduce our investments in tax exempt municipal securities and increase our investments in taxable securities. For statutory purposes investments are generally held at amortized cost, therefore the realized gains increased our statutory policyholders' position or statutory capital. The impairment losses recognized in 2012 and 2011 were primarily on our auction rate securities. The gross unrealized gains on our investment portfolio were \$46.8 million at December 31, 2012.

We had net realized investment gains on the sale of fixed income investments of \$102.6 million, offset by \$9.6 million in OTTI losses in 2010. In 2010, we reduced our investments in tax exempt municipal securities and increased our investments in taxable securities since the tax benefits to holding tax exempt securities was no longer available. We also sold securities to decrease the duration of the portfolio to provide cash to meet our anticipated claim obligations. The impairment losses in 2010 included credit losses related to debt instruments issued by health facilities, an inflation linked bond and specific issuer auction rate securities.

Other revenue

Other revenue for 2012 decreased, when compared to 2011, due primarily to a decrease in gains recognized on debt repurchases, slightly offset by an increase in contract underwriting fees. We recognized \$17.8 million of gains in 2012 on the repurchase of \$70.9 million in par value of our 5.375% Senior Notes due in November 2015, compared to \$27.7 million in gains recognized on the repurchase of \$129.0 million in par value of our 5.375% Senior Notes in 2011.

Other revenue for 2011 increased, when compared to 2010, due to \$27.7 million in gains recognized on the repurchase of \$129 million in par value of our 5.375% Senior Notes due in November 2015, somewhat offset by a decrease in contract underwriting revenue.

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Losses

As discussed in "Critical Accounting Policies" below 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 and are defined as an insured loan with a mortgage payment that is 45 days or more 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. Historically, a substantial majority of borrowers have eventually cured their delinquent loans by making their overdue payments, but this percentage has decreased significantly in recent years.

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. Current conditions in the housing and mortgage industries make these assumptions more volatile than they would otherwise be. 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 further deterioration of regional or national economic conditions, including unemployment, leading to a reduction in borrowers' income and thus their ability to make mortgage payments, and a further drop in housing values that could result in, among other things, greater losses on loans that have pool insurance, and may affect borrower willingness to continue to make mortgage payments when the value of the home is below the mortgage balance, and mitigation from rescissions being materially less than assumed. Our estimates are also affected by any agreements we enter into regarding claim payments, such as the settlement agreements discussed in Note 20 – "Litigation and Contingencies" to our consolidated financial statements. Changes to our estimates could result in a material impact to our results of operations, even in a stable economic environment.

In addition, our loss reserving methodology incorporates the effects rescission activity is expected to have on the losses we will pay on our delinquent inventory. A variance between ultimate actual rescission rates and these estimates could materially affect our losses. See our risk factor titled "Our losses could increase if we do not prevail in proceedings challenging whether our rescissions were proper or rescission rates decrease faster than we are projecting" below.

Our estimates could also be positively affected by efforts to assist current borrowers in refinancing to new loans, assisting delinquent borrowers in reducing their mortgage payments, and forestalling foreclosures. If these benefits occur, we anticipate they will do so under non-HAMP programs. See discussion of HAMP under "Overview – Loan Modification and Other Similar Programs."

Losses incurred

In 2012, net losses incurred were \$2,067 million, comprised of \$1,494 million of current year loss development and \$573 million of unfavorable prior years' loss development. In 2011, net losses incurred were \$1,715 million, comprised of \$1,814 million of current year loss development, offset by \$99 million of favorable prior years' loss development. In 2010, net losses incurred were \$1,608 million, comprised of which \$1,875 million of current year loss development, offset by \$267 million of favorable prior years' loss development.

See Note 9 – "Loss Reserves" to our consolidated financial statements and under "Critical Accounting Policies" below for a discussion of our losses incurred and rescissions.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Information about the composition of the primary insurance default inventory at December 31, 2012, 2011 and 2010 appears in the table below.

	December 31,		
	2012	2011	2010
Total loans delinquent (1)	139,845	175,639	214,724
Percentage of loans delinquent (default rate)	13.90%	16.11%	17.48%
Prime loans delinquent (2)	90,270	112,403	134,787
Percentage of prime loans delinquent (default rate)	10.44%	12.20%	13.11%
A-minus loans delinquent (2)	20,884	25,989	31,566
Percent of A-minus loans delinquent (default rate)	32.92%	35.10%	36.69%
Subprime credit loans delinquent (2)	7,668	9,326	11,132
Percentage of subprime credit loans delinquent (default rate) ...	40.78%	43.60%	45.66%
Reduced documentation loans delinquent (3)	21,023	27,921	37,239
Percentage of reduced documentation loans delinquent (default rate)	35.23%	37.96%	41.66%

General Notes: (a) The FICO credit score for a loan with multiple borrowers is the lowest of the borrowers' "decision FICO scores." A borrower's "decision FICO score" is determined as follows: if there are three FICO scores available, the middle FICO score is used; if two FICO scores are available, the lower of the two is used; if only one FICO score is available, it is used.

(b) Servicers continue to pay our premiums for nearly all of the loans in our default inventory, but in some cases, servicers stop paying our premiums. In those cases, even though the loans continue to be included in our default inventory, the applicable loans are removed from our insurance in force and risk in force. Loans where servicers have stopped paying premiums include 9,054 defaults with a risk of \$456 million as of December 31, 2012.

(1) At December 31, 2012, 2011 and 2010 25,282, 30,250 and 36,066 loans in default, respectively, related to Wall Street bulk transactions.

(2) We define prime loans as those having FICO credit scores of 620 or greater, A-minus loans as those having FICO credit scores of 575-619, and subprime credit loans as those having FICO credit scores of less than 575, all as reported to us at the time a commitment to insure is issued. Most A-minus and subprime credit loans were written through the bulk channel. However, we classify all loans without complete documentation as "reduced documentation" loans regardless of FICO score rather than as a prime, "A-minus" or "subprime" loan; in the table above, such loans appear only in the reduced documentation category and they do not appear in any of the other categories.

(3) In accordance with industry practice, loans approved by GSE and other automated underwriting (AU) systems under "doc waiver" programs that do not require verification of borrower income are classified by MGIC as "full documentation." Based in part on information provided by the GSEs, we estimate full documentation loans of this type were approximately 4% of 2007 NIW. Information for other periods is not available. We understand these AU systems grant such doc waivers for loans they judge to have higher credit quality. We also understand that the GSEs terminated their "doc waiver" programs, with respect to new commitments, in the second half of 2008.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

The primary and pool loss reserves at December 31, 2012, 2011 and 2010 appear in the table below.

Gross Reserves

	December 31,		
	2012	2011	2010
Primary:			
Direct loss reserves (in millions)	\$ 3,744	\$ 4,249	\$ 5,146
Ending default inventory.....	139,845	175,639	214,724
Average direct reserve per default.....	\$ 26,771	\$ 24,193	\$ 23,966
Primary claims received inventory included in ending default inventory	11,731	12,610	20,898
Pool (1):			
Direct loss reserves (in millions):			
With aggregate loss limits	\$ 120	\$ 278	\$ 700
Without aggregate loss limits	20	21	30
Reserves related to Freddie Mac settlement (2)	167	-	-
Total pool direct loss reserves.....	\$ 307	\$ 299	\$ 730
Ending default inventory:			
With aggregate loss limits	7,243	31,483	41,786
Without aggregate loss limits	1,351	1,488	1,543
Total pool ending default inventory	8,594	32,971	43,329
Pool claims received inventory included in ending default inventory.....	304	1,398	2,510
Other gross reserves (in millions)	\$ 6	\$ 10	\$ 8

- (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 Note 20 – “Litigation and Contingencies” to our consolidated financial statements for a discussion of our settlement with Freddie Mac regarding a pool policy.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

The primary default inventory and primary loss reserves by region at December 31, 2012, 2011 and 2010 appears in the table below.

Losses by Region

Primary Default Inventory

<u>Region</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Great Lakes.....	16,538	22,158	27,663
Mid-Atlantic.....	6,948	8,058	9,660
New England.....	6,160	6,913	7,702
North Central.....	16,367	20,860	24,192
Northeast.....	17,553	18,385	19,056
Pacific.....	13,235	18,381	25,438
Plains.....	4,126	5,462	7,045
South Central.....	15,418	21,035	28,984
Southeast.....	43,500	54,387	64,984
Total.....	<u>139,845</u>	<u>175,639</u>	<u>214,724</u>

Primary Loss Reserves

(In millions)

<u>Region</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Great Lakes.....	\$ 295	\$ 348	\$ 426
Mid-Atlantic.....	178	205	231
New England.....	144	149	174
North Central.....	445	454	495
Northeast.....	371	325	374
Pacific.....	599	750	886
Plains.....	69	84	107
South Central.....	301	413	555
Southeast.....	1,089	1,198	1,395
Total before IBNR and LAE....	\$ 3,491	\$ 3,926	\$ 4,643
IBNR and LAE.....	253	323	503
Total.....	<u>\$ 3,744</u>	<u>\$ 4,249</u>	<u>\$ 5,146</u>

Regions contain the states as follows:

Great Lakes: IN, KY, MI, OH
Mid-Atlantic: DC, DE, MD, VA, WV
New England: CT, MA, ME, NH, RI, VT
North Central: IL, MN, MO, WI
Northeast: NJ, NY, PA
Pacific: CA, HI, NV, OR, WA
Plains: IA, ID, KS, MT, ND, NE, SD, WY
South Central: AK, AZ, CO, LA, NM, OK, TX, UT
Southeast: AL, AR, FL, GA, MS, NC, SC, TN

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

The primary loss reserves (before IBNR and LAE) at December 31, 2012, 2011 and 2010 separated between our flow and bulk business appears in the table below.

Primary loss reserves

(In millions)

	2012	2011	2010
Flow	\$ 2,586	\$ 2,820	\$ 3,329
Bulk	905	1,106	1,314
Total primary reserves	<u>\$ 3,491</u>	<u>\$ 3,926</u>	<u>\$ 4,643</u>

The average claim paid, as shown in the table below, can vary materially from period to period based upon a variety of factors, on both a national and state basis, including the geographic mix, average loan amount and average coverage percentage of loans for which claims are paid.

The primary average claim paid for the top 5 states (based on 2012 paid claims) for the years ended December 31, 2012, 2011 and 2010 appears in the table below.

Primary average claim paid

	2012	2011	2010
Florida	\$ 57,181	\$ 59,216	\$ 61,290
California	87,305	85,205	88,761
Illinois	47,615	49,654	51,073
Arizona	54,758	55,503	57,925
Michigan	33,706	35,092	35,675
All other states	43,590	45,005	44,330
All states	\$ 48,722	\$ 49,887	\$ 50,173

The primary average loan size of our insurance in force at December 31, 2012, 2011 and 2010 appears in the table below.

Primary average loan size

	2012	2011	2010
Total insurance in force	\$ 161,060	\$ 158,590	\$ 155,700
Prime (FICO 620 & >)	162,450	158,870	155,050
A-Minus (FICO 575-619)	128,850	130,700	130,360
Subprime (FICO < 575)	119,630	121,130	117,410
Reduced doc (All FICOs)(1)	188,210	194,060	198,000

- (1) In this report we classify loans without complete documentation as “reduced documentation” loans regardless of FICO credit score rather than as prime, “A-” or “subprime” loans; in the table above, such loans appear only in the reduced documentation category and they do not appear in any of the other categories.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

The primary average loan size of our insurance in force at December 31, 2012, 2011 and 2010 for the top 5 states (based on 2012 paid claims) appears in the table below.

Primary average loan size

	2012	2011	2010
Florida	\$ 171,884	\$ 174,439	\$ 174,203
California	281,288	284,034	283,459
Illinois	154,158	154,084	151,479
Arizona	181,912	182,705	184,508
Michigan	125,733	123,709	121,282
All other states	155,508	152,372	148,991

Information about net paid claims during the years ended December 31, 2012, 2011 and 2010 appears in the table below.

Net paid claims (In millions)

	2012	2011	2010
Prime (FICO 620 & >).	\$ 1,558	\$ 1,772	\$ 1,400
A-Minus (FICO 575-619).	235	283	265
Subprime (FICO < 575)	65	70	77
Reduced doc (All FICOs)(1)	372	429	451
Pool (2)	334	480	177
Other	5	6	3
Direct losses paid.	2,569	3,040	2,373
Reinsurance	(90)	(140)	(126)
Net losses paid	2,479	2,900	2,247
LAE	45	60	71
Net losses and LAE paid before terminations	2,524	2,960	2,318
Reinsurance terminations	(6)	(39)	(38)
Net losses and LAE paid.	<u>\$ 2,518</u>	<u>\$ 2,921</u>	<u>\$ 2,280</u>

(1) In this report we classify loans without complete documentation as “reduced documentation” loans regardless of FICO credit score rather than as prime, “A-” or “subprime” loans; in the table above, such loans appear only in the reduced documentation category and they do not appear in any of the other categories.

(2) 2012 includes \$100 million paid under the terms of the settlement with Freddie Mac as discussed under Note 20 - "Litigation and Contingencies" to our consolidated financial statements.

Primary claims paid for the top 15 states (based on 2012 paid claims) and all other states for the years ended December 31, 2012, 2011 and 2010 appears in the table below.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Paid Claims by state (In millions)

	2012	2011	2010
Florida	\$ 317	\$ 303	\$ 340
California	309	357	288
Illinois	144	101	91
Arizona	122	203	156
Michigan	110	138	130
Georgia	99	130	97
Nevada	88	134	95
Ohio	70	76	68
Texas	69	108	87
Washington	64	74	41
Minnesota	59	65	56
Wisconsin	50	46	36
North Carolina	48	40	38
Virginia	48	66	57
Maryland	47	51	50
All other states	586	662	563
	<u>\$ 2,230</u>	<u>\$ 2,554</u>	<u>\$ 2,193</u>
Other (Pool, LAE, Reinsurance)	288	367	87
Net losses and LAE paid	<u>\$ 2,518</u>	<u>\$ 2,921</u>	<u>\$ 2,280</u>

We believe paid claims, on a quarterly basis, peaked in the second quarter of 2011 and that the overall level of total paid claims will continue to decline, assuming recent foreclosure patterns continue.

The GSEs have introduced new short sale programs in 2012, which could result in claim payments being accelerated on more recent notices. While a short sale would likely result in the claim being received and paid sooner than would occur through a foreclosure the amount of the claim payment could be less. We do not know what the level of participation in these programs will be. In 2011 and 2012, our claim payments on default notices received in the current year have increased, in part, due to an increase in short sales. See Note 9 – “Loss Reserves” to our consolidated financial statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

The primary default inventory for the top 15 states (based on 2012 paid claims) at December 31, 2012, 2011 and 2010 appears in the table below.

	2012	2011	2010
Florida	22,024	27,533	32,788
California	6,201	9,542	14,070
Illinois	9,313	11,420	12,548
Arizona	2,161	3,809	6,781
Michigan	4,808	7,269	10,278
Georgia	5,100	6,744	9,117
Nevada	2,053	3,001	4,729
Ohio	6,647	8,357	9,850
Texas	6,924	8,961	11,602
Washington	3,053	3,467	3,888
Minnesota	1,937	2,778	3,672
Wisconsin	3,086	3,945	4,519
North Carolina	3,956	4,929	5,641
Virginia	2,100	2,647	3,627
Maryland	3,486	3,869	4,264
All other states	56,996	67,368	77,350
	<u>139,845</u>	<u>175,639</u>	<u>214,724</u>

The primary default inventory at December 31, 2012, 2011 and 2010 separated between our flow and bulk business appears in the table below.

	2012	2011	2010
Flow	107,497	134,101	162,621
Bulk	32,348	41,538	52,103
	<u>139,845</u>	<u>175,639</u>	<u>214,724</u>

The flow default inventory by policy year at December 31, 2012, 2011 and 2010 appears in the table below.

Flow default inventory by policy year

Policy year:	2012	2011	2010
2002 and prior	9,157	12,006	14,914
2003	5,731	7,403	9,069
2004	8,142	10,116	12,077
2005	12,582	15,594	18,789
2006	18,257	23,078	28,284
2007	40,357	50,664	62,855
2008	11,914	14,247	16,059
2009	901	800	546
2010	264	168	28
2011	148	25	-
2012	44	-	-
	<u>107,497</u>	<u>134,101</u>	<u>162,621</u>

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

As of December 31, 2012, 26% of our primary insurance in force was written subsequent to December 31, 2009, 32% of our primary insurance in force was written subsequent to December 31, 2008, and 46% of our primary insurance in force was written subsequent to December 31, 2007. On our flow business, the highest claim frequency years have typically been the third and fourth year after the year of loan origination. On our bulk business, the period of highest claims frequency has generally occurred earlier than in the historical pattern on our flow business. However, the pattern of claims 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.

Premium deficiency

Beginning in 2007, when we stopped writing Wall Street bulk business, we began to separately measure the performance of these transactions and established a premium deficiency reserve related to this business. The premium deficiency reserve reflects the present value of expected future losses and expenses that exceeded the present value of expected future premiums and already established loss reserves. This premium deficiency reserve as of December 31, 2012, 2011 and 2010 was \$74 million, \$135 million and \$179 million, respectively. The discount rate used in the calculation of the premium deficiency reserve at December 31, 2012, 2011 and 2010 was 1.3%, 2.3% and 2.5%, respectively.

See Note 10 – “Premium Deficiency Reserve” to our consolidated financial statements in for a discussion of our premium deficiency reserve, as well as under “Critical Accounting Policies” below.

Underwriting and other expenses

Underwriting and other expenses for 2012 decreased when compared to 2011. The decrease primarily reflects our reduction in headcount.

Underwriting and other expenses for 2011 decreased when compared to 2010. The decrease reflects our reductions in headcount as well as our lower contract underwriting volume.

Ratios

The table below presents our GAAP loss, expense and combined ratios for our combined insurance operations for the years ended December 31, 2012, 2011 and 2010.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Loss ratio	200.1%	152.6%	137.5%
Underwriting expense ratio	15.2%	16.0%	16.3%
Combined ratio.....	<u>215.3%</u>	<u>168.6%</u>	<u>153.8%</u>

The loss ratio is the ratio, expressed as a percentage, of the sum of incurred losses and loss adjustment expenses to net premiums earned. The loss ratio does not reflect any effects due to premium deficiency. The increase in the loss ratio in 2012 compared to 2011, was due to an increase in losses incurred, as well as a decrease in premiums earned. The underwriting expense ratio is the ratio, expressed as a percentage, of underwriting expenses to net premiums written. The decrease in the underwriting expense ratio in 2012 compared to 2011, was due to a decrease in underwriting and other expenses of the combined insurance operations, partially offset by a decrease in premiums written. The combined ratio is the sum of the loss ratio and the underwriting expense ratio.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

The increase in the loss ratio in 2011, compared to 2010, was due to an increase in losses incurred, as well as a decrease in premiums earned. The decrease in the underwriting expense ratio in 2011, compared to 2010, was due to a decrease in underwriting and other expenses of the combined insurance operations, partially offset by a decrease in premiums written.

Interest expense

Interest expense for 2012 decreased when compared to 2011. The decrease is primarily due to lower interest on our Senior Notes due to repayments and repurchases, partially offset by an increase in amortization on our junior debentures.

Interest expense for 2011 increased when compared to 2010. The increase is due to the issuance of our 5% Convertible Senior Notes in April 2010 as well as an increase in amortization on our junior debentures, somewhat offset by lower interest on our Senior Notes due to repayments and repurchases.

Income taxes

The effective tax rate benefit on our pre-tax loss was (0.2%) in 2012 compared to the effective tax rate provision of 0.3%, and 1.2% in 2011, and 2010, respectively. During those periods, the benefit from income taxes was eliminated or reduced by the recognition of a valuation allowance.

See Note 14 – “Income Taxes” to our consolidated financial statements for a discussion of our tax position.

Financial Condition

At December 31, 2012 the total fair value of our investment portfolio was \$4.2 billion. In addition, at December 31, 2012 our total assets included approximately \$1.0 billion of cash and cash equivalents as shown on our consolidated balance sheet. At December 31, 2012, based on fair value, less than 1% of our fixed income securities were below investment grade securities. The percentage of investments rated BBB may continue to increase as we reinvest to achieve higher yields and, in part, due to the reduced availability of highly rated corporate securities. Lower rated investments have greater risk. Greater than 99% of our fixed income securities are readily marketable. The composition of ratings at December 31, 2012, 2011 and 2010 are shown in the table below.

Investment Portfolio Ratings

	December 31,		
	2012	2011	2010
AAA.....	52%	37%	43%
AA	15%	26%	29%
A	22%	27%	23%
BBB	11%	10%	5%
Investment grade	100%	100%	100%
Below investment grade	-	-	-
Total.....	<u>100%</u>	<u>100%</u>	<u>100%</u>

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

The ratings above are provided by one or more of the following major rating agencies: 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 4% of our investment portfolio, excluding cash and cash equivalents, is guaranteed by financial guarantors. We evaluate the credit risk of securities through analysis of the underlying fundamentals. The extent of our analysis depends on a variety of factors, including the issuer's sector, scale, profitability, debt cover, ratings and the tenor of the investment. At December 31, 2012, less than 1% of our fixed income securities were relying on financial guaranty insurance to elevate their rating.

We primarily place our investments in investment grade securities pursuant to our investment policy guidelines. The policy guidelines also limit the amount of our credit exposure to any one issue, issuer and type of instrument. At December 31, 2012, the modified duration of our fixed income investment portfolio was 2.5 years, which means that an instantaneous parallel shift in the yield curve of 100 basis points would result in a change of 2.5% 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 6 – "Investments" to our consolidated financial statements for additional disclosure surrounding our investment portfolio.

At December 31, 2012, we had outstanding \$100.1 million, 5.375% Senior Notes due in November 2015, with an approximate fair value of \$80 million. At December 31, 2012, we also had \$345 million principal amount of 5% Convertible Senior Notes outstanding due in 2017, with an approximate fair value of \$243 million and \$389.5 million principal amount of 9% Convertible Junior Subordinated Debentures due in 2063 outstanding, which at December 31, 2012 are reflected as a liability on our consolidated balance sheet at the current amortized value of \$380 million, with the unamortized discount reflected in equity. The fair value of the convertible debentures was approximately \$173 million at December 31, 2012. See Note 8 – "Debt" to our consolidated financial statements for additional disclosure on our debt.

See Note 14 – "Income Taxes" to our consolidated financial statements for a description of our federal income tax contingencies.

Our principal exposure to loss is our obligation to pay claims under MGIC's mortgage guaranty insurance policies. At December 31, 2012, MGIC's direct (before any reinsurance) primary and pool risk in force, which is the unpaid principal balance of insured loans as reflected in our records multiplied by the coverage percentage, and taking account of any loss limit, was approximately \$43.0 billion. In addition, as part of our contract underwriting activities provided through a non-insurance subsidiary, 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 our 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. These obligations have been primarily funded by contributions from our holding company and, in part, from the operations of the subsidiary. A generally positive economic environment for residential real estate that continued until approximately 2007 may have mitigated the effect of some of these costs in previous years. Historically, a material portion of our new insurance written through the flow channel has involved loans for which that subsidiary provided contract underwriting services, including new insurance written between 2006 and 2008. Claims for remedies may be made a number of years after the underwriting work was performed. We believe the rescission of mortgage insurance coverage on loans for which the subsidiary provided contract underwriting services may make a claim for a contract underwriting remedy more likely to occur. Beginning in the second half of 2009, our subsidiary has experienced an increase in claims for contract underwriting remedies, which has continued throughout 2012. The related contract underwriting remedy expense was approximately \$27 million, \$23 million and \$19 million for the years ended December 31, 2012, 2011 and 2010. We expect to pay remedy claims in the next two years in amounts similar to what

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

we have paid in recent years, and to fund these payments through capital contributions to MGIC and its affiliates from our holding company's cash and investments.

Liquidity and Capital Resources

Overview

Our sources of funds consist primarily of:

- our investment portfolio (which is discussed in "Financial Condition" above), and interest income on the portfolio,
- net premiums that we will receive from our existing insurance in force as well as policies that we write in the future and
- amounts that we expect to recover from captives (which is discussed in "Results of Consolidated Operations – Risk sharing arrangements" above).

Our obligations consist primarily of:

- claim payments under MGIC's mortgage guaranty insurance policies,
- \$100 million of 5.375% Senior Notes due in November 2015,
- \$345 million of Convertible Senior Notes due in May 2017,
- \$390 million of Convertible Junior Debentures due in April 2063,
- interest on the foregoing debt instruments, including deferred interest on our convertible debentures, and
- the other costs and operating expenses of our business.

Holders of both of the convertible issues may convert their notes into shares of our common stock at their option prior to certain dates prescribed under the terms of their issuance, in which case our corresponding obligation will be eliminated.

Since 2009, our claim payments have exceeded our premiums received. We expect that this trend will continue. Due to the uncertainty regarding how factors such as foreclosure moratoriums, servicing and court delays, failures by servicers to follow proper procedures in foreclosure proceedings, loan modifications and claims investigations and rescissions, will affect our future paid claims it has become even more difficult to estimate the amount and timing of future claim payments. When we experience cash shortfalls, we can fund them through sales of short-term investments and other investment portfolio securities, subject to insurance regulatory requirements regarding the payment of dividends to the extent funds were required by an entity other than the seller. In addition, we align the maturities of our investment portfolio with our estimate of future obligations. A significant portion of our investment portfolio securities are held by our insurance subsidiaries. As long as the trends discussed above continue, we expect to experience significant declines in our investment portfolio.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

The following table summarizes our consolidated cash flows from operating, investing and financing activities:

	For the year ended December 31,		
	2012	2011	2010
	(In thousands)		
Total cash (used in) provided by:			
Operating activities.....	\$ (1,568,600)	\$ (1,883,851)	\$ (875,430)
Investing activities	1,653,533	1,754,217	(111,904)
Financing activities.....	(53,107)	(178,721)	1,105,749
Increase (decrease) in cash and cash equivalents ..	<u>\$ 31,826</u>	<u>\$ (308,355)</u>	<u>\$ 118,415</u>

Cash used in operating activities for 2012 was lower compared to 2011 primarily due to a decrease in losses paid, partially offset by a decrease in premiums collected. Cash used in operating activities for 2011 was higher compared to 2010 primarily due to an increase in losses paid as well as a decrease in premiums collected.

Cash provided by investing activities for 2012 was lower compared to 2011 but at a considerably high level for both periods as we elected to realize gains, by selling certain securities, given the favorable market conditions experienced in 2011 and 2012. We then reinvested the funds taking into account our anticipated future claim payment obligations. We also continue to reduce our investments in tax exempt municipal securities and increase our investments in taxable securities. Cash provided by investing activities for 2011 was significantly higher compared to 2010 due to the factors described above.

Cash used in financing activities for 2012 was lower compared to 2011, as we made less debt repurchases in 2012 than 2011. In 2012 we repurchased \$70.9 million in par value of our 5.375% Senior Notes due in November 2015 at a cost of \$53.1 million, compared to repurchases of \$129 million in par value of our 5.375% Senior Notes in 2011 at a cost of \$101.3 million. In 2011 we also repaid approximately \$77 million in par value of senior notes that came due. Cash used in financing activities was higher in 2011 compared to 2010. In 2010 we received net proceeds from the public offering and sale of our common stock of approximately \$772 million as well as net proceeds from our concurrent debt offering of approximately \$334 million.

Debt at Our Holding Company and Holding Company Capital Resources

The senior notes, convertible senior notes and convertible debentures are obligations of MGIC Investment Corporation and not of its subsidiaries. The payment of dividends from our insurance subsidiaries, which prior to raising capital in the public markets in 2008 and 2010 had been the principal source of our holding company cash inflow, is restricted by insurance regulation. MGIC is the principal source of dividend-paying capacity. Since 2008, MGIC has not paid any dividends to our holding company. Through 2013, MGIC cannot pay any dividends to our holding company without approval from the OCI. In connection with the approval of MIC as an eligible mortgage insurer, Freddie Mac and Fannie Mae have imposed dividend restrictions on MGIC and MIC through December 31, 2013.

At December 31, 2012, we had approximately \$315 million in cash and investments at our holding company.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

As of December 31, 2012, our holding company's debt obligations were \$835 million in par value consisting of:

- \$100 million in par value of Senior Notes due in November 2015, with an annual interest cost of \$5 million;
- \$345 million in par value of Convertible Senior Notes due in 2017, with an annual interest cost of \$17 million; and
- \$390 million in par value of Convertible Junior Debentures due in 2063, with an annual interest cost of \$35 million

See Note 8 – “Debt” to our consolidated financial statements for additional information about this indebtedness, including restrictive covenants in our Senior Notes and our election to defer interest on our Convertible Junior Debentures. Any deferred interest compounds at the stated rate of 9%. The description in Note 8 - “Debt” to our consolidated financial statements is qualified in its entirety by the terms of the notes and debentures. The terms of our Senior Notes are contained in the Officer's Certificate, dated as of October 4, 2005, which specifies the interest rate, maturity date and other terms, and in the Indenture dated as of October 15, 2000, between us and the trustee, included as an exhibit to our Form 8-K filed with the SEC on October 19, 2000 (the “2000 Indenture”). The terms of our Convertible Senior Notes are contained in a Supplemental Indenture, dated as of April 26, 2010, between us and U.S. Bank National Association, as trustee, which is included as an exhibit to our 8-K filed with the SEC on April 30, 2010, and in the 2000 Indenture. The terms of our Convertible Junior Debentures are contained in the Indenture dated as of March 28, 2008, between us and U.S. Bank National Association filed as an exhibit to our Form 10-Q filed with the SEC on May 12, 2008.

Our holding company has no other material sources of cash inflows other than investment income. Furthermore, our holding company contributed \$100 million in December 2012 and \$200 million in December 2011 to support its insurance operations. Any further contributions to our insurance operations or other non-insurance affiliates would further decrease our holding company cash and investments. See discussion of our non-insurance contract underwriting services under “Financial Condition” above and in Note 20 – “Litigation and Contingencies” to our consolidated financial statements.

In the second quarter of 2012, we repurchased for cash approximately \$70.9 million in par value of our 5.375% Senior Notes due in November 2015, at a cost of \$53.1 million. We recognized \$17.8 million in gains on the repurchases, which is included in other revenue on the Consolidated Statements of Operations for the year ended December 31, 2012. In 2011, we repurchased for cash approximately \$129.0 million in par value of our 5.375% Senior Notes due in November 2015, at a cost of \$101.3 million. We recognized \$27.7 million in gains on the repurchases, which is included in other revenue on the Consolidated Statements of Operations for the year ended December 31, 2011. 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.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

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.

The premium deficiency reserve discussed in Note 10 – “Premium Deficiency Reserve” to our consolidated financial statements is not recorded as a liability on the statutory balance sheet and is not a component of statutory net income. The present value of expected future premiums and already established loss reserves and statutory contingency reserves, exceeds the present value of expected future losses and expenses on our total in force book, so no deficiency is recorded on a statutory basis. On a GAAP basis, contingency loss reserves are not established and thus not considered when calculating premium deficiency reserve and policies are grouped based on how they are acquired, serviced and measured.

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

	December 31,	
	2012	2011
	(In millions, except ratio)	
Risk in force - net (1).....	\$ 30,802	\$ 31,769
Statutory policyholders' surplus	\$ 689	\$ 1,569
Statutory contingency reserve	-	-
Statutory policyholders' position	\$ 689	\$ 1,569
 Risk-to-capital	 44.7:1	 20.3:1

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

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

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

	December 31,	
	2012	2011
	(In millions, except ratio)	
Risk in force - net (1)	\$ 36,113	\$ 36,805
Statutory policyholders' surplus	\$ 749	\$ 1,657
Statutory contingency reserve	<u>6</u>	<u>4</u>
Statutory policyholders' position	\$ 755	\$ 1,661
 Risk-to-capital	 47.8:1	 22.2:1

(1) Risk in force – net, as shown in the table above, is net of reinsurance and exposure on policies currently in default (\$6.5 billion at December 31, 2012 and \$8.6 billion at December 31, 2011) and for which loss reserves have been established.

Our risk-to-capital ratio will increase if the percentage decrease in capital exceeds the percentage decrease in insured risk. Therefore, as capital decreases, the same dollar decrease in capital will cause a greater percentage decrease in capital and a greater increase in the risk-to-capital ratio.

For additional information regarding regulatory capital see Note 1 – “Nature of Business – Capital” to our consolidated financial statements as well as our risk factor titled “Capital requirements may prevent us from continuing to write new insurance on an uninterrupted basis” below.

Financial Strength Ratings

The financial strength of MGIC, our principal mortgage insurance subsidiary, is rated B2 by Moody's Investors Service with a negative outlook. Standard & Poor's Rating Services' insurer financial strength rating of MGIC is B- with a negative outlook. For further information about the importance of MGIC's ratings, see our risk factor titled “We may not continue to meet the GSEs' mortgage insurer eligibility requirements” below.

The financial strength of MIC, a subsidiary of MGIC, is rated Ba3 by Moody's Investors Service with a negative outlook. Standard & Poor's Rating Services' insurer financial strength rating of MIC is B- with a negative outlook. For further information about the importance of MIC's ratings, see our risk factor titled “Competition or changes in our relationships with our customers could reduce our revenues or increase our losses” below.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Contractual Obligations

At December 31, 2012, 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	\$ 2,717	\$ 58	\$ 216	\$ 441	\$ 2,002
Operating lease obligations	7	4	2	1	-
Tax obligations.....	18	-	-	18	-
Purchase obligations.....	2	1	1	-	-
Pension, SERP and other post-retirement benefit plans	174	11	27	31	105
Other long-term liabilities	4,057	2,104	1,601	352	-
Total.....	<u>\$ 6,975</u>	<u>\$ 2,178</u>	<u>\$ 1,847</u>	<u>\$ 843</u>	<u>\$ 2,107</u>

Our long-term debt obligations at December 31, 2012 include, \$100 million of 5.375% Senior Notes due in November 2015, \$345 million of 5% Convertible Senior Notes due in May 2017 and \$389.5 million in convertible debentures due in April 2063, including related interest, as discussed in Note 8 – “Debt” to our consolidated financial statements below and under “Liquidity and Capital Resources” above. The interest payment on our convertible debentures that was scheduled to be paid on October 1, 2012, but which we elected to defer as discussed in Note 8 – “Debt” to our consolidated financial statements, is included in the “More than 5 years” column in the table 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. Tax obligations consist primarily of amounts related to our current dispute with the IRS, as discussed in Note 14 – “Income Taxes” to our consolidated financial statements. 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 for 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, as well as future payments required under the settlement agreement with Freddie Mac as discussed in Note 20 – “Litigation and Contingencies” to our consolidated financial statements. 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 uncertainty regarding how certain factors, such as foreclosure moratoriums, servicing and court delays, failures by servicers to follow proper procedures in foreclosure proceedings, loan modifications, claims investigations and claim rescissions, will affect our future paid claims it has become even more difficult to estimate the amount and timing of future claim payments. Current conditions in the housing and mortgage industries make all of the assumptions discussed in this paragraph more volatile than they would otherwise be. See Note 9 – “Loss Reserves” to our consolidated financial statements and “-Critical Accounting Policies” below. 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.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

Critical Accounting Policies

We believe that the accounting policies described below involved significant judgments and estimates used in the preparation of our consolidated financial statements.

Loss reserves and premium deficiency reserves

Loss reserves

Reserves are established for reported insurance losses and loss adjustment expenses based on when notices of default on insured mortgage loans are received. A default is defined as an insured loan with a mortgage payment that is 45 days or more past due. Reserves are also established for estimated losses incurred on notices of default not yet reported. Even though the accounting standard, Accounting Standards Codification ("ASC") 944, regarding accounting and reporting by insurance entities specifically excluded mortgage insurance from its guidance relating to loss reserves, we establish loss reserves using the general principles contained in the insurance standard. However, consistent with industry standards for mortgage insurers, we do not establish loss reserves for future claims on insured loans which are not currently in default.

We establish reserves using estimated claim rates and claim amounts in estimating the ultimate loss. The liability for reinsurance assumed is based on information provided by the ceding companies.

The incurred but not reported, or IBNR, reserves referred to above result from defaults occurring prior to the close of an accounting period, but which have not been reported to us. Consistent with reserves for reported defaults, IBNR reserves are established using estimated claim rates and claim amounts for the estimated number of defaults not reported. As of December 31, 2012 and 2011, we had IBNR reserves of approximately \$180 million and \$244 million, respectively.

Reserves also provide for the estimated costs of settling claims, including legal and other expenses and general expenses of administering the claims settlement process.

The estimated claim rates and claim amounts represent what we believe reflect the best estimate of what will actually be paid on the loans in default as of the reserve date. If a policy is rescinded we do not expect that it will result in a claim payment and thus the rescission generally reduces the historical claim rate used in establishing reserves. In addition, if a loan cures its delinquency, including successful loan modifications that result in a cure being reported to us, the cure reduces the historical claim rate used in establishing reserves. Our methodology to determine the estimate of claim rates and claim amounts are based on our review of recent trends in the default inventory. To establish reserves we utilize a reserving model that continually incorporates historical data on the rate at which defaults resulted in a claim, or the claim rate. This historical data includes the effects of rescissions, which are included as cures within the model. The model also incorporates an estimate for the amount of the claim we will pay, or severity. The severity is estimated using the historical percentage of our claim paid compared to our loan exposure, as well as the risk in force of the loans currently in default. We review recent trends in the claim rate, severity, the change in the level of defaults by geography and the change in average loan exposure. As a result, the process to determine reserves does not include quantitative ranges of outcomes that are reasonably likely to occur.

The claim rates and claim amounts are likely to be affected by external events, including actual economic conditions such as changes in unemployment rate, interest rate or housing value. Our estimation process does not include a correlation between claim rates and claim amounts to projected economic conditions such as changes in unemployment rate, interest rate or housing value. Our experience is that analysis of that nature would not produce reliable results. The results would not be reliable as the change

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

in one economic condition cannot be isolated to determine its sole effect on our ultimate paid losses as our ultimate paid losses are also influenced at the same time by other economic conditions. Additionally, the changes and interaction of these economic conditions are not likely homogeneous throughout the regions in which we conduct business. Each economic environment influences our ultimate paid losses differently, even if apparently similar in nature. Furthermore, changes in economic conditions may not necessarily be reflected in our loss development in the quarter or year in which the changes occur. Typically, actual claim results often lag changes in economic conditions by at least nine to twelve months.

In considering the potential sensitivity of the factors underlying our best estimate of loss reserves, it is possible that even a relatively small change in estimated claim rate or a relatively small percentage change in estimated claim amount could have a significant impact on reserves and, correspondingly, on results of operations. For example, a \$1,000 change in the average severity reserve factor combined with a 1% change in the average claim rate reserve factor would change the reserve amount by approximately \$152 million as of December 31, 2012. Historically, it has not been uncommon for us to experience variability in the development of the loss reserves through the end of the following year at this level or higher, as shown by the historical development of our loss reserves in the table below:

	Losses incurred related to prior years (1)	Reserve at end of prior year
	(In thousands)	
2012	\$ 573,120	\$ 4,557,512
2011	(99,328)	5,884,171
2010	(266,908)	6,704,990
2009	466,765	4,775,552
2008	387,104	2,642,479

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

See Note 9 - "Loss Reserves" to our consolidated financial statements for a discussion of recent loss development.

Estimation of losses is inherently judgmental. The conditions that affect the claim rate and claim severity include the current and future state of the economy, including unemployment and local housing markets. Current conditions in the housing and mortgage industries make these assumptions more volatile than they would otherwise be. 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 further deterioration of regional or national economic conditions, including unemployment, leading to a reduction in borrowers' income and thus their ability to make mortgage payments, and a further drop in housing values that could result in, among other things, greater losses on loans that have pool insurance, and may affect borrower willingness to continue to make mortgage payments when the value of the home is below the mortgage balance and mitigation from rescissions being materially less than assumed. Our estimates are also affected by any agreements we enter into regarding claim payments, such as the probable settlement agreements discussed in Note 20 - "Litigation and Contingencies" to our consolidated financial statements. Changes to our estimates could result in a material impact to our results of operations, even in a stable economic environment.

Our estimates could also be positively affected by government efforts to assist current borrowers in refinancing to new loans, assisting delinquent borrowers and lenders in reducing their mortgage payments, and forestalling foreclosures.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Loss reserves in the most recent years contain a greater degree of uncertainty, even though the estimates are based on the best available data.

In addition, our loss reserving methodology incorporates the effects rescission activity is expected to have on the losses we will pay on our delinquent inventory. We do not utilize an explicit rescission rate in our reserving methodology, but rather our reserving methodology incorporates the effects rescission activity has had on our historical claim rate and claim severities. A variance between ultimate actual rescission rates and these estimates could materially affect our losses.

Information regarding the ever-to-date rescission rates by the quarter in which the claim was received appears in the table below. No information is presented for claims received in the most recent two quarters to allow sufficient time for a substantial percentage of the claims received in those two quarters to reach resolution.

As of December 31, 2012

Ever to Date Rescission Rates on Primary Claims Received (based on count)

Quarter in Which the Claim was Received	ETD Rescission Rate (1)	ETD Claims Resolution Percentage (2)
Q1 2011.....	13.3%	98.6%
Q2 2011.....	10.3%	97.5%
Q3 2011.....	7.9%	96.7%
Q4 2011.....	7.5%	96.1%
Q1 2012.....	6.1%	95.1%
Q2 2012.....	4.6%	93.9%

- (1) This percentage is claims received, during the quarter shown, that have been rescinded as of our most recently completed quarter divided by the total claims received during the quarter shown. In certain cases we rescind coverage before a claim is received. Such rescissions, which have not been material, are not included in the statistics in this table.
- (2) This percentage is claims received, during the quarter shown, that have been resolved as of our most recently completed quarter divided by the total claims received during the quarter shown. Claims resolved principally consist of claims paid plus claims for which we have informed the insured of our decision not to pay the claim. Although our decision to not pay a claim is made after we have given the insured an opportunity to dispute the facts underlying our decision to not pay the claim, these decisions are sometimes reversed after further discussion with the insured. The number of rescission reversals has been immaterial, but could increase materially if we enter into material resolution agreements.

Note: As discussed in Note 20 – “Litigation and Contingencies” to our consolidated financial statements we have made substantial progress in reaching an agreement with Countrywide regarding rescissions. In connection with the Countrywide proceedings, we have voluntarily suspended rescissions of coverage related to loans that we believe could be included in a potential resolution. As of December 31, 2012, coverage on approximately 2,150 loans, representing total potential claim payments of approximately \$160 million, that we had determined was rescindable were affected by our decision to suspend such rescissions. Substantially all of these potential rescissions relate to claims received beginning in the first quarter of 2011 or later. As of December 31, 2012, coverage on approximately 250 loans, representing total potential claims payments of approximately \$17 million, were affected by our decision to suspend such rescissions for another customer for which

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

we also consider settlement probable. See Note 20 – “Litigation and Contingencies” for a discussion of probable settlements. In addition, as of December 31, 2012, approximately 240 rescissions, representing total potential claim payments of approximately \$16 million, were affected by our decision to suspend rescissions for customers other than those for which we consider settlement probable, as defined in ASC 450-20. The decision to suspend these potential rescissions does not represent the only reason for the recent decline in the percentage of claims that have been resolved through rescissions and we continue to expect that our rescissions will continue to decline.

We anticipate that the ever-to-date rescission rate on the more recent quarters will increase as the ever-to-date resolution percentage moves closer to 100%.

For more information regarding rescissions, rescission settlements and related legal proceedings, see Note 9 – “Loss Reserves” and Note 20 – “Litigation and Contingencies” to our consolidated financial statements.

Premium deficiency reserve

After our reserves are established, we perform premium deficiency calculations using best estimate assumptions as of the testing date. The calculation of premium deficiency reserves requires the use of significant judgments and estimates to determine the present value of future premium and present value of expected losses and expenses on our business. The present value of future premium relies on, among other things, assumptions about persistency and repayment patterns on underlying loans. The present value of expected losses and expenses depends on assumptions relating to severity of claims and claim rates on current defaults, and expected defaults in future periods. These assumptions also include an estimate of expected rescission activity. Assumptions used in calculating the deficiency reserves can be affected by volatility in the current housing and mortgage lending industries. To the extent premium patterns and actual loss experience differ from the assumptions used in calculating the premium deficiency reserves, the differences between the actual results and our estimate will affect future period earnings.

The establishment of premium deficiency reserves is subject to inherent uncertainty and requires judgment by management. The actual amount of claim payments and premium collections may vary significantly from the premium deficiency reserve estimates. Similar to our loss reserve estimates, our estimates for premium deficiency reserves could be adversely affected by several factors, including a deterioration of regional or economic conditions leading to a reduction in borrowers' income and thus their ability to make mortgage payments, and a drop in housing values that could expose us to greater losses. Changes to our estimates could result in material changes in our operations, even in a stable economic environment. Adjustments to premium deficiency reserves estimates are reflected in the financial statements in the years in which the adjustments are made.

As is the case with our loss reserves, as discussed above, the severity of claims and claim rates, as well as persistency for the premium deficiency calculation, are likely to be affected by external events, including actual economic conditions, as well as future rescission activity. However, our estimation process does not include a correlation between these economic conditions and our assumptions because it is our experience that an analysis of that nature would not produce reliable results. In considering the potential sensitivity of the factors underlying management's best estimate of premium deficiency reserves, it is possible that even a relatively small change in estimated claim rate or a relatively small percentage change in estimated claim amount could have a significant impact on the premium deficiency reserve and, correspondingly, on our results of operations. For example, a \$1,000 change in the average severity combined with a 1% change in the average claim rate could change the Wall Street bulk premium deficiency reserve amount by approximately \$62 million. Additionally, a 5% change in the persistency of the underlying loans could change the Wall Street bulk premium deficiency reserve amount by

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

approximately \$13 million. We do not anticipate changes in the discount rate will be significant enough as to result in material changes in the calculation.

Revenue recognition

When a policy term ends, the primary mortgage insurance written by us is renewable at the insured's option through continued payment of the premium in accordance with the schedule established at the inception of the policy term. We have no ability to reunderwrite or reprice these policies after issuance. Premiums written under policies having single and annual premium payments are initially deferred as unearned premium reserve and earned over the policy term. Premiums written on policies covering more than one year are amortized over the policy life in accordance with the expiration of risk which is the anticipated claim payment pattern based on historical experience. Premiums written on annual policies are earned on a monthly pro rata basis. Premiums written on monthly policies are earned as the monthly coverage is provided. When a policy is cancelled, all premium that is non-refundable is immediately earned. Any refundable premium is returned to the lender. Cancellations include rescissions and policies cancelled due to claim payment. When a policy is rescinded, all previously collected premium is returned to the lender and when a claim is paid we return any premium received since the date of default. The liability associated with our estimate of premium to be returned is accrued for separately and separate components of this liability are included in "Other liabilities" and "Premium deficiency reserves" on our consolidated balance sheet. Changes in these liabilities affect premiums written and earned and change in premium deficiency reserve, respectively. The actual return of premium affects premium written and earned. Policy cancellations also lower the persistency rate which is a variable used in calculating the rate of amortization of deferred policy acquisition costs discussed below.

Fee income of our non-insurance subsidiaries is earned and recognized as the services are provided and the customer is obligated to pay.

Deferred insurance policy acquisition costs

Costs directly associated with the successful acquisition of mortgage insurance policies, consisting of employee compensation and other policy issuance and underwriting expenses, are initially deferred and reported as deferred insurance policy acquisition costs. Deferred insurance policy acquisition costs arising from each book of business are charged against revenue in the same proportion that the underwriting profit for the period of the charge bears to the total underwriting profit over the life of the policies. The underwriting profit and the life of the policies are estimated and are reviewed quarterly and updated when necessary to reflect actual experience and any changes to key variables such as persistency or loss development. Interest is accrued on the unamortized balance of deferred insurance policy acquisition costs.

Because our insurance premiums are earned over time, changes in persistency result in deferred insurance policy acquisition costs being amortized against revenue over a comparable period of time. At December 31, 2012, the persistency rate of our primary mortgage insurance was 79.8%, compared to 82.9% at December 31, 2011. This change did not significantly affect the amortization of deferred insurance policy acquisition costs for the period ended December 31, 2012. A 10% change in persistency would not have a material effect on the amortization of deferred insurance policy acquisition costs in the subsequent year.

If a premium deficiency exists, we reduce the related deferred insurance policy acquisition costs by the amount of the deficiency or to zero through a charge to current period earnings. If the deficiency is more than the deferred insurance policy acquisition costs balance, we then establish a premium deficiency reserve equal to the excess, by means of a charge to current period earnings.

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Fair Value Measurements

For the years ended December 31, 2012, 2011 and 2010, we did not elect the fair value option for any financial instruments acquired for which the primary basis of accounting is not fair value.

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

Level 1 – Quoted prices for identical instruments in active markets that we have the ability to access. Financial assets utilizing Level 1 inputs primarily include certain U.S. Treasury securities and obligations of U.S. government corporations and agencies and Australian government and semi government securities.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and inputs, other than quoted prices, that are observable in the marketplace for the financial instrument. The observable inputs are used in valuation models to calculate the fair value of the financial instruments. Financial assets utilizing Level 2 inputs primarily include certain municipal and corporate bonds.

Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or value drivers are unobservable. Level 3 inputs reflect our own assumptions about the assumptions a market participant would use in pricing an asset or liability. Financial assets utilizing Level 3 inputs include certain state and auction rate (backed by student loans) securities. Non-financial assets which utilize Level 3 inputs include real estate acquired through claim settlement.

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 including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two sided markets, benchmark securities, bids, offers and reference data including market research publications. Inputs may be weighted differently for any security, and not all inputs are used for each security evaluation. Market indicators, industry and economic events are also considered. This information is evaluated using a multidimensional pricing model. Quality controls are performed throughout this process which includes reviewing tolerance reports, trading information and data changes, and directional moves compared to market moves. This model combines all inputs to arrive at a value assigned to each security. On a quarterly basis, we perform quality controls over values received from the pricing sources which include reviewing tolerance reports, trading information and data changes, and directional moves compared to market moves. We have not made any adjustments to the prices obtained from the independent pricing sources.

Assets and liabilities classified as Level 3 are as follows:

- Securities available-for-sale classified in Level 3 are not readily marketable and are valued using internally developed models based on the present value of expected cash flows. Our Level 3 securities primarily consist of auction rate securities as observable inputs or value drivers are unavailable due to events described in Note 6 – “Investments” to our consolidated financial statements. Due to limited market information, we utilized a discounted cash flow (“DCF”) model to derive an estimate of fair value of these assets at December 31, 2012 and 2011. The DCF model is based on the following key assumptions.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*continued*)

- Nominal credit risk as substantially all of the underlying collateral of these securities is ultimately guaranteed by the United States Department of Education;
- Time to liquidity through December 31, 2013;
- Continued receipt of contractual interest; and
- Discount rates ranging from 16.87% to 18.35%, which include a spread for liquidity risk.

Real estate acquired through claim settlement is fair valued at the lower of our acquisition cost or a percentage of appraised value. The percentage applied to appraised value is based upon our historical sales experience adjusted for current trends.

Investment Portfolio

Our entire investment portfolio is classified as available-for-sale and is reported at fair value. The related unrealized gains or losses are, after considering the related tax expense or benefit, recognized as a component of accumulated other comprehensive income in shareholders' equity. Realized investment gains and losses are reported in income based upon specific identification of securities sold.

Each quarter we perform reviews of our investments in order to determine whether declines in fair value below amortized cost were considered other-than-temporary in accordance with applicable guidance. In evaluating whether a decline in fair value is other-than-temporary, we consider several factors including, but not limited to:

- our intent to sell the security or whether it is more likely than not that we will be required to sell the security before recovery;
- extent and duration of the decline;
- failure of the issuer to make scheduled interest or principal payments;
- change in rating below investment grade; and
- adverse conditions specifically related to the security, an industry, or a geographic area.

Under the current guidance a debt security impairment is deemed other than temporary if we either intend to sell the security, or it is more likely than not that we will be required to sell the security before recovery or we do not expect to collect cash flows sufficient to recover the amortized cost basis of the security. During 2012, 2011 and 2010 we recognized OTTI losses in earnings of \$2.3 million, \$0.7 million and \$9.6 million, respectively.

Risk Factors

Forward Looking Statements and Risk Factors

As used below, “we,” “our” and “us” refer to MGIC Investment Corporation’s consolidated operations or to MGIC Investment Corporation, as the context requires; “MGIC” refers to Mortgage Guaranty Insurance Corporation; and “MIC” refers to MGIC Indemnity Corporation.

Our actual results could be affected by the risk factors below. These risk factors are an integral part of this annual report. These risk 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, including matters that inherently refer to future events. Among others, statements that include words such as “believe,” “anticipate,” “will” or “expect,” or words of similar import, are forward looking statements. We are not undertaking any obligation to update any forward looking statements or other statements we may make even though these statements may be affected by events or circumstances occurring after the forward looking statements or other statements were made. No reader of this annual report should rely on these statements being current at any time other than the time at which our Annual Report on Form 10-K for the year ended December 31, 2012 was filed with the Securities and Exchange Commission.

Capital requirements may prevent us from continuing to write new insurance on an uninterrupted basis.

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 “Capital Requirements.” New insurance written in the jurisdictions that have Capital Requirements represented approximately 50% of new insurance written in 2011 and 2012. While formulations of minimum capital vary among jurisdictions, the most common formulation allows for a maximum risk-to-capital ratio of 25 to 1. A risk-to-capital ratio will increase if the percentage decrease in capital exceeds the percentage decrease in insured risk. Therefore, as capital decreases, the same dollar decrease in capital will cause a greater percentage decrease in capital and a greater increase in the risk-to-capital ratio. 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 December 31, 2012, MGIC’s risk-to-capital ratio was 44.7 to 1, exceeding the maximum allowed by many jurisdictions, and its policyholder position was \$640 million below the required MPP of \$1.2 billion. We expect MGIC’s risk-to-capital ratio to increase above its December 31, 2012 level. At December 31, 2012, the risk-to-capital ratio of our combined insurance operations (which includes reinsurance affiliates) was 47.8 to 1. A higher risk-to-capital ratio on a combined basis may indicate that, in order for MGIC or MIC to continue to utilize reinsurance arrangements with its subsidiaries or subsidiaries of our holding company, additional capital contributions to the reinsurance affiliates could be needed. These reinsurance arrangements permit MGIC and MIC to write insurance with a higher coverage percentage than they could on their own under certain state-specific requirements.

Risk Factors (*continued*)

Statement of Statutory Accounting Principles No. 101 (“SSAP No. 101”) became effective January 1, 2012 and prescribed new standards for determining the amount of deferred tax assets that can be recognized as admitted assets for determining statutory capital. Under a permitted practice effective September 30, 2012 and until further notice, the Office of the Commissioner of Insurance of the State of Wisconsin (“OCI”) has approved MGIC to report its net deferred tax asset as an admitted asset in an amount not to exceed 10% of surplus as regards policyholders, notwithstanding contrary provisions of SSAP No. 101. At December 31, 2012, had MGIC calculated its net deferred tax assets based on the provisions of SSAP No. 101, no deferred tax assets would have been admitted. Pursuant to the permitted practice, deferred tax assets of \$63 million were included in statutory capital.

Although MGIC does not meet the Capital Requirements of Wisconsin, the OCI has waived them until December 31, 2013. In place of the Capital Requirements, the OCI Order containing the waiver of Capital Requirements (the “OCI Order”) provides that MGIC can write new business as long as it maintains regulatory capital that the OCI determines is reasonably in excess of a level that would constitute a financially hazardous condition. The OCI Order requires MGIC Investment Corporation, through the earlier of December 31, 2013 and the termination of the OCI Order (the “Covered Period”), to make cash equity contributions to MGIC as may be necessary so that its “Liquid Assets” are at least \$1 billion (this portion of the OCI Order is referred to as the “Keepwell Provision”). “Liquid Assets,” which include those of MGIC as well as those held in certain of our subsidiaries, including our Australian subsidiaries, but excluding MIC and its reinsurance affiliates, are the sum of (i) the aggregate cash and cash equivalents, (ii) fair market value of investments and (iii) assets held in trusts supporting the obligations of captive mortgage reinsurers to MGIC. As of December 31, 2012, “Liquid Assets” were approximately \$4.8 billion. Although we do not expect that MGIC’s Liquid Assets will fall below \$1 billion during the Covered Period, we do expect the amount of Liquid Assets to continue to decline materially after December 31, 2012 and through the end of the Covered Period as MGIC’s claim payments and other uses of cash continue to exceed cash generated from operations. You should read the rest of these risk factors for additional information about factors that could negatively affect MGIC’s Liquid Assets.

The OCI, in its sole discretion, may modify, terminate or extend its waiver of Capital Requirements, although any modification or extension of the Keepwell Provision requires our written consent. If the OCI modifies or terminates its waiver, or if it fails to renew its waiver upon expiration, depending on the circumstances, MGIC could be prevented from writing new business in all jurisdictions if MGIC does not comply with the Capital Requirements. We cannot assure you that MGIC could obtain the additional capital necessary to comply with the Capital Requirements. At present, the amount of additional capital we would need to comply with the Capital Requirements would be substantial. See “— Your ownership in our company may be diluted by additional capital that we raise or if the holders of our outstanding convertible debt convert that debt into shares of our common stock.” If MGIC were prevented from writing new business in all jurisdictions, our insurance operations in MGIC would be in run-off (meaning no new loans would be insured but loans previously insured would continue to be covered, with premiums continuing to be received and losses continuing to be paid on those loans) until MGIC either met the Capital Requirements or obtained a necessary waiver to allow it to once again write new business. Furthermore, if the OCI revokes or fails to renew MGIC’s waiver, MIC’s ability to write new business would be severely limited because approval by Fannie Mae and Freddie Mac (the “GSEs”) of MIC (discussed below) is conditioned upon the continued effectiveness of the OCI Order.

MGIC applied for waivers in the other jurisdictions with Capital Requirements and, at this time, has active waivers from seven of them. MIC is writing new business in the jurisdictions where MGIC does not have active waivers. As a result, MGIC and MIC are collectively writing business on a nationwide basis.

Insurance departments, in their sole discretion, may modify, terminate or extend their waivers of Capital Requirements. If an insurance department other than the OCI modifies or terminates its waiver, or

Risk Factors (*continued*)

if it fails to grant a waiver or renew its waiver after expiration, depending on the circumstances, MGIC could be prevented from writing new business in that particular jurisdiction. Also, depending on the level of losses that MGIC experiences in the future, it is possible that regulatory action by one or more jurisdictions, including those that do not have specific Capital Requirements, may prevent MGIC from continuing to write new insurance in that jurisdiction. As discussed below, under certain conditions, this business would be written in MIC. You should read the rest of these risk factors for additional information about factors that could negatively affect MGIC's statutory capital and compliance with Capital Requirements.

MGIC's failure to meet the Capital Requirements to insure new business does not necessarily mean that MGIC does not have sufficient resources to pay claims on its insurance liabilities. While we believe that MGIC has sufficient claims paying resources to meet its claim obligations on its insurance in force on a timely basis, we cannot assure you that the events that led to MGIC failing to meet Capital Requirements would not also result in it not having sufficient claims paying resources. Furthermore, our estimates of MGIC's claims paying resources and claim obligations are based on various assumptions. These assumptions include the timing of the receipt of claims on loans in our delinquency inventory and future claims that we anticipate will ultimately be received, our anticipated rescission activity, premiums, housing values and unemployment rates. These assumptions are subject to inherent uncertainty and require judgment by management. Current conditions in the domestic economy make the assumptions about when anticipated claims will be received, housing values, and unemployment rates highly volatile in the sense that there is a wide range of reasonably possible outcomes. Our anticipated rescission activity is also subject to inherent uncertainty due to the difficulty of predicting the amount of claims that will be rescinded and the outcome of any legal proceedings or settlement discussions related to rescissions. You should read the rest of these risk factors for additional information about factors that could negatively affect MGIC's claims paying resources.

As part of our longstanding plan to write new business in MIC, a direct subsidiary of MGIC, MGIC has made capital contributions to MIC. As of December 31, 2012, MIC had statutory capital of \$448 million. In the third quarter of 2012, we began writing new mortgage insurance in MIC on the same policy terms as MGIC, in those jurisdictions where we did not have active waivers of Capital Requirements for MGIC. In the second half of 2012, MIC's new insurance written was \$2.4 billion, which includes business from certain jurisdictions for which new insurance is again being written in MGIC after it received the necessary waivers. We are currently writing new mortgage insurance in MIC in Florida, Idaho, Missouri, New Jersey, New York, North Carolina, Ohio and Puerto Rico. Approximately 19% of new insurance written in 2011 and 2012 was from jurisdictions in which MIC is currently writing business. We project MIC can write 100% of our new insurance for at least five years if MGIC is unable to write new business. This projection is based on the 18:1 risk-to-capital limitation prescribed by Freddie Mac's approval of MIC (discussed below) and assumes the mix and level of new insurance written in the future would be the same as we wrote in 2012. It also assumes MIC's GSE eligibility would extend throughout this period. If we had to write substantially more of our business in MIC and our levels of new insurance written were to increase materially, MIC may require additional capital to stay below Freddie Mac's prescribed risk-to-capital limitation or a waiver of that limitation may be required. MIC is licensed to write business in all jurisdictions and, subject to the conditions and restrictions discussed below, has received the necessary approvals from GSEs and the OCI to write business in all of the jurisdictions that have not waived their Capital Requirements for MGIC.

Under an agreement in place with Fannie Mae, as amended November 30, 2012, MIC will be eligible to write mortgage insurance through December 31, 2013, in those jurisdictions (other than Wisconsin) in which MGIC cannot write new insurance due to MGIC's failure to meet Capital Requirements and to obtain a waiver of them. MIC is also approved to write mortgage insurance for 60 days in jurisdictions that do not have Capital Requirements if a jurisdiction notifies MGIC that, due to its financial condition, it may no longer write new business. The agreement provides that Fannie Mae may, in its discretion, extend such

Risk Factors *(continued)*

approval to no later than December 31, 2013. The agreement with Fannie Mae, including certain conditions and restrictions to its continued effectiveness, is summarized more fully in, and included as an exhibit to, our Form 8-K filed with the Securities and Exchange Commission (the “SEC”) on November 30, 2012. Such conditions include the continued effectiveness of the OCI Order and the continued applicability of the Keepwell Provision of the OCI Order.

Under a letter from Freddie Mac that was amended and restated as of November 30, 2012, Freddie Mac approved MIC to write business only in those jurisdictions (other than Wisconsin) where either (a) MGIC is unable to write business because it does not meet the Capital Requirements and does not obtain waivers of them, or (b) MGIC received notice that it may not write business because of that jurisdiction’s view of MGIC’s financial condition. This approval of MIC, which may be withdrawn at any time, expires December 31, 2013, or earlier if a financial examination by the OCI determines that there is a reasonable probability that MGIC will be unable to honor claim obligations at any time in the five years after the examination, or if MGIC fails to honor claim payments. The approval from Freddie Mac, including certain conditions and restrictions to its continued effectiveness, is summarized more fully in, and included as an exhibit to, our Form 8-K filed with the SEC on November 30, 2012. Such conditions include requirements that MIC not exceed a risk-to-capital ratio of 18:1 (at December 31, 2012, MIC’s risk-to-capital ratio was 1.2 to 1); MGIC and MIC comply with all terms and conditions of the OCI Order; the OCI Order remain effective; we contribute \$100 million to MGIC on or before December 3, 2012 (which we did); MGIC enter into and comply with the payment terms of the settlement agreement with Freddie Mac and the FHFA dated December 1, 2012 (for more information about the settlement agreement, see “— We are involved in legal proceedings and are subject to the risk of additional legal proceedings in the future”); the OCI issue the order described in the next paragraph (which it did); and MIC provide MGIC access to the capital of MIC in an amount necessary for MGIC to maintain sufficient liquidity to satisfy its obligations under insurance policies issued by MGIC.

On November 29, 2012, the OCI issued an order, effective until December 31, 2013, establishing a procedure for MIC to pay a dividend to MGIC if either of the following two events occurs: (1) an OCI examination determines that there is a reasonable probability that MGIC will be unable to honor its policy obligations at any time during the five years after the examination, or (2) MGIC fails to honor its policy obligations that it in good faith believes are valid. If one of these events occurs, the OCI is to conduct a review (to be completed within 60 days after the triggering event) to determine the maximum single dividend MIC could prudently pay to MGIC for the benefit of MGIC’s policyholders, taking account of the interests of MIC’s policyholders and the general public and certain standards for dividends imposed by Wisconsin law. Upon the completion of the review, the OCI will authorize, and MIC will pay, such a dividend within 30 days.

We cannot assure you that the GSEs will approve or continue to approve MIC to write new business in all jurisdictions in which MGIC is unable to do so. If one GSE does not approve MIC in all jurisdictions in which MGIC is unable to write new business, MIC may be able to write insurance on loans that will be sold to the other GSE or retained by private investors. However, because lenders may not know which GSE will purchase their loans until mortgage insurance has been procured, lenders may be unwilling to procure mortgage insurance from MIC. Furthermore, if we are unable to write business on a nationwide basis utilizing a combination of MGIC and MIC, lenders may be unwilling to procure insurance from us anywhere. In addition, new insurance written can be influenced by a lender’s assessment of the financial strength of our insurance operations. In this regard, see “— Competition or changes in our relationships with our customers could reduce our revenues or increase our losses.”

Risk Factors *(continued)*

The amount of insurance we write could be adversely affected if the definition of Qualified Residential Mortgage results in a reduction of the number of low down payment loans available to be insured or if lenders and investors select alternatives to private mortgage insurance.

The financial reform legislation that was passed in July 2010 (the “Dodd-Frank Act” or “Dodd-Frank”) requires a securitizer to retain at least 5% of the risk associated with mortgage loans that are securitized, and in some cases the retained risk may be allocated between the securitizer and the lender that originated the loan. This risk retention requirement does not apply to mortgage loans that are Qualified Residential Mortgages (“QRMs”) or that are insured by the FHA or another federal agency. In March 2011, federal regulators requested public comments on a proposed risk retention rule that includes a definition of QRM. The proposed definition of QRM contains many underwriting requirements, including a maximum loan-to-value ratio (“LTV”) of 80% on a home purchase transaction, a prohibition on seller contributions toward a borrower’s down payment or closing costs, and certain limits on a borrower’s debt-to-income ratio. The LTV is to be calculated without including mortgage insurance. None of our new risk written in 2012 was on loans that would qualify as QRMs under the March 2011 proposed rules.

The regulators also requested public comments regarding an alternative QRM definition, the underwriting requirements of which would allow loans with a maximum LTV of 90% and higher debt-to-income ratios than allowed under the proposed QRM definition, and that may consider mortgage insurance in determining whether the LTV requirement is met. We estimate that approximately 22% of our new risk written in 2012 was on loans that would have met the alternative QRM definition. The regulators also requested that the public comments include information that may be used to assess whether mortgage insurance reduces the risk of default. We submitted a comment letter, including studies to the effect that mortgage insurance reduces the risk of default.

Under the proposed rule, because of the capital support provided by the U.S. Government, the GSEs satisfy the Dodd-Frank risk-retention requirements while they are in conservatorship. Therefore, under the proposed rule, lenders that originate loans that are sold to the GSEs while they are in conservatorship would not be required to retain risk associated with those loans. The public comment period for the proposed rule expired in August 2011. At this time we do not know when a final rule will be issued, although it was not expected that the final QRM rule would be issued until the final rule defining Qualified Mortgages (“QMs”) (discussed below) was issued. The Consumer Financial Protection Bureau (the “CFPB”) issued the final QM rule on January 10, 2013.

Depending on, among other things, (a) the final definition of QRM and its requirements for LTV, seller contributions and debt-to-income ratio, (b) to what extent, if any, the presence of mortgage insurance would allow for a higher LTV in the definition of QRM, and (c) whether lenders choose mortgage insurance for non-QRM loans, the amount of new insurance that we write may be materially adversely affected. For other factors that could decrease the demand for mortgage insurance, see “— If the volume of low down payment home mortgage originations declines, the amount of insurance that we write could decline, which would reduce our revenues” and “— The implementation of the Basel III capital accord, or other changes to our customers’ capital requirements, may discourage the use of mortgage insurance.”

As noted above, on January 10, 2013, the CFPB issued the final rule defining QM, in order to implement laws requiring lenders to consider a borrower’s ability to repay a home loan before extending credit. The QM rule prohibits loans with certain features, such as negative amortization, points and fees in excess of 3% of the loan amount, and terms exceeding 30 years, from being considered QMs. The rule also establishes general underwriting criteria for QMs including that a borrower have a total debt-to-income ratio of less than or equal to 43%. The rule provides a temporary category of QMs that have more flexible underwriting requirements so long as they satisfy the general product feature requirements of QMs and so long as they meet the underwriting requirements of the GSEs or those of the U.S. Department of Housing

Risk Factors (*continued*)

and Urban Development, Department of Veterans Affairs or Rural Housing Service (collectively, “Other Federal Agencies”). The temporary category of QMs that meet the underwriting requirements of the GSEs or the Other Federal Agencies will phase out when the GSEs or the Other Federal Agencies issue their own qualified mortgage rules, if the GSEs’ conservatorship ends, and in any case after seven years. We expect that most lenders will be reluctant to make loans that do not qualify as QMs because they will not be entitled to the presumptions about compliance with the ability-to-pay requirements. Given the credit characteristics presented to us, we estimate that 99% of our new risk written in 2012 was for mortgages that would have met the QM definition and 91% of our new risk written in 2012 was for mortgages that would have met the QM definition even without the temporary category allowed for mortgages that meet the GSEs’ underwriting requirements. In making these estimates, we have not considered the limitation on points and fees because the information is not available to us. We do not believe such limitation would materially affect the percentage of our new risk written meeting the QM definition. The QM rule is scheduled to become effective in January 2014.

Alternatives to private mortgage insurance include:

- lenders using government mortgage insurance programs, including those of the Federal Housing Administration, or FHA, and the Veterans Administration,
- lenders and other investors holding mortgages in portfolio and self-insuring,
- investors using risk mitigation techniques other than private mortgage insurance, using other risk mitigation techniques in conjunction with reduced levels of private mortgage insurance coverage, or accepting credit risk without credit enhancement, and
- lenders originating mortgages using piggyback structures to avoid private mortgage insurance, such as a first mortgage with an 80% loan-to-value ratio and a second mortgage with a 10%, 15% or 20% loan-to-value ratio (referred to as 80-10-10, 80-15-5 or 80-20 loans, respectively) rather than a first mortgage with a 90%, 95% or 100% loan-to-value ratio that has private mortgage insurance.

The FHA substantially increased its market share beginning in 2008, and beginning in 2011, that market share began to gradually decline. We believe that the FHA’s market share increased, in part, because private mortgage insurers tightened their underwriting guidelines (which led to increased utilization of the FHA’s programs) and because of increases in the amount of loan level delivery fees that the GSEs assess on loans (which result in higher costs to borrowers). In addition, federal legislation and programs provided the FHA with greater flexibility in establishing new products and increased the FHA’s competitive position against private mortgage insurers. We believe that the FHA’s current premium pricing, when compared to our current credit-tiered premium pricing (and considering the effects of GSE pricing changes), has allowed us to be more competitive with the FHA than in the recent past for loans with high FICO credit scores. We cannot predict, however, the FHA’s share of new insurance written in the future due to, among other factors, different loan eligibility terms between the FHA and the GSEs; future increases in guarantee fees charged by the GSEs; changes to the FHA’s annual premiums; and the total profitability that may be realized by mortgage lenders from securitizing loans through Ginnie Mae when compared to securitizing loans through Fannie Mae or Freddie Mac.

Risk Factors (*continued*)

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.

Substantially all of our insurance written is for loans sold to Fannie Mae and Freddie Mac. The business practices of the GSEs affect the entire relationship between them, lenders and mortgage insurers and include:

- the level of private mortgage insurance coverage, subject to the limitations of the GSEs' charters (which may be changed by federal legislation), when private mortgage insurance is used as the required credit enhancement on low down payment mortgages,
- the amount of loan level delivery fees (which result in higher costs to borrowers) that the GSEs assess on loans that require mortgage insurance,
- whether the GSEs influence the mortgage lender's selection of the mortgage insurer providing coverage and, if so, any transactions that are related to that selection,
- the underwriting standards that determine what loans are eligible for purchase by the GSEs, which can affect the quality of the risk insured by the mortgage insurer and the availability of mortgage loans,
- the terms on which mortgage insurance coverage can be canceled before reaching the cancellation thresholds established by law,
- the programs established by the GSEs intended to avoid or mitigate loss on insured mortgages and the circumstances in which mortgage servicers must implement such programs,
- the terms that the GSEs require to be included in mortgage insurance policies for loans that they purchase, and
- the extent to which the GSEs intervene in mortgage insurers' rescission practices or rescission settlement practices with lenders. For additional information, see "— Our losses could increase if we do not prevail in proceedings challenging whether our rescissions were proper, we enter into material resolution arrangements or rescission rates decrease faster than we are projecting."

The 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 mortgage market 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. In addition, these factors may increase the likelihood that the charters of the GSEs are changed by new federal legislation. 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 was released in February 2011 and while it does not provide any definitive timeline for GSE reform, it does recommend using a combination of federal housing policy changes to wind down the GSEs, shrink the government's footprint in housing finance, and help bring private capital back to the mortgage market. In 2012, Members of Congress introduced several bills intended to scale back the GSEs, however, no legislation was 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 domestic residential housing finance system in the future or the impact of any such changes on our business. In addition, the timing of the impact 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.

Risk Factors *(continued)*

The GSEs have different loan purchase programs that allow different levels of mortgage insurance coverage. Under the “charter coverage” program, on certain loans lenders may choose a mortgage insurance coverage percentage that is less than the GSEs’ “standard coverage” and only the minimum required by the GSEs’ charters, with the GSEs paying a lower price for such loans. In 2011 and 2012, nearly all of our volume was on loans with GSE standard coverage. We charge higher premium rates for higher coverage percentages. To the extent lenders selling loans to the GSEs in the future choose charter coverage for loans that we insure, our revenues would be reduced and we could experience other adverse effects.

We may not continue to meet the GSEs’ mortgage insurer eligibility requirements.

Substantially all of our insurance written is for loans sold to Fannie Mae and Freddie Mac, each of which has mortgage insurer eligibility requirements to maintain the highest level of eligibility, including a financial strength rating of Aa3/AA-. Because MGIC does not meet such financial strength rating requirements of Fannie Mae and Freddie Mac (its financial strength rating from Moody’s is B2 with a negative outlook and from Standard & Poor’s is B- with a negative outlook), MGIC is currently operating with each GSE as an eligible insurer under a remediation plan. We believe that the GSEs view remediation plans as a continuing process of interaction with a mortgage insurer and MGIC will continue to operate under a remediation plan for the foreseeable future. There can be no assurance that MGIC will be able to continue to operate as an eligible mortgage insurer under a remediation plan. In particular, the GSEs are currently in discussions with mortgage insurers regarding their standard mortgage insurer eligibility requirements. We also understand the FHFA and the GSEs are separately developing mortgage insurer capital standards that would replace the use of external credit ratings. The GSEs may include any new eligibility requirements as part of our current remediation plan. MIC’s financial strength rating from Moody’s is Ba3 with a negative outlook and from Standard & Poor’s is B- with a negative outlook. Therefore, MIC also does not meet the financial strength rating requirements of the GSEs and is currently operating with each GSE as an eligible insurer under the approvals discussed above. See “— Capital requirements may prevent us from continuing to write new insurance on an uninterrupted basis.” If MGIC or MIC cease 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.

We have reported net losses for the last six years, expect to continue to report annual net losses, and cannot assure you when we will return to profitability.

For the years ended December 31, 2012, 2011, 2010, 2009, 2008 and 2007, we had a net loss of \$0.9 billion, \$0.5 billion, \$0.4 billion, \$1.3 billion, \$0.5 billion and \$1.7 billion, respectively. We currently expect to continue to report annual net losses, the size of which will depend primarily on the amount of our incurred and paid losses from our business written prior to 2009. Our incurred and paid losses are dependent on factors that make prediction of their amounts difficult and any forecasts are subject to significant volatility. Although we currently expect to return to profitability on an annual basis, we cannot assure you when, or if, this will occur. Conditions that could delay our return to profitability include high unemployment rates, low cure rates, low housing values, changes to our current rescission practices and unfavorable resolution of ongoing legal proceedings. You should read the rest of these risk factors for additional information about factors that could increase our net losses in the future. The net losses we have experienced have eroded, and any future net losses will erode, our shareholders’ equity and could result in equity being negative.

Risk Factors *(continued)*

Our losses could increase if we do not prevail in proceedings challenging whether our rescissions were proper, we enter into material resolution arrangements or rescission rates decrease faster than we are projecting.

Prior to 2008, rescissions of coverage on loans were not a material portion of our claims resolved during a year. However, beginning in 2008, our rescissions of coverage on loans have materially mitigated our paid losses. In each of 2009 and 2010, rescissions mitigated our paid losses by approximately \$1.2 billion; in 2011, rescissions mitigated our paid losses by approximately \$0.6 billion; and in 2012, rescissions mitigated our paid losses by approximately \$0.3 billion (in each case, the figure includes amounts that would have either resulted in a claim payment or been charged to a deductible under a bulk or pool policy, and may have been charged to a captive reinsurer). In recent quarters, less than 10% 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 and reversals of rescissions. Historically, the number of rescissions that we have reversed has been immaterial. A variance between ultimate actual rescission and reversal rates and our estimates, as a result of the outcome of claims investigations, litigation, settlements or other factors, could materially affect our losses. See “— Because loss reserve estimates are subject to uncertainties and are based on assumptions that are currently very volatile, paid claims may be substantially different than our loss reserves.” We estimate rescissions mitigated our incurred losses by approximately \$2.5 billion in 2009 and \$0.2 billion in 2010. In 2011, we estimate that rescissions had no significant impact on our losses incurred. All of these figures include the benefit of claims not paid in the period as well as the impact of changes in our estimated expected rescission activity on our loss reserves in the period. In the fourth quarter of 2012, we estimate that our rescission benefit in loss reserves was reduced due to probable rescission settlement agreements and that other rescissions had no significant impact on our losses incurred in 2012. For more information about the rescission benefit in loss reserves, see Note 9 – “Loss Reserves” to our consolidated financial statements. For information about two settlements that we believe are probable, as defined in ASC 450-20, see “— We are involved in legal proceedings and are subject to the risk of additional legal proceedings in the future.” The completion of those settlements, assuming they occur, may encourage other customers to seek remedies against us.

If the insured disputes our right to rescind coverage, the outcome of the dispute ultimately would be determined by legal proceedings. Under our policies, legal proceedings disputing our right to rescind coverage may be brought up to three years after the lender has obtained title to the property (typically through a foreclosure) or the property was sold in a sale that we approved, whichever is applicable, although in a few jurisdictions there is a longer time to bring such an action. For the majority of our rescissions since the beginning of 2009 that are not subject to a settlement agreement, this period in which a dispute may be brought has not ended. Until a liability associated with a settlement agreement or litigation becomes probable and can be reasonably estimated, we consider a rescission resolved for financial reporting purposes even though legal proceedings have been initiated and are ongoing. Although it is reasonably possible that, when the proceedings are completed, there will be a determination that we were not entitled to rescind in all cases, we are sometimes unable to make a reasonable estimate or range of estimates of the potential liability. Under ASC 450-20, an estimated loss from such proceedings is accrued for only if we determine that the loss is probable and can be reasonably estimated. Therefore, when establishing our loss reserves, we do not generally include additional loss reserves that would reflect an adverse outcome from ongoing legal proceedings.

In April 2011, Freddie Mac advised its servicers that they must obtain its prior approval for rescission settlements and Fannie Mae advised its servicers that they are prohibited from entering into such settlements. In addition, in April 2011, Fannie Mae notified us that we must obtain its prior approval to enter into certain settlements. Since those announcements, the GSEs have approved our settlement

Risk Factors *(continued)*

agreement with one customer and have rejected settlement agreements that were structured differently. We have reached and implemented settlement agreements that do not require GSE approval, but they have not been material in the aggregate.

As noted in “— We are involved in legal proceedings and are subject to the risk of additional legal proceedings in the future,” we have been in mediation with Countrywide Home Loans (“Countrywide”) concerning our dispute regarding rescissions and have made substantial progress in reaching an agreement to settle it. In addition to the proceedings involving Countrywide, we are involved in legal proceedings with respect to rescissions that we do not consider to be collectively material in amount. We continue to discuss with other customers their objections to material rescissions and have reached settlement terms with several of our significant customers. In connection with some of these settlement discussions, we have suspended rescissions related to loans that we believe could be included in potential settlements. As of December 31, 2012, approximately 240 rescissions, representing total potential claim payments of approximately \$16 million, were affected by our decision to suspend rescissions for customers other than the two customers for which we consider a settlement agreement probable, as defined in ASC 450-20. Although it is reasonably possible that, when the discussions or legal proceedings with customers regarding rescissions are completed, there will be a conclusion or determination that we were not entitled to rescind in all cases, we are unable to make a reasonable estimate or range of estimates of the potential liability.

We are involved in legal proceedings and are subject to the risk of additional legal proceedings in the future.

Consumers continue to bring lawsuits against home mortgage lenders and settlement service providers. Mortgage insurers, including MGIC, have been involved in litigation alleging 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. MGIC’s settlement of class action litigation against it under RESPA became final in October 2003. MGIC settled the named plaintiffs’ claims in litigation against it under FCRA in December 2004, following denial of class certification in June 2004. Since December 2006, class action litigation has been brought against a number of large lenders alleging that their captive mortgage reinsurance arrangements violated RESPA. Beginning in December 2011, MGIC, various mortgage lenders and various other mortgage insurers have been named as defendants in twelve lawsuits, alleged to be class actions, filed in various U.S. District Courts. Three of those cases have previously been dismissed. The complaints in all nine of the remaining cases allege various causes of action related to the captive mortgage reinsurance arrangements of the mortgage lenders, including that the defendants violated RESPA by paying excessive premiums to the lenders’ captive reinsurer in relation to the risk assumed by that captive. MGIC denies any wrongdoing and intends to vigorously defend itself against the allegations in the lawsuits. There can be no assurance that we will not be subject to further litigation under RESPA (or FCRA) or that the outcome of any such litigation, including the lawsuits mentioned above, would not have a material adverse effect on us.

Since June 2005, various state and federal regulators have also conducted investigations or requested information regarding captive mortgage reinsurance arrangements, including (1) a request received by MGIC in June 2005 from the New York Department of Financial Services for information regarding captive mortgage reinsurance arrangements and other types of arrangements in which lenders receive compensation; (2) the Minnesota Department of Commerce (the “MN Department”), which regulates insurance, began requesting information in February 2006, regarding captive mortgage reinsurance and certain other matters in response to which MGIC has provided information on several occasions, including as recently as May 2011; (3) various subpoenas received by MGIC beginning in March 2008 from the U.S. Department of Housing and Urban Development (“HUD”), seeking information about captive mortgage reinsurance similar to that requested by the MN Department, but not limited in scope to the state of

Risk Factors (*continued*)

Minnesota; and (4) correspondence received by MGIC in January 2012 from the CFPB indicating that HUD had transferred authority to the CFPB to investigate captive reinsurance arrangements in the mortgage insurance industry and requesting, among other things, certain information regarding captive mortgage reinsurance transactions in which we participated. In June 2012, we received a Civil Investigative Demand (“CID”) from the CFPB requiring additional information and documentation regarding captive mortgage reinsurance. We have met with, and expect to continue to meet with, the CFPB to discuss the CID and how to resolve its investigation. MGIC has also filed a petition to modify the CID which petition is currently pending. While MGIC believes it would have strong defenses to any claims the CFPB might bring against it as a result of the investigation, it continues to work with the CFPB to try to resolve the investigation and any concerns that the CFPB may have about MGIC’s past and current captive reinsurance practices. If MGIC cannot resolve the concerns of the CFPB, it is possible that the CFPB would assert various RESPA and possibly other claims against it. Other insurance departments or other officials, including attorneys general, may also seek information about or investigate captive mortgage reinsurance.

Various regulators, including the CFPB, state insurance commissioners and state attorneys general may bring actions seeking various forms of relief, including civil penalties and injunctions against 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 captive reinsurance arrangements 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.

We are subject to comprehensive, detailed regulation by state insurance departments. These regulations are principally designed for the protection of our insured policyholders, rather than for the benefit of investors. Although their scope varies, state insurance laws generally grant broad supervisory powers to agencies or officials to examine insurance companies and enforce rules or exercise discretion affecting almost every significant aspect of the insurance business. Given the recent significant losses incurred by many insurers in the mortgage and financial guaranty industries, our insurance subsidiaries have been subject to heightened scrutiny by insurance regulators. State insurance regulatory authorities could take actions, including changes in capital requirements or termination of waivers of capital requirements, that could have a material adverse effect on us. As noted above, in January 2013, the CFPB issued rules to implement laws requiring mortgage lenders to make ability-to-pay determinations prior to extending credit. We are uncertain whether the CFPB will issue any other rules or regulations that affect our business apart from any action it may take as a result of its investigation of captive mortgage reinsurance. Such rules and regulations could have a material adverse effect on us.

In October 2010, a purported class action lawsuit was filed against MGIC in the U.S. District Court for the Western District of Pennsylvania by a loan applicant on whose behalf a now-settled action we previously disclosed had been filed by the U.S. Department of Justice. In this lawsuit, the loan applicant alleged that MGIC discriminated against her and certain proposed class members on the basis of sex and familial status when MGIC underwrote their loans for mortgage insurance. In May 2011, the District Court granted MGIC’s motion to dismiss with respect to all claims except certain Fair Housing Act claims. On November 29, 2012, the District Court granted final approval for a class action settlement of the lawsuit. The settlement created a settlement class of 265 borrowers. Under the terms of the settlement, MGIC deposited \$500,000 into an escrow account to fund possible payments to affected borrowers. In addition, MGIC paid the named plaintiff an “incentive fee” of \$7,500 and paid class counsels’ fees of \$337,500. Any funds remaining in the escrow account after payment of all claims approved under the procedures established by the settlement will be returned to MGIC.

We understand several law firms have, among other things, issued press releases to the effect that they are investigating us, including whether the fiduciaries of our 401(k) plan breached their fiduciary duties

Risk Factors (*continued*)

regarding the plan's investment in or holding of our common stock or whether we breached other legal or fiduciary obligations to our shareholders. We intend to defend vigorously any proceedings that may result from these investigations.

With limited exceptions, our bylaws provide that our officers and 401(k) plan fiduciaries are entitled to indemnification from us for claims against them.

We have made substantial progress in reaching an agreement with Countrywide to settle the dispute we have regarding rescissions. Since December 2009, we have been involved in legal proceedings with Countrywide in which Countrywide alleged that MGIC denied valid mortgage insurance claims. (In our SEC reports, we refer to rescissions of insurance and denials of claims collectively as "rescissions" and variations of that term.) In addition to the claim amounts it alleged MGIC had improperly denied, Countrywide contended it was entitled to other damages of almost \$700 million as well as exemplary damages. We sought a determination in those proceedings that we were entitled to rescind coverage on the applicable loans. From January 1, 2008 through December 31, 2012, rescissions of coverage on Countrywide-related loans mitigated our paid losses on the order of \$445 million. This amount is the amount we estimate we would have paid had the coverage not been rescinded. In addition, in connection with mediation we were holding with Countrywide, we voluntarily suspended rescissions related to loans that we believed could be covered by a settlement. As of December 31, 2012, coverage on approximately 2,150 loans, representing total potential claim payments of approximately \$160 million, that we had determined was rescindable was affected by our decision to suspend such rescissions. While there can be no assurance that we will actually enter into a settlement agreement with Countrywide, we have determined that a settlement is probable.

We are also discussing a settlement with another customer. We have also determined that it is probable we will reach a settlement of our dispute with this customer. As of December 31, 2012, coverage on approximately 250 loans, representing total potential claim payments of approximately \$17 million, was affected by our decision to suspend rescissions for that customer.

We are now able to reasonably estimate the probable loss associated with each probable settlement and, as required by ASC 450-20, we have recorded the estimated impact of the two probable settlements referred to above in our financial statements for the quarter ending December 31, 2012. The aggregate impact to loss reserves for the probable settlement agreements was an increase of approximately \$100 million. This impact was somewhat offset by impacts to our return premium accrual and premium deficiency reserve. All of these impacts were reflected in the fourth quarter 2012 financial results. If we are not able to reach settlement with Countrywide, we intend to defend MGIC against any related legal proceedings, vigorously.

The flow policies at issue with Countrywide are in the same form as the flow policies that we use with all of our customers, and the bulk policies at issue vary from one another, but are generally similar to those used in the majority of our Wall Street bulk transactions. A settlement with Countrywide may encourage other customers to pursue remedies against us. From January 1, 2008 through December 31, 2012, we estimate that total rescissions mitigated our incurred losses by approximately \$2.9 billion, which included approximately \$2.9 billion of mitigation on paid losses, excluding \$0.6 billion that would have been applied to a deductible. At December 31, 2012, we estimate that our total loss reserves were benefited from anticipated rescissions by approximately \$0.2 billion.

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, including the requirement to mitigate our loss by performing reasonable loss mitigation efforts or, for example, diligently pursuing a foreclosure or bankruptcy relief in a timely manner. We call such reduction of claims submitted to us "curtailments." In

Risk Factors *(continued)*

2012, curtailments reduced our average claim paid by approximately 4%. In addition, the claims submitted to us sometimes include costs and expenses not covered by our insurance policies, such as mortgage insurance premiums, hazard insurance premiums for periods after the claim date and losses resulting from property damage that has not been repaired. These other adjustments reduced claim amounts by less than the amount of curtailments.

After we pay a claim, servicers and insureds sometimes object to our curtailments and other adjustments. We review these objections if they are sent to us within 90 days after the claim was paid. Historically, we have not had material disputes regarding our curtailments or other adjustments. As part of our settlement discussions, Countrywide informed us that they object to approximately \$40 million of curtailment and other adjustments. In connection with any settlement agreement with Countrywide, we expect we would enter into a separate agreement with them that would provide for a process to resolve this dispute. However, we do not believe a loss is probable regarding this curtailment dispute and have not accrued any reserves that would reflect an adverse outcome to this dispute. We intend to defend vigorously our position regarding the correctness of these curtailments under our insurance policy. Although we have not had other material objections to our curtailment and adjustment practices, there can be no assurances that we will not face additional challenges to such practices.

A non-insurance subsidiary of our holding company is a shareholder of the corporation that operates the Mortgage Electronic Registration System (“MERS”). Our subsidiary, as a shareholder of MERS, has been named as a defendant (along with MERS and its other shareholders) in nine lawsuits asserting various causes of action arising from allegedly improper recording and foreclosure activities by MERS. Three of those lawsuits remain pending and the other six lawsuits have been dismissed without an appeal. The damages sought in the remaining cases are substantial. We deny any wrongdoing and intend to defend ourselves against the allegations in the lawsuits, vigorously.

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.

Resolution of our dispute with the Internal Revenue Service could adversely affect us.

The Internal Revenue Service (“IRS”) completed examinations of our federal income tax returns for the years 2000 through 2007 and issued assessments for unpaid 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”). This portfolio has been managed and maintained during years prior to, during and subsequent to the examination period. 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. The IRS assessment related to the REMIC issue is \$190.7 million in taxes and penalties. There would also be applicable interest which, when computed on the amount of the assessment, is substantial. Depending on the outcome of this matter, additional state income taxes along with any applicable interest may become due when a final resolution is reached and could also be substantial.

We appealed these assessments within the IRS and, in 2007, we made a payment of \$65.2 million to the United States Department of the Treasury related to this assessment. In August 2010, we reached a tentative settlement agreement with the IRS which was not finalized. We currently expect to receive a statutory notice of deficiency (commonly referred to as a “90-day letter”) for the disputed amounts after the first quarter of 2013. We would then be required to litigate their validity in order to avoid payment to the IRS of the entire amount assessed. Any such litigation could be lengthy and costly in terms of legal fees and related expenses. We continue to believe that our previously recorded tax provisions and

Risk Factors *(continued)*

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 and statutory capital. In this regard, see “— Capital requirements may prevent us from continuing to write new insurance on an uninterrupted basis.”

Because we establish loss reserves only upon a loan default rather than based on estimates of our ultimate losses on risk in force, losses may have a disproportionate adverse effect on our earnings in certain periods.

In accordance with accounting principles generally accepted in the United States, commonly referred to as GAAP, we establish loss reserves only for loans in default. Reserves are established for reported insurance losses and loss adjustment expenses based on when notices of default on insured mortgage loans are received. Reserves are also established for estimated losses incurred on notices of default that have not yet been reported to us by the servicers (this is often referred to as “IBNR”). We establish reserves using estimated claim rates and claim amounts in estimating the ultimate loss. 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, except in the case where a premium deficiency exists. As a result, future losses may have a material impact on future results as such losses emerge.

Because loss reserve estimates are subject to uncertainties and are based on assumptions that are currently very volatile, paid claims may be substantially different than our loss reserves.

We establish reserves using estimated claim rates and claim amounts in estimating the ultimate loss on delinquent loans. The estimated claim rates and claim amounts represent our best estimates of what we will actually pay on the loans in default as of the reserve date and incorporate anticipated mitigation from rescissions. We rescind coverage on loans and deny claims in cases where we believe our policy allows us to do so. Therefore, when establishing our loss reserves, unless we have determined that a loss is probable and can be reasonably estimated, we do not include additional loss reserves that would reflect an adverse development from ongoing dispute resolution proceedings. For more information regarding our legal proceedings, see “— We are involved in legal proceedings and are subject to the risk of additional legal proceedings in the future.”

The establishment of loss reserves is subject to inherent uncertainty and requires judgment by management. Current conditions in the housing and mortgage industries make the assumptions that we use to establish loss reserves more volatile than they would otherwise be. The actual amount of the claim payments may be substantially different than our loss reserve estimates. Our estimates could be adversely affected by several factors, including a deterioration of regional or national economic conditions, including unemployment, leading to a reduction in borrowers’ income and thus their ability to make mortgage payments, a drop in housing values that could result in, among other things, greater losses on loans that have pool insurance, and may affect borrower willingness to continue to make mortgage payments when the value of the home is below the mortgage balance, and mitigation from rescissions being materially less than assumed. Changes to our estimates could result in material impact to our results of operations, even in a stable economic environment, and there can be no assurance that actual claims paid by us will not be substantially different than our loss reserves.

We rely on our management team and our business could be harmed if we are unable to retain qualified personnel.

Our industry is undergoing a fundamental shift following the mortgage crisis: long-standing competitors have gone out of business and two newly capitalized, privately-held start-ups that are not

Risk Factors *(continued)*

encumbered with a portfolio of pre-crisis mortgages, have been formed. Former executives from other mortgage insurers have joined these two new competitors. In addition, in February 2013, a worldwide insurer and reinsurer with mortgage insurance operations in Europe announced that it was purchasing CMG Mortgage Insurance Company. Our success depends, in part, on the skills, working relationships and continued services of our management team and other key personnel. The departure of key personnel could adversely affect the conduct of our business. In such event, we would be required to obtain other personnel to manage and operate our business, and there can be no assurance that we would be able to employ a suitable replacement for the departing individuals, or that a replacement could be hired on terms that are favorable to us. We currently have not entered into any employment agreements with our officers or key personnel. Volatility or lack of performance in our stock price may affect our ability to retain our key personnel or attract replacements should key personnel depart.

Loan modification and other similar programs may not continue to provide material benefits to us and our losses on loans that re-default can be higher than what we would have paid had the loan not been modified.

Beginning in the fourth quarter of 2008, the federal government, including through the Federal Deposit Insurance Corporation and the GSEs, and several lenders have adopted programs to modify loans to make them more affordable to borrowers with the goal of reducing the number of foreclosures. During 2010, 2011 and 2012, we were notified of modifications that cured delinquencies that had they become paid claims would have resulted in approximately \$3.2 billion, \$1.8 billion and \$1.2 billion, respectively, of estimated claim payments. As noted below, we cannot predict with a high degree of confidence what the ultimate re-default rate on these modifications will be. Although the recent re-default rate has been lower, for internal reporting purposes, we assume approximately 50% of these modifications will ultimately re-default, and those re-defaults may result in future claim payments. Because modifications cure the defaults with respect to the previously defaulted loans, our loss reserves do not account for potential re-defaults unless at the time the reserve is established, the re-default has already occurred. Based on information that is provided to us, most of the modifications resulted in reduced payments from interest rate and/or amortization period adjustments; less than 5% resulted in principal forgiveness.

One loan modification program is the Home Affordable Modification Program (“HAMP”). Some of HAMP’s eligibility criteria relate to the borrower’s current income and non-mortgage debt payments. Because the GSEs and servicers do not share such information with us, we cannot determine with certainty the number of loans in our delinquent inventory that are eligible to participate in HAMP. We believe that it could take several months from the time a borrower has made all of the payments during HAMP’s three month “trial modification” period for the loan to be reported to us as a cured delinquency.

We rely on information provided to us by the GSEs and servicers. We do not receive all of the information from such sources that is required to determine with certainty the number of loans that are participating in, or have successfully completed, HAMP. We are aware of approximately 9,300 loans in our primary delinquent inventory at December 31, 2012 for which the HAMP trial period has begun and which trial periods have not been reported to us as completed or cancelled. Through December 31, 2012 approximately 44,400 delinquent primary loans have cured their delinquency after entering HAMP and are not in default. In 2011 and 2012, approximately 18% and 17%, respectively, of our primary cures were the result of a modification, with HAMP accounting for approximately 70% of those modifications in each year. By comparison, in 2010, approximately 27% of our primary cures were the result of a modification, with HAMP accounting for approximately 60% of those modifications. We believe that we have realized the majority of the benefits from HAMP because the number of loans insured by us that we are aware are entering HAMP trial modification periods has decreased significantly since 2010. Recent announcements by the U.S. Treasury have extended the end date of the HAMP program through 2013, expanded the eligibility criteria of HAMP and increased lenders’ incentives to modify loans through principal forgiveness. Approximately 66% of the loans in our primary delinquent inventory are guaranteed by the

Risk Factors *(continued)*

GSEs. The GSEs have informed us that they already use expanded criteria (beyond the HAMP guidelines) for determining eligibility for loan modification and currently do not offer principal forgiveness. Therefore, we currently expect new loan modifications will continue to only modestly mitigate our losses in 2013.

In 2009, the GSEs began offering the Home Affordable Refinance Program (“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. We allow the 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. To incent lenders to allow more current borrowers to refinance their loans, in October 2011, the GSEs and their regulator, FHFA, announced an expansion of HARP. The expansion includes, among other changes, releasing certain representations in certain circumstances benefitting the GSEs. We have agreed to allow these additional HARP refinances, including releasing the insured in certain circumstances from certain rescission rights we would have under our policy. While an expansion of HARP may result in fewer delinquent loans and claims in the future, our ability to rescind coverage will be limited in certain circumstances. We are unable to predict what net impact these changes may have on our incurred or paid losses. Approximately 11% of our primary insurance in force has benefitted from HARP and is still in force.

The effect on us of loan modifications depends on how many modified loans subsequently re-default, which in turn can be affected by changes in housing values. Re-defaults can result in losses for us that could be greater than we would have paid had the loan not been modified. At this point, we cannot predict with a high degree of confidence what the ultimate re-default rate will be. In addition, because we do not have information in our database for all of the parameters used to determine which loans are eligible for modification programs, our estimates of the number of loans qualifying for modification programs are inherently uncertain. If legislation is enacted to permit a portion of a borrower’s mortgage loan balance to be reduced in bankruptcy and if the borrower re-defaults after such reduction, then the amount we would be responsible to cover would be calculated after adding back the reduction. Unless a lender has obtained our prior approval, if a borrower’s mortgage loan balance is reduced outside the bankruptcy context, including in association with a loan modification, and if the borrower re-defaults after such reduction, then under the terms of our policy the amount we would be responsible to cover would be calculated net of the reduction.

Eligibility under certain loan modification programs can also 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.

If the volume of low down payment home mortgage originations declines, the amount of insurance that we write could decline, which would reduce our revenues.

The factors that affect the volume of low down payment mortgage originations include:

- restrictions on mortgage credit due to more stringent underwriting standards, liquidity issues and risk-retention requirements associated with non-QRM loans affecting lenders,
- the level of home mortgage interest rates and the deductibility of mortgage interest for income tax purposes,
- the health of the domestic economy as well as conditions in regional and local economies,
- housing affordability,

Risk Factors *(continued)*

- population trends, including the rate of household formation,
- the rate of home price appreciation, which in times of heavy refinancing can affect whether refinance loans have loan-to-value ratios that require private mortgage insurance, and
- government housing policy encouraging loans to first-time homebuyers.

As noted above, in January 2013, the CFPB issued rules to implement laws requiring mortgage lenders to make ability-to-pay determinations prior to extending credit. We are uncertain whether this Bureau will issue any other rules or regulations that affect our business or the volume of low down payment home mortgage originations. Such rules and regulations could have a material adverse effect on our financial position or results of operations.

A decline in the volume of low down payment home mortgage originations could decrease demand for mortgage insurance, decrease our new insurance written and reduce our revenues. For other factors that could decrease the demand for mortgage insurance, see “— The amount of insurance we write could be adversely affected if the definition of Qualified Residential Mortgage results in a reduction of the number of low down payment loans available to be insured or if lenders and investors select alternatives to private mortgage insurance” and “— The implementation of the Basel III capital accord, or other changes to our customers’ capital requirements, may discourage the use of mortgage insurance.”

Competition or changes in our relationships with our customers could reduce our revenues or increase our losses.

As noted above, the FHA substantially increased its market share beginning in 2008 and beginning in 2011, that market share began to gradually decline. It is difficult to predict the FHA’s future market share due to, among other factors, different loan eligibility terms between the FHA and the GSEs, future increases in guarantee fees charged by the GSEs, changes to the FHA’s annual premiums, and the total profitability that may be realized by mortgage lenders from securitizing loans through Ginnie Mae when compared to securitizing loans through Fannie Mae or Freddie Mac.

In recent years, the level of competition within the private mortgage insurance industry has been intense as many large mortgage lenders reduced the number of private mortgage insurers with whom they do business. At the same time, consolidation among mortgage lenders has increased the share of the mortgage lending market held by large lenders. During 2011 and 2012, approximately 9% and 10%, respectively, of our new insurance written was for loans for which one lender was the original insured, although revenue from such loans was significantly less than 10% of our revenues during each of those periods. Our private mortgage insurance competitors include:

- Genworth Mortgage Insurance Corporation,
- United Guaranty Residential Insurance Company,
- Radian Guaranty Inc.,
- CMG Mortgage Insurance Company (whose owners have agreed to sell it to a worldwide insurer and reinsurer), and
- Essent Guaranty, Inc.

Until 2010 the mortgage insurance industry had not had new entrants in many years. In 2010, Essent Guaranty, Inc. began writing new mortgage insurance. Essent has publicly reported that one of our

Risk Factors (*continued*)

customers, JPMorgan Chase, is one of its investors. During 2012, another new company, NMI Holdings Inc., raised \$550 million in order to enter the mortgage insurance business. NMI Holdings has been approved as an eligible mortgage insurer by the GSEs and we believe that NMI Holdings expects to launch its business in the second quarter of 2013. In addition, in February 2013, a worldwide insurer and reinsurer with mortgage insurance operations in Europe announced that it was purchasing CMG Mortgage Insurance Company. The perceived increase in credit quality of loans that are being insured today, the deterioration of the financial strength ratings of the existing mortgage insurance companies and the possibility of a decrease in the FHA's share of the mortgage insurance market may encourage additional new entrants.

PMI Mortgage Insurance Company and Republic Mortgage Insurance Company ceased writing business in 2011. Based on public disclosures, these competitors approximated slightly more than 20% of the private mortgage insurance industry volume in the first half of 2011. Most of the market share of these two former competitors has gone to other mortgage insurers and not to us because, among other reasons, some competitors have materially lower premiums than we do on single premium policies, one of these competitors also uses a risk weighted pricing model that typically results in lower premiums than we charge on certain loans and several of these competitors have streamlined their underwriting to be closely aligned with that of the GSEs. We continuously monitor the competitive landscape and make adjustments to our pricing and underwriting guidelines as warranted.

Our relationships with our customers could be adversely affected by a variety of factors, including tightening of and adherence to our underwriting guidelines, which have resulted in our declining to insure some of the loans originated by our customers and rescission of coverage on loans that affect the customer. We have ongoing discussions with lenders who are significant customers regarding their objections to our rescissions. In the fourth quarter of 2009, Countrywide commenced litigation against us as a result of its dissatisfaction with our rescission practices shortly after Countrywide ceased doing business with us. See “— We are involved in legal proceedings and are subject to the risk of additional legal proceedings in the future” for more information, including about the probable settlement of that litigation.

We believe many lenders assess a mortgage insurer's financial strength rating and risk-to-capital ratio as important elements of the process through which they select mortgage insurers. As a result of MGIC's and MIC's less than investment grade financial strength ratings and MGIC's risk-to-capital ratio level being above the maximum allowed by some jurisdictions, MGIC and MIC may be competitively disadvantaged with these lenders. MGIC's financial strength rating from Moody's is B2 with a negative outlook and from Standard & Poor's is B- with a negative outlook. MIC's financial strength rating from Moody's is Ba3 with a negative outlook and from Standard & Poor's is B- with a negative outlook. It is possible that MGIC's financial strength ratings could decline from these levels. MGIC's risk-to-capital ratio exceeds 25:1 and the applicable minimum capital requirement of certain states. We currently expect to continue to report a risk-to-capital ratio in excess of 25:1. Our risk-to-capital ratio will depend primarily on the level of incurred losses, any settlement with the IRS, and the volume of new risk written. Our incurred losses are dependent upon factors that make prediction of their amounts difficult and any forecasts are subject to significant volatility. Although we expect the risk-to-capital ratio to eventually decline, we cannot assure you of when, or if, this will occur. Conditions that could delay the decline in the risk-to-capital ratio include high unemployment rates, low cure rates, low housing values, changes to our current rescission practices, unfavorable resolution of ongoing legal proceedings and the volume of new insurance written in MIC.

Downturns in the domestic economy or declines in the value of borrowers' homes from their value at the time their loans closed may result in more homeowners defaulting and our losses increasing.

Losses result from events that reduce a borrower's ability to continue to make mortgage payments, such as unemployment, and whether the home of a borrower who defaults on his mortgage can be sold for an amount that will cover unpaid principal and interest and the expenses of the sale. In general, favorable

Risk Factors *(continued)*

economic conditions reduce the likelihood that borrowers will lack sufficient income to pay their mortgages and also favorably affect the value of homes, thereby reducing and in some cases even eliminating a loss from a mortgage default. A deterioration in economic conditions, including an increase in unemployment, generally increases the likelihood that borrowers will not have sufficient income to pay their mortgages and can also adversely affect housing values, which in turn can influence the willingness of borrowers with sufficient resources to make mortgage payments to do so when the mortgage balance exceeds the value of the home. Housing values may decline even absent a deterioration in economic conditions due to declines in demand for homes, which in turn may result from changes in buyers' perceptions of the potential for future appreciation, restrictions on and the cost of mortgage credit due to more stringent underwriting standards, liquidity issues and risk-retention requirements associated with non-QRM loans affecting lenders, higher interest rates generally or changes to the deductibility of mortgage interest for income tax purposes, or other factors. The residential mortgage market in the United States has for some time experienced a variety of poor or worsening economic conditions, including a material nationwide decline in housing values, with declines continuing into early 2012 in a number of geographic areas. Although housing values have recently been increasing in certain markets, they generally remain significantly below their early 2007 levels. Changes in housing values and unemployment levels are inherently difficult to forecast given the uncertainty in the current market environment, including uncertainty about the effect of actions the federal government has taken and may take with respect to tax policies, mortgage finance programs and policies, and housing finance reform.

The mix of business we write also affects the likelihood of losses occurring.

Even when housing values are stable or rising, mortgages with certain characteristics have higher probabilities of claims. These characteristics include loans with loan-to-value ratios over 95% (or in certain markets that have experienced declining housing values, over 90%), FICO credit scores below 620, limited underwriting, including limited borrower documentation, or higher total debt-to-income ratios, as well as loans having combinations of higher risk factors. As of December 31, 2012, approximately 24.2% of our primary risk in force consisted of loans with loan-to-value ratios greater than 95%, 7.8% had FICO credit scores below 620, and 8.5% had limited underwriting, including limited borrower documentation, each attribute as determined at the time of loan origination. A material portion of these loans were written in 2005 — 2007 or the first quarter of 2008. In accordance with industry practice, loans approved by GSEs and other automated underwriting systems under “doc waiver” programs that do not require verification of borrower income are classified by us as “full documentation.” For additional information about such loans, see footnote 4 to the table titled “Default Statistics for the MGIC Book” in Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2012.

From time to time, in response to market conditions, we change the types of loans that we insure and the guidelines under which we insure them. In addition, we make exceptions to our underwriting guidelines on a loan-by-loan basis and for certain customer programs. Together, the number of loans for which exceptions were made accounted for fewer than 5% of the loans we insured in 2011 and fewer than 2% of the loans we insured in 2012. A large percentage of the exceptions were made for loans with debt-to-income ratios slightly above our guidelines or financial reserves slightly below our guidelines. While the debt-to-income ratio contained in our guidelines exceeds the general requirements of the Qualified Mortgage (“QM”) definition, it is within the underwriting guidelines of the GSEs. The rule containing the QM definition provides a temporary category of QMs that have more flexible underwriting requirements so long as they satisfy the general product feature requirements of QMs and so long as they meet the underwriting requirements of certain agencies, including the GSEs. For more information, see “— The amount of insurance we write could be adversely affected if the definition of Qualified Residential Mortgage results in a reduction of the number of low down payment loans available to be insured or if lenders and investors select alternatives to private mortgage insurance.” Beginning in September 2009, we have made changes to our underwriting guidelines that have allowed certain loans to be eligible for insurance that were not eligible prior to those changes and we expect to continue to make changes in

Risk Factors (*continued*)

appropriate circumstances in the future. As noted above in “— Competition or changes in our relationships with our customers could reduce our revenues or increase our losses,” in the first quarter of 2012, we made changes to streamline our underwriting guidelines and lowered our premium rates on loans with credit scores of 760 or higher. Our underwriting guidelines are available on our website at <http://www.mgic.com/underwriting/index.html>.

During the second quarter of 2012, we began writing a portion of our new insurance under an endorsement to our master policy that limits our ability to rescind coverage on loans that meet the conditions in that endorsement, which is filed as Exhibit 99.7 to our quarterly report on Form 10-Q for the quarter ended March 31, 2012 (filed with the SEC on May 10, 2012). Availability of the endorsement is subject to approval in specified jurisdictions. We estimate that approximately 33% of our new insurance written in the fourth quarter of 2012 and 41% of our new insurance written in December 2012, was written under this endorsement. We expect that eventually a significant portion of our new insurance written will have rescission terms equivalent to those in this endorsement.

As of December 31, 2012, approximately 2.2% of our primary risk in force written through the flow channel, and 27.5% of our primary risk in force written through the bulk channel, consisted of adjustable rate mortgages in which the initial interest rate may be adjusted during the five years after the mortgage closing (“ARMs”). In the current interest rate environment, interest rates resetting in the near future are unlikely to exceed the interest rates at origination. We classify as fixed rate loans adjustable rate mortgages in which the initial interest rate is fixed during the five years after the mortgage closing. If interest rates should rise between the time of origination of such loans and when their interest rates may be reset, claims on ARMs and adjustable rate mortgages whose interest rates may only be adjusted after five years would be substantially higher than for fixed rate loans. In addition, we have insured “interest-only” loans, which may also be ARMs, and loans with negative amortization features, such as pay option ARMs. We believe claim rates on these loans will be substantially higher than on loans without scheduled payment increases that are made to borrowers of comparable credit quality.

Although we attempt to incorporate these higher expected claim rates into our underwriting and pricing models, there can be no assurance that the premiums earned and the associated investment income will be adequate to compensate for actual losses even under our current underwriting guidelines. We do, however, believe that given the various changes in our underwriting guidelines that were effective beginning in the first quarter of 2008, our insurance written beginning in the second quarter of 2008 will generate underwriting profits.

The premiums we charge may not be adequate to compensate us for our liabilities for losses and as a result any inadequacy could materially affect our financial condition and results of operations.

We set premiums at the time a policy is issued based on our expectations regarding likely performance over the long-term. Our premiums are subject to approval by state regulatory agencies, which can delay or limit our ability to increase our premiums. Generally, we cannot cancel the mortgage insurance coverage or adjust renewal premiums during the life of a mortgage insurance policy. As a result, higher than anticipated claims generally cannot be offset by premium increases on policies in force or mitigated by our non-renewal or cancellation of insurance coverage. The premiums we charge, and the associated investment income, may not be adequate to compensate us for the risks and costs associated with the insurance coverage provided to customers. An increase in the number or size of claims, compared to what we anticipate, could adversely affect our results of operations or financial condition.

In January 2008, we announced that we had decided to stop writing the portion of our bulk business that insures loans included in Wall Street securitizations because the performance of such loans deteriorated materially in the fourth quarter of 2007 and this deterioration was materially worse than we experienced for loans insured through the flow channel or loans insured through the remainder of our bulk

Risk Factors *(continued)*

channel. As of December 31, 2007 we established a premium deficiency reserve of approximately \$1.2 billion. As of December 31, 2012, the premium deficiency reserve was \$74 million, which reflects the present value of expected future losses and expenses that exceeds the present value of expected future premium and already established loss reserves on these bulk transactions.

We continue to experience material losses, especially on the 2006 and 2007 books. The ultimate amount of these losses will depend in part on general economic conditions, including unemployment, and the direction of home prices, which in turn will be influenced by general economic conditions and other factors. Because we cannot predict future home prices or general economic conditions with confidence, there is significant uncertainty surrounding what our ultimate losses will be on our 2006 and 2007 books. Our current expectation, however, is that these books will continue to generate material incurred and paid losses for a number of years. There can be no assurance that an additional premium deficiency reserve on Wall Street Bulk or on other portions of our insurance portfolio will not be required.

It is uncertain what effect the extended timeframes in the foreclosure process, due to moratoriums, suspensions or issues arising from the investigation of servicers' foreclosure procedures, will have on us.

In response to the significant increase in the number of foreclosures that began in 2009, various government entities and private parties have from time to time enacted foreclosure (or equivalent) moratoriums and suspensions (which we collectively refer to as moratoriums). In October 2010, a number of mortgage servicers temporarily halted some or all of the foreclosures they were processing after discovering deficiencies in their foreclosure processes and those of their service providers. In response to the deficiencies, some states changed their foreclosure laws to require additional review and verification of the accuracy of foreclosure filings. Some states also added requirements to the foreclosure process, including mediation processes and requirements to file new affidavits. Certain state courts have issued rulings calling into question the validity of some existing foreclosure practices. These actions halted or significantly delayed foreclosures. Furthermore five of the nation's largest mortgage servicers agreed to implement new servicing and foreclosure practices as part of a settlement announced in February 2012, with the federal government and the attorneys general of 49 states.

Past moratoriums or delays were designed to afford time to determine whether loans could be modified and did not stop the accrual of interest or affect other expenses on a loan, and we cannot predict whether any future moratorium or lengthened timeframes would do so. Therefore, unless a loan is cured during a moratorium or delay, at the completion of a foreclosure, additional interest and expenses may be due to the lender from the borrower. In some circumstances, our paid claim amount may include some additional interest and expenses. For moratoriums or delays resulting from investigations into servicers and other parties' actions in foreclosure proceedings, our willingness to pay additional interest and expenses may be different, subject to the terms of our mortgage insurance policies. The various moratoriums and extended timeframes may temporarily delay our receipt of claims and may increase the length of time a loan remains in our delinquent loan inventory.

We do not know what effect improprieties that may have occurred in a particular foreclosure have on the validity of that foreclosure, once it was completed and the property transferred to the lender. Under our policy, in general, completion of a foreclosure is a condition precedent to the filing of a claim. Beginning in 2011 and from time to time, various courts have ruled that servicers did not provide sufficient evidence that they were the holders of the mortgages and therefore they lacked authority to foreclose. Some courts in other jurisdictions have considered similar issues and reached similar conclusions, but other courts have reached different conclusions. These decisions have not had a direct impact on our claims processes or rescissions.

Risk Factors *(continued)*

We are susceptible to disruptions in the servicing of mortgage loans that we insure.

We depend on reliable, consistent third-party servicing of the loans that we insure. Over the last several years, the mortgage loan servicing industry has experienced consolidation. The resulting reduction in the number of servicers could lead to disruptions in the servicing of mortgage loans covered by our insurance policies. In addition, current housing market trends have led to significant increases in the number of delinquent mortgage loans requiring servicing. These increases have strained the resources of servicers, reducing their ability to undertake mitigation efforts that could help limit our losses, and have resulted in an increasing amount of delinquent loan servicing being transferred to specialty servicers. The transfer of servicing can cause a disruption in the servicing of delinquent loans. Future housing market conditions could lead to additional increases in delinquencies. Managing a substantially higher volume of non-performing loans could lead to increased disruptions in the servicing of mortgages. Investigations into whether servicers have acted improperly in foreclosure proceedings may further strain the resources of servicers.

If interest rates decline, house prices appreciate or mortgage insurance cancellation requirements change, the length of time that our policies remain in force could decline and result in declines in our revenue.

In each year, most of our premiums are from insurance that has been written in prior years. As a result, the length of time insurance remains in force, which is also generally referred to as persistency, is a significant determinant of our revenues. The factors affecting the length of time our insurance remains in force include:

- the level of current mortgage interest rates compared to the mortgage coupon rates on the insurance in force, which affects the vulnerability of the insurance in force to refinancings, and
- mortgage insurance cancellation policies of mortgage investors along with the current value of the homes underlying the mortgages in the insurance in force.

Our persistency rate was 79.8% at December 31, 2012, compared to 82.9% at December 31, 2011 and 84.4% at December 31, 2010. During the 1990s, our year-end persistency ranged from a high of 87.4% at December 31, 1990 to a low of 68.1% at December 31, 1998. 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.

Current mortgage interest rates are at or near historic lows. The high-quality mortgages insured by us in recent years that have not experienced significant declines in underlying home prices, are especially vulnerable to refinancing. Future premiums on our insurance in force represent a material portion of our claims paying resources. We are unsure what the impact on our revenues will be as mortgages are refinanced, because the number of policies we write for replacement mortgages may be more or less than the terminated policies associated with the refinanced mortgages.

Your ownership in our company may be diluted by additional capital that we raise or if the holders of our outstanding convertible debt convert that debt into shares of our common stock.

As noted above under “— Capital requirements may prevent us from continuing to write new insurance on an uninterrupted basis,” we may need to raise additional equity capital. Any future issuance of equity securities may substantially dilute your ownership interest in our company. In addition, the market price of our common stock could decline as a result of sales of a large number of shares or similar securities in the market or the perception that such sales could occur.

Risk Factors *(continued)*

We have \$389.5 million principal amount of 9% Convertible Junior Subordinated Debentures outstanding. The principal amount of the debentures is currently convertible, at the holder's option, at an initial conversion rate, which is subject to adjustment, of 74.0741 common shares per \$1,000 principal amount of debentures. This represents an initial conversion price of approximately \$13.50 per share. We have elected to defer the payment of approximately \$17.5 million of interest on these debentures that was scheduled to be paid on October 1, 2012. We expect to defer additional interest in the future. If a holder elects to convert its debentures, the interest that has been deferred on the debentures being converted is also converted into shares of our common stock. The conversion rate for such 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 the associated debentures. We also have \$345 million principal amount of 5% Convertible Senior Notes outstanding. The Convertible Senior Notes are convertible, at the holder's option, at an initial conversion rate, which is subject to adjustment, of 74.4186 shares per \$1,000 principal amount at any time prior to the maturity date. This represents an initial conversion price of approximately \$13.44 per share. We do not have the right to defer interest on these Convertible Senior Notes.

Our common stock could be delisted from the NYSE

The listing of our common stock on the New York Stock Exchange, or NYSE, is subject to compliance with NYSE's continued listing standards. Among other things, those standards require that the average closing price of our common stock during any consecutive 30-day trading period not fall below \$1.00. Although we have not failed this standard, on three trading days in August 2012, the closing price of our stock fell below \$1.00. If we are notified by the NYSE that we have not satisfied this stock price standard, then we would have a period of time in which to cure the deficiency, such as by effecting a reverse stock split. The NYSE can also, in its discretion, discontinue listing our common stock under certain circumstances. For example, if we cease writing new insurance, our common stock could be delisted from the NYSE unless we cure the deficiency during the time provided by the NYSE. If the NYSE were to delist our common stock, it likely would result in a significant decline in the trading price, trading volume and liquidity of our common stock. We also expect that the suspension and delisting of our common stock would lead to decreases in analyst coverage and market-making activity relating to our common stock, as well as reduced information about trading prices and volume. As a result, it could become significantly more difficult for our shareholders to sell their shares of our common stock at prices comparable to those in effect prior to delisting or at all.

Our debt obligations materially exceed our holding company cash and investments

At December 31, 2012, we had approximately \$315 million in cash and investments at our holding company and our holding company's debt obligations were \$835 million in par value, consisting of \$100 million of Senior Notes due in November 2015, \$345 million of Convertible Senior Notes due in 2017, and \$390 million of Convertible Junior Debentures due in 2063. Annual debt service on the debt outstanding as of December 31, 2012, is \$58 million, including approximately \$35 million on the Convertible Junior Debentures for which we have deferred the interest that was scheduled to be paid on October 1, 2012. Any deferred interest compounds at the stated rate of 9%.

The Senior Notes, Convertible Senior Notes and Convertible Junior Debentures are obligations of our holding company, MGIC Investment Corporation, and not of its subsidiaries. Our holding company has no material sources of cash inflows other than investment income. The payment of dividends from our insurance subsidiaries, which prior to raising capital in the public markets in 2008 and 2010 had been the principal source of our holding company cash inflow, is restricted by insurance regulation. MGIC is the principal source of dividend-paying capacity. Since 2008, MGIC has not paid any dividends to our holding company. Through 2013, MGIC cannot pay any dividends to our holding company without approval from the OCI. In connection with the approval of MIC as an eligible mortgage insurer, Freddie Mac and Fannie Mae have imposed dividend restrictions on MGIC and MIC through December 31, 2013. Any additional

Risk Factors *(continued)*

capital contributions to our subsidiaries would further decrease our holding company cash and investments. See “Management’s Discussion and Analysis—Financial Condition” above for information about capital that may be required by our non-insurance subsidiaries. See Note 8 – “Debt” to our consolidated financial statements for additional information about the holding company’s debt obligations, including restrictive covenants in our Senior Notes and our right to defer interest on our Convertible Junior Debentures.

We could be adversely affected if personal information on consumers that we maintain is improperly disclosed.

As part of our business, we maintain large amounts of personal information on consumers. While we believe we have appropriate information security policies and systems to prevent unauthorized disclosure, there can be no assurance that unauthorized disclosure, either through the actions of third parties or employees, will not occur. Unauthorized disclosure could adversely affect our reputation and expose us to material claims for damages.

The implementation of the Basel III capital accord, or other changes to our customers’ capital requirements, may discourage the use of mortgage insurance.

In 1988, the Basel Committee on Banking Supervision (the “Basel Committee”) developed the Basel Capital Accord (Basel I), which set out international benchmarks for assessing banks’ capital adequacy requirements. In June 2005, the Basel Committee issued an update to Basel I (as revised in November 2005, Basel II). Basel II was implemented by many banks in the United States and many other countries in 2009 and 2010.

In December 2010, the Basel Committee released the nearly final version of Basel III. In June 2012, federal regulators requested public comments on proposed rules to implement Basel III. The proposed Basel III rules would increase the capital requirements of many banking organizations. Among other provisions, the proposed rules contain a range of risk weightings for residential mortgages held for investment by certain banking organizations, with the specific weighting dependent upon, among other things, a loan’s LTV. Unlike previous Basel rules, the proposed Basel III rules do not consider mortgage insurance when calculating a loan’s risk weighting. The rules, if implemented as proposed, may reduce the incentive of banking organizations to purchase mortgage insurance for loans held for investment. The proposed Basel III rules continue to afford FHA-insured loans and Ginnie Mae mortgage-backed securities (“MBS”) a lower risk weighting than Fannie Mae and Freddie Mac MBS. Therefore, with respect to capital requirements, FHA-insured loans will continue to have a competitive advantage over loans insured by private mortgage insurance and then sold to and securitized by the GSEs. Public comments to the proposed rules were due by October 22, 2012. It is uncertain what form the final rules will take. We are continuing to evaluate the potential effects of the proposed Basel III rules on our business.

Our Australian operations may suffer significant losses.

We began international operations in Australia, where we started to write business in June 2007. Since 2008, we are no longer writing new business in Australia. Our existing risk in force in Australia is subject to the risks described in the general economic and insurance business-related factors discussed above. In addition to these risks, we are subject to a number of other risks from having deployed capital in Australia, including foreign currency exchange rate fluctuations and interest-rate volatility particular to Australia.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, however, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our internal control over financial reporting using the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on such evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2012.

PricewaterhouseCoopers LLP, an independent registered public accounting firm has audited the consolidated financial statements and effectiveness of internal control over financial reporting, as of December 31, 2012 as stated in their report which appears herein.

Report of Independent Registered Public Accounting Firm

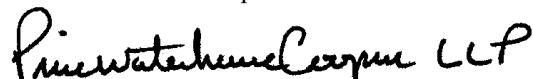
To the Board of Directors and Shareholders of
MGIC Investment Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive income, shareholders' equity and of cash flows present fairly, in all material respects, the financial position of MGIC Investment Corporation and its subsidiaries (the "Company") at December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP



Milwaukee, Wisconsin
March 1, 2013

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
December 31, 2012 and 2011

Consolidated Balance Sheets

	<u>2012</u>	<u>2011</u>
	(In thousands)	
ASSETS		
Investment portfolio (notes 6 and 7):		
Securities, available-for-sale, at fair value:		
Fixed maturities (amortized cost, 2012 - \$4,185,937; 2011 - \$5,700,894)	\$ 4,227,339	\$ 5,820,900
Equity securities.....	<u>2,936</u>	<u>2,747</u>
Total investment portfolio	4,230,275	5,823,647
Cash and cash equivalents	1,027,625	995,799
Accrued investment income.....	27,243	55,666
Reinsurance recoverable on loss reserves (note 11)	104,848	154,607
Reinsurance recoverable on paid losses.....	15,605	19,891
Premiums receivable	67,828	71,073
Home office and equipment, net	27,190	28,145
Deferred insurance policy acquisition costs	11,245	7,505
Other assets	62,465	59,897
Total assets	<u>\$ 5,574,324</u>	<u>\$ 7,216,230</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Loss reserves (notes 9 and 11)	\$ 4,056,843	\$ 4,557,512
Premium deficiency reserve (note 10)	73,781	134,817
Unearned premiums (note 11).....	138,840	154,866
Senior notes (note 8).....	99,910	170,515
Convertible senior notes (note 8).....	345,000	345,000
Convertible junior debentures (note 8).....	379,609	344,422
Other liabilities.....	283,401	312,283
Total liabilities	<u>5,377,384</u>	<u>6,019,415</u>
Contingencies (note 20)		
Shareholders' equity (note 15):		
Common stock (one dollar par value, shares authorized 680,000; shares issued 2012 and 2011 - 205,047; outstanding 2012 - 202,032; 2011 - 201,172)	205,047	205,047
Paid-in capital.....	1,135,296	1,135,821
Treasury stock (shares at cost 2012 - 3,015; 2011 - 3,875).....	(104,959)	(162,542)
Accumulated other comprehensive (loss) income, net of tax (note 3)...	(48,163)	30,124
Retained deficit	(990,281)	(11,635)
Total shareholders' equity	<u>196,940</u>	<u>1,196,815</u>
Total liabilities and shareholders' equity.....	<u>\$ 5,574,324</u>	<u>\$ 7,216,230</u>

See accompanying notes to consolidated financial statements.

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
Years Ended December 31, 2012, 2011 and 2010

Consolidated Statements of Operations

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	(In thousands, except per share data)		
Revenues:			
Premiums written:			
Direct.....	\$ 1,049,549	\$ 1,119,182	\$ 1,169,081
Assumed (note 11)	2,425	(4,898)	3,090
Ceded (note 11)	<u>(34,142)</u>	<u>(49,904)</u>	<u>(70,376)</u>
Net premiums written.....	1,017,832	1,064,380	1,101,795
Decrease in unearned premiums.....	<u>15,338</u>	<u>59,455</u>	<u>66,952</u>
Net premiums earned (note 11)	1,033,170	1,123,835	1,168,747
Investment income, net of expenses (note 6).....	121,640	201,270	247,253
Realized investment gains, net (note 6)	197,719	143,430	102,581
Total other-than-temporary impairment losses	(2,310)	(715)	(9,644)
Portion of losses recognized in other comprehensive income (loss), before taxes (note 3)	<u>-</u>	<u>-</u>	<u>-</u>
Net impairment losses recognized in earnings	(2,310)	(715)	(9,644)
Other revenue	<u>28,145</u>	<u>36,459</u>	<u>11,588</u>
Total revenues	<u>1,378,364</u>	<u>1,504,279</u>	<u>1,520,525</u>
Losses and expenses:			
Losses incurred, net (notes 9 and 11)	2,067,253	1,714,707	1,607,541
Change in premium deficiency reserve (note 10).....	(61,036)	(44,150)	(51,347)
Amortization of deferred policy acquisition costs	7,452	6,880	7,062
Other underwriting and operating expenses, net.....	193,995	207,870	218,080
Interest expense (note 8)	<u>99,344</u>	<u>103,271</u>	<u>98,589</u>
Total losses and expenses.....	<u>2,307,008</u>	<u>1,988,578</u>	<u>1,879,925</u>
Loss before tax	(928,644)	(484,299)	(359,400)
(Benefit from) provision for income taxes (note 14).....	<u>(1,565)</u>	<u>1,593</u>	<u>4,335</u>
Net loss	<u>\$ (927,079)</u>	<u>\$ (485,892)</u>	<u>\$ (363,735)</u>
Loss per share (note 3):			
Basic	<u>\$ (4.59)</u>	<u>\$ (2.42)</u>	<u>\$ (2.06)</u>
Diluted.....	<u>\$ (4.59)</u>	<u>\$ (2.42)</u>	<u>\$ (2.06)</u>
Weighted average common shares outstanding - basic (note 3)	<u>201,892</u>	<u>201,019</u>	<u>176,406</u>
Weighted average common shares outstanding - diluted (note 3)	<u>201,892</u>	<u>201,019</u>	<u>176,406</u>
Dividends per share	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to consolidated financial statements.

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
Years Ended December 31, 2012, 2011 and 2010

Consolidated Statements of Comprehensive Income

	<u>2012</u>	<u>2011</u> (In thousands)	<u>2010</u>
Net Loss	\$ (927,079)	\$ (485,892)	\$ (363,735)
Other comprehensive income (loss), net of tax (note 3):			
Unrealized holding (losses) gains for the period included in accumulated other comprehensive income (loss).....	(12,646)	68,822	(7,534)
Less: net gains (losses) reclassified out of accumulated other comprehensive income (loss) into earnings for the period	<u>66,013</u>	<u>47,765</u>	<u>61,540</u>
Change in unrealized investment gains and losses (note 6)	(78,659)	21,057	(69,074)
Amortization related to benefit plans (note 13).....	(1,221)	(12,862)	6,390
Foreign currency translation adjustment	<u>1,593</u>	<u>(207)</u>	<u>10,665</u>
Other comprehensive (loss) income, net of tax	<u>(78,287)</u>	<u>7,988</u>	<u>(52,019)</u>
Total comprehensive loss	<u>\$ (1,005,366)</u>	<u>\$ (477,904)</u>	<u>\$ (415,754)</u>

See accompanying notes to consolidated financial statements.

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
Years Ended December 31, 2010, 2011 and 2012

Consolidated Statements of Shareholders' Equity

	<u>Common stock</u>	<u>Paid-in capital</u>	<u>Treasury stock</u> (In thousands)	<u>Accumulated other comprehensive income (loss) (note 3)</u>	<u>Retained earnings/(deficit)</u>
Balance, December 31, 2009	\$ 130,163	\$ 443,294	\$ (269,738)	\$ 74,155	\$ 924,707
Net loss	-	-	-	-	(363,735)
Change in unrealized investment gains and losses, net	-	-	-	(69,074)	-
Common stock shares issued (note 15)	74,884	697,492	-	-	-
Reissuance of treasury stock, net. . .	-	(14,425)	47,106	-	(35,410)
Equity compensation	-	12,581	-	-	-
Defined benefit plan adjustments, net.	-	-	-	6,390	-
Unrealized foreign currency translation adjustment, net	-	-	-	10,665	-
Balance, December 31, 2010	\$ 205,047	\$ 1,138,942	\$ (222,632)	\$ 22,136	\$ 525,562
Net loss	-	-	-	-	(485,892)
Change in unrealized investment gains and losses, net	-	-	-	21,057	-
Reissuance of treasury stock, net. . .	-	(14,577)	60,090	-	(51,305)
Equity compensation	-	11,456	-	-	-
Defined benefit plan adjustments, net.	-	-	-	(12,862)	-
Unrealized foreign currency translation adjustment, net	-	-	-	(207)	-
Balance, December 31, 2011	\$ 205,047	\$ 1,135,821	\$ (162,542)	\$ 30,124	\$ (11,635)
Net loss	-	-	-	-	(927,079)
Change in unrealized investment gains and losses, net (note 6) . . .	-	-	-	(78,659)	-
Reissuance of treasury stock, net (note 15)	-	(8,749)	57,583	-	(51,567)
Equity compensation (note 18)	-	8,224	-	-	-
Defined benefit plan adjustments, net (note 13)	-	-	-	(1,221)	-
Unrealized foreign currency translation adjustment, net	-	-	-	1,593	-
Balance, December 31, 2012	<u>\$ 205,047</u>	<u>\$ 1,135,296</u>	<u>\$ (104,959)</u>	<u>\$ (48,163)</u>	<u>\$ (990,281)</u>

See accompanying notes to consolidated financial statements.

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
Years Ended December 31, 2012, 2011 and 2010

Consolidated Statements of Cash Flow

	<u>2012</u>	<u>2011</u>	<u>2010</u>
		(In thousands)	
Cash flows from operating activities:			
Net loss	\$ (927,079)	\$ (485,892)	\$ (363,735)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and other amortization	100,135	84,828	60,882
Deferred tax benefit	(34)	(738)	(75)
Realized investment gains, net	(197,719)	(143,430)	(102,581)
Net investment impairment losses	2,310	715	9,644
Gain on repurchase on senior notes	(17,775)	(27,688)	-
Other	(21,026)	(14,218)	(13,646)
Change in certain assets and liabilities:			
Accrued investment income	28,423	14,639	9,523
Reinsurance recoverable on loss reserves	49,759	120,683	56,937
Reinsurance recoverable on paid losses	4,286	14,269	(24,863)
Premiums receivable	3,245	8,494	10,572
Deferred insurance policy acquisition costs	(3,740)	777	740
Real estate	(1,842)	4,599	(2,390)
Loss reserves	(500,669)	(1,326,659)	(820,819)
Premium deficiency reserve	(61,036)	(44,150)	(14,219)
Unearned premiums	(16,026)	(60,291)	(65,581)
Return premium	(11,700)	(28,300)	90,500
Income taxes payable (current)	1,888	(1,489)	293,681
Net cash used in operating activities	<u>(1,568,600)</u>	<u>(1,883,851)</u>	<u>(875,430)</u>
Cash flows from investing activities:			
Investment purchases:			
Equity securities	(132)	(126)	(156)
Fixed maturities	(5,025,204)	(4,393,471)	(5,225,794)
Proceeds from sale of:			
Equity securities	-	504	-
Fixed maturities	5,216,934	4,742,213	4,287,312
Proceeds from maturity of fixed maturities	1,461,955	1,407,325	740,959
Repayment of note receivable from joint ventures	-	-	83,500
Net (decrease) increase in payable for securities	(20)	(2,228)	2,275
Net cash provided by (used in) investing activities	<u>1,653,533</u>	<u>1,754,217</u>	<u>(111,904)</u>
Cash flows from financing activities:			
Repayment of long-term debt	(53,107)	(178,721)	(1,000)
Net proceeds from convertible senior notes	-	-	334,373
Common stock shares issued	-	-	772,376
Net cash (used in) provided by financing activities	<u>(53,107)</u>	<u>(178,721)</u>	<u>1,105,749</u>
Net increase (decrease) in cash and cash equivalents	31,826	(308,355)	118,415
Cash and cash equivalents at beginning of year	995,799	1,304,154	1,185,739
Cash and cash equivalents at end of year	<u>\$ 1,027,625</u>	<u>\$ 995,799</u>	<u>\$ 1,304,154</u>

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. Nature of Business

MGIC Investment Corporation is a holding company which, through Mortgage Guaranty Insurance Corporation (“MGIC”), MGIC Indemnity Corporation (“MIC”) and several other subsidiaries, is principally engaged in the mortgage insurance business. We provide mortgage insurance to lenders throughout the United States and to government sponsored entities (“GSEs”) to protect against loss from defaults on low down payment residential mortgage loans. Our principal product is primary mortgage insurance. Primary mortgage insurance may be written through the flow channel, in which loans are insured in individual, loan-by-loan transactions. Primary mortgage insurance may also be written through the bulk channel, in which portfolios of loans are individually insured in single, bulk transactions. Prior to 2008, we wrote significant volume through the bulk channel, substantially all of which was Wall Street bulk business, which we discontinued writing in 2007. We have not written any business through the bulk channel since 2008. Prior to 2009, we also wrote pool mortgage insurance. Pool insurance generally covers the excess of the loss on a defaulted mortgage loan which exceeds the claim payment under the primary coverage, if primary insurance is required on that mortgage loan, as well as the total loss on a defaulted mortgage loan which did not require primary insurance. Pool insurance may have a stated aggregate loss limit for a pool of loans and may also have a deductible under which no losses are paid by the insurer until losses on the pool of loans exceed the deductible. Through certain other non-insurance subsidiaries, we also provide various services for the mortgage finance industry, such as contract underwriting and portfolio analysis and retention. We began our international operations in Australia, where we started to write business in June 2007. Since 2008, we are no longer writing new business in Australia. Our Australian operations are included in our consolidated financial statements; however they are not material to our consolidated results.

At December 31, 2012, our direct domestic primary insurance in force was \$162.1 billion, which represents the principal balance in our records of all mortgage loans that we insure, and our direct domestic primary risk in force was \$41.7 billion, which represents the insurance in force multiplied by the insurance coverage percentage. Our direct pool risk in force at December 31, 2012 was approximately \$1.3 billion (\$0.4 billion on pool policies with aggregate loss limits and \$0.9 billion on pool policies without aggregate loss limits). Our risk in force in Australia at December 31, 2012 was approximately \$680 million which represents the risk associated with 100% coverage on the insurance in force. The mortgage insurance we provided in Australia only covers the unpaid loan balance after the sale of the underlying property.

Capital

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 “Capital Requirements.” New insurance written in the jurisdictions that have Capital Requirements represented approximately 50% of new insurance written in 2011 and 2012. While formulations of minimum capital vary among jurisdictions, the most common formulation allows for a maximum risk-to-capital ratio of 25 to 1. A risk-to-capital ratio will increase if the percentage decrease in capital exceeds the percentage decrease in insured risk. Therefore, as capital decreases, the same dollar decrease in capital will cause a greater percentage decrease in capital and a greater increase in the risk-to-capital ratio. 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.

Notes (continued)

At December 31, 2012, MGIC's risk-to-capital ratio was 44.7 to 1, exceeding the maximum allowed by many jurisdictions, and its policyholder position was \$640 million below the required MPP of \$1.2 billion. We expect MGIC's risk-to-capital ratio to increase above its December 31, 2012 level. At December 31, 2012, the risk-to-capital ratio of our combined insurance operations (which includes reinsurance affiliates) was 47.8 to 1. A higher risk-to-capital ratio on a combined basis may indicate that, in order for MGIC or MIC to continue to utilize reinsurance arrangements with its subsidiaries or subsidiaries of our holding company, additional capital contributions to the reinsurance affiliates could be needed. These reinsurance arrangements permit MGIC and MIC to write insurance with a higher coverage percentage than they could on their own under certain state-specific requirements.

Statement of Statutory Accounting Principles No. 101 ("SSAP No. 101"), became effective January 1, 2012 and prescribed new standards for determining the amount of deferred tax assets that can be recognized as admitted assets for determining statutory capital. Under a permitted practice effective September 30, 2012 and until further notice, the Office of the Commissioner of Insurance of the State of Wisconsin ("OCI") has approved MGIC to report its net deferred tax asset as an admitted asset in an amount not to exceed 10% of surplus as regards policyholders, notwithstanding any contrary provisions of SSAP No. 101. At December 31, 2012, had MGIC calculated its net deferred tax assets based on the provisions of SSAP No. 101, no deferred tax assets would have been admitted. Pursuant to the permitted practice, deferred tax assets of approximately \$63 million were included in statutory capital.

Although MGIC does not meet the Capital Requirements of Wisconsin, the OCI has waived them until December 31, 2013. In place of the Capital Requirements, the OCI Order containing the waiver of Capital Requirements (the "OCI Order") provides that MGIC can write new business as long as it maintains regulatory capital that the OCI determines is reasonably in excess of a level that would constitute a financially hazardous condition. The OCI Order requires MGIC Investment Corporation, through the earlier of December 31, 2013 and the termination of the OCI Order (the "Covered Period"), to make cash equity contributions to MGIC as may be necessary so that its "Liquid Assets" are at least \$1 billion (this portion of the OCI Order is referred to as the "Keepwell Provision"). "Liquid Assets," which include those of MGIC as well as those held in certain of our subsidiaries, including our Australian subsidiaries, but excluding MIC and its reinsurance affiliates, are the sum of (i) the aggregate cash and cash equivalents, (ii) fair market value of investments and (iii) assets held in trusts supporting the obligations of captive mortgage reinsurers to MGIC. As of December 31, 2012, "Liquid Assets" were approximately \$4.8 billion. Although we do not expect that MGIC's Liquid Assets will fall below \$1 billion during the Covered Period, we do expect the amount of Liquid Assets to continue to decline materially after December 31, 2012 and through the end of the Covered Period as MGIC's claim payments and other uses of cash continue to exceed cash generated from operations. Factors that could negatively impact MGIC's Liquid Assets are discussed throughout the financial statement footnotes.

The OCI, in its sole discretion, may modify, terminate or extend its waiver of Capital Requirements, although any modification or extension of the Keepwell Provision requires our written consent. If the OCI modifies or terminates its waiver, or if it fails to renew its waiver upon expiration, depending on the circumstances, MGIC could be prevented from writing new business in all jurisdictions if MGIC does not comply with the Capital Requirements. We cannot assure you that MGIC could obtain the additional capital necessary to comply with the Capital Requirements. At present, the amount of additional capital we would need to comply with the Capital Requirements would be substantial. If MGIC were prevented from writing new business in all jurisdictions, our insurance operations in MGIC would be in run-off (meaning no new loans would be insured but loans previously insured would continue to be covered, with premiums continuing to be received and losses continuing to be paid on those loans) until MGIC either met the Capital Requirements or obtained a necessary waiver to allow it to once again write new business. Furthermore, if the OCI revokes or fails to renew MGIC's waiver, MIC's ability to write new business would be severely limited because the GSEs' approval of MIC (discussed below) is conditioned upon the continued effectiveness of the OCI Order.

Notes (continued)

MGIC applied for waivers in the other jurisdictions with Capital Requirements and, at this time, has active waivers from seven of them. MIC is writing new business in the jurisdictions where MGIC does not have active waivers. As a result, MGIC and MIC are collectively writing business on a nationwide basis.

Insurance departments, in their sole discretion, may modify, terminate or extend their waivers of Capital Requirements. If an insurance department other than the OCI modifies or terminates its waiver, or if it fails to grant a waiver or renew its waiver after expiration, depending on the circumstances, MGIC could be prevented from writing new business in that particular jurisdiction. Also, depending on the level of losses that MGIC experiences in the future, it is possible that regulatory action by one or more jurisdictions, including those that do not have specific Capital Requirements, may prevent MGIC from continuing to write new insurance in that jurisdiction. As discussed below, under certain conditions, this business would be written in MIC. Factors that could negatively impact MGIC's statutory capital and compliance with Capital Requirements are discussed throughout the financial statement footnotes.

MGIC's failure to meet the Capital Requirements to insure new business does not necessarily mean that MGIC does not have sufficient resources to pay claims on its insurance liabilities. While we believe that MGIC has sufficient claims paying resources to meet its claim obligations on its insurance in force on a timely basis, we cannot assure you that the events that led to MGIC failing to meet Capital Requirements would not also result in it not having sufficient claims paying resources. Furthermore, our estimates of MGIC's claims paying resources and claim obligations are based on various assumptions. These assumptions include the timing of the receipt of claims on loans in our delinquency inventory and future claims that we anticipate will ultimately be received, our anticipated rescission activity, premiums, housing values and unemployment rates. These assumptions are subject to inherent uncertainty and require judgment by management. Current conditions in the domestic economy make the assumptions about when anticipated claims will be received, housing values, and unemployment rates highly volatile in the sense that there is a wide range of reasonably possible outcomes. Our anticipated rescission activity is also subject to inherent uncertainty due to the difficulty of predicting the amount of claims that will be rescinded and the outcome of any legal proceedings or settlement discussions related to rescissions. Factors that could negatively affect MGIC's claims paying resources are discussed throughout the financial statement footnotes.

As part of our longstanding plan to write new business in MIC, a direct subsidiary of MGIC, MGIC has made capital contributions to MIC. As of December 31, 2012, MIC had statutory capital of \$448 million. In the third quarter of 2012, we began writing new mortgage insurance in MIC on the same policy terms as MGIC, in those jurisdictions where we did not have active waivers of Capital Requirements for MGIC. In the second half of 2012, MIC's new insurance written was \$2.4 billion, which includes business from certain jurisdictions for which new insurance is again being written in MGIC after it received the necessary waivers. We project MIC can write 100% of our new insurance for at least five years if MGIC is unable to write new business. This projection is based on the 18:1 risk-to-capital limitation prescribed by Freddie Mac's approval of MIC (discussed below) and assumes the mix and level of new insurance written in the future would be the same as we wrote in 2012. It also assumes MIC's eligibility would extend throughout this period. We are currently writing new mortgage insurance in MIC in Florida, Idaho, Missouri, New Jersey, New York, North Carolina, Ohio and Puerto Rico. Approximately 19% of new insurance written in 2011 and 2012 was from jurisdictions in which MIC is currently writing business. If we had to write substantially more of our business in MIC and our levels of new insurance written were to increase materially, MIC may require additional capital to stay below Freddie Mac's prescribed risk-to-capital limit or a waiver of Freddie Mac's risk-to-capital limitation may be required. MIC is licensed to write business in all jurisdictions and, subject to the conditions and restrictions discussed below, has received the necessary approvals from the GSEs and the OCI to write business in all of the jurisdictions that have not waived their Capital Requirements for MGIC.

Notes (continued)

Under an agreement in place with Fannie Mae, as amended November 30, 2012, MIC will be eligible to write mortgage insurance through December 31, 2013, in those jurisdictions (other than Wisconsin) in which MGIC cannot write new insurance due to MGIC's failure to meet Capital Requirements and to obtain a waiver of them. MIC is also approved to write mortgage insurance for 60 days in jurisdictions that do not have Capital Requirements if a jurisdiction notifies MGIC that, due to its financial condition, it may no longer write new business. The agreement provides that Fannie Mae may, in its discretion, extend such approval to no later than December 31, 2013. The agreement with Fannie Mae contains certain conditions and restrictions to its continued effectiveness including the continued effectiveness of the OCI Order and the continued applicability of the Keepwell Provision of the OCI Order.

Under a letter from Freddie Mac that was amended and restated as of November 30, 2012, Freddie Mac approved MIC to write business only in those jurisdictions (other than Wisconsin) where either (a) MGIC is unable to write business because it does not meet the Capital Requirements and does not obtain waivers of them, or (b) MGIC received notice that it may not write business because of that jurisdiction's view of MGIC's financial condition. This approval of MIC, which may be withdrawn at any time, expires December 31, 2013, or earlier if a financial examination by the OCI determines that there is a reasonable probability that MGIC will be unable to honor claim obligations at any time in the five years after the examination, or if MGIC fails to honor claim payments. The approval from Freddie Mac, contains certain conditions and restrictions to its continued effectiveness, including requirements that MIC not exceed a risk-to-capital ratio of 18:1 (at December 31, 2012, MIC's risk-to-capital ratio was 1.2 to 1); MGIC and MIC comply with all terms and conditions of the OCI Order; the OCI Order remain effective; we contribute \$100 million to MGIC on or before December 3, 2012 (which we did); MGIC enter into and comply with the payment terms of the settlement agreement with Freddie Mac and the FHFA dated December 1, 2012 (for more information about the settlement agreement, see Note 20 – "Litigation and Contingencies"); the OCI issue the order described in the next paragraph (which it did); and MIC provide MGIC access to the capital of MIC in an amount necessary for MGIC to maintain sufficient liquidity to satisfy its obligations under insurance policies issued by MGIC.

On November 29, 2012, the OCI issued an order, effective until December 31, 2013, establishing a procedure for MIC to pay a dividend to MGIC if either of the following two events occurs: (1) an OCI examination determines that there is a reasonable probability that MGIC will be unable to honor its policy obligations at any time during the five years after the examination, or (2) MGIC fails to honor its policy obligations that it in good faith believes are valid. If one of these events occurs, the OCI is to conduct a review (to be completed within 60 days after the triggering event) to determine the maximum single dividend MIC could prudently pay to MGIC for the benefit of MGIC's policyholders, taking account of the interests of MIC's policyholders and the general public and certain standards for dividends imposed by Wisconsin law. Upon the completion of the review, the OCI will authorize, and MIC will pay, such a dividend within 30 days.

We cannot assure you that the GSEs will approve or continue to approve MIC to write business in all jurisdictions in which MGIC is unable to do so. If one GSE does not approve MIC in all jurisdictions in which MGIC is unable to write new business, MIC may be able to write insurance on loans that will be sold to the other GSE or retained by private investors. However, because lenders may not know which GSE will purchase their loans until mortgage insurance has been procured, lenders may be unwilling to procure mortgage insurance from MIC. Furthermore, if we are unable to write business on a nationwide basis utilizing a combination of MGIC and MIC, lenders may be unwilling to procure insurance from us anywhere. In addition, new insurance written can be influenced by a lender's assessment of the financial strength of our insurance operations.

See additional disclosure regarding statutory capital in Note 17 – "Statutory Capital."

Notes (continued)

2. Basis of Presentation

The accompanying financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America (“GAAP”), as codified in the Accounting Standards Codification. In accordance with GAAP, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of MGIC Investment Corporation and its majority-owned subsidiaries. All intercompany transactions have been eliminated.

3. Summary of Significant Accounting Policies

Fair Value Measurements

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

- Level 1 – Quoted prices for identical instruments in active markets that we can access. Financial assets utilizing Level 1 inputs primarily include certain U.S. Treasury securities and obligations of U.S. government corporations and agencies and Australian government and semi government securities.
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and inputs, other than quoted prices, that are observable in the marketplace for the financial instrument. The observable inputs are used in valuation models to calculate the fair value of the financial instruments. Financial assets utilizing Level 2 inputs primarily include certain municipal and corporate bonds.
- Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or value drivers are unobservable. Level 3 inputs reflect our own assumptions about the assumptions a market participant would use in pricing an asset or liability. Financial assets utilizing Level 3 inputs include certain state and auction rate (backed by student loans) securities. Non-financial assets which utilize Level 3 inputs include real estate acquired through claim settlement.

To determine the fair value of securities available-for-sale in Level 1 and Level 2 of the fair value hierarchy, independent pricing sources have been utilized. One price is provided per security based on observable market data. To ensure securities are appropriately classified in the fair value hierarchy, we review the pricing techniques and methodologies of the independent pricing sources and believe that their policies adequately consider market activity, either based on specific transactions for the issue valued or based on modeling of securities with similar credit quality, duration, yield and structure that were recently traded. A variety of inputs are utilized by the independent pricing sources including benchmark yields, reported trades, non-binding broker/dealer quotes, issuer spreads, two sided markets, benchmark securities, bids, offers and reference data including data published in market research publications. Inputs may be weighted differently for any security, and not all inputs are used for each security evaluation. Market indicators, industry and economic events are also considered. This information is evaluated using a multidimensional pricing model. Quality controls are performed by the independent pricing sources throughout this process, which include reviewing tolerance reports, trading information and data changes,

Notes (continued)

and directional moves compared to market moves. This model combines all inputs to arrive at a value assigned to each security. In addition, on a quarterly basis, we perform quality controls over values received from the pricing sources which include reviewing tolerance reports, trading information and data changes, and directional moves compared to market moves. We have not made any adjustments to the prices obtained from the independent pricing sources.

Assets classified as Level 3 are as follows:

- Securities available-for-sale classified in Level 3 are not readily marketable and are valued using internally developed models based on the present value of expected cash flows. Our Level 3 securities primarily consist of auction rate securities for which observable inputs or value drivers are unavailable due to events described in Note 6 – “Investments.” Due to limited market information, we utilized a discounted cash flow (“DCF”) model to derive an estimate of fair value of these assets at December 31, 2012 and 2011. The DCF model for estimating the fair value of the auction rate securities as of December 31, 2012 is based on the following key assumptions:
 - Nominal credit risk as substantially all of the underlying collateral of these securities is ultimately guaranteed by the United States Department of Education;
 - Time to liquidity through December 31, 2013;
 - Continued receipt of contractual interest; and
 - Discount rates ranging from 16.87% to 18.35%, which include a spread for liquidity risk.

The spread for liquidity risk at December 31, 2012 increased significantly from September 30, 2012, due to our decision to consider offers from outside the auction process on our remaining two auction rate securities. These secondary market transactions have historically had a higher discount to par than transactions associated with the issuers or trustees.

- Real estate acquired through claim settlement is fair valued at the lower of our acquisition cost or a percentage of appraised value. The percentage applied to appraised value is based upon our historical sales experience adjusted for current trends.

Investments

Our entire investment portfolio is classified as available-for-sale and is reported at fair value. The related unrealized gains or losses are, after considering the related tax expense or benefit, recognized as a component of accumulated other comprehensive income in shareholders’ equity. Realized investment gains and losses are reported in income based upon specific identification of securities sold. (See Note 6 – “Investments.”)

Each quarter we perform reviews of our investments in order to determine whether declines in fair value below amortized cost were considered other-than-temporary in accordance with applicable guidance. In evaluating whether a decline in fair value is other-than-temporary, we consider several factors including, but not limited to:

- our intent to sell the security or whether it is more likely than not that we will be required to sell the security before recovery;
- extent and duration of the decline;
- failure of the issuer to make scheduled interest or principal payments;
- change in rating below investment grade; and
- adverse conditions specifically related to the security, an industry, or a geographic area.

Notes (continued)

Under the current guidance a debt security impairment is deemed other than temporary if (1) we either intend to sell the security, or it is more likely than not that we will be required to sell the security before recovery or (2) we do not expect to collect cash flows sufficient to recover the amortized cost basis of the security.

Home Office and Equipment

Home office and equipment is carried at cost net of depreciation. For financial statement reporting purposes, depreciation is determined on a straight-line basis for the home office, equipment and data processing hardware over estimated lives of 45, 5 and 3 years, respectively. For income tax purposes, we use accelerated depreciation methods.

Home office and equipment is shown net of accumulated depreciation of \$51.3 million, \$65.2 million and \$62.9 million at December 31, 2012, 2011 and 2010, respectively. Depreciation expense for the years ended December 31, 2012, 2011 and 2010 was \$1.9 million, \$2.3 million and \$2.9 million, respectively.

Deferred Insurance Policy Acquisition Costs

Costs directly associated with the successful acquisition of mortgage insurance business, consisting of employee compensation and other policy issuance and underwriting expenses, are initially deferred and reported as deferred insurance policy acquisition costs (“DAC”). For each underwriting year of business, these costs are amortized to income in proportion to estimated gross profits over the estimated life of the policies. We utilize anticipated investment income in our calculation. This includes accruing interest on the unamortized balance of DAC. The estimates for each underwriting year are reviewed quarterly and updated when necessary to reflect actual experience and any changes to key variables such as persistency or loss development. If a premium deficiency exists, we reduce the related DAC by the amount of the deficiency or to zero through a charge to current period earnings. If the deficiency is more than the related DAC balance, we then establish a premium deficiency reserve equal to the excess, by means of a charge to current period earnings.

Loss Reserves

Reserves are established for reported insurance losses and loss adjustment expenses based on when we receive notices of default on insured mortgage loans. We define a default as an insured loan with a mortgage payment that is 45 days or more past due. Reserves are also established for estimated losses incurred on notices of default not yet reported to us. Even though the accounting standard, Accounting Standards Codification (“ASC”) 944, regarding accounting and reporting by insurance entities specifically excludes mortgage insurance from its guidance relating to loss reserves, we establish loss reserves using the general principles contained in the insurance standard. However, consistent with industry standards for mortgage insurers, we do not establish loss reserves for future claims on insured loans which are not currently in default. Loss reserves are established by estimating the number of loans in our inventory of delinquent loans that will result in a claim payment, which is referred to as the claim rate, and further estimating the amount of the claim payment, which is referred to as claim severity. Our loss estimates are established based upon historical experience, including rescission and loan modification activity. Adjustments to reserve estimates are reflected in the financial statements in the years in which the adjustments are made. The liability for reinsurance assumed is based on information provided by the ceding companies.

The incurred but not reported (“IBNR”) reserves result from defaults occurring prior to the close of an accounting period, but which have not been reported to us. Consistent with reserves for reported defaults, IBNR reserves are established using estimated claim rates and claim amounts for the estimated number of defaults not reported.

Notes (continued)

Reserves also provide for the estimated costs of settling claims, including legal and other expenses and general expenses of administering the claims settlement process. (See Note 9 – “Loss Reserves.”)

Premium Deficiency Reserve

After our loss reserves are initially established, we perform premium deficiency tests using our best estimate assumptions as of the testing date. Premium deficiency reserves are established, if necessary, when the present value of expected future losses and expenses exceeds the present value of expected future premium and already established reserves. The discount rate used in the calculation of the premium deficiency reserve was based upon our pre-tax investment yield at year-end. Products are grouped for premium deficiency purposes based on similarities in the way the products are acquired, serviced and measured for profitability.

Calculations of premium deficiency reserves require the use of significant judgments and estimates to determine the present value of future premium and present value of expected losses and expenses on our business. The present value of future premium relies on, among other factors, assumptions about persistency and repayment patterns on underlying loans. The present value of expected losses and expenses depends on assumptions relating to severity of claims and claim rates on current defaults, and expected defaults in future periods. These assumptions also include an estimate of expected rescission activity. Assumptions used in calculating the deficiency reserves can be affected by volatility in the current housing and mortgage lending industries and these effects could be material. To the extent premium patterns and actual loss experience differ from the assumptions used in calculating the premium deficiency reserves, the differences between the actual results and our estimate will affect future period earnings. (See Note 10 - “Premium Deficiency Reserve.”)

Revenue Recognition

We write policies which are guaranteed renewable contracts at the insured’s option on a single, annual or monthly premium basis. We have no ability to reunderwrite or reprice these contracts. Premiums written on a single premium basis and an annual premium basis are initially deferred as unearned premium reserve and earned over the policy term. Premiums written on policies covering more than one year are amortized over the policy life in accordance with the expiration of risk which is the anticipated claim payment pattern based on historical experience. Premiums written on annual policies are earned on a monthly pro rata basis. Premiums written on monthly policies are earned as coverage is provided. When a policy is cancelled, all premium that is non-refundable is immediately earned. Any refundable premium is returned to the lender. Cancellations include rescissions and policies cancelled due to claim payment. When a policy is rescinded, all previously collected premium is returned to the lender and when a claim is paid we return any premium received since the date of default. The liability associated with our estimate of premium to be returned is accrued for separately and separate components of this liability are included in “Other liabilities” and “Premium deficiency reserves” on our consolidated balance sheet. Changes in these liabilities affect premiums written and earned and change in premium deficiency reserve, respectively. The actual return of premium for all periods affects premiums written and earned. Policy cancellations also lower the persistency rate which is a variable used in calculating the rate of amortization of deferred insurance policy acquisition costs.

Fee income of our non-insurance subsidiaries is earned and recognized as the services are provided and the customer is obligated to pay. Fee income consists primarily of contract underwriting and related fee-based services provided to lenders and is included in “Other revenue” on the statement of operations.

Notes (continued)

Income Taxes

Deferred income taxes are provided under the liability method, which recognizes the future tax effects of temporary differences between amounts reported in the financial statements and the tax bases of these items. The expected tax effects are computed at the current federal tax rate. We review the need to establish a deferred tax asset valuation allowance on a quarterly basis. We analyze several factors, among which are the severity and frequency of operating losses, our capacity for the carryback or carryforward of any losses, the expected occurrence of future income or loss and available tax planning alternatives. As discussed in Note 14 – “Income Taxes,” we have reduced our benefit from income tax through the recognition of a valuation allowance.

We provide for uncertain tax positions and the related interest and penalties based on our assessment of whether a tax benefit is more likely than not to be sustained under any examination by taxing authorities.

Benefit Plans

We have a non-contributory defined benefit pension plan covering substantially all employees, as well as a supplemental executive retirement plan. Retirement benefits are based on compensation and years of service. We recognize these retirement benefit costs over the period during which employees render the service that qualifies them for benefits. Our policy is to fund pension cost as required under the Employee Retirement Income Security Act of 1974.

We offer both medical and dental benefits for retired domestic employees, their eligible spouses and dependents until the retiree reaches the age of 65. Under the plan retirees pay a premium for these benefits. We accrue the estimated costs of retiree medical and dental benefits over the period during which employees render the service that qualifies them for benefits. Historically benefits were generally funded as they were due, however beginning in 2009 some benefits have been paid from the fund. The cost to us has not been significant. (See Note 13 – “Benefit Plans.”)

Reinsurance

Loss reserves and unearned premiums are reported before taking credit for amounts ceded under reinsurance treaties. Ceded loss reserves are reflected as “Reinsurance recoverable on loss reserves.” Ceded unearned premiums are included in “Other assets.” Amounts due from reinsurers on paid claims are reflected as “Reinsurance recoverable on paid losses.” Ceded premiums payable are included in “Other liabilities.” We remain liable for all reinsurance ceded. (See Note 11 – “Reinsurance.”)

Foreign Currency Translation

Assets and liabilities denominated in a foreign currency are translated at the year-end exchange rates. Operating results are translated at average rates of exchange prevailing during the year. Unrealized gains and losses, net of deferred taxes, resulting from translation are included in accumulated other comprehensive income in stockholders’ equity. Gains and losses resulting from transactions in a foreign currency are recorded in current period net income at the rate on the transaction date.

Share-Based Compensation

We have certain share-based compensation plans. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period which generally corresponds to the vesting period. The fair value of awards classified as liabilities is

Notes (continued)

remeasured at each reporting period until the award is settled. Awards under our plans generally vest over periods ranging from one to five years. (See Note 18 – “Share-based Compensation Plans.”)

Earnings Per Share

Our basic EPS is based on the weighted average number of common shares outstanding, which excludes participating securities (with non-forfeitable rights to dividends) of 1.1 million, 1.1 million and 1.8 million, respectively, for the years ended December 31, 2012, 2011 and 2010 because they were anti-dilutive due to our reported net loss. Typically, diluted EPS is based on the weighted average number of common shares outstanding plus common stock equivalents which include certain stock awards, stock options and the dilutive effect of our convertible debt. In accordance with accounting guidance, if we report a net loss from continuing operations, then our diluted EPS is computed in the same manner as the basic EPS. In addition, if any common stock equivalents are anti-dilutive they are always excluded from the calculation. The following is a reconciliation of the weighted average number of shares; for the years ended December 31, 2012, 2011 and 2010, common stock equivalents of 61.7 million, 55.6 million and 47.4 million, respectively, were not included because they were anti-dilutive.

	Years Ended December 31,		
	2012	2011	2010
	(In thousands, except per share data)		
Basic loss per share:			
Average common shares outstanding.....	201,892	201,019	176,406
Net loss	\$ (927,079)	\$ (485,892)	\$ (363,735)
Basic loss per share.....	<u>\$ (4.59)</u>	<u>\$ (2.42)</u>	<u>\$ (2.06)</u>
Diluted loss per share:			
Weighted-average shares - Basic	201,892	201,019	176,406
Common stock equivalents	-	-	-
Weighted-average shares - Diluted	201,892	201,019	176,406
Net loss	\$ (927,079)	\$ (485,892)	\$ (363,735)
Diluted loss per share.....	<u>\$ (4.59)</u>	<u>\$ (2.42)</u>	<u>\$ (2.06)</u>

Notes (continued)

Other Comprehensive Income

Our other comprehensive income for the years ended December 31, 2012, 2011 and 2010 was as follows:

	2012			
	<u>Before tax</u>	<u>Tax effect</u>	<u>Valuation allowance</u>	<u>Net of tax</u>
	(In thousands)			
Other comprehensive income (loss):				
Change in unrealized gains and losses on investments	\$ (78,546)	\$ 27,510	\$ (27,623)	\$ (78,659)
Amortization related to benefit plans	(1,221)	428	(428)	(1,221)
Unrealized foreign currency translation adjustment	2,452	(859)	-	1,593
Other comprehensive income (loss)	<u>\$ (77,315)</u>	<u>\$ 27,079</u>	<u>\$ (28,051)</u>	<u>\$ (78,287)</u>
	2011			
	<u>Before tax</u>	<u>Tax effect</u>	<u>Valuation allowance</u>	<u>Net of tax</u>
	(In thousands)			
Other comprehensive income (loss):				
Change in unrealized gains and losses on investments	\$ 31,662	\$ (10,605)	\$ -	\$ 21,057
Amortization related to benefit plans	(19,789)	6,927	-	(12,862)
Unrealized foreign currency translation adjustment	(318)	111	-	(207)
Other comprehensive income (loss)	<u>\$ 11,555</u>	<u>\$ (3,567)</u>	<u>\$ -</u>	<u>\$ 7,988</u>
	2010			
	<u>Before tax</u>	<u>Tax effect</u>	<u>Valuation allowance</u>	<u>Net of tax</u>
	(In thousands)			
Other comprehensive income (loss):				
Change in unrealized gains and losses on investments	\$ (71,308)	\$ 27,220	\$ (24,986)	\$ (69,074)
Amortization related to benefit plans	6,390	(2,236)	2,236	6,390
Unrealized foreign currency translation adjustment	15,615	(5,479)	529	10,665
Other comprehensive income (loss)	<u>\$ (49,303)</u>	<u>\$ 19,505</u>	<u>\$ (22,221)</u>	<u>\$ (52,019)</u>

See Note 14 – “Income Taxes” for a discussion of the valuation allowance.

Our total accumulated other comprehensive income was as follows:

Notes (continued)

	December 31,	
	2012	2011
	(In thousands)	
Unrealized gains (losses) on investments	\$ 41,541	\$ 120,087
Defined benefit plans	(71,804)	(70,582)
Foreign currency translation adjustment	32,747	30,294
Accumulated other comprehensive income, before tax	2,484	79,799
Tax effect (1)	(50,647)	(49,675)
Total accumulated other comprehensive (loss) income	<u>\$ (48,163)</u>	<u>\$ 30,124</u>

(1) Tax effect does not approximate 35% due to amounts of tax benefits not provided in various periods due to our tax valuation allowance.

Cash and Cash Equivalents

We consider money market funds and investments with original maturities of three months or less to be cash equivalents.

Subsequent Events

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

4. New Accounting Policies

In May 2011, new guidance was issued regarding fair value measurement. The guidance in the new standard is intended to harmonize the fair value measurement and disclosure requirements for accounting principles generally accepted in the United States (“GAAP”) and International Financial Reporting Standards. Many of the changes in the standard represent clarifications to existing guidance, but the standard also includes some new guidance and new required disclosures. Our disclosures reflect the requirements of this new guidance beginning with the first quarter of 2012.

In June 2011, as amended in December 2011, new guidance was issued requiring entities to present net income and other comprehensive income in either a single continuous statement or in two separate, but consecutive, statements of net income and other comprehensive income. The option to present items of other comprehensive income in the statement of changes in equity is eliminated. Our disclosures reflect the requirements of this new guidance beginning with the first quarter of 2012. Other provisions of this guidance regarding reclassifications out of other comprehensive income were finalized in February 2013. We are currently evaluating these additional provisions and intend to meet the new requirements beginning in the first quarter of 2013.

In October 2010, new guidance was issued on accounting for costs associated with acquiring or renewing insurance contracts. The new guidance changed how insurance companies account for acquisition costs, particularly in determining what costs are deferrable. The new requirements were effective beginning in the first quarter of 2012 and we have adopted them prospectively. Under the new guidance in effect, for the year ended December 31, 2012, we deferred \$9.2 million of acquisition costs. For the year ended December 31, 2011, we deferred \$5.2 million in acquisition costs and under the new guidance we would have deferred \$7.2 million of such costs. Acquisition costs are not deferred on a statutory accounting basis; therefore this new guidance has no impact on our statutory capital.

5. Related Party Transactions

Notes (continued)

There were no related party transactions during 2012, 2011 or 2010.

6. Investments

The amortized cost, gross unrealized gains and losses and fair value of the investment portfolio at December 31, 2012 and 2011 are shown below.

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses (1)</u>	<u>Fair Value</u>
<u>December 31, 2012:</u>		(In thousands)		
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 863,282	\$ 3,040	\$ (71)	\$ 866,251
Obligations of U.S. states and political subdivisions	795,935	16,965	(506)	812,394
Corporate debt securities (2)	1,792,646	15,470	(2,739)	1,805,377
Residential mortgage-backed securities	451,352	871	(1,314)	450,909
Commercial mortgage-backed securities	150,232	524	(414)	150,342
Debt securities issued by foreign sovereign governments	132,490	9,784	(208)	142,066
Total debt securities	4,185,937	46,654	(5,252)	4,227,339
Equity securities	2,797	139	-	2,936
Total investment portfolio	<u>\$ 4,188,734</u>	<u>\$ 46,793</u>	<u>\$ (5,252)</u>	<u>\$ 4,230,275</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses (1)</u>	<u>Fair Value</u>
<u>December 31, 2011:</u>		(In thousands)		
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 592,108	\$ 4,965	\$ (36)	\$ 597,037
Obligations of U.S. states and political subdivisions	2,255,192	74,918	(6,639)	2,323,471
Corporate debt securities (2)	2,007,720	32,750	(7,619)	2,032,851
Residential mortgage-backed securities	441,589	4,113	(285)	445,417
Commercial mortgage-backed securities	257,530	7,404	-	264,934
Debt securities issued by foreign sovereign governments	146,755	10,441	(6)	157,190
Total debt securities	5,700,894	134,591	(14,585)	5,820,900
Equity securities	2,666	82	(1)	2,747
Total investment portfolio	<u>\$ 5,703,560</u>	<u>\$ 134,673</u>	<u>\$ (14,586)</u>	<u>\$ 5,823,647</u>

(1) There were no other-than-temporary impairment losses recorded in other comprehensive income at December 31, 2012 and 2011.

(2) Includes investments in corporate asset-backed securities with a fair value of \$324 million and \$199 million at December 31, 2012 and 2011, respectively.

Notes (continued)

Our foreign investments primarily consist of the investment portfolio supporting our Australian domiciled subsidiary. This portfolio is comprised of Australian government and semi government securities, representing 88% of the market value of our foreign investments with the remaining 11% invested in corporate securities and 1% in cash equivalents. The The Australian portfolio is rated AAA, by one or more of the following major rating agencies: Moody's, Standard & Poor's and Fitch Ratings.

The amortized cost and fair values of debt securities at December 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Because most auction rate and mortgage-backed securities provide for periodic payments throughout their lives, they are listed below in separate categories.

<u>December 31, 2012</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In thousands)	
Due in one year or less	\$ 1,097,193	\$ 1,099,383
Due after one year through five years.....	1,673,962	1,696,376
Due after five years through ten years	480,319	491,933
Due after ten years	315,765	321,282
	<u>3,567,239</u>	<u>3,608,974</u>
Residential mortgage-backed securities.....	451,352	450,909
Commercial mortgage-backed securities.....	150,232	150,342
Auction rate securities (1).....	<u>17,114</u>	<u>17,114</u>
Total at December 31, 2012.....	<u>\$ 4,185,937</u>	<u>\$ 4,227,339</u>

(1) At December 31, 2012, 100% of auction rate securities had a contractual maturity greater than 10 years.

Notes (continued)

At December 31, 2012 and 2011, the investment portfolio had gross unrealized losses of \$5.3 million and \$14.6 million, respectively. For those securities in an unrealized loss position, the length of time the securities were in such a position, as measured by their month-end fair values, is as follows:

	<u>Less Than 12 Months</u>		<u>12 Months or Greater</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<u>December 31, 2012</u>						
	(In thousands)					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 24,094	\$ 71	\$ -	\$ -	\$ 24,094	\$ 71
Obligations of U.S. states and political subdivisions	156,111	505	1,006	1	157,117	506
Corporate debt securities	310,440	2,737	3,353	2	313,793	2,739
Residential mortgage-backed securities	315,000	982	19,939	332	334,939	1,314
Commercial mortgage-backed securities	72,689	414	-	-	72,689	414
Debt securities issued by foreign sovereign governments	14,695	208	-	-	14,695	208
Total investment portfolio..	<u>\$ 893,029</u>	<u>\$ 4,917</u>	<u>\$ 24,298</u>	<u>\$ 335</u>	<u>\$ 917,327</u>	<u>\$ 5,252</u>
	<u>Less Than 12 Months</u>		<u>12 Months or Greater</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<u>December 31, 2011</u>						
	(In thousands)					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 78,546	\$ 36	\$ -	\$ -	\$ 78,546	\$ 36
Obligations of U.S. states and political subdivisions	188,879	837	137,965	5,802	326,844	6,639
Corporate debt securities	689,396	6,709	28,174	910	717,570	7,619
Residential mortgage-backed securities	120,405	285	-	-	120,405	285
Debt securities issued by foreign sovereign governments	484	6	-	-	484	6
Equity securities	-	-	33	1	33	1
Total investment portfolio..	<u>\$ 1,077,710</u>	<u>\$ 7,873</u>	<u>\$ 166,172</u>	<u>\$ 6,713</u>	<u>\$ 1,243,882</u>	<u>\$ 14,586</u>

The unrealized losses in all categories of our investments at December 31, 2012 were primarily caused by the difference in interest rates at December 31, 2012, compared to interest rates at the time of purchase. At December 31, 2011, the securities in an unrealized loss position for 12 months or greater are primarily auction rate securities (“ARS”) backed by student loans. See further discussion of these securities below. The unrealized losses in all categories of our investments were primarily caused by the difference in interest rates at December 31, 2011, compared to the interest rates at the time of purchase as well as the liquidity discount rate applied in our auction rate securities discounted cash flow model.

Notes (continued)

The fair value of our ARS backed by student loans was approximately \$17 million and \$170 million at December 31, 2012 and 2011, respectively. The two ARS we hold are collateralized by portfolios of student loans, both of which are ultimately 97% guaranteed by the United States Department of Education. At December 31, 2012, our remaining ARS portfolio was 100% AAA/Aaa-rated by one or more of the major rating agencies.

Under the current guidance a debt security impairment is deemed other than temporary if we either intend to sell the security, or it is more likely than not that we will be required to sell the security before recovery or we do not expect to collect cash flows sufficient to recover the amortized cost basis of the security. During 2012 we recognized OTTI losses in earnings of \$2.3 million, related to impairments on certain ARS, some of which were previously impaired in 2011. During 2011 we recognized OTTI losses in earnings of \$0.7 million. During 2010 we recognized OTTI losses in earnings of \$9.6 million. In 2010, our OTTI losses were primarily related to certain securities for which the expected cash flows are not sufficient to recover the amortized cost.

For the years ended December 31, 2012 and 2011, there were no credit losses recognized in earnings for which a portion of an OTTI loss was recognized in accumulated other comprehensive income (loss).

Net investment income is comprised of the following:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
		(In thousands)	
Fixed maturities	\$ 122,886	\$ 202,301	\$ 236,734
Equity securities	200	330	315
Cash equivalents	333	496	1,526
Interest on Sherman note	-	-	10,796
Other	<u>782</u>	<u>926</u>	<u>1,081</u>
Investment income	124,201	204,053	250,452
Investment expenses	<u>(2,561)</u>	<u>(2,783)</u>	<u>(3,199)</u>
Net investment income	<u>\$ 121,640</u>	<u>\$ 201,270</u>	<u>\$ 247,253</u>

Notes (continued)

The net realized investment gains (losses), including impairment losses, and change in net unrealized appreciation (depreciation) of investments are as follows:

	<u>2012</u>	<u>2011</u> (In thousands)	<u>2010</u>
Net realized investment gains (losses) on investments:			
Fixed maturities	\$ 195,652	\$ 142,284	\$ 93,017
Equity securities	487	330	151
Joint ventures	-	-	(466)
Other	<u>(730)</u>	<u>101</u>	<u>235</u>
Total net realized investment gains	<u>\$ 195,409</u>	<u>\$ 142,715</u>	<u>\$ 92,937</u>
Change in net unrealized appreciation (depreciation):			
Fixed maturities	\$ (78,604)	\$ 31,576	\$ (71,304)
Equity securities	58	86	(4)
Other	-	-	-
Total change in net unrealized appreciation (depreciation)...	<u>\$ (78,546)</u>	<u>\$ 31,662</u>	<u>\$ (71,308)</u>

The gross realized gains, gross realized losses and impairment losses are as follows:

	<u>2012</u>	<u>2011</u> (In thousands)	<u>2010</u>
Gross realized gains	\$ 213,827	\$ 158,659	\$ 119,325
Gross realized losses	(16,108)	(15,229)	(16,278)
Impairment losses	<u>(2,310)</u>	<u>(715)</u>	<u>(9,644)</u>
Net realized gains on securities	195,409	142,715	93,403
Loss from joint ventures	-	-	(466)
Total net realized gains	<u>\$ 195,409</u>	<u>\$ 142,715</u>	<u>\$ 92,937</u>

We had \$21.4 million and \$22.3 million of investments on deposit with various states at December 31, 2012 and 2011, respectively, due to regulatory requirements of those state insurance departments.

Notes (continued)

7. Fair Value Measurements

Fair value measurements for items measured at fair value included the following as of December 31, 2012 and 2011:

	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
		(In thousands)		
<u>December 31, 2012</u>				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 866,251	\$ 866,251	\$ -	\$ -
Obligations of U.S. states and political subdivisions	812,394	-	809,264	3,130
Corporate debt securities	1,805,377	-	1,788,263	17,114
Residential mortgage-backed securities	450,909	-	450,909	-
Commercial mortgage-backed securities ...	150,342	-	150,342	-
Debt securities issued by foreign sovereign governments	142,066	142,066	-	-
Total debt securities	4,227,339	1,008,317	3,198,778	20,244
Equity securities	2,936	2,615	-	321
Total investments	<u>\$ 4,230,275</u>	<u>\$ 1,010,932</u>	<u>\$ 3,198,778</u>	<u>\$ 20,565</u>
Real estate acquired (1)	\$ 3,463	\$ -	\$ -	\$ 3,463

(1) Real estate acquired through claim settlement, which is held for sale, is reported in Other Assets on the consolidated balance sheet.

	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
		(In thousands)		
<u>December 31, 2011</u>				
U.S. Treasury securities and obligations of U.S. government corporations and agencies.....	\$ 597,037	\$ 597,037	\$ -	\$ -
Obligations of U.S. states and political subdivisions	2,323,471	-	2,209,245	114,226
Corporate debt securities.....	2,032,851	1,455	1,971,168	60,228
Residential mortgage-backed securities	445,417	-	445,417	-
Commercial mortgage-backed securities ...	264,934	-	264,934	-
Debt securities issued by foreign sovereign governments.....	157,190	147,976	9,214	-
Total debt securities	5,820,900	746,468	4,899,978	174,454
Equity securities	2,747	2,426	-	321
Total investments	<u>\$ 5,823,647</u>	<u>\$ 748,894</u>	<u>\$ 4,899,978</u>	<u>\$ 174,775</u>
Real estate acquired (1)	\$ 1,621	\$ -	\$ -	\$ 1,621

(1) Real estate acquired through claim settlement, which is held for sale, is reported in Other Assets on the consolidated balance sheet.

Notes (continued)

There were no transfers of securities between Level 1 and Level 2 during 2012 or 2011.

For assets and liabilities measured at fair value using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances for the years ended December 31, 2012 and 2011 and 2010 is as follows:

	Obligations of U.S. States and Political Subdivisions	Corporate Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
	(In thousands)				
Balance at December 31, 2011	\$ 114,226	\$ 60,228	\$ 321	\$ 174,775	\$ 1,621
Total realized/unrealized gains (losses):					
Included in earnings and reported as realized investment gains (losses), net	(8,669)	(3,129)	-	(11,798)	-
Included in earnings and reported as net impairment losses recognized in earnings	-	(2,310)	-	(2,310)	-
Included in earnings and reported as losses incurred, net	-	-	-	-	(1,126)
Included in other comprehensive income	5,630	733	-	6,363	-
Purchases	27	-	-	27	11,991
Sales	(108,084)	(38,408)	-	(146,492)	(9,023)
Transfers into Level 3	-	-	-	-	-
Transfers out of Level 3	-	-	-	-	-
Balance at December 31, 2012	<u>\$ 3,130</u>	<u>\$ 17,114</u>	<u>\$ 321</u>	<u>\$ 20,565</u>	<u>\$ 3,463</u>
Amount of total losses included in earnings for the year ended December 31, 2012 attributable to the change in unrealized losses on assets still held at December 31, 2012	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Notes (continued)

	Obligations of U.S. States and Political Subdivisions	Corporate Debt Securities	Equity Securities	Total Investments	Real Estate Acquired
			(In thousands)		
Balance at December 31, 2010	\$ 295,690	\$ 70,053	\$ 321	\$ 366,064	\$ 6,220
Total realized/unrealized gains (losses):					
Included in earnings and reported as realized investment gains (losses), net	(7,883)	200	-	(7,683)	-
Included in earnings and reported as net impairment losses recognized in earnings	-	(662)	-	(662)	-
Included in earnings and reported as losses incurred, net	-	-	-	-	(371)
Included in other comprehensive income	6,894	637	-	7,531	-
Purchases	-	-	-	-	5,279
Sales	(180,475)	(10,000)	-	(190,475)	(9,507)
Transfers into Level 3	-	-	-	-	-
Transfers out of Level 3	-	-	-	-	-
Balance at December 31, 2011	<u>\$ 114,226</u>	<u>\$ 60,228</u>	<u>\$ 321</u>	<u>\$ 174,775</u>	<u>\$ 1,621</u>
Amount of total losses included in earnings for the year ended December 31, 2011 attributable to the change in unrealized losses on assets still held at December 31, 2011	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Notes (continued)

	<u>Obligations of U.S. States and Political Subdivisions</u>	<u>Corporate Debt Securities</u>	<u>Equity Securities</u> (In thousands)	<u>Total Investments</u>	<u>Real Estate Acquired</u>
Balance at December 31, 2009	\$ 370,341	\$ 129,338	\$ 321	\$ 500,000	\$ 3,830
Total realized/unrealized gains (losses):					
Included in earnings and reported as realized investment gains (losses), net	-	(2,880)	-	(2,880)	-
Included in earnings and reported as net impairment losses recognized in earnings	-	(2,677)	-	(2,677)	-
Included in earnings and reported as losses incurred, net	-	-	-	-	(1,926)
Included in other comprehensive income	4,913	5,342	-	10,255	-
Purchases	-	-	-	-	15,606
Sales	(79,564)	(59,070)	-	(138,634)	(11,290)
Transfers into Level 3	-	-	-	-	-
Transfers out of Level 3	-	-	-	-	-
Balance at December 31, 2010	<u>\$ 295,690</u>	<u>\$ 70,053</u>	<u>\$ 321</u>	<u>\$ 366,064</u>	<u>\$ 6,220</u>

Amount of total losses included in
earnings for the year ended
December 31, 2010 attributable to
the change in unrealized losses on
assets still held at December 31,
2010

<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
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Additional fair value disclosures related to our investment portfolio are included in Note 6 – “Investments.” Fair value disclosures related to our debt are included in Note 8 – “Debt.”

8. Debt

Senior Notes

At December 31, 2012 and 2011 we had outstanding \$100.1 million and \$171.0 million, respectively, of 5.375% Senior Notes due in November 2015. During 2012 we repurchased \$70.9 million in par value of those Senior Notes. We recognized a gain on the repurchases of approximately \$17.8 million, which is included in other revenue on the Consolidated Statements of Operations for the year ended December 31, 2012. During 2011 we repurchased \$129.0 million in par value of these same Senior Notes. We recognized a gain on the repurchases of approximately \$27.7 million, which is included in other revenue on the Consolidated Statements of Operations for the year ended December 31, 2011. Covenants in the Senior Notes include the requirement that there be no liens on the stock of the designated subsidiaries unless the Senior Notes are equally and ratably secured; that there be no disposition of the stock of designated subsidiaries unless all of the stock is disposed of for consideration equal to the fair market value of the stock; and that we and the designated subsidiaries preserve our corporate existence, rights and franchises unless we or any such subsidiary determines that such preservation is no longer necessary in the conduct of its business and that the loss thereof is not disadvantageous to the Senior Notes. A designated subsidiary is any of our consolidated subsidiaries which has shareholders' equity of at least 15% of our consolidated shareholders' equity. We were in compliance with all covenants at December 31, 2012.

Notes (continued)

If we fail to meet any of the covenants of the Senior Notes; there is a failure to pay when due at maturity, or a default results in the acceleration of maturity of, any of our other debt in an aggregate amount of \$40 million or more; or we fail to make a payment of principal on the Senior Notes when due or a payment of interest on the Senior Notes within thirty days after due and we are not successful in obtaining an agreement from holders of a majority of the Senior Notes to change (or waive) the applicable requirement or payment default, then the holders of 25% or more of our Senior Notes would have the right to accelerate the maturity of those notes. In addition, the trustee of the Senior Notes could, independent of any action by holders of Senior Notes, accelerate the maturity of the Senior Notes. The amounts we owe under the Senior Notes would also be accelerated upon certain bankruptcy or insolvency-related events involving our holding company, including certain events involving the appointment of a custodian, receiver, liquidator, assignee, trustee or other similar official (collectively, an “Insolvency Official”) of our holding company or any substantial part of its property or the consent of our holding company to such an appointment. The description above is not intended to be complete in all respects. Moreover, the description is qualified in its entirety by the terms of the notes, which are contained in the Indenture, dated as of October 15, 2000, between us and U.S. Bank, National Association, as trustee, and in an Officer’s Certificate dated as of October 4, 2005, which specifies the interest rate, maturity date and other terms of the Senior Notes.

Interest payments on the Senior Notes outstanding at the beginning of 2012 were \$7.4 million and \$14.9 million for the years ended December 31, 2012 and 2011, respectively. For the year ended December 31, 2011 we also had interest payments of \$4.4 million related to Senior Notes repaid in 2011.

Convertible Senior Notes

At December 31, 2012 and 2011 we had outstanding \$345 million principal amount of 5% Convertible Senior Notes due in 2017. Interest on the Convertible Senior Notes is payable semi-annually in arrears on May 1 and November 1 of each year. The Convertible Senior Notes will mature on May 1, 2017, unless earlier converted by the holders or repurchased by us. Covenants in the Convertible Senior Notes include a requirement to notify holders in advance of certain events and that we and the designated subsidiaries (defined above) preserve our corporate existence, rights and franchises unless we or any such subsidiary determines that such preservation is no longer necessary in the conduct of its business and that the loss thereof is not disadvantageous to the Convertible Senior Notes.

If we fail to meet any of the covenants of the Convertible Senior Notes; there is a failure to pay when due at maturity, or a default results in the acceleration of maturity of, any of our other debt in an aggregate amount of \$40 million or more; a final judgment for the payment of \$40 million or more (excluding any amounts covered by insurance) is rendered against us or any of our subsidiaries which judgment is not discharged or stayed within certain time limits; or we fail to make a payment of principal on the Convertible Senior Notes when due or a payment of interest on the Convertible Senior Notes within thirty days after due and we are not successful in obtaining an agreement from holders of a majority of the Convertible Senior Notes to change (or waive) the applicable requirement or payment default, then the holders of 25% or more of the Convertible Senior Notes would have the right to accelerate the maturity of those notes. In addition, the trustee of the Convertible Senior Notes could, independent of any action by holders, accelerate the maturity of the Convertible Senior Notes. The amounts we owe under the Convertible Senior Notes would also be accelerated upon certain bankruptcy or insolvency-related events involving our holding company or a Significant Subsidiary, including the failure to have dismissed or stayed a petition seeking relief under bankruptcy or insolvency laws or the consent of our holding company or a Significant Subsidiary to the appointment of an Insolvency Official for all or substantially all of their respective property. “Significant Subsidiary” is defined in Regulation S-X under the Securities Act of 1933 and is measured as of the most recently completed fiscal year. As of December 31, 2012, MGIC and MGIC Reinsurance Corporation of Wisconsin were our Significant Subsidiaries.

Notes (continued)

The Convertible Senior Notes are convertible, at the holder's option, at an initial conversion rate, which is subject to adjustment, of 74.4186 shares per \$1,000 principal amount at any time prior to the maturity date. This represents an initial conversion price of approximately \$13.44 per share. These Convertible Senior Notes will be equal in right of payment to our existing Senior Notes, discussed above, and will be senior in right of payment to our existing Convertible Junior Debentures, discussed below. Debt issuance costs are being amortized to interest expense over the contractual life of the Convertible Senior Notes. The provisions of the Convertible Senior Notes are complex. The description above is not intended to be complete in all respects. Moreover, that description is qualified in its entirety by the terms of the notes, which are contained in the Supplemental Indenture, dated as of April 26, 2010, between us and U.S. Bank National Association, as trustee, and the Indenture dated as of October 15, 2000, between us and the trustee.

Interest payments on the Convertible Senior Notes were \$17.3 million in each of the years ended December 31, 2012 and 2011.

Convertible Junior Subordinated Debentures

At December 31, 2012 and 2011 we had outstanding \$389.5 million principal amount of 9% Convertible Junior Subordinated Debentures due in 2063 (the "debentures"). The debentures have an effective interest rate of 19% that reflects our non-convertible debt borrowing rate at the time of issuance. At December 31, 2012 and 2011 the amortized value of the principal amount of the debentures is reflected as a liability on our consolidated balance sheet of \$379.6 million and \$344.4 million, respectively, with the unamortized discount reflected in equity. The debentures rank junior to all of our existing and future senior indebtedness.

Violations of the covenants under the Indenture governing the debentures, including covenants to provide certain documents to the trustee, are not events of default under the Indenture and would not allow the acceleration of amounts that we owe under the debentures. Similarly, events of default under, or acceleration of, any of our other obligations, including those described above, would not allow the acceleration of amounts that we owe under the debentures. However, if we fail to pay principal or interest when due under the debentures, then the holders of 25% or more of the debentures would have the right to accelerate the maturity of them. In addition, the trustee of the debentures could, independent of any action by holders, accelerate the maturity of the debentures. The amounts we owe under the Convertible Junior Subordinated Debentures would also be accelerated upon certain bankruptcy or insolvency-related events involving our holding company, including the appointment of a custodian of it or any substantial part of its properties.

Interest on the debentures is payable semi-annually in arrears on April 1 and October 1 of each year. As long as no event of default with respect to the debentures has occurred and is continuing, we may defer interest, under an optional deferral provision, for one or more consecutive interest periods up to ten years without giving rise to an event of default. Deferred interest will accrue additional interest at the rate then applicable to the debentures. During an optional deferral period we may not pay or declare dividends on our common stock.

On September 11, 2012, we sent notice to the holders of record of our debentures that we were deferring to October 1, 2022, the interest payment of \$17.5 million that was scheduled to be paid on October 1, 2012. During this 10-year deferral period the deferred interest will continue to accrue and compound semi-annually to the extent permitted by applicable law at an annual rate of 9%.

When interest on the debentures is deferred, we are required, not later than a specified time, to use reasonable commercial efforts to begin selling qualifying securities to persons who are not our affiliates.

Notes (continued)

The specified time is one business day after we pay interest on the debentures that was not deferred, or if earlier, the fifth anniversary of the scheduled interest payment date on which the deferral started. Qualifying securities are common stock, certain warrants and certain non-cumulative perpetual preferred stock. The requirement to use such efforts to sell such securities is called the Alternative Payment Mechanism.

The net proceeds of Alternative Payment Mechanism sales are to be applied to the payment of deferred interest, including the compound portion. We cannot pay deferred interest other than from the net proceeds of Alternative Payment Mechanism sales, except at the final maturity of the debentures or at the tenth anniversary of the start of the interest deferral. The Alternative Payment Mechanism does not require us to sell common stock or warrants before the fifth anniversary of the interest payment date on which that deferral started if the net proceeds (counting any net proceeds of those securities previously sold under the Alternative Payment Mechanism) would exceed the 2% cap. The 2% cap is 2% of the average closing price of our common stock times the number of our outstanding shares of common stock. The average price is determined over a specified period ending before the issuance of the common stock or warrants being sold, and the number of outstanding shares is determined as of the date of our most recent publicly released financial statements.

We are not required to issue under the Alternative Payment Mechanism a total of more than 10 million shares of common stock, including shares underlying qualifying warrants. In addition, we may not issue under the Alternative Payment Mechanism qualifying preferred stock if the total net proceeds of all issuances would exceed 25% of the aggregate principal amount of the debentures.

The Alternative Payment Mechanism does not apply during any period between scheduled interest payment dates if there is a “market disruption event” that occurs over a specified portion of such period. Market disruption events include any material adverse change in domestic or international economic or financial conditions.

The provisions of the debentures are complex. The description above is not intended to be complete in all respects. Moreover, that description is qualified in its entirety by the terms of the debentures, which are contained in the Indenture, dated as of March 28, 2008, between us and U.S. Bank National Association, as trustee.

We may redeem the debentures prior to April 6, 2013, in whole but not in part, only in the event of a specified tax or rating agency event, as defined in the Indenture. In any such event, the redemption price will be equal to the greater of (1) 100% of the principal amount of the debentures being redeemed and (2) the applicable make-whole amount, as defined in the Indenture, in each case plus any accrued but unpaid interest. On or after April 6, 2013, we may redeem the debentures in whole or in part from time to time, at our option, at a redemption price equal to 100% of the principal amount of the debentures 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 debentures for at least 20 of the 30 trading days preceding notice of the redemption. We will not be able to redeem the debentures, other than in the event of a specified tax event or rating agency event, during an optional deferral period.

The debentures are currently convertible, at the holder’s option, at an initial conversion rate, which is subject to adjustment, of 74.0741 common shares per \$1,000 principal amount of debentures at any time prior to the maturity date. This represents an initial conversion price of approximately \$13.50 per share. If a holder elects to convert their debentures, deferred interest owed on the debentures being converted is also converted into shares of our common stock. The conversion rate for any deferred interest is based on the average price that our shares traded at during a 5-day period immediately prior to the election to convert. In lieu of issuing shares of common stock upon conversion of the debentures occurring after April

Notes (continued)

6, 2013, we may, at our option, make a cash payment to converting holders equal to the value of all or some of the shares of our common stock otherwise issuable upon conversion.

Interest payments on the debentures were \$17.5 million for the year ended December 31, 2012 and \$35.1 million for the year ended December 31, 2011.

All Debt

The par value and fair value of our debt at December 31, 2012 and 2011 appears in the table below.

	<u>Par Value</u>	<u>Total Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
			(In thousands)		
<u>December 31, 2012</u>					
Liabilities:					
Senior Notes	\$ 100,118	\$ 79,594	\$ 79,594	\$ -	\$ -
Convertible Senior Notes	345,000	242,880	242,880	-	-
Convertible Junior Subordinated Debentures	<u>389,522</u>	<u>173,096</u>	<u>-</u>	<u>173,096</u>	<u>-</u>
Total Debt	<u>\$ 834,640</u>	<u>\$ 495,570</u>	<u>\$ 322,474</u>	<u>\$ 173,096</u>	<u>\$ -</u>
<u>December 31, 2011</u>					
Liabilities:					
Senior Notes	\$ 171,000	\$ 116,708	\$ 116,708	\$ -	\$ -
Convertible Senior Notes	345,000	202,256	202,256	-	-
Convertible Junior Subordinated Debentures	<u>389,522</u>	<u>189,648</u>	<u>-</u>	<u>189,648</u>	<u>-</u>
Total Debt	<u>\$ 905,522</u>	<u>\$ 508,612</u>	<u>\$ 318,964</u>	<u>\$ 189,648</u>	<u>\$ -</u>

The fair value of our Senior Notes and Convertible Senior Notes was determined using publicly available trade information and are considered Level 1 securities as described in Note 7 – “Fair Value Measurements.” The fair value of our debentures was determined using available pricing for these debentures or similar instruments and are considered Level 2 securities as described in Note 7 – “Fair Value Measurements.”

The Senior Notes, Convertible Senior Notes and Convertible Junior Debentures are obligations of our holding company, MGIC Investment Corporation, and not of its subsidiaries. At December 31, 2012, we had approximately \$315 million in cash and investments at our holding company. The net unrealized gains on our holding company investment portfolio were approximately \$2 million at December 31, 2012. The modified duration of the holding company investment portfolio, excluding cash and cash equivalents, was 2.2 years at December 31, 2012.

9. Loss Reserves

As described in Note 3 – “Summary of Significant Accounting Policies,” we establish reserves to recognize the estimated liability for losses and loss adjustment expenses related to defaults on insured

Notes (continued)

mortgage loans. Loss reserves are established by estimating the number of loans in our inventory of delinquent loans that will result in a claim payment, which is referred to as the claim rate, and further estimating the amount of the claim payment, which is referred to as claim severity.

Estimation of losses is inherently judgmental. The conditions that affect the claim rate and claim severity include the current and future state of the domestic economy, including unemployment, and the current and future strength of local housing markets. Current conditions in the housing and mortgage industries make these assumptions more volatile than they would otherwise be. The actual amount of the claim payments may be substantially different than our loss reserve estimates. Our estimates could be adversely affected by several factors, including a deterioration of regional or national economic conditions, including unemployment, leading to a reduction in borrowers' income and thus their ability to make mortgage payments, and a drop in housing values that could result in, among other things, greater losses on loans that have pool insurance, and may affect borrower willingness to continue to make mortgage payments when the value of the home is below the mortgage balance, and mitigation from rescissions being materially less than assumed. 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 following table provides a reconciliation of beginning and ending loss reserves for each of the past three years:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
		(In thousands)	
Reserve at beginning of year	\$ 4,557,512	\$ 5,884,171	\$ 6,704,990
Less reinsurance recoverable	<u>154,607</u>	<u>275,290</u>	<u>332,227</u>
Net reserve at beginning of year (1)	4,402,905	5,608,881	6,372,763
Adjustment to reserves (2)	<u>-</u>	<u>-</u>	<u>(92,000)</u>
Adjusted beginning reserves	4,402,905	5,608,881	6,280,763
Losses incurred:			
Losses and LAE incurred in respect of default notices received in:			
Current year	1,494,133	1,814,035	1,874,449
Prior years (3)	<u>573,120</u>	<u>(99,328)</u>	<u>(266,908)</u>
Subtotal (4)	<u>2,067,253</u>	<u>1,714,707</u>	<u>1,607,541</u>
Losses paid:			
Losses and LAE paid in respect of default notices received in:			
Current year	134,509	121,383	60,897
Prior years (5)	2,389,985	2,838,069	2,256,206
Reinsurance terminations (6)	<u>(6,331)</u>	<u>(38,769)</u>	<u>(37,680)</u>
Subtotal (7)	<u>2,518,163</u>	<u>2,920,683</u>	<u>2,279,423</u>
Net reserve at end of year (8)	3,951,995	4,402,905	5,608,881
Plus reinsurance recoverables	<u>104,848</u>	<u>154,607</u>	<u>275,290</u>
Reserve at end of year	<u>\$ 4,056,843</u>	<u>\$ 4,557,512</u>	<u>\$ 5,884,171</u>

(1) At December 31, 2011, 2010 and 2009 the estimated reduction in loss reserves related to rescissions approximated \$0.7 billion, \$1.3 billion and \$2.1 billion, respectively.

Notes (continued)

- (2) In periods prior to 2010 an estimate of premium to be refunded in conjunction with claim payments was included in Loss Reserves. In 2010, we separately stated portions of this liability in Other liabilities and Premium deficiency reserve on the consolidated balance sheet.
- (3) A negative number for prior year losses incurred indicates a redundancy of prior year loss reserves, and a positive number for prior year losses incurred indicates a deficiency of prior year loss reserves. See table below regarding prior year loss development.
- (4) Our estimated rescissions were reduced by approximately \$0.2 billion in 2012 due to our probable settlement agreements (See Note 20 – “Litigation and Contingencies”), other rescissions had no significant impact on our losses incurred in 2012. Rescissions mitigated our incurred losses by an estimated \$0.2 billion in 2010. Rescissions did not have a significant impact on incurred losses in 2011.
- (5) In 2012, includes \$0.1 billion payment under the Freddie Mac settlement agreement (See Note 20 – “Litigation and Contingencies”).
- (6) In a termination, the reinsurance agreement is cancelled, with no future premium ceded and funds for any incurred but unpaid losses transferred to us. The transferred funds result in an increase in our investment portfolio (including cash and cash equivalents) and a decrease in net losses paid (reduction to 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. (See Note 11 – “Reinsurance”)
- (7) Rescissions mitigated our paid losses by an estimated \$0.3 billion, \$0.6 billion and \$1.0 billion in 2012, 2011 and 2010, respectively, which excludes amounts that may have been applied to a deductible.
- (8) At December 31, 2012, 2011 and 2010 the estimated reduction in loss reserves related to rescissions approximated \$0.2 billion, \$0.7 billion and \$1.3 billion, respectively.

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

Losses incurred on default notices received in the current year decreased in 2012 compared to 2011, and in 2011 compared to 2010, primarily due to a decrease in the number of new default notices received, net of cures. These factors were somewhat offset by a smaller benefit from captive arrangements.

Notes (continued)

The prior year development of the reserves in 2012, 2011 and 2010 is reflected in the table below.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
		(In millions)	
Prior year loss development:			
Pool policy settlement (1)	\$ 267	\$ -	\$ -
Estimated probable rescission settlements (1)	100	-	-
Increase (decrease) in estimated claim rate on primary defaults	260	200	(432)
Decrease in estimated severity on primary defaults	(70)	(165)	-
Change in estimates related to pool reserves, LAE reserves and reinsurance (2)	16	(134)	165
Total prior year loss development	<u>\$ 573</u>	<u>\$ (99)</u>	<u>\$ (267)</u>

- (1) See Note 20 - "Litigation and Contingencies" for a discussion of our settlement with Freddie Mac and our probable settlements regarding rescissions.
- (2) Includes approximately (\$114) million related to LAE reserves in 2011 and approximately \$185 million related to pool reserves in 2010.

The increase (decrease) in the claim rate was based on the resolution of approximately 55%, 57% and 55% in 2012, 2011 and 2010, respectively of the prior year default inventory, as well as a re-estimation of amounts to be ultimately paid on defaults remaining in inventory from the end of the prior year and estimated incurred but not reported items from the end of the prior year. In addition, during 2012, lower estimated rescission rates, as well as our experience on defaults that are 12 months or more delinquent have increased our estimate of the claim rate. In 2010, our estimated claim rates decreased due to greater cures experienced, a portion of which resulted from loan modifications. The decrease in the estimated severity in 2012 and 2011 was based on the resolution of the prior year default inventory. The decrease in estimated loss adjustment expense in 2011 was based on recent historical trends in the costs associated with resolving a claim. In 2010, the increase in estimated pool severity was based on the resolution of defaults that occurred in prior periods with higher claim amounts, which in part, were applied to remaining deductibles on certain pool policies.

The "Losses paid" section of the table above shows the breakdown between claims paid on default notices received in the current year, claims paid on default notices received in prior years and the decrease in losses paid related to terminated reinsurance agreements as noted in footnote (6) of the table above. It has historically taken, prior to the last few years, on average, approximately twelve months for a default which is not cured to develop into a paid claim, therefore, most losses paid relate to default notices received in prior years. Due to a combination of reasons that had slowed the rate at which claims are received and paid, including foreclosure moratoriums and suspensions, servicing delays, court delays, loan modifications, our fraud investigations and our claim rescissions and denials for misrepresentation, it is difficult to estimate how long it may take for current and future defaults that do not cure to develop into paid claims. In 2012 and 2011, we experienced an increase in claims paid on default notices received in the current year due to fewer claim investigations and an increase in short sales.

The liability associated with our estimate of premiums to be refunded on expected claim payments is accrued for separately at December 31, 2012 and 2011 and approximated \$134 million and \$114 million, respectively. Separate components of this liability are included in "Other liabilities" and "Premium deficiency reserve" on our consolidated balance sheet. (See Note 3 - "Summary of Significant Accounting Policies - Revenue Recognition")

Notes (continued)

A rollforward of our primary default inventory for the years ended December 31, 2012, 2011 and 2010 appears in the table below. 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 by transfers of servicing between loan servicers.

	2012	2011	2010
Default inventory at beginning of period	175,639	214,724	250,440
New Notices.....	133,232	169,305	205,069
Cures	(120,248)	(149,643)	(183,017)
Paid (including those charged to a deductible or captive).....	(45,741)	(51,138)	(43,826)
Rescissions and denials.....	(3,037)	(7,609)	(13,942)
Default inventory at end of period	<u>139,845</u>	<u>175,639</u>	<u>214,724</u>

Pool insurance notice inventory decreased from 32,971 at December 31, 2011 to 8,594 at December 31, 2012. During the third quarter of 2012, approximately 15,600 pool notices were removed from the pool notice inventory due to the exhaustion of the aggregate loss on a pool policy we have with Freddie Mac. See Note 20 – “Litigation and Contingencies” for a discussion of our settlement with Freddie Mac regarding this pool policy. The pool insurance notice inventory was 43,329 at December 31, 2010.

The decrease in the primary default inventory experienced during 2012 and 2011 was generally across all markets and all book years. However the percentage of loans in the inventory that have been in default for 12 or more consecutive months has increased, as shown in the table below. Historically as a default ages it becomes more likely to result in a claim.

Aging of the Primary Default Inventory

	December 31,					
	2012		2011		2010	
Consecutive months in default						
3 months or less.....	23,282	17%	31,456	18%	37,640	18%
4 - 11 months	34,688	25%	46,352	26%	58,701	27%
12 months or more	81,875	58%	97,831	56%	118,383	55%
Total primary default inventory...	<u>139,845</u>	<u>100%</u>	<u>175,639</u>	<u>100%</u>	<u>214,724</u>	<u>100%</u>
Primary claims received inventory included in ending default inventory (1).....	11,731	8%	12,610	7%	20,898	10%

- (1) Our claims received inventory includes suspended rescissions as discussed in Note 20 – “Litigation and Contingencies”. In connection with the Countrywide proceedings, we have voluntarily suspended rescissions of coverage related to loans that we believe could be included in a potential resolution. As of December 31, 2012, coverage on approximately 2,150 loans, representing total potential claim payments of approximately \$160 million, that we had determined was rescindable were affected by our decision to suspend such rescissions. Substantially all of these potential rescissions relate to claims received beginning in the first quarter of 2011 or later. As of December 31, 2012, coverage on approximately 250 loans, representing total potential claim payments of approximately \$17 million, were affected by our decision to suspend rescissions for another customer for which we also consider settlement probable. In addition, as of December 31, 2012, approximately 240 rescissions, representing total potential claim payments of approximately \$16 million, were affected by our decision to suspend rescissions for customers other than

Notes (continued)

those for which we consider settlement probable, as defined in ASC 450-20.

The length of time 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

	December 31,					
	2012		2011		2010	
3 payments or less.....	34,245	24%	42,804	24%	51,003	24%
4 - 11 payments	34,458	25%	47,864	27%	65,797	31%
12 payments or more	71,142	51%	84,971	49%	97,924	45%
Total primary default inventory....	<u>139,845</u>	<u>100%</u>	<u>175,639</u>	<u>100%</u>	<u>214,724</u>	<u>100%</u>

Rescissions

Before paying a claim, we can review the loan file to determine whether we are required, under the applicable insurance policy, to pay the claim or whether we are entitled to reduce the amount of the claim. For example, all of our insurance policies provide that we can reduce or deny a claim if the servicer did not comply with its obligation to mitigate our loss by performing reasonable loss mitigation efforts or diligently pursuing a foreclosure or bankruptcy relief in a timely manner. We also do not cover losses resulting from property damage that has not been repaired.

In addition, subject to rescission caps in certain of our Wall Street bulk transactions, all of our insurance policies allow us to rescind coverage under certain circumstances. Because we can review the loan origination documents and information as part of our normal processing when a claim is submitted to us, rescissions occur on a loan by loan basis most often after we have received a claim. Prior to 2008, rescissions of coverage on loans were not a material portion of our claims resolved during a year. However, beginning in 2008, our rescissions of coverage on loans have materially mitigated our paid losses. In each of 2009 and 2010, rescissions mitigated our paid losses by approximately \$1.2 billion; in 2011, rescissions mitigated our paid losses by approximately \$0.6 billion; and in 2012, rescissions mitigated our paid losses by approximately \$0.3 billion (in each case, the figure includes amounts that would have either resulted in a claim payment or been charged to a deductible under a bulk or pool policy, and may have been charged to a captive reinsurer). In recent quarters, less than 10% 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 and reversals of rescissions. Historically, the number of rescissions that we have reversed has been immaterial. A variance between ultimate actual rescission and reversal rates and our estimates, as a result of the outcome of claims investigations, litigation, settlements or other factors, could materially affect our losses. We estimate rescissions mitigated our incurred losses by approximately \$2.5 billion in 2009 and \$0.2 billion in 2010. In 2011, we estimate that rescissions had no significant impact on our losses incurred. All of these figures include the benefit of claims not paid in the period as well as the impact of changes in our estimated expected rescission activity on our loss reserves in the period. In the fourth quarter of 2012, we estimate that our rescission benefit in loss reserves was reduced due to probable rescission settlement agreements and that other rescissions had no significant impact on our losses incurred in 2012. For information about two settlements that we believe are probable, as defined in ASC 450-20, see Note 20 – “Litigation and Contingencies.” The completion of those settlements, assuming they occur, may encourage other lender-customers to seek remedies against us.

Notes (continued)

We do not utilize an explicit rescission rate in our reserving methodology, but rather our reserving methodology incorporates the effects rescission activity has had on our historical claim rate and claim severities. A variance between ultimate actual rescission rates and these estimates could materially affect our losses incurred. Our estimation process does not include a direct correlation between claim rates and severities to projected rescission activity or other economic conditions such as changes in unemployment rates, interest rates or housing values. Our experience is that analysis of that nature would not produce reliable results, as the change in one condition cannot be isolated to determine its sole effect on our ultimate paid losses as our ultimate paid losses are also influenced at the same time by other economic conditions. The estimation of the impact of rescissions on incurred losses must be considered together with the various other factors impacting incurred losses and not in isolation.

The table below represents our estimate of the impact rescissions have had on reducing our loss reserves, paid losses and losses incurred.

	<u>2012</u>	<u>2011</u> (In billions)	<u>2010</u>
Estimated rescission reduction - beginning reserve	\$ 0.7	\$ 1.3	\$ 2.1
Estimated rescission reduction - losses incurred (1).....	(0.2)	-	0.2
Rescission reduction - paid claims	0.3	0.6	1.2
Amounts that may have been applied to a deductible	-	-	(0.2)
Net rescission reduction - paid claims	<u>0.3</u>	<u>0.6</u>	<u>1.0</u>
Estimated rescission reduction - ending reserve	<u>\$ 0.2</u>	<u>\$ 0.7</u>	<u>\$ 1.3</u>

- (1) As discussed in Note 20 – “Litigation and Contingencies” we have made substantial progress in reaching an agreement with Countrywide to settle the dispute we have concerning rescissions. We have determined that a settlement with Countrywide is probable and under this probable settlement agreement, we estimate that our rescission benefit in loss reserves was reduced by approximately \$0.2 billion. This adjustment to loss reserves was partially offset by an estimated benefit of approximately \$0.1 billion under the terms of the settlement agreements we consider probable, as defined in ASC 450-20. As a result, in the fourth quarter of 2012, we increased our loss reserve estimates by approximately \$0.1 billion to reflect potential settlements we consider probable.

At December 31, 2012, our loss reserves continued to be impacted by expected rescission activity. We expect that the reduction of our loss reserves due to rescissions will continue to decline.

If the insured disputes our right to rescind coverage, the outcome of the dispute ultimately would be determined by legal proceedings. Under our policies, legal proceedings disputing our right to rescind coverage may be brought up to three years after the lender has obtained title to the property (typically through a foreclosure) or the property was sold in a sale that we approved, whichever is applicable, although in a few jurisdictions there is a longer time to bring such an action. For the majority of our rescissions since the beginning of 2009 that are not subject to a settlement agreement, this period in which a dispute may be brought has not ended. Until a liability associated with a settlement agreement or litigation becomes probable and can be reasonably estimated, we consider a rescission resolved for financial reporting purposes even though legal proceedings have been initiated and are ongoing. Although it is reasonably possible that, when the proceedings are completed, there will be a determination that we were not entitled to rescind in all cases, we are sometimes unable to make a reasonable estimate or range of estimates of the potential liability. Under ASC 450-20, an estimated loss from such proceedings is accrued for only if we determine that the loss is probable and can be reasonably estimated. Therefore, when establishing our loss reserves, we do not generally include additional loss reserves that would reflect

Notes (continued)

an adverse outcome from ongoing legal proceedings. For more information about these legal proceedings, see Note 20 – “Litigation and Contingencies.”

The liability associated with our estimate of premiums to be refunded on expected future rescissions is accrued for separately. At December 31, 2012 and 2011 the estimate of this liability totaled \$18 million and \$58 million, respectively. Separate components of this liability are included in “Other liabilities” and “Premium deficiency reserve” on our consolidated balance sheet. Changes in the liability affect premiums written and earned and change in premium deficiency reserve.

In April 2011, Freddie Mac advised its servicers that they must obtain its prior approval for rescission settlements and Fannie Mae advised its servicers that they are prohibited from entering into such settlements. In addition, in April 2011, Fannie Mae notified us that we must obtain its prior approval to enter into certain settlements. Since those announcements, the GSEs have approved our settlement agreement with one customer and have rejected settlement agreements that were structured differently. We have reached and implemented settlement agreements that do not require GSE approval, but they have not been material in the aggregate.

As discussed in Note 20 – “Litigation and Contingencies” we have made substantial progress in reaching an agreement with Countrywide concerning rescissions. In addition to the proceedings involving Countrywide, we are involved in legal proceedings with respect to rescissions that we do not consider to be collectively material in amount. We continue to discuss with other customers their objections to material rescissions and have reached settlement terms with several of our significant customers. In connection with some of these settlement discussions, we have suspended rescissions related to loans that we believe could be included in potential settlements. As of December 31, 2012, approximately 240 rescissions, representing total potential claim payments of approximately \$16 million, were affected by our decision to suspend rescissions for customers other than the two customers for which we consider a settlement agreement probable, as defined in ASC 450-20. Although it is reasonably possible that, when the discussions or legal proceedings with customers regarding rescissions are completed, there will be a conclusion or determination that we were not entitled to rescind in all cases, we are unable to make a reasonable estimate or range of estimates of the potential liability.

10. Premium Deficiency Reserve

Beginning in 2007, when we stopped writing Wall Street bulk business, we began to separately measure the performance of these transactions and established a premium deficiency reserve related to this business. The premium deficiency reserve reflects the present value of expected future losses and expenses that exceeded the present value of expected future premiums and already established loss reserves.

Notes (continued)

The components of the premium deficiency reserve at December 31, 2012, 2011 and 2010 appear in the table below.

	December 31,		
	2012	2011	2010
		(In millions)	
Present value of expected future premium	\$ 445	\$ 494	\$ 506
Present value of expected future paid losses and expenses	(1,285)	(1,455)	(1,760)
Net present value of future cash flows	(840)	(961)	(1,254)
Established loss reserves	766	826	1,075
Net deficiency	<u>\$ (74)</u>	<u>\$ (135)</u>	<u>\$ (179)</u>
Discount rate utilized at December 31,	1.3%	2.3%	2.5%

Each quarter, we re-estimate the premium deficiency reserve on the remaining Wall Street bulk insurance in force. The premium deficiency reserve primarily changes from quarter to quarter as a result of two factors. First, it changes as the actual premiums, losses and expenses that were previously estimated are recognized. Each period such items are reflected in our financial statements as earned premium, losses incurred and expenses. The difference between the amount and timing of actual earned premiums, losses incurred and expenses and our previous estimates used to establish the premium deficiency reserves has an effect (either positive or negative) on that period's results. Second, the premium deficiency reserve changes as our assumptions relating to the present value of expected future premiums, losses and expenses on the remaining Wall Street bulk insurance in force change. Changes to these assumptions also have an effect on that period's results.

The decrease in the premium deficiency reserve for the years ended December 31, 2012, 2011 and 2010 was \$61 million, \$44 million and \$14 million, respectively, as shown in the charts below. The decrease represents the net result of actual premiums, losses and expenses as well as a net change in assumptions for these periods. The change in assumptions for 2012 is primarily related to higher estimated ultimate losses resulting principally from an increase in the number of projected claims that will ultimately be paid. The change in assumptions for 2011 is primarily related to higher estimated ultimate premiums resulting principally from an increase in the projected persistency rate, somewhat offset by higher estimated ultimate losses resulting principally from an increase in the number of projected claims that will ultimately be paid. The change in assumptions for 2010 is primarily related to higher estimated ultimate premiums, which is principally related to an increase in the projected persistency rate.

The decrease in the premium deficiency reserve for the years ended December 31, 2012, 2011 and 2010 appears in the table below.

Notes (continued)

	Year ended December 31,		
	2012	2011	2010
	(In millions)		
Premium Deficiency Reserve at beginning of period	\$ (135)	\$ (179)	\$ (193)
Adjustment to premium deficiency reserve (1)	<u>-</u>	<u>-</u>	<u>(37)</u>
Adjusted premium deficiency reserve at beginning of period	(135)	(179)	(230)
Paid claims and loss adjustment expenses	\$ 279	\$ 334	\$ 426
Decrease in loss reserves	(60)	(249)	(425)
Premium earned	(102)	(120)	(128)
Effects of present valuing on future premiums, losses and expenses	<u>(1)</u>	<u>(8)</u>	<u>(25)</u>
Change in premium deficiency reserve to reflect actual premium, losses and expenses recognized	116	(43)	(152)
Change in premium deficiency reserve to reflect change in assumptions relating to future premiums, losses, expenses and discount rate (2)	<u>(55)</u>	<u>87</u>	<u>203</u>
Premium Deficiency Reserve at end of period	<u>\$ (74)</u>	<u>\$ (135)</u>	<u>\$ (179)</u>

- (1) In periods prior to 2010 an estimate of premium to be refunded in conjunction with claim payments was included in Loss Reserves. In 2010, we separately stated this liability in Premium deficiency reserve on the consolidated balance sheet. (See Note 3 - "Summary of Significant Accounting Policies – Revenue Recognition")
- (2) A (negative) positive number for changes in assumptions relating to premiums, losses, expenses and discount rate indicates a (deficiency) redundancy of prior premium deficiency reserves.

Each quarter we perform a premium deficiency analysis on the portion of our book of business not covered by the premium deficiency described above. As of December 31, 2012, the analysis concluded that there was no premium deficiency on such portion of our book of business. For the reasons discussed below, our analysis of any potential deficiency reserve is subject to inherent uncertainty and requires significant judgment by management. To the extent, in a future period, expected losses are higher or expected premiums are lower than the assumptions we used in our analysis, we could be required to record a premium deficiency reserve on this portion of our book of business in such period.

The calculation of premium deficiency reserves requires the use of significant judgments and estimates to determine the present value of future premium and present value of expected losses and expenses on our business. The calculation of future premium depends on, among other things, assumptions about persistency and repayment patterns on underlying loans. The calculation of expected losses and expenses depends on assumptions relating to severity of claims and claim rates on current defaults, and expected defaults in future periods. These assumptions also include an estimate of expected rescission activity. Similar to our loss reserve estimates, our estimates for premium deficiency reserves

Notes (continued)

could be adversely affected by several factors, including a deterioration of regional or economic conditions leading to a reduction in borrowers' income and thus their ability to make mortgage payments, and a drop in housing values that could expose us to greater losses. Assumptions used in calculating the deficiency reserves can also be affected by volatility in the current housing and mortgage lending industries. To the extent premium patterns and actual loss experience differ from the assumptions used in calculating the premium deficiency reserves, the differences between the actual results and our estimates will affect future period earnings and could be material.

11. Reinsurance

We cede a portion of our business to reinsurers and record assets for reinsurance recoverable on loss reserves and prepaid reinsurance premiums. We cede primary business to reinsurance subsidiaries and affiliates of certain mortgage lenders ("captives"). The majority of ceded premiums relates to these agreements. Historically, most of these reinsurance arrangements were aggregate excess of loss reinsurance agreements, and the remainder have been quota share agreements. Under the aggregate excess of loss agreements, we are responsible for the first aggregate layer of loss (typically 4% or 5%), the captives are responsible for the second aggregate layer of loss (typically 5% or 10%) and we are responsible for any remaining loss. The layers are typically expressed as a percentage of the original risk on an annual book of business reinsured by the captive. The premium cessions on these agreements typically range from 25% to 40% of the direct premium. Under a quota share arrangement premiums and losses are shared on a pro-rata basis between us and the captives, with the captive's portion of both premiums and losses typically ranging from 25% to 50%. Effective January 1, 2009, we no longer cede new business under excess of loss reinsurance treaties with captives. Loans reinsured on an excess of loss basis through December 31, 2008 will run off pursuant to the terms of the particular captive arrangement. New business remains eligible to be ceded under quota share reinsurance arrangements, limited to a maximum 25% cede rate. During 2009 through 2012, many of our captive arrangements have either been terminated or placed into run-off.

Under reinsurance agreements with captives, the captives are required to maintain a separate trust account, of which we are the sole beneficiary. Premiums ceded to a captive are deposited into the applicable trust account to support the captive's layer of insured risk. These amounts are held in the trust account and are available to pay reinsured losses. The trust assets are primarily invested in money market funds and government issued securities. The captive's ultimate liability is limited to the assets in the trust account. When specific time periods are met and the individual trust account balance has reached a required level, then the individual captive may make authorized withdrawals from its applicable trust account. In most cases, the captives are also allowed to withdraw funds from the trust account to pay verifiable federal income taxes and operational expenses. Conversely, if the account balance falls below certain thresholds, the individual captive may be required to contribute funds to the trust account. However, in most cases, our sole remedy if a captive does not contribute such funds is to put the captive into run-off (in a run-off, no new loans are reinsured by the captive but loans previously reinsured continue to be covered, with premium and losses continuing to be ceded on those loans). In the event that the captive's incurred but unpaid losses exceed the funds in the trust account, and the captive does not deposit adequate funds to cure the shortfall, we may also be allowed to terminate the captive agreement, assume the captive's obligations, transfer the assets in the relevant trust accounts to us, and retain all future premium payments.

The reinsurance recoverable on loss reserves as of December 31, 2012 and 2011 was approximately \$105 million and \$155 million, respectively. The reinsurance recoverable on loss reserves related to captive agreements was approximately \$104 million at December 31, 2012, which was supported by \$303 million of trust assets, while at December 31, 2011 the reinsurance recoverable on loss reserves related to captives was \$142 million which was supported by \$359 million in trust assets. As of December 31, 2012

Notes (continued)

and 2011 there was an additional \$25 million and \$27 million, respectively, of trust assets in captive agreements where there was no related reinsurance recoverable on loss reserves. During 2012 and 2011, \$6 million and \$39 million, respectively, of trust fund assets were transferred to us as a result of captive terminations. The transferred funds resulted in an increase in our investment portfolio (including cash and cash equivalents) and a decrease in our 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.

Since 2005, we have entered into three separate aggregate excess of loss reinsurance agreements under which we ceded approximately \$130 million of risk in force in the aggregate to three special purpose reinsurance companies. In 2008, we terminated one of these excess of loss reinsurance agreements. One agreement is in the final stages of termination, with no ceded risk in force at December 31, 2012. The remaining agreement had ceded risk in force at December 31, 2012 of approximately \$0.8 million. We receive a ceding commission under certain reinsurance agreements.

Generally, reinsurance recoverables on primary loss reserves, paid losses and prepaid reinsurance premiums are supported by trust funds or letters of credit. As such, we have not established an allowance against these recoverables.

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
		(In thousands)	
Premiums earned:			
Direct	\$ 1,065,663	\$ 1,170,868	\$ 1,236,949
Assumed	2,425	3,891	3,091
Ceded	(34,918)	(50,924)	(71,293)
Net premiums earned	<u>\$ 1,033,170</u>	<u>\$ 1,123,835</u>	<u>\$ 1,168,747</u>
Losses incurred:			
Direct	\$ 2,115,974	\$ 1,775,122	\$ 1,716,538
Assumed	6,912	5,229	4,128
Ceded	(55,633)	(65,644)	(113,125)
Net losses incurred	<u>\$ 2,067,253</u>	<u>\$ 1,714,707</u>	<u>\$ 1,607,541</u>

See Note 20 – “Litigation and Contingencies” for a discussion of requests or subpoenas for information regarding captive mortgage reinsurance arrangements.

In the third quarter of 2011, our Australian writing company terminated a reinsurance agreement under which it had assumed business from a third party. As a result of that termination, it returned approximately \$7 million in unearned premium and it has no further obligations under this reinsurance agreement. The termination of this reinsurance agreement had no significant impact on our remaining risk in force in Australia.

12. Investments in Joint Ventures

Sherman

In August 2008 we sold our entire interest in Sherman Financial Group, LLC (“Sherman”) to Sherman. Our interest sold represented approximately 24.25% of Sherman’s equity. The sale price was \$124.5 million in cash and Sherman’s unsecured promissory note in the principal amount of \$85 million

Notes (continued)

(the “Note”). The scheduled maturity of the Note was February 13, 2011 and it paid interest, monthly, at the annual rate equal to three-month LIBOR plus 500 basis points. Sherman repaid the Note in December 2010 for approximately \$83.5 million. The carrying value of the Note at the time of repayment was approximately \$84.0 million. The loss recognized on the repayment of \$0.5 million is included in net realized investment gains on the statement of operations for the year ended December 31, 2010.

13. Benefit Plans

We have a non-contributory defined benefit pension plan covering substantially all domestic employees, as well as a supplemental executive retirement plan. We also offer both medical and dental benefits for retired domestic employees and their spouses under a postretirement benefit plan. The following tables provide the components of aggregate annual net periodic benefit cost, changes in the benefit obligation and the funded status of the pension, supplemental executive retirement and other postretirement benefit plans as recognized in the consolidated balance sheet:

Components of Net Periodic Benefit Cost for fiscal year ending

	Pension and Supplemental Executive Retirement Plans			Other Postretirement Benefits		
	<u>12/31/2012</u>	<u>12/31/2011</u>	<u>12/31/2010</u>	<u>12/31/2012</u>	<u>12/31/2011</u>	<u>12/31/2010</u>
	(In thousands)					
1. Company Service Cost	\$ 9,662	8,917	\$ 8,531	\$ 1,226	1,090	\$ 1,126
2. Interest Cost.....	16,481	16,098	15,535	1,144	1,350	1,183
3. Expected Return on Assets ...	(18,211)	(17,373)	(14,502)	(3,162)	(3,299)	(2,891)
4. Other Adjustments	-	-	-	-	-	-
<i>Subtotal</i>	<u>7,932</u>	<u>7,642</u>	<u>9,564</u>	<u>(792)</u>	<u>(859)</u>	<u>(582)</u>
5. Amortization of:						
a. Net Transition Obligation/(Asset)	-	-	-	-	-	-
b. Net Prior Service Cost/(Credit)	665	661	650	(6,217)	(6,217)	(6,138)
c. Net Losses/(Gains).....	<u>5,829</u>	<u>4,010</u>	<u>5,924</u>	<u>797</u>	<u>632</u>	<u>764</u>
<i>Total Amortization</i>	<u>6,494</u>	<u>4,671</u>	<u>6,574</u>	<u>(5,420)</u>	<u>(5,585)</u>	<u>(5,374)</u>
6. Net Periodic Benefit Cost	14,426	12,313	16,138	(6,212)	(6,445)	(5,956)
7. Cost of settlements or curtailments	-	-	-	-	-	-
8. Total Expense for Year	<u>\$ 14,426</u>	<u>12,313</u>	<u>\$ 16,138</u>	<u>\$ (6,212)</u>	<u>(6,445)</u>	<u>\$ (5,956)</u>

Development of Funded Status

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	<u>12/31/2012</u>	<u>12/31/2011</u>	<u>12/31/2012</u>	<u>12/31/2011</u>
	(In thousands)			

Actuarial Value of Benefit Obligations

1. Measurement Date	12/31/2012	12/31/2011	12/31/2012	12/31/2011
2. Accumulated Benefit Obligation.....	\$ 331,985	\$ 297,145	\$ 16,284	\$ 25,007

Funded Status/Asset (Liability) on the Consolidated Balance Sheet

1. Projected Benefit Obligation	\$ (362,657)	\$ (318,048)	\$ (16,284)	\$ (25,007)
2. Plan Assets at Fair Value	<u>340,335</u>	<u>305,748</u>	<u>49,391</u>	<u>42,578</u>
3. Funded Status - Overfunded/Asset.....	N/A	N/A	\$ 33,107	\$ 17,571
4. Funded Status - Underfunded/Liability.....	\$ (22,322)	\$ (12,300)	N/A	N/A

Notes (continued)

Accumulated Other Comprehensive Income

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	12/31/2012	12/31/2011	12/31/2012	12/31/2011
	(In thousands)			
1. Net Actuarial (Gain)/Loss.....	\$ 106,661	\$ 95,298	\$ 1,985	\$ 14,109
2. Net Prior Service Cost/(Credit)	1,775	2,278	(38,587)	(41,072)
3. Net Transition Obligation/(Asset).....	-	-	-	-
4. Total at Year End	\$ 108,436	\$ 97,576	\$ (36,602)	\$ (26,964)

Under Statement of Statutory Accounting Principles (“SSAP”) No. 92 and No. 102, which became effective January 1, 2013, the measurement of pension and other postretirement benefit liabilities will begin to include non-vested employees. This measurement, referred to as the projected benefit obligation, is the measurement currently used under GAAP, as disclosed in the tables above. The new SSAPs will increase our statutory benefit obligations. We have evaluated the provisions of this guidance, and we do not expect the new guidance to have a material impact on our statutory benefit obligations.

The changes in the projected benefit obligation are as follows:

Change in Projected Benefit Obligation

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	12/31/2012	12/31/2011	12/31/2012	12/31/2011
	(In thousands)			
1. Benefit Obligation at Beginning of Year ..	\$ 318,048	\$ 291,456	\$ 25,007	\$ 26,200
2. Company Service Cost	9,662	8,917	1,226	1,090
3. Interest Cost	16,481	16,098	1,144	1,350
4. Plan Participants’ Contributions	-	-	356	261
5. Net Actuarial (Gain)/Loss due to Assumption Changes	37,418	23,037	(6,517)	397
6. Net Actuarial (Gain)/Loss due to Plan Experience	634	(6,544)	(497)	(3,643)
7. Benefit Payments from Fund (1).....	(19,483)	(14,692)	(661)	(560)
8. Benefit Payments Directly by Company...	(265)	(316)	(42)	(87)
9. Plan Amendments	162	92	(3,732)	-
10. Other Adjustment	-	-	-	-
11. Benefit Obligation at End of Year	\$ 362,657	\$ 318,048	\$ 16,284	\$ 25,007

(1) In 2012, includes lump sum payments of \$12.0 million from our pension plan to eligible participants, which were former employees with vested benefits of \$100 thousand or less. Additional former employees may elect this option in 2013. In 2011, includes lump sum payments of \$8.2 million from our pension plan to eligible participants, which were former employees with vested benefits of \$50 thousand or less.

Notes (continued)

The changes in the fair value of the net assets available for plan benefits are as follows:

Change in Plan Assets

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	12/31/2012	12/31/2011	12/31/2012	12/31/2011
	(In thousands)			
1. Fair Value of Plan Assets at Beginning of Year	\$ 305,748	\$ 284,080	\$ 42,578	\$ 44,362
2. Company Contributions	15,265	20,316	-	-
3. Plan Participants' Contributions	-	-	356	261
4. Benefit Payments from Fund	(19,483)	(14,692)	(661)	(560)
5. Benefit Payments paid directly by Company	(265)	(316)	(42)	(87)
6. Actual Return on Assets	39,070	16,360	7,474	(1,224)
7. Other Adjustment	-	-	(314)	(173)
8. Fair Value of Plan Assets at End of Year	\$ 340,335	\$ 305,748	\$ 49,391	\$ 42,578

Change in Accumulated Other Comprehensive Income (AOCI)

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	12/31/2012	12/31/2011	12/31/2012	12/31/2011
	(In thousands)			
1. AOCI in Prior Year	\$ 97,576	\$ 84,649	\$ (26,964)	\$ (33,827)
2. Increase/(Decrease) in AOCI				
a. Recognized during year - Prior Service (Cost)/Credit	(665)	(661)	6,217	6,217
b. Recognized during year - Net Actuarial (Losses)/Gains	(5,829)	(4,010)	(797)	(632)
c. Occurring during year - Prior Service Cost	162	92	(3,732)	-
d. Occurring during year - Net Actuarial Losses/(Gains)	17,192	17,507	(11,326)	1,278
3. AOCI in Current Year	\$ 108,436	\$ 97,576	\$ (36,602)	\$ (26,964)

Amortizations Expected to be Recognized During Next Fiscal Year Ending

	Pension and Supplemental Executive Retirement Plans	Other Postretirement Benefits
	12/31/2013	12/31/2013
	(In thousands)	
1. Amortization of Net Transition Obligation/(Asset)	\$ -	\$ -
2. Amortization of Prior Service Cost/(Credit)	500	(6,649)
3. Amortization of Net Losses/(Gains)	6,063	-

The projected benefit obligations, net periodic benefit costs and accumulated postretirement benefit obligation for the plans were determined using the following weighted average assumptions.

Notes (continued)

Actuarial Assumptions

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	<u>12/31/2012</u>	<u>12/31/2011</u>	<u>12/31/2012</u>	<u>12/31/2011</u>
<u>Weighted-Average Assumptions Used to Determine Benefit Obligations at year end</u>				
1. Discount Rate.....	4.25%	5.25%	3.85%	4.75%
2. Rate of Compensation Increase.....	3.00%	3.00%	N/A	N/A
<u>Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost for Year</u>				
1. Discount Rate.....	5.25%	5.75%	4.75%	5.50%
2. Expected Long-term Return on Plan Assets.....	6.00%	6.00%	7.50%	7.50%
3. Rate of Compensation Increase.....	3.00%	3.00%	N/A	N/A
<u>Assumed Health Care Cost Trend Rates at year end</u>				
1. Health Care Cost Trend Rate Assumed for Next Year	N/A	N/A	7.50%	8.00%
2. Rate to Which the Cost Trend Rate is Assumed to Decline (Ultimate Trend Rate)	N/A	N/A	5.00%	5.00%
3. Year That the Rate Reaches the Ultimate Trend Rate	N/A	N/A	2018	2018

In selecting a discount rate, we performed a hypothetical cash flow bond matching exercise, matching our expected pension plan and postretirement medical plan cash flows, respectively, against a selected portfolio of high quality corporate bonds. The modeling was performed using a bond portfolio of noncallable bonds with at least \$50 million outstanding. The average yield of these hypothetical bond portfolios was used as the benchmark for determining the discount rate. In selecting the expected long-term rate of return on assets, we considered the average rate of earnings expected on the classes of funds invested or to be invested to provide for the benefits of these plans. This included considering the trusts' targeted asset allocation for the year and the expected returns likely to be earned over the next 20 years.

The weighted-average asset allocations of the plans are as follows:

Plan Assets

	Pension Plan		Other Postretirement Benefits	
	<u>12/31/2012</u>	<u>12/31/2011</u>	<u>12/31/2012</u>	<u>12/31/2011</u>
<u>Allocation of Assets at year end</u>				
1. Equity Securities	40%	38%	100%	100%
2. Debt Securities.....	60%	62%	0%	0%
3. Other	0%	0%	0%	0%
4. Total.....	100%	100%	100%	100%

In accordance with fair value guidance, we applied the following fair value hierarchy in order to measure fair value of our benefit plan assets:

Level 1 – Quoted prices for identical instruments in active markets that we have the ability to access. Financial assets utilizing Level 1 inputs include equity securities, mutual funds, money market funds and certain U.S. Treasury securities and obligations of U.S. government corporations and agencies.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and inputs, other than quoted prices, that are

Notes (continued)

observable in the marketplace for the financial instrument. The observable inputs are used in valuation models to calculate the fair value of the financial instruments. Financial assets utilizing Level 2 inputs include certain municipal, corporate and foreign bonds.

Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or value drivers are unobservable. Level 3 inputs reflect our own assumptions about the assumptions a market participant would use in pricing an asset or liability. There are no securities that utilize Level 3 inputs.

To determine the fair value of securities 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 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. In addition, on a quarterly basis, we perform quality controls over values received from the pricing source (the “Trustee”) which include comparing values to other independent pricing sources. In addition, we review annually the Trustee’s auditor’s report on internal controls in order to determine that their controls around valuing securities are operating effectively. We have not made any adjustments to the prices obtained from the independent sources.

The following table sets forth by level, within the fair value hierarchy, the pension plan assets at fair value as of December 31, 2012.

Assets at Fair Value as of December 31, 2012

Pension Plan	Level 1	Level 2	Level 3	Total
		(In thousands)		
Domestic Mutual Funds	\$ 45,071	\$ -	\$ -	\$ 45,071
International Mutual Funds	39,479	-	-	39,479
Common Stocks	54,210	-	-	54,210
Corporate Bonds	-	130,643	-	130,643
U.S. Government Securities	25,859	-	-	25,859
Municipals	-	26,595	-	26,595
Foreign Bonds	-	17,710	-	17,710
Foreign Stocks	768	-	-	768
Total Assets at fair value	<u>\$ 165,387</u>	<u>\$ 174,948</u>	<u>\$ -</u>	<u>\$ 340,335</u>

Our pension plan portfolio is designed to achieve the following objectives over each market cycle and for at least 5 years:

Fixed income allocation

- Protect actuarial benefit payment stream through asset liability matching
- Reduce volatility of investment returns compared to actuarial benefit liability

Notes (continued)

Equity allocation

- Protect long tailed liabilities through the use of equity portfolio
- Achieve competitive investment results

The primary focus in developing asset allocation ranges for the portfolio is the assessment of the portfolio's investment objectives and the level of risk that is acceptable to obtain those objectives. To achieve these goals the minimum and maximum allocation ranges for fixed income securities and equity securities are:

	<u>Minimum</u>	<u>Maximum</u>
Fixed income.....	40%	100%
Equity	0%	60%
Cash equivalents	0%	10%

The following table sets forth by level, within the fair value hierarchy, the postretirement plan assets at fair value as of December 31, 2012.

Assets at Fair Value as of December 31, 2012

Postretirement Plan	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
		(In thousands)		
Domestic Mutual Funds	\$ 34,720	\$ -	\$ -	\$ 34,720
International Mutual Funds	14,671	-	-	14,671
Total Assets at fair value.....	<u>\$ 49,391</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 49,391</u>

Our postretirement plan portfolio is designed to achieve the following objectives over each market cycle and for at least 5 years:

- Total return should exceed growth in the Consumer Price Index
- Achieve competitive investment results

The primary focus in developing asset allocation ranges for the portfolio is the assessment of the portfolio's investment objectives and the level of risk that is acceptable to obtain those objectives. To achieve these goals the minimum and maximum allocation ranges for fixed income securities and equity securities are:

	<u>Minimum</u>	<u>Maximum</u>
Fixed income.....	0%	10%
Equity	90%	100%

Given the long term nature of this portfolio and the lack of any immediate need for significant cash flow, it is anticipated that the equity investments will consist of growth stocks and will typically be at the higher end of the allocation ranges above.

Investment in international oriented funds is limited to a maximum of 30% of the equity range. The current international allocation is invested in two mutual funds with 5% of the equity allocation in a fund which has the objective of investments primarily in equity securities of emerging markets countries, and 25% of the equity allocation in a fund investing in securities of companies based outside the United States. It invests in companies primarily based in Europe and the Pacific Basin, and includes common and preferred stocks, convertibles, ADRs, EDRs, bonds and cash. In addition to the foreign mutual funds,

Notes (continued)

separately managed accounts have investments in equity securities of foreign corporations, and fixed income securities issued by foreign entities.

The following tables show the estimated future contributions and estimated future benefit payments.

	Pension and Supplemental Executive Retirement Plans 12/31/2012	Other Postretirement Benefits 12/31/2012

	Pension and Supplemental Executive Retirement Plans 12/31/2012	Other Postretirement Benefits 12/31/2012
	(In thousands)	
Benefit Payments (Total)		
<u>Actual Benefit Payments for the Year Ending:</u>		
1. Current	\$ 19,748	\$ 347
<u>Expected Benefit Payments for the Year Ending:</u>		
2. Current + 1	10,253	670
3. Current + 2	12,333	764
4. Current + 3	13,258	782
5. Current + 4	14,011	831
6. Current + 5	15,357	932
7. Current + 6 – 10	97,759	6,880

Health care sensitivities

For measurement purposes, an 8.0% health care trend rate was used for benefits for retirees before they reach age 65 for 2012. In 2013, the rate is assumed to be 7.5%, decreasing to 5.0% by 2018 and remaining at this level beyond.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A 1% change in the health care trend rate assumption would have the following effects on other postretirement benefits:

	1-Percentage Point Increase	1-Percentage Point Decrease
	(In thousands)	
Effect on total service and interest cost components	\$ 506	\$ (401)
Effect on postretirement benefit obligation	2,772	(2,121)

We have a profit sharing and 401(k) savings plan for employees. At the discretion of the Board of Directors, we may make a contribution of up to 5% of each participant's eligible compensation. We provide a matching 401(k) savings contribution on employees' before-tax contributions at a rate of 80% of the first \$1,000 contributed and 40% of the next \$2,000 contributed. We recognized expenses related to these plans of \$3.1 million, \$3.6 million and \$3.7 million in 2012, 2011 and 2010, respectively.

Notes (continued)

14. Income Taxes

Net deferred tax assets and liabilities as of December 31, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
	(In thousands)	
Total deferred tax assets	\$ 997,784	\$ 683,645
Total deferred tax liabilities	(44,350)	(86,490)
Net deferred tax asset before valuation allowance	953,434	597,155
Valuation allowance	(965,987)	(608,761)
Net deferred tax liability	<u>\$ (12,553)</u>	<u>\$ (11,606)</u>

The components of the net deferred tax liability as of December 31, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
	(In thousands)	
Convertible debentures	\$ (3,470)	\$ (15,785)
Net operating loss	866,700	506,614
Loss reserves	55,615	60,478
Unrealized (appreciation) depreciation in investments	(14,448)	(42,009)
Mortgage investments	14,602	18,944
Deferred compensation	13,288	17,447
Premium deficiency reserves	25,823	47,186
Loss due to “other than temporary” impairments	1,088	11,068
Other, net	(5,764)	(6,788)
Net deferred tax asset before valuation allowance	953,434	597,155
Valuation allowance	(965,987)	(608,761)
Net deferred tax liability	<u>\$ (12,553)</u>	<u>\$ (11,606)</u>

We review the need to adjust the deferred tax asset valuation allowance on a quarterly basis. We analyze several factors, among which are the severity and frequency of operating losses, our capacity for the carryback or carryforward of any losses, the expected occurrence of future income or loss and available tax planning alternatives. Based on our analysis and the level of cumulative operating losses, we have reduced our benefit from income tax through the recognition of a valuation allowance.

Beginning with the first quarter of 2009, any benefit from income taxes, relating to operating losses, has been reduced or eliminated by the establishment of a valuation allowance. During 2010, our deferred tax valuation allowance was increased due to a decrease in the deferred tax liability related to \$63.5 million of losses that were recorded in other comprehensive income. During 2011, our deferred tax asset valuation allowance was reduced due to an increase in the deferred tax liability related to \$2.3 million of income that was recorded in other comprehensive income. During 2012, our deferred tax valuation allowance was increased due to a decrease in the deferred tax liability related to \$80.1 million of losses that were recorded in other comprehensive income. In the event of future operating losses, it is likely that the valuation allowance will be adjusted by any taxes recorded to equity for changes in other comprehensive income.

Notes (continued)

The effect of the change in valuation allowance on the benefit from income taxes was as follows:

	<u>2012</u>	<u>2011</u> (In thousands)	<u>2010</u>
Benefit from income taxes	\$ (330,740)	\$ (196,835)	\$ (145,334)
Change in valuation allowance	329,175	198,428	149,669
(Benefit from) provision for income taxes	<u>\$ (1,565)</u>	<u>\$ 1,593</u>	<u>\$ 4,335</u>

The increase in the valuation allowance that was included in other comprehensive income was \$28.1 million, zero, and \$22.2 million for the years ended December 31, 2012, 2011 and 2010, respectively. The total valuation allowance as of December 31, 2012, December 31, 2011 and December 31, 2010 was \$966.0 million, \$608.8 million and \$410.3 million, respectively.

Giving full effect to the carryback of net operating losses for federal income tax purposes, we have approximately \$2,477 million of net operating loss carryforwards on a regular tax basis and \$1,595 million of net operating loss carryforwards for computing the alternative minimum tax as of December 31, 2012. Any unutilized carryforwards are scheduled to expire at the end of tax years 2029 through 2032.

The following summarizes the components of the (benefit from) provision for income taxes:

	<u>2012</u>	<u>2011</u> (In thousands)	<u>2010</u>
Current	\$ (4,251)	\$ 598	\$ 1,618
Deferred	90	(945)	(19)
Other	2,596	1,940	2,736
(Benefit from) provision for income taxes	<u>\$ (1,565)</u>	<u>\$ 1,593</u>	<u>\$ 4,335</u>

We received \$7.0 million and \$289.1 million in federal income tax refunds in 2012 and 2010, respectively. Proceeds received in 2010 were primarily from the carryback of 2009 losses.

The reconciliation of the federal statutory income tax benefit rate to the effective income tax (benefit) rate is as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Federal statutory income tax benefit rate	(35.0)%	(35.0)%	(35.0)%
Valuation allowance	35.4	41.0	41.6
Tax exempt municipal bond interest	(0.8)	(5.4)	(10.5)
Other, net	0.2	(0.3)	5.1
Effective income tax (benefit) rate	<u>(0.2)%</u>	<u>0.3%</u>	<u>1.2%</u>

The Internal Revenue Service (“IRS”) completed examinations of our federal income tax returns for the years 2000 through 2007 and issued assessments for unpaid 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”). This portfolio has been managed and maintained during years prior to, during and subsequent to the examination period. 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. The IRS assessment related to the REMIC issue is \$190.7 million in taxes and penalties. There would also be applicable interest which, when computed on the amount of the

Notes (continued)

assessment, is substantial. Depending on the outcome of this matter, additional state income taxes along with any applicable interest may become due when a final resolution is reached and could also be substantial.

We appealed these assessments within the IRS and, in 2007, we made a payment of \$65.2 million to the United States Department of the Treasury related to this assessment. In August 2010, we reached a tentative settlement agreement with the IRS which was not finalized. We currently expect to receive a statutory notice of deficiency (commonly referred to as a “90-day letter”) for the disputed amounts after the first quarter of 2013. We would then be required to litigate their validity in order to avoid payment to the IRS of the entire amount assessed. Any such litigation could be lengthy and costly in terms of legal fees and related expenses. 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 and statutory capital. In this regard, see Note 1 – “Nature of Business - Capital.”

In March 2012, we received a Revenue Agent’s Report from the IRS related to the examination of our federal income tax returns for the years 2008 and 2009. In January 2013, we received a Revenue Agent’s Report from the IRS related to the examination of our federal income tax return for the year 2010. The adjustments that are proposed by the IRS are temporary in nature and will have no material effect on the financial statements.

Under current guidance, when evaluating a tax position for recognition and measurement, an entity shall presume that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information. The interpretation adopts a benefit recognition model with a two-step approach, a more-likely-than-not threshold for recognition and derecognition, and a measurement attribute that is the greatest amount of benefit that is cumulatively greater than 50% likely of being realized. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	Unrecognized tax benefits		
	2012	2011	2010
	(In thousands)		
Balance at beginning of year	\$ 110,080	\$ 109,282	\$ 91,117
Additions based on tax positions related to the current year	-	-	-
Additions for tax positions of prior years	511	798	18,165
Reductions for tax positions of prior years	(4,041)	-	-
Settlements	(2,000)	-	-
Balance at end of year	<u>\$ 104,550</u>	<u>\$ 110,080</u>	<u>\$ 109,282</u>

The total amount of the unrecognized tax benefits, related to our aforementioned REMIC issue, that would affect our effective tax rate is \$92.0 million. We recognize interest accrued and penalties related to unrecognized tax benefits in income taxes. During 2012, we recognized \$(1.4) million in interest. As of December 31, 2012 and 2011, we had \$25.3 million and \$26.7 million of accrued interest related to uncertain tax positions, respectively. The statute of limitations related to the consolidated federal income tax return is closed for all years prior to 2000.

Notes (continued)

15. Shareholders' Equity

In April 2012, we amended our Articles of Incorporation to increase our authorized common stock from 460 million shares to 680 million shares.

We have a Shareholders Rights Agreement (the "Agreement"), which was amended in July 2012, that seeks to diminish the risk that our ability to use our net operating losses ("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-half of one share of our Common Stock at a Purchase Price of \$14 per full share (equivalent to \$7.00 for each one-half 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, 2015, 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.

In April 2010 we completed the public offering and sale of 74,883,720 shares of our common stock at a price of \$10.75 per share. We received net proceeds of approximately \$772.4 million, after deducting underwriting discount and offering expenses. The shares of common stock sold were newly issued shares.

We have 35.9 million authorized shares reserved for conversion under our convertible debentures, including deferred interest, and 25.7 million authorized shares reserved for conversion under our convertible senior notes. (See Note 8 – "Debt")

16. Dividend Restrictions

Our insurance subsidiaries are subject to statutory regulations as to maintenance of policyholders' surplus and payment of dividends. The maximum amount of dividends that the insurance subsidiaries may pay in any twelve-month period without regulatory approval by the Office of the Commissioner of Insurance of the State of Wisconsin 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 senior notes, convertible senior notes and convertible debentures, discussed in Note 8 – "Debt", are obligations of MGIC Investment Corporation, our holding company, and not of its subsidiaries. The

Notes (continued)

payment of dividends from our insurance subsidiaries, which prior to raising capital in the public markets in 2008 and 2010 had been the principal source of our holding company cash inflow, is restricted by insurance regulation. MGIC is the principal source of dividend-paying capacity. In 2009 through 2012, MGIC has not paid any dividends to our holding company. In 2013, MGIC and our other insurance subsidiaries cannot pay any dividends to our holding company without approval from the OCI. In connection with the approval of MIC as an eligible mortgage insurer, Freddie Mac and Fannie Mae have imposed dividend restrictions on MGIC and MIC through December 31, 2013.

In the fourth quarter of 2008, we suspended the payment of dividends to shareholders.

17. Statutory Capital

Accounting Principles

The accounting principles used in determining statutory financial amounts differ from GAAP, primarily for the following reasons:

Under statutory accounting practices, including practices prescribed by the OCI, mortgage guaranty insurance companies are required to maintain contingency loss reserves equal to 50% of premiums earned. Such amounts cannot be withdrawn for a period of ten years except as permitted by insurance regulations. With regulatory approval a mortgage guaranty insurance company may make early withdrawals from the contingency reserve when incurred losses exceed 35% of net premiums earned in a calendar year. Changes in contingency loss reserves impact the statutory statement of operations. Contingency loss reserves are not reflected as liabilities under GAAP and changes in contingency loss reserves do not impact GAAP operations. A premium deficiency reserve that may be recorded on a GAAP basis when present value of expected future losses and expenses exceeds the present value of expected future premiums and already established loss reserves, may not be recorded on a statutory basis if the present value of expected future premiums and already established loss reserves and statutory contingency reserves, exceeds the present value of expected future losses and expenses. On a GAAP basis, when calculating a premium deficiency reserve policies are grouped based on how they are acquired, serviced and measured. On a statutory basis, a premium deficiency reserve is calculated on all policies in force.

Under statutory accounting practices, insurance policy acquisition costs are charged against operations in the year incurred. Under GAAP, these costs are deferred and amortized as the related premiums are earned commensurate with the expiration of risk.

Under statutory accounting practices, purchases of tax and loss bonds are accounted for as investments. Under GAAP, purchases of tax and loss bonds are recorded as payments of current income taxes.

Under statutory accounting practices, changes in deferred tax assets and liabilities are recognized as a separate component of gains and losses in statutory surplus. Under GAAP, changes in deferred tax assets and liabilities are recorded on the statement of operations as a component of the (benefit) provision for income tax.

Under statutory accounting practices, fixed maturity investments are generally valued at amortized cost. Under GAAP, those investments which we do not have the ability and intent to hold to maturity are considered to be available-for-sale and are recorded at fair value, with the unrealized gain or loss recognized, net of tax, as an increase or decrease to shareholders' equity.

Notes (continued)

Under statutory accounting practices, certain assets, including certain deferred tax assets, designated as non-admitted assets, are charged directly against statutory surplus. Such assets are reflected on the GAAP financial statements.

SSAP No. 101 became effective January 1, 2012 and prescribed new standards for determining the amount of deferred tax assets that can be recognized as admitted assets for determining statutory capital. Under a permitted practice effective September 30, 2012 and until further notice, the OCI has approved MGIC to report its net deferred tax asset as an admitted asset in an amount not to exceed 10% of surplus as regards policyholders, notwithstanding any contrary provisions of SSAP No. 101. At December 31, 2012, had MGIC calculated its net deferred tax assets based on the provisions of SSAP No. 101, no deferred tax assets would have been admitted. Pursuant to the permitted practice, deferred tax assets of approximately \$63 million were included in statutory capital.

The statutory net income, surplus and the contingency reserve liability of the insurance subsidiaries (excluding the non-insurance subsidiaries of our parent company), as well as the surplus contributions made to MGIC and other insurance subsidiaries and dividends paid by MGIC to us, are included below. The surplus amounts included below are the combined surplus of our insurance operations as utilized in our risk-to-capital calculations.

Year Ended December 31,	<u>Net (Loss) Income</u>	<u>Surplus</u> (In thousands)	<u>Contingency Reserve</u>
2012	\$ (902,878)	\$ 748,592	\$ 6,430
2011	(436,277)	1,657,349	4,104
2010	113,651	1,692,392	5,480

Year Ended December 31,	<u>Additions to the surplus of MGIC from parent company funds</u>	<u>Additions to the surplus of other insurance subsidiaries from parent company funds</u> (In thousands)	<u>Dividends paid by MGIC to the parent company</u>
2012	\$ 100,000	\$ -	\$ -
2011	200,000	-	-
2010	200,000	-	-

Statutory Capital Requirements

The Office of the Commissioner of Insurance of Wisconsin is MGIC's principal insurance regulator. To assess a mortgage guaranty insurer's capital adequacy, Wisconsin's insurance regulations require that a mortgage guaranty insurance company maintain "policyholders position" of not less than a minimum computed under a formula (such minimum, the "MPP"). Policyholders position is the insurer's net worth or surplus, contingency reserve and a portion of the reserves for unearned premiums, with credit given for authorized reinsurance. The minimum required by the formula depends on the insurance in force and whether the loans insured are primary insurance or pool insurance and further depends on the LTV ratio of the individual loans and their coverage percentage (and in the case of pool insurance, the amount of any deductible). If a mortgage guaranty insurer does not meet MPP it may be prohibited from writing new business until its policyholders position meets the minimum.

Some states that regulate us have provisions that limit the risk-to-capital ratio of a mortgage guaranty insurance company to 25 to 1. This ratio is computed on a statutory basis for our insurance entities and is our net risk in force divided by our policyholders' position. Policyholders' position consists primarily of

Notes (continued)

statutory policyholders' surplus, plus the statutory contingency reserve. The statutory contingency reserve is reported as a liability on the statutory balance sheet. A mortgage guaranty 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 guaranty insurance company may make early withdrawals from the contingency reserve when incurred losses exceed 35% of net earned premium in a calendar year. If an insurance company's risk-to-capital ratio exceeds the limit applicable in a state, it may be prohibited from writing new business in that state until its risk-to-capital ratio falls below the limit.

At December 31, 2012, MGIC's risk-to-capital ratio was 44.7 to 1, exceeding the maximum allowed by many jurisdictions, and its policyholder position was \$640 million below the required MPP of \$1.2 billion. We expect MGIC's risk-to-capital ratio to increase and to continue to exceed 25 to 1. At December 31, 2012, the risk-to-capital ratio of our combined insurance operations (which includes reinsurance affiliates) was 47.8 to 1. A higher risk-to-capital ratio on a combined basis may indicate that, in order for MGIC or MIC to continue to utilize reinsurance arrangements with its subsidiaries or subsidiaries of our holding company, additional capital contributions to the reinsurance affiliates could be needed. These reinsurance arrangements permit MGIC and MIC to write insurance with a higher coverage percentage than they could on their own under certain state-specific requirements. See Note 1 – "Nature of Business – Capital" for additional information regarding our statutory capital.

18. Share-Based Compensation Plans

We have certain share-based compensation plans. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period which generally corresponds to the vesting period. The fair value of awards classified as liabilities is remeasured at each reporting period until the award is settled. Awards under our plans generally vest over periods ranging from one to five years.

We have a stock incentive plan that was adopted in May 2011. When the 2011 plan was adopted, no further awards could be made under our previous 2002 plan. All share based compensation granted in 2011 was granted under the 2002 plan prior to the adoption of the 2011 plan. The purpose of the 2011 plan is to motivate and incent performance by, and to retain the services of, key employees and non-employee directors through receipt of equity-based and other incentive awards under the plan. The maximum number of shares of stock that can be awarded under the 2011 plan is 7.0 million. Awards issued under the plan that are subsequently forfeited will not count against the limit on the maximum number of shares that may be issued under the plan. In addition, shares used for income tax withholding or used for payment of the exercise price of an option will not be counted against such limit. The plan provides for the award of stock options, stock appreciation rights, restricted stock and restricted stock units, as well as cash incentive awards. No awards may be granted after May 5, 2021 under the 2011 plan. The exercise price of options is the closing price of the common stock on the New York Stock Exchange on the date of grant. The vesting provisions of options, restricted stock and restricted stock units are determined at the time of grant. Shares issued under the 2011 plan are treasury shares if available, otherwise they will be newly issued shares. Treasury shares will continue to be issued for unit awards under the 2002 plan as they vest.

The compensation cost that has been charged against income for the share-based plans was \$8.6 million, \$12.1 million and \$13.7 million for the years ended December 31, 2012, 2011 and 2010, respectively. The related income tax benefit, before valuation allowance, recognized for the share-based compensation plans was \$3.0 million, \$4.2 million and \$1.5 million for the years ended December 31, 2012, 2011 and 2010, respectively. See Note 14 – "Income Taxes" for a discussion of our valuation allowance.

Notes (continued)

A summary of option activity in the stock incentive plans during 2012 is as follows:

	<u>Weighted Average Exercise Price</u>	<u>Shares Subject to Option</u>
Outstanding, December 31, 2011.....	\$ 60.50	1,420,500
Granted	-	-
Exercised	-	-
Forfeited or expired	63.78	(542,200)
Outstanding, December 31, 2012.....	<u>\$ 58.48</u>	<u>878,300</u>

There were no options granted or exercised in 2012, 2011 or 2010.

The following is a summary of stock options outstanding, all of which are exercisable, at December 31, 2012:

<u>Exercise Price</u>	<u>Options Outstanding and Exercisable</u>		
	<u>Shares</u>	<u>Remaining Average Life (years)</u>	<u>Weighted Average Exercise Price</u>
\$43.70	348,500	0.1	\$ 43.70
\$68.20	529,800	1.1	\$ 68.20
Total.....	<u>878,300</u>	0.7	\$ 58.48

The aggregate intrinsic value of options outstanding and options exercisable at December 31, 2012 was zero. The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price of \$2.66 as of December 31, 2012 which would have been received by the option holders had all option holders exercised their options on that date. Because our closing stock price at December 31, 2012 was below all exercise prices, none of the outstanding options had any intrinsic value.

A summary of restricted stock or restricted stock unit activity during 2012 is as follows:

	<u>Weighted Average Grant Date Fair Market Value</u>	<u>Shares</u>
Restricted stock outstanding at December 31, 2011	\$ 12.88	2,945,762
Granted	3.97	1,810,445
Vested	7.62	(1,470,965)
Forfeited	58.24	(207,660)
Restricted stock outstanding at December 31, 2012	<u>\$ 7.08</u>	<u>3,077,582</u>

At December 31, 2012, the 3.1 million shares of restricted stock outstanding consisted of 2.3 million shares that are subject to performance conditions ("performance shares") and 0.8 million shares that are subject only to service conditions ("time vested shares"). The weighted-average grant date fair value of restricted stock granted during 2011 and 2010 was \$8.94 and \$6.82, respectively. The fair value of restricted stock granted is the closing price of the common stock on the New York Stock Exchange on the date of grant. The total fair value of restricted stock vested during 2012, 2011 and 2010 was \$6.9 million, \$14.9 million and \$8.5 million, respectively.

Notes (continued)

As of December 31, 2012, there was \$8.8 million of total unrecognized compensation cost related to nonvested share-based compensation agreements granted under the plans. Of this total, \$7.5 million of unrecognized compensation costs relate to performance shares and \$1.3 million relates to time vested shares. The unrecognized costs associated with the performance shares may or may not be recognized in future periods, depending upon whether or not the performance conditions are met. The cost associated with the time vested shares is expected to be recognized over a weighted-average period of 1.3 years.

During 2011, we granted 449,350 shares that will be settled as cash payments over the vesting period under the 2002 stock incentive plan. The grant date fair value of these restricted share units was \$8.94 in 2011. During 2012, 147,968 shares of this grant vested resulting in cash payments of \$0.6 million and 1,200 shares of this grant were forfeited. During 2011, 5,400 shares of this grant were forfeited. As of December 31, 2012, there was \$0.4 million of total unrecognized compensation cost related to the 294,782 nonvested shares under this grant. The unrecognized compensation cost associated with this grant is expected to be recognized over a period of 1.1 years.

At December 31, 2012, 5.2 million shares were available for future grant under the 2011 stock incentive plan.

19. Leases

We lease certain office space as well as data processing equipment and autos under operating leases that expire during the next six years. Generally, rental payments are fixed.

Total rental expense under operating leases was \$4.8 million, \$5.4 million and \$6.3 million in 2012, 2011 and 2010, respectively.

At December 31, 2012, minimum future operating lease payments are as follows (in thousands):

2013	\$ 4,377
2014	1,931
2015	497
2016	306
2017 and thereafter	174
Total (1)	<u>\$ 7,285</u>

(1) Minimum payments have not been reduced by minimum sublease rentals of \$38 thousand due in the future under noncancelable subleases.

20. Litigation And Contingencies

Consumers continue to bring lawsuits against home mortgage lenders and settlement service providers. Mortgage insurers, including MGIC, have been involved in litigation alleging 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. MGIC's settlement of class action litigation against it under RESPA became final in October 2003. MGIC settled the named plaintiffs' claims in litigation against it under FCRA in December 2004, following denial of class certification in June 2004. Since December 2006, class action litigation has been brought against a number of large lenders alleging that their captive mortgage reinsurance arrangements violated RESPA. Beginning in December 2011, MGIC, various mortgage lenders and various other mortgage insurers have been named as defendants in twelve lawsuits, alleged to be class actions, filed in various U.S. District Courts. Three of those cases have previously been dismissed. The complaints in all nine of

Notes (continued)

the remaining cases allege various causes of action related to the captive mortgage reinsurance arrangements of the mortgage lenders, including that the defendants violated RESPA by paying excessive premiums to the lenders' captive reinsurer in relation to the risk assumed by that captive. MGIC denies any wrongdoing and intends to vigorously defend itself against the allegations in the lawsuits. There can be no assurance that we will not be subject to further litigation under RESPA (or FCRA) or that the outcome of any such litigation, including the lawsuits mentioned above, would not have a material adverse effect on us.

Since June 2005, various state and federal regulators have also conducted investigations or requested information regarding captive mortgage reinsurance arrangements, including (1) a request received by MGIC in June 2005 from the New York Department of Financial Services for information regarding captive mortgage reinsurance arrangements and other types of arrangements in which lenders receive compensation; (2) the Minnesota Department of Commerce (the "MN Department"), which regulates insurance, began requesting information in February 2006, regarding captive mortgage reinsurance and certain other matters in response to which MGIC has provided information on several occasions, including as recently as May 2011; (3) various subpoenas received by MGIC beginning in March 2008 from the U.S. Department of Housing and Urban Development ("HUD"), seeking information about captive mortgage reinsurance similar to that requested by the MN Department, but not limited in scope to the state of Minnesota; and (4) correspondence received by MGIC in January 2012 from the Consumer Financial Protection Bureau ("CFPB") indicating that HUD had transferred authority to the CFPB to investigate captive reinsurance arrangements in the mortgage insurance industry and requesting, among other things, certain information regarding captive mortgage reinsurance transactions in which we participated. In June 2012, we received a Civil Investigative Demand ("CID") from the CFPB requiring additional information and documentation regarding captive mortgage reinsurance. We have met with, and expect to continue to meet with, the CFPB to discuss the Civil Investigative Demand and how to resolve its investigation. MGIC has also filed a petition to modify the CID which petition is currently pending. While MGIC believes it would have strong defenses to any claims the CFPB might bring against it as a result of the investigation, it continues to work with the CFPB to try to resolve the investigation and any concerns that the CFPB may have about MGIC's past and current captive reinsurance practices. If MGIC cannot resolve the concerns of the CFPB, it is possible that the CFPB would assert various RESPA and possibly other claims against it. Other insurance departments or other officials, including attorneys general, may also seek information about or investigate captive mortgage reinsurance.

Various regulators, including the CFPB, state insurance commissioners and state attorneys general may bring actions seeking various forms of relief, including civil penalties and injunctions against 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 captive reinsurance arrangements 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.

We are subject to comprehensive, detailed regulation by state insurance departments. These regulations are principally designed for the protection of our insured policyholders, rather than for the benefit of investors. Although their scope varies, state insurance laws generally grant broad supervisory powers to agencies or officials to examine insurance companies and enforce rules or exercise discretion affecting almost every significant aspect of the insurance business. Given the recent significant losses incurred by many insurers in the mortgage and financial guaranty industries, our insurance subsidiaries have been subject to heightened scrutiny by insurance regulators. State insurance regulatory authorities could take actions, including changes in capital requirements or termination of waivers of capital requirements, that could have a material adverse effect on us. In January 2013, the CFPB issued rules to implement laws requiring mortgage lenders to make ability-to-pay determinations prior to extending

Notes (continued)

credit. We are uncertain whether the CFPB will issue any other rules or regulations that affect our business apart from any action it may take as a result of its investigation of captive mortgage reinsurance. Such rules and regulations could have a material adverse effect on us.

In October 2010, a purported class action lawsuit was filed against MGIC in the U.S. District Court for the Western District of Pennsylvania by a loan applicant on whose behalf a now-settled action we previously disclosed had been filed by the U.S. Department of Justice. In this lawsuit, the loan applicant alleged that MGIC discriminated against her and certain proposed class members on the basis of sex and familial status when MGIC underwrote their loans for mortgage insurance. In May 2011, the District Court granted MGIC's motion to dismiss with respect to all claims except certain Fair Housing Act claims. On November 29, 2012, the District Court granted final approval for a class action settlement of the lawsuit. The settlement created a settlement class of 265 borrowers. Under the terms of the settlement, MGIC deposited \$500,000 into an escrow account to fund possible payments to affected borrowers. In addition, MGIC paid the named plaintiff an "incentive fee" of \$7,500 and paid class counsels' fees of \$337,500. Any funds remaining in the escrow account after payment of all claims approved under the procedures established by the settlement will be returned to MGIC.

We understand several law firms have, among other things, issued press releases to the effect that they are investigating us, including whether the fiduciaries of our 401(k) plan breached their fiduciary duties regarding the plan's investment in or holding of our common stock or whether we breached other legal or fiduciary obligations to our shareholders. We intend to defend vigorously any proceedings that may result from these investigations.

With limited exceptions, our bylaws provide that our officers and 401(k) plan fiduciaries are entitled to indemnification from us for claims against them.

We have made substantial progress in reaching an agreement with Countrywide to settle the dispute we have regarding rescissions. Since December 2009, we have been involved in legal proceedings with Countrywide in which Countrywide alleged that MGIC denied valid mortgage insurance claims. (In these financial statement footnotes, we refer to rescissions of insurance and denials of claims collectively as "rescissions" and variations of that term.) In addition to the claim amounts it alleged MGIC had improperly denied, Countrywide contended it was entitled to other damages of almost \$700 million as well as exemplary damages. We sought a determination in those proceedings that we were entitled to rescind coverage on the applicable loans. From January 1, 2008 through December 31, 2012, rescissions of coverage on Countrywide-related loans mitigated our paid losses on the order of \$445 million. This amount is the amount we estimate we would have paid had the coverage not been rescinded. In addition, in connection with mediation, we voluntarily suspended rescissions related to loans that we believed could be covered by a settlement. As of December 31, 2012, coverage on approximately 2,150 loans, representing total potential claim payments of approximately \$160 million, that we had determined was rescindable was affected by our decision to suspend such rescissions. While there can be no assurance that we will actually enter into a settlement agreement with Countrywide, we have determined that a settlement with Countrywide is probable.

We are also discussing a settlement with another customer. We have also determined that it is probable we will reach a settlement of our dispute with this customer. As of December 31, 2012, coverage on approximately 250 loans, representing total potential claim payments of approximately \$17 million, was affected by our decision to suspend rescissions for that customer.

We are now able to reasonably estimate the probable loss associated with each probable settlement and, as required by ASC 450-20, we have recorded the estimated impact of the two probable settlements referred to above in our financial statements for the quarter ending December 31, 2012. The aggregate

Notes (continued)

impact to loss reserves for the probable settlement agreements was an increase of approximately \$100 million. This impact was somewhat offset by impacts to our return premium accrual and premium deficiency reserve. All of these impacts were reflected in the fourth quarter 2012 financial results. If we are not able to reach settlement with Countrywide, we intend to defend MGIC against any related legal proceedings, vigorously.

The flow policies at issue with Countrywide are in the same form as the flow policies that we use with all of our customers, and the bulk policies at issue vary from one another, but are generally similar to those used in the majority of our Wall Street bulk transactions. From January 1, 2008 through December 31, 2012, we estimate that total rescissions mitigated our incurred losses by approximately \$2.9 billion, which included approximately \$2.9 billion of mitigation on paid losses, excluding \$0.6 billion that would have been applied to a deductible. At December 31, 2012, we estimate that our total loss reserves were benefited from anticipated rescissions by approximately \$0.2 billion.

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, including the requirement to mitigate our loss by performing reasonable loss mitigation efforts or, for example, diligently pursuing a foreclosure or bankruptcy relief in a timely manner. We call such reduction of claims submitted to us “curtailments.” In 2012, curtailments reduced our average claim paid by approximately 4%. In addition, the claims submitted to us sometimes include costs and expenses not covered by our insurance policies, such as mortgage insurance premiums, hazard insurance premiums for periods after the claim date and losses resulting from property damage that has not been repaired. These other adjustments reduced claim amounts by less than the amount of curtailments.

After we pay a claim, servicers and insureds sometimes object to our curtailments and other adjustments. We review these objections if they are sent to us within 90 days after the claim was paid. Historically, we have not had material disputes regarding our curtailments or other adjustments. As part of our settlement discussions, Countrywide informed us that they object to approximately \$40 million of curtailment and other adjustments. In connection with any settlement agreement with Countrywide, we expect we would enter into a separate agreement with them that would provide for a process to resolve this dispute. However, we do not believe a loss is probable regarding this curtailment dispute and have not accrued any reserves that would reflect an adverse outcome to this dispute. We intend to defend vigorously our position regarding the correctness of these curtailments under our insurance policy. Although we have not had other material objections to our curtailment and adjustment practices, there can be no assurances that we will not face additional challenges to such practices.

MGIC and Freddie Mac disagreed on the amount of the aggregate loss limit under certain pool insurance policies (the “Disputed Policies”). On December 1, 2012, an Agreement of Settlement, Compromise and Release (the “Settlement Agreement”) between MGIC, Freddie Mac and the FHFA became effective, settling their dispute regarding the Disputed Policies. Under the Settlement Agreement, MGIC is to pay Freddie Mac a total of \$267.5 million in satisfaction of all obligations under the Disputed Policies. Of the total, \$100 million was paid in December 2012, as required by the Settlement Agreement, and the remaining \$167.5 million is to be paid in 48 equal installments that began on January 2, 2013.

If MGIC fails to make payments as required by the Settlement Agreement, or if payments or obligations to make payments are set aside, voided or otherwise rendered unenforceable (a “Default”), then Freddie Mac may elect to: (a) to collect an additional settlement payment of \$57.5 million (for a Default occurring on or after December 1, 2015), \$82.5 million (for a Default occurring on or after December 1, 2014, but before December 1, 2015) or \$132.5 million (for a Default occurring before December 1, 2014), in addition to the remainder of the \$267.5 million that it has not received or retained

Notes (continued)

due to the Default, (b) to keep all payments previously retained and reinitiate litigation regarding the Disputed Policies, seeking damages of \$540 million less the amounts previously retained, or (c) seek specific performance of the Settlement Agreement.

MGIC has also agreed to indemnify Freddie Mac and FHFA from any claims made against either of them by MGIC and certain associated parties of MGIC (including regulators and creditors) that are premised upon the performance of the Settlement Agreement.

A non-insurance subsidiary of our holding company is a shareholder of the corporation that operates the Mortgage Electronic Registration System (“MERS”). Our subsidiary, as a shareholder of MERS, has been named as a defendant (along with MERS and its other shareholders) in nine lawsuits asserting various causes of action arising from allegedly improper recording and foreclosure activities by MERS. Three of those lawsuits remain pending and the other six lawsuits have been dismissed without an appeal. The damages sought in the remaining cases are substantial. We deny any wrongdoing and intend to vigorously defend ourselves against the allegations in the lawsuits.

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.

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. These obligations have been primarily funded by contributions from our holding company and, in part, from the operations of the subsidiary. A generally positive economic environment for residential real estate that continued until approximately 2007 may have mitigated the effect of some of these costs in previous years. Historically, a material portion of our new insurance written through the flow channel has involved loans for which that subsidiary provided contract underwriting services, including new insurance written between 2006 and 2008. Claims for remedies may be made a number of years after the underwriting work was performed. We believe the rescission of mortgage insurance coverage on loans for which the subsidiary provided contract underwriting services may make a claim for a contract underwriting remedy more likely to occur. Beginning in the second half of 2009, our subsidiary experienced an increase in claims for contract underwriting remedies, which has continued throughout 2012. The related contract underwriting remedy expense was approximately \$27 million, \$23 million and \$19 million for the years ended December 31, 2012, 2011 and 2010.

See Note 14 – “Income Taxes” for a description of federal income tax contingencies.

Notes (continued)

21. Unaudited Quarterly Financial Data

2012:	Quarter				2012
	First	Second	Third	Fourth (b)	Year
	(In thousands, except share data)				
Net premiums written.....	\$ 254,986	\$ 238,605	\$ 263,505	\$ 260,736	\$ 1,017,832
Net premiums earned	262,405	242,628	266,432	261,705	1,033,170
Investment income, net of expenses	37,408	32,178	30,394	21,660	121,640
Loss incurred, net	337,088	551,408	490,121	688,636	2,067,253
Change in premium deficiency reserves	(14,183)	(27,358)	(9,144)	(10,351)	(61,036)
Underwriting and other operating expenses	50,343	48,910	50,678	51,516	201,447
Interest expense	24,627	24,912	24,478	25,327	99,344
Net income (loss)	(19,555)	(273,891)	(246,942)	(386,691)	(927,079)
Income (loss) per share (a):					
Basic	(0.10)	(1.36)	(1.22)	(1.91)	(4.59)
Diluted	(0.10)	(1.36)	(1.22)	(1.91)	(4.59)

2011:	Quarter				2011
	First	Second	Third	Fourth	Year
	(In thousands, except share data)				
Net premiums written	\$ 274,463	\$ 270,399	\$ 255,745	\$ 263,773	\$ 1,064,380
Net premiums earned	288,546	284,454	275,094	275,741	1,123,835
Investment income, net of expenses	56,543	55,490	48,898	40,339	201,270
Loss incurred, net	310,431	459,552	462,654	482,070	1,714,707
Change in premium deficiency reserves	(9,018)	(11,035)	(12,388)	(11,709)	(44,150)
Underwriting and other operating expenses	57,550	54,043	52,477	50,680	214,750
Interest expense	26,042	26,326	25,761	25,142	103,271
Net income (loss)	(33,661)	(151,732)	(165,205)	(135,294)	(485,892)
Income (loss) per share (a):					
Basic	(0.17)	(0.75)	(0.82)	(0.67)	(2.42)
Diluted	(0.17)	(0.75)	(0.82)	(0.67)	(2.42)

- (a) Due to the use of weighted average shares outstanding when calculating earnings per share, the sum of the quarterly per share data may not equal the per share data for the year.
- (b) The results for the fourth quarter of 2012 include a loss of approximately \$267 million related to our settlement with Freddie Mac and approximately \$100 million related to our probable rescission settlement agreements. See Note 20 – “Litigation and Contingencies.”

Directors

James A. Abbott
Chairman and Principal
 American Security Mortgage Corp.
 Charlotte, NC
 A mortgage banking company

Curt S. Culver
Chairman and Chief Executive Officer
 MGIC Investment Corporation
 Milwaukee, WI

Thomas M. Hagerty
Managing Director
 Thomas H. Lee Partner, L.P.
 Boston, MA
 A private investment firm

Timothy A. Holt
Former Senior Vice President and Chief Investment Officer
 Aetna, Inc.
 Hartford, CT
 A diversified health care benefits company

Kenneth M. Jastrow, II
Non-Executive Chairman
 Forestar Group Inc.
 Austin, TX

A company engaged in various real estate and natural resource businesses

Daniel P. Kearney
Business Consultant and Private Investor
 Chicago, IL

Michael E. Lehman
Chief Financial Officer
 Arista Networks
 Santa Clara, CA
 A cloud networking firm

William A. McIntosh
Former Executive Committee Member and Managing Director
 Salomon Brothers Inc
 New York, NY
 An investment banking firm

Leslie M. Muma
Former President and Chief Executive Officer
 Fiserv, Inc.
 Brookfield, WI
 A financial industry automation products and services company

Donald T. Nicolaisen
Former Chief Accountant
 United States Securities and Exchange Commission
 Washington, DC

Mark M. Zandi
Chief Economist
 Moody's Analytics, Inc.
 West Chester, PA
 A risk measurement and management firm

Officers

MGIC Investment Corporation

Chairman and Chief Executive Officer
 Curt S. Culver

President and Chief Operating Officer
 Patrick Sinks

Executive Vice Presidents
 Jeffrey H. Lane
General Counsel and Secretary

J. Michael Lauer
Chief Financial Officer

Senior Vice President
 Timothy J. Mattke
Controller and Chief Accounting Officer

Vice President
 Lisa M. Pendergast
Treasurer

Mortgage Guaranty Insurance Corporation

Chairman and Chief Executive Officer
 Curt S. Culver

President and Chief Operating Officer
 Patrick Sinks

Executive Vice Presidents
 Jeffrey H. Lane
General Counsel and Secretary

J. Michael Lauer
Chief Financial Officer

Lawrence J. Pierzchalski
Risk Management

Senior Vice Presidents
 Gregory A. Chi
Information Services and Chief Information Officer

Carla A. Gallas
Claims

Timothy J. Mattke
Controller and Chief Accounting Officer

Cheryl L. Webb
Field Operations

Michael J. Zimmerman
Investor Relations

Vice Presidents
 Gary A. Antonovich
Internal Audit

Stephen M. Dempsey
Managing Director

Sandra K. Dunst
Claims Operations

Edward G. Durant
Analytic Services

Mary L. Elkins
Information Services – Systems Development

Susan E. Friedrich
Information Services – Chief Information Security Officer

David A. Greco
Credit Policy

Heidi A. Heyrman
Regulatory Relations, Assistant General Counsel and Assistant Secretary

Steven F. Himebauch
National Accounts

James J. Hughes
Managing Director

Malcom T. Hurst
Sales

Eric B. Klopfer
Corporate Strategy

Mark J. Krauter
National Accounts

Robin D. Mallory
Managing Director

Mark E. Marple
Mortgage Banking Strategies

Salvatore A. Miosi
Marketing

Jerome J. Murphy
Field Operations

Jeffrey N. Nielsen
Financial Planning/Analysis

Lisa M. Pendergast
Treasurer

Eric L. Rice
Sales

John R. Schroeder
Risk Management

Julie K. Sperber
Assistant Controller

Dan D. Stilwell
Chief Compliance Officer, Assistant General Counsel and Assistant Secretary

James R. Stirling
Information Services - Chief Technology Officer

Kurt J. Thomas
Human Resources

Steven M. Thompson
Risk Management

Martha F. Tsuchihashi
Securities Law Counsel, Assistant General Counsel and Assistant Secretary

Kathleen E. Valenti
Loss Mitigation

Bernhard W. Verhoeven
Risk Management

Carie L. Vos
Claims Administration

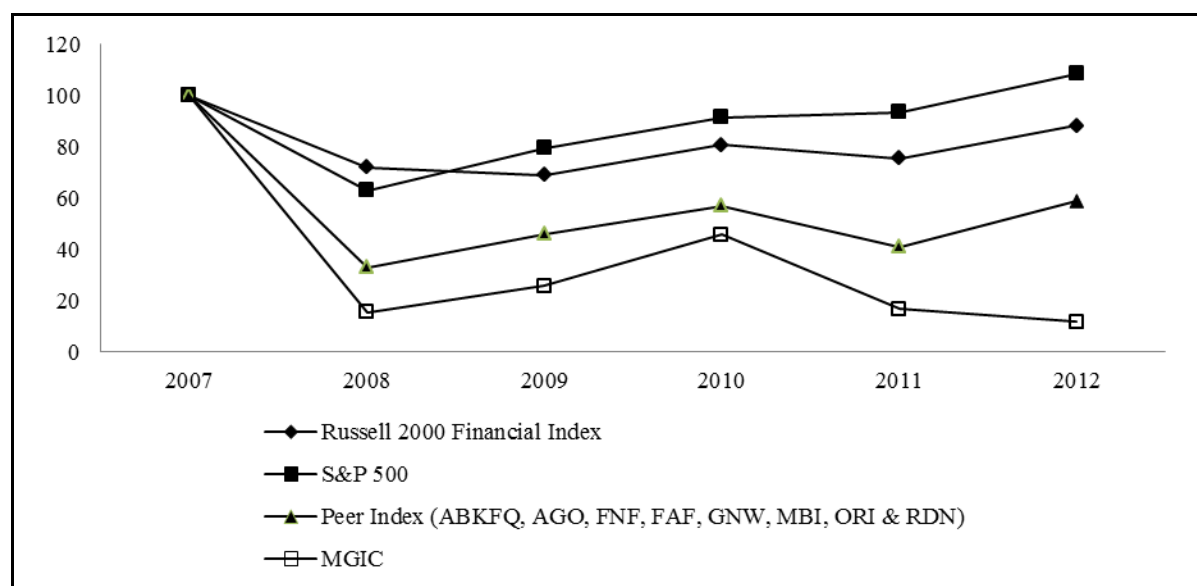
John S. Wiseman
Managing Director

Jerry L. Wormmeester
National Accounts

Performance Graph

The graph below compares the cumulative total return on (a) our Common Stock, (b) a composite peer group index selected by us, (c) the Russell 2000 Financial Index and (d) the S&P 500. Our peer group index consists of the peers against which we analyze our executive compensation: Ambac Financial Group, Assured Guaranty, Fidelity National Financial, First American Financial, Genworth Financial, MBIA, Old Republic International and Radian Group.

We selected this peer group because it includes all of our direct competitors that are public and whose mortgage insurance operations are a significant part of their overall business, financial guaranty insurers, and other financial services companies focused on the residential real estate industry that are believed to be potential competitors for executive talent.



	2007	2008	2009	2010	2011	2012
Russell 2000 Financial Index	100	72	69	81	76	88
S&P 500	100	63	80	92	94	109
Peer Index (ABKFQ, AGO, FNF, FAF, GNW, MBI, ORI & RDN)	100	33	46	57	41	59
MGIC	100	16	26	46	17	12

Shareholder Information

The Annual Meeting

The Annual Meeting of Shareholders of MGIC Investment Corporation will convene at 9 a.m. Central Time on April 25, 2013 in the Bradley Pavilion of the Marcus Center for the Performing Arts, 929 North Water Street, Milwaukee, Wisconsin.

10-K Report

Copies of the Annual Report on Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission, are available without charge to shareholders on request from:

**Secretary
MGIC Investment Corporation
P. O. Box 488
Milwaukee, WI 53201**

The Annual Report on Form 10-K referred to above includes as exhibits certifications from the Company's Chief Executive Officer and Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act. Following the 2012 Annual Meeting of Shareholders, the Company's Chief Executive Officer submitted a Written Affirmation to the New York Stock Exchange that he was not aware of any violation by the Company of the corporate governance listing standards of the Exchange.

Transfer Agent and Registrar

Wells Fargo Bank Minnesota, N.A.
Shareowner Services
P. O. Box 64854
St. Paul, Minnesota 55164
(800) 468-9716

Corporate Headquarters

MGIC Plaza
250 East Kilbourn Avenue
Milwaukee, Wisconsin 53202

Mailing Address

P. O. Box 488
Milwaukee, Wisconsin 53201

Shareholder Services

(414) 347-6596

MGIC Stock

MGIC Investment Corporation Common Stock is listed on the New York Stock Exchange under the symbol MTG. At March 1, 2013, 202,303,017 shares were outstanding. The following table sets forth for 2011 and 2012 by quarter the high and low sales prices of the Common Stock on the New York Stock Exchange.

Quarter	2011		2012	
	High	Low	High	Low
1st	\$11.79	\$ 7.74	\$5.05	\$ 3.59
2nd	9.64	5.41	5.09	2.22
3rd	6.82	1.59	3.08	0.84
4th	3.99	1.51	2.66	1.50

In October 2008, the Company's Board suspended payment of our dividend. Accordingly, no cash dividends were paid in 2011 or 2012. The payment of future dividends is subject to the discretion of our Board and will depend on many factors, including our operating results, financial condition and capital position. See Note 8 - "Debt" to our consolidated financial statements for dividend restrictions that apply when we elect to defer interest on our Convertible Junior Debentures.

The Company is a holding company and the payment of dividends from its insurance subsidiaries is restricted by insurance regulations. For a discussion of these restrictions, see "Management's Discussion and Analysis - Liquidity and Capital Resources" and Note 16 - "Dividend restrictions" to our consolidated financial statements.

As of February 15, 2013, the number of shareholders of record was 227. In addition, we estimate that there are approximately 20,000 beneficial owners of shares held by brokers and fiduciaries.

MGIC Investment Corporation

MGIC Plaza, Milwaukee, Wisconsin 53202 • www.mgic.com

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