

MGIC

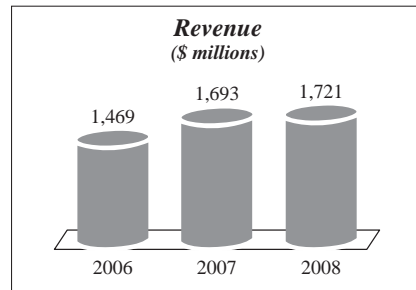
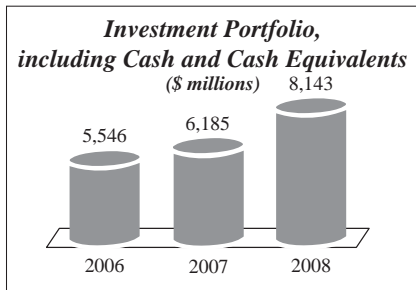
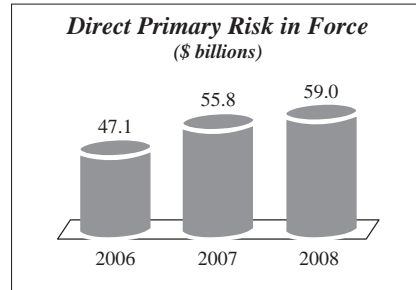
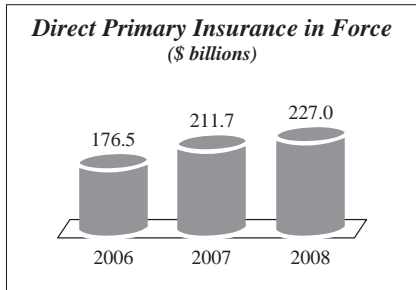
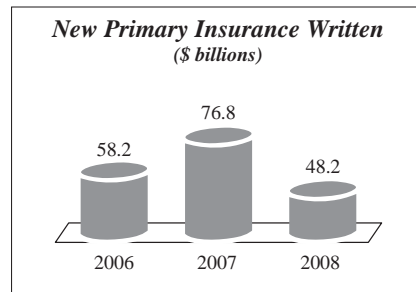
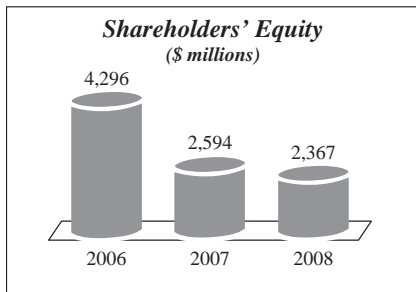


2008

MGIC Investment Corporation Annual Report

Financial Summary

	<u>2006</u>	<u>2007</u>	<u>2008</u>
Net income (loss) (\$ millions)	564.7	(1,670.0)	(518.9)
Diluted earnings (loss) per share (\$)	6.65	(20.54)	(4.55)
Return on equity (%)	13.4	(42.2)	(19.3)



Fellow Shareholders



This past year will not be a year easily forgotten by any of us connected to the mortgage business. Early in the year the majority of discussions regarding the health of the housing market and the overall economy were primarily centered on the impact from non-traditional delinquencies and foreclosures. At that time, it was generally assumed that while the economy and home values would continue to fall somewhat more, the economy would still expand, and the change would be orderly. However, the deterioration of performance and value of these non-traditional loans, and the value of securities and derivatives based on those loans, was far more rapid and severe than had been experienced previously. This caused lenders to recognize higher credit losses which, in turn, resulted in severe tightening of credit standards. Beginning in the third quarter, many of the nation's largest financial institutions began to report significant credit losses that, in some cases, led to forced mergers, conservatorship or bankruptcy. Lending standards became even more restrictive and eventually led to the dysfunctional credit markets that began in September. The economy continues to struggle as consumers are "hunkering down" and spending less which, in turn, is leading to substantially higher unemployment.

As the nation's largest private mortgage insurer, we continued to suffer from this environment, and our financial results reflect that fact as we reported a net loss of \$519 million. Losses incurred were \$3.1 billion versus revenues of \$1.7 billion. Losses incurred were driven higher primarily as a result of increased delinquencies and declining home prices, especially in Arizona, California, Florida and Nevada. With weak employment impacting our country nationally, the number of delinquent loans increased by 70% during the year, causing paid losses to increase to \$1.4 billion, from \$870 million in 2007. Persistency continued to increase, ending the year at 84%, while insurance in force ended the year at \$227 billion with investments, cash and cash equivalents totaling over \$8.1 billion. Shareholders' equity declined to \$2.4 billion.

Like our consumer counterparts, MGIC also "hunkered down" in 2008 as we took significant actions to improve our capital position, including raising \$840 million of capital through the sale of securities, selling our remaining stake in Sherman, eliminating the common stock dividend, increasing our premium rate pricing, eliminating excess of loss captive reinsurance treaties on new business, reevaluating our international activities and materially tightening our underwriting guidelines. Until the third quarter of 2008, we believed that our capital raising activities earlier in the year would insulate us from a further need for more capital. However, the economy has continued to decline, and unless recent loss trends mitigate, we may not be able to maintain the required minimum capital to write new business. While we believe that we have more than adequate capital to pay all of our insured claim obligations, we are considering options to obtain capital to write new business, which could occur through the use of claims-paying resources that are not needed to cover obligations on our existing insurance in force, from reinsurance and/or through the sale of equity or debt securities. While we have not pursued raising capital from private sources, we have been in discussions with both the U.S. Treasury and the State of Wisconsin Insurance Department to explore capital options. We believe that one of these options will develop in a manner that, combined with any benefits achieved from the national loan modification and refinance efforts, will allow MGIC to continue to write new insurance on an uninterrupted basis.

While the negative news and results have been non-stop this past year and clearly have played a role in creating a pessimism I have not witnessed before in this country, I continue to be heartened by the financial strength of the private mortgage insurance model. We are at ground zero, and at a crossroads of falling real estate values, record foreclosures and climbing unemployment, and yet, we are still standing with, we believe, more than enough capital to pay all of our insured claim obligations. Our private mortgage insurance model is one of the few credit enhancements that has survived the financial tsunami that hit our country and, as a result, I believe it will be the credit enhancement of choice in the mortgage business going forward. And while the FHA has been insuring the lion's share of today's business, that should be short-lived as I believe significant changes need to be made to its premium rate structure, coverage levels and underwriting criteria to preserve its future viability.

Fellow Shareholders

We need a return to old, to the co-insurance model, where every mortgage participant wins or loses together — borrower, lender, insurer, investor. The lack of “skin in the game” is exactly the issue that led to our country’s financial problems, as borrowers had no equity, and lenders sold all the risk. And, the best model to do that is one that starts with private mortgage insurance.

I realize that the last 18 months have been a very difficult time for all of us — shareholders, customers, borrowers and co-workers — and that we are currently in the midst of one of the most severe economic contractions in many generations. However, I remain confident that MGIC and the private mortgage insurance industry (as well as the country) will be able to weather these difficult market conditions and continue to enable Americans to obtain affordable and sustainable low down payment loans and achieve the long-held goal of owning their own home.

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 are 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,				
	2008	2007	2006	2005	2004
Summary of Operations (\$ thousands, except per share data)					
Revenues:					
Net premiums written	\$1,466,047	1,345,794	\$1,217,236	\$1,252,310	\$1,305,417
Net premiums earned	\$1,393,180	1,262,390	\$1,187,409	\$1,238,692	\$1,329,428
Investment income, net	308,517	259,828	240,621	228,854	215,053
Realized investment (losses) gains, net	(12,486)	142,195	(4,264)	14,857	17,242
Other revenue	32,315	28,793	45,403	44,127	50,970
Total revenues.	<u>1,721,526</u>	<u>1,693,206</u>	<u>1,469,169</u>	<u>1,526,530</u>	<u>1,612,693</u>
Losses and expenses:					
Losses incurred, net.	3,071,501	2,365,423	613,635	553,530	700,999
Change in premium deficiency reserves	(756,505)	1,210,841	—	—	—
Underwriting and other expenses . .	271,314	309,610	290,858	275,416	278,786
Reinsurance fee	1,781	—	—	—	—
Interest expense.	71,164	41,986	39,348	41,091	41,131
Total losses and expenses	<u>2,659,255</u>	<u>3,927,860</u>	<u>943,841</u>	<u>870,037</u>	<u>1,020,916</u>
(Loss) income before tax and joint ventures	(937,729)	(2,234,654)	525,328	656,493	591,777
(Credit) provision for income tax . . .	(394,329)	(833,977)	130,097	176,932	159,348
Income (loss) from joint ventures, net of tax	24,486	(269,341)	169,508	147,312	120,757
Net (loss) income	<u>\$ (518,914)</u>	<u>(1,670,018)</u>	<u>\$ 564,739</u>	<u>\$ 626,873</u>	<u>\$ 553,186</u>
Weighted average common shares					
outstanding (in thousands)	113,962	81,294	84,950	92,443	98,245
Diluted (loss) earnings per share	\$ (4.55)	(20.54)	\$ 6.65	\$ 6.78	\$ 5.63
Dividends per share	\$ 0.075	0.775	\$ 1.00	\$ 0.525	\$ 0.225
Balance sheet data (\$ thousands, except per share data)					
Total investments	\$7,045,536	5,896,233	\$5,252,422	\$5,295,430	\$5,418,988
Total assets	9,182,829	7,716,361	6,621,671	6,357,569	6,380,691
Loss reserves.	4,775,552	2,642,479	1,125,715	1,124,454	1,185,594
Premium deficiency reserves	454,336	1,210,841	—	—	—
Short- and long-term debt	698,446	798,250	781,277	685,163	639,303
Convertible debentures.	375,593	—	—	—	—
Shareholders' equity	2,367,200	2,594,343	4,295,877	4,165,055	4,143,639
Book value per share	18.93	31.72	51.88	47.31	43.05
New primary insurance written					
(\$ millions).	\$ 48,230	\$ 76,806	\$ 58,242	\$ 61,503	\$ 62,902
New primary risk written					
(\$ millions).	11,669	19,632	15,937	16,836	16,792
New pool risk written					
(\$ millions)(1)	145	211	240	358	208

Five-Year Summary of Financial Information (cont.)

	Year Ended December 31,				
	2008	2007	2006	2005	2004
Insurance in force (at year-end)					
(\$ millions)					
Direct primary insurance	226,955	211,745	176,531	170,029	177,091
Direct primary risk	58,981	55,794	47,079	44,860	45,981
Direct pool risk(1)	1,902	2,800	3,063	2,909	3,022
Primary loans in default ratios					
Policies in force.	1,472,757	1,437,432	1,283,174	1,303,084	1,413,678
Loans in default.	182,188	107,120	78,628	85,788	85,487
Percentage of loans in default	12.37%	7.45%	6.13%	6.58%	6.05%
Percentage of loans in default —					
bulk	32.64%	21.91%	14.87%	14.72%	14.06%
Insurance operating ratios (GAAP)					
Loss ratio(2)	220.4%	187.3%	51.7%	44.7%	52.7%
Expense ratio(2)	14.2%	15.8%	17.0%	15.9%	14.6%
Combined ratio	234.6%	203.1%	68.7%	60.6%	67.3%
Risk-to-capital ratio (statutory)					
Combined insurance companies	14.7:1	11.9:1	7.5:1	7.4:1	7.9:1

- (1) Represents contractual aggregate loss limits and, for the years ended December 31, 2008, 2007, 2006, 2005 and 2004, for \$2.5 billion, \$4.1 billion, \$4.4 billion, \$5.0 billion and \$4.9 billion, respectively, of risk without such limits, risk is calculated at \$1 million, \$2 million, \$4 million, \$51 million and \$65 million, respectively, for new risk written and \$150 million, \$475 million, \$473 million, \$469 million and \$418 million, respectively, for risk in force, the estimated amount that would credit enhance these loans to a “AA” level based on a rating agency model.
- (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. As calculated, the loss ratio does not reflect any effects due to premium deficiency. 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

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, 2008 which was filed with the SEC on March 2, 2009. 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 Form 10-K was filed with the SEC. Our Risk Factors are an integral portion of Management's Discussion and Analysis and appear immediately after it.

Overview

Through our subsidiary MGIC, we are the leading provider of private mortgage insurance in the United States to the home mortgage lending industry. Our principal product is primary mortgage insurance. Primary mortgage insurance may be written through the flow market channel, in which loans are insured in individual, loan-by-loan transactions. Primary mortgage insurance may also be written through the bulk market 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 expect any future business written through the bulk channel will be insignificant to us. Prior to 2009, we also wrote pool mortgage insurance. We do not expect we will write any significant pool mortgage insurance in the future.

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 delinquency table under "Results of Consolidated Operations-Losses-Losses Incurred". The discussion of our business in this document generally does not apply to our Australian operations which are immaterial. The results of our operations in Australia are included in the consolidated results disclosed. For additional information about our Australian operations, see "— Australia" below.

Forward Looking Statements

As discussed under "Risk Factors" in this annual report to which readers of this annual report should refer because such risk factors are an integral part of the discussion below, actual results may differ materially from the results contemplated by forward looking statements. We are not undertaking any obligation to update any forward looking statements or other statements we may make in the following discussion or elsewhere in this annual report 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 annual report should rely on these statements being accurate 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 two particularly significant challenges, which we believe are shared by the other participants in our industry:

- Whether we will have access to sufficient capital to continue to write new business. This challenge is discussed under "Capital" below.
- Whether private mortgage insurance will remain a significant credit enhancement alternative for low down payment single family mortgages. This challenge is discussed under "Future of the Domestic Residential Housing Finance System" below.

Capital

The mortgage insurance industry is experiencing material losses, especially on the 2006 and 2007 books. The ultimate amount of these losses will depend in part on general economic conditions, including

Management's Discussion and Analysis (*continued*)

unemployment, and the direction of home prices in California, Florida and other distressed markets, 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. Our view of potential losses on these books has trended upward since the first quarter of 2008, including since the time at which we finalized our Quarterly Report on Form 10-Q for the third quarter of 2008.

The Office of the Commissioner of Insurance of Wisconsin ("OCI") 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 prescribed formula. Policyholders position is the insurer's net worth, contingency reserve and a portion of the reserves for unearned premiums, with credit given for authorized reinsurance. The minimum policyholders position (MPP) 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 cannot write new business until its policyholders position meets the minimum.

In February 2009, we received clarification from the OCI regarding the methodology used in calculating the excess of our policyholders position over the MPP. The clarification effectively reduces the required MPP by our reserves established for delinquent loans, beginning with our December 31, 2008 calculations. At December 31, 2008, MGIC's policyholders position exceeded the required minimum by more than \$1.5 billion, and we exceeded the required minimum by \$1.6 billion on a combined statutory basis. (The combined figures give effect to reinsurance with subsidiaries of our holding company.)

Some states that regulate us have provisions that limit the risk-to-capital ratio (see "Liquidity and Capital Resources — Risk to Capital") of a mortgage guaranty insurance company to 25:1. 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. It is also our understanding that certain states have clarified their calculation of risk-to-capital to reduce risk in force for established loss reserves. We have used this methodology beginning with our December 31, 2008 calculations. At December 31, 2008 MGIC's risk-to-capital was 12.9:1 and was 14.7:1 on a combined statutory basis.

In addition to the uncertainties that could result in increased losses, there are other items that could favorably impact our future losses. For example, our estimated loss reserves reflect loss mitigation from rescissions using only the rate at which we have rescinded claims during recent periods, as discussed under "Results of Consolidated Operations — Losses — Losses Incurred". In light of the number of claims investigations we are pursuing and our perception that books of insurance we wrote before 2008 contain a significant number of loans involving fraud, we expect our rescission rate during future periods to increase. The insured can dispute our right to rescind coverage, and whether the requirements to rescind are met ultimately would be determined by arbitration or judicial proceedings. Also, our estimated loss reserves do not take account of the effect of potential benefits that might be realized from third party and governmental loan modification programs.

Because these and other factors that will affect our future losses are subject to significant uncertainty, there is significant uncertainty regarding the level of our future losses. However, unless recent loss trends materially mitigate, MGIC's policyholders position could decline and its risk-to-capital could increase beyond the levels necessary to meet regulatory requirements and this could occur before the end of 2009.

An inability to write new business does not mean that we do not have sufficient resources to pay claims. We believe we have more than adequate resources to pay claims on our insurance in force, even in scenarios in which losses materially exceed those that would result in not meeting MPP and risk-to-capital requirements. Our claims paying resources principally consist of our investment portfolio, captive reinsurance trust funds and future premiums on our insurance in force, net of premiums ceded to captive and other reinsurers.

Management's Discussion and Analysis (*continued*)

We are considering options to obtain capital to write new business, which could occur through the sale of equity or debt securities, from reinsurance and/or through the use of claims paying resources that should not be needed to cover obligations on our existing insurance in force. While we have not pursued raising capital from private sources, we initiated discussions with the US Treasury late in October 2008 to seek a capital investment and/or reinsurance under the Troubled Assets Relief Program ("TARP"). We understand there is intense competition for TARP and other government assistance. We cannot predict whether we will be successful in obtaining capital from any source but any sale of additional securities could dilute substantially the interest of existing shareholders and other forms of capital relief could also result in additional costs.

Our senior management believes that one of the capital generating options referred to above will be feasible or that the uncertainties described above will develop in a manner such that we will be able to continue to write new business through the end of 2009. We can, however, give no assurance in this regard, and higher losses, adverse changes in our relationship with the GSEs, or reduced benefits from loss mitigation, among other factors, could result in senior management's belief not being realized. In addition, to the extent this belief of senior management is a "forward-looking statement" under Section 21E(c) of the Securities Exchange Act of 1934, as amended (and without thereby suggesting that other forward-looking statements we make in this annual report are not accompanied by meaningful cautionary statements because the reference to such cautionary statements does not appear in immediate proximity to such other forward-looking statements), the statements under "Risk Factors" are intended to provide additional meaningful cautionary statements that identify additional material factors that could cause actual results to differ materially from those in this forward-looking statement of senior management.

Future of the Domestic Housing Finance System

For decades, Fannie Mae and Freddie Mac have been the principal factor in determining the availability of single-family mortgages in the United States for conforming loans. From the summer of 2007 to the summer of 2008, the combined common and preferred equity market capitalization of the GSEs declined on the order of \$140 billion, the FHFA was appointed conservator of each GSE and their most senior management was replaced by executives designated by the federal government. As their conservator, FHFA controls and directs the operations of Fannie Mae and Freddie Mac. In connection with the conservatorship, the United States Treasury has committed a \$200 billion facility to each GSE to support its capital, which is a \$100 billion increase from the original facility established for each GSE at the time the conservatorship began. Both GSEs have either drawn or announced their intention to draw material amounts under their respective facilities to cure deficiencies in their regulatory capital as of September 30, 2008, which is the last period end reported on prior to finalization of this annual report.

Under the charters of the GSEs, which are contained in federal statutes subject to amendment by legislation, the GSEs must obtain credit enhancement on single-family mortgages that they purchase when the LTV ratio exceeds 80%. Such low down payment mortgages form the foundation of our business. For decades private mortgage insurance has been the mortgage market's preferred form of credit enhancement for conforming loans. (For a few years that ended in 2007, piggyback loans, which are loans comprised of both a first and second mortgage, with the LTV ratio of the first mortgage below what investors require for mortgage insurance, took substantial market share from private mortgage insurance. As shown by their recent performance in declining housing markets, we believe piggybacks cannot be fairly viewed as credit enhancements.)

As a result of the conservatorship of the GSEs and the mortgage insurance programs of the FHA and other federal agencies, the federal government has assumed the leading role in the residential mortgage market. These circumstances could lead Congress to undertake a wide ranging review of the system of residential mortgage finance in the United States, including what role the government should play. We believe there are strong policy reasons that favor the continuation of private mortgage insurance as the preferred credit enhancement for conforming loans. We cannot predict, however, the scope of any changes that may be made

Management's Discussion and Analysis (*continued*)

to the housing finance system as a result of such review or the effect such changes would have on our industry.

Debt at our Holding Company and Holding Company Capital Resources

At December 31, 2008, we had approximately \$394 million in short-term investments at our holding company. These investments were virtually all of our holding company's liquid assets. Our holding company's obligations include \$1.090 billion in indebtedness, \$400 million of which is scheduled to mature before the end of 2011 and must be serviced pending scheduled maturity. See Notes 6 and 7 to our consolidated financial statements included below for additional information about this indebtedness. See "Liquidity and Capital Resources — Debt at our Holding Company and Holding Company Capital Resources" for information about restrictions on MGIC's payment of dividends to our holding company and our expectation that we will not be seeking additional dividends that would increase our holding company's cash resources in 2009. Historically, dividends from MGIC have been the principal source of our holding company's cash inflow.

Private and Public Efforts to Modify Mortgage Loans and Reduce Foreclosure

In September the Emergency Economic Stabilization Act of 2008 was enacted. Included in this legislation is the TARP which, among other provisions, allows mortgage assets to be purchased by the federal government from financial institutions. To the extent assets are acquired or controlled by a government agency such agency must implement a plan that seeks to maximize assistance to homeowners to minimize foreclosures. In February 2009, the Obama Administration announced the Homeowner Affordability and Stability Plan that has the intent of helping millions of homeowners receive more favorable mortgage terms. Full details of the plan were not available at the time this annual report was finalized.

In the fourth quarter of 2008, the Federal Deposit Insurance Corporation, in its capacity as a receiver for troubled banks, the GSEs and several lenders adopted programs to modify loans to make them more affordable to borrowers with the goal of reducing the number of foreclosures. Similarly, various state and local governments have enacted foreclosure moratoriums, many with the stated goal of reducing foreclosures by giving lenders and borrowers additional time to modify loans to make them more affordable to borrowers.

There can be no assurance that foreclosure avoidance or modification plans will materially reduce the level of delinquencies and claims we are currently experiencing or could experience in the future. For additional information about the potential impact that any plans and programs enacted by legislation may have on us, see the risk factor titled "Loan modification and other similar programs may not provide material benefits to us" under "Risk Factors" below.

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 the size of the in force book of insurance, 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 other mortgage insurers and alternatives to mortgage insurance.
- Cancellations, which reduce the size of the in force book of insurance that generates premiums. 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.

Management's Discussion and Analysis (*continued*)

- Rescissions, which require us to return any premiums received related to the rescinded policy.
- 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. Hence, changes 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 ceded to captives. 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 fixed income securities rated “A” or higher. The principal factors that influence investment income are the size of the portfolio and its yield. As measured by amortized cost (which excludes changes in fair 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 issuance or dividend payments. Realized gains and losses are a function of the difference between the amount received on sale of a security and the security’s amortized cost, as well as any “other than temporary” impairments. The amount received on 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,” except in the case of premium deficiency reserves, we recognize an estimate of this expense only for delinquent loans. Losses incurred are generally affected by:

- The state of the economy 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.
- 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. Higher average loan amounts tend to increase losses incurred.
- The percentage of coverage on insured loans. Deeper average coverage tends 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.
- Rescission rates. Our estimated loss reserves reflect mitigation from rescissions of coverage using only the rate at which we have rescinded claims during recent periods. As we continue to investigate more claims for misrepresentation, we expect the number of rescissions to increase. The rate of rescissions may also continue to increase as fraud may be more prevalent in our insurance in force, which could ultimately decrease our losses incurred from what they would have been had our rescission rate been lower.

Management's Discussion and Analysis (*continued*)

- The distribution of claims over the life of a book. Historically, the first two years after a loan is originated are a period of relatively low claims, with claims increasing substantially for several years subsequent and then declining, although persistency, the condition of the economy and other factors can affect this pattern. For example, a weak economy can lead to claims from older books continuing at stable levels or experiencing a lower rate of decline. We are currently seeing such performance as it relates to delinquencies from our older books and, to the extent we were notified of such delinquencies as of December 31, 2008, such performance is reflected in our loss reserves.
- Changes in premium deficiency reserves

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.

- 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 debt obligations. Our long-term debt obligations at December 31, 2008 include our \$300 million of 5.375% Senior Notes due in November 2015, \$200 million of 5.625% Senior Notes due in September 2011, \$200 million outstanding under a credit facility expiring in March 2010 and \$390 million in convertible debentures due in 2063, as discussed in Notes 6 and 7 to our consolidated financial statements included below and under "Liquidity and Capital Resources" below.

- Income (loss) from joint ventures

Our results of operations have also been affected by the results of our joint ventures, which are accounted for under the equity method. Historically, joint venture income principally consisted of the aggregate results of our investment in two less than majority owned joint ventures, Credit-Based Asset Servicing and Securitization LLC (C-BASS) and Sherman Financial Group LLC (Sherman).

C-BASS

C-BASS, a limited liability company, is an unconsolidated, less than 50%-owned joint venture investment of ours that is not controlled by us. Historically, C-BASS was principally engaged in the business of investing in the credit risk of subprime single-family residential mortgages. In the third quarter of 2007, as a result of margin calls from lenders that C-BASS was unable to meet, C-BASS's purchases of mortgages and mortgage securities and its securitization activities ceased. C-BASS is managing its portfolio pursuant to a consensual, non-bankruptcy restructuring, under which its assets are to be paid out over time to its secured and unsecured creditors.

In 2007, joint venture losses included an impairment charge equal to our entire equity interest in C-BASS, as well as the reduction of the carrying value of our \$50 million note from C-BASS to zero, which was due to equity losses incurred by C-BASS in the fourth quarter of 2007.

Management's Discussion and Analysis (*continued*)

Sherman

During the period in which we held an equity interest in Sherman, Sherman was principally engaged in purchasing and collecting for its own account delinquent consumer receivables, which are primarily unsecured, and in originating and servicing subprime credit card receivables. The factors that affect Sherman's consolidated results of operations are discussed in our Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2008, to which you should refer.

Beginning in the first quarter of 2008, our joint venture income principally consisted of income from Sherman. In the third quarter of 2008, we sold our entire interest in Sherman to Sherman. As a result, beginning in the fourth quarter of 2008, our results of operations are no longer affected by any joint venture results. See "Results of Consolidated Operations — Joint Ventures — Sherman" for discussion of our sale of interest in Sherman and related note receivable.

Mortgage Insurance Earnings and Cash Flow Cycle

In our industry, a "book" is the group of loans that a mortgage insurer insures 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. 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 losses increase.

Australia

In 2007, we began providing mortgage insurance to lenders in Australia. At December 31, 2008 the equity value of our Australian operations was approximately \$100 million and our risk in force in Australia was approximately \$1.0 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. In view of our need to dedicate capital to our domestic mortgage insurance operations, we have been exploring alternatives for our Australian activities which may include a sale of our Australian operations. As a result, we have reduced our Australian headcount and suspended writing new business in Australia. We do not expect to write new business in Australia unless required in connection with an agreed upon sale of this business.

Summary of 2008 Results

Our results of operations in 2008 were principally affected by:

- Premiums written and earned

Premiums written and earned during 2008 increased compared to 2007. The increase in premiums resulted from the continued increase in the average insurance in force; however the effect of the higher in force has been somewhat offset by lower average premium yields due to a shift in the mix of new writings to loans with lower loan-to-value ratios, higher FICO scores and full documentation, which carry lower premium rates.

- Investment income

Investment income in 2008 was higher when compared to 2007 due to an increase in the average amortized cost of invested assets, offset by a decrease in the pre-tax yield.

Management's Discussion and Analysis (*continued*)

- Realized (losses) gains

Realized losses for 2008 included "other than temporary" impairments on our investment portfolio of approximately \$62.5 million and realized losses on the sales of investments of approximately \$12.8 million, offset by a \$62.8 million gain from the sale of our remaining interest in Sherman. Realized gains in 2007 included a \$162.9 million pre-tax gain on the sale of a portion of our interest in Sherman.

- Losses incurred

Losses incurred for 2008 significantly increased compared to 2007 primarily due to a significant increase in the default inventory, offset by a smaller increase in the estimates regarding how much will be paid on claims, or severity, and a slight decrease in the estimates regarding how many delinquencies will result in a claim, or claim rate, when compared to 2007. The default inventory increased by 75,068 delinquencies in 2008, compared to an increase of 28,492 in 2007. The continued increase in estimated severity was primarily the result of the default inventory containing higher loan exposures with expected higher average claim payments as well as our inability to mitigate losses through the sale of properties due to home price declines. The decrease in estimated claim rate for 2008 was primarily due to an increase in our loss mitigation efforts that resulted in an increased number of rescissions and claim denials for misrepresentation, ineligibility and policy exclusions.

- Premium deficiency

During 2008 the premium deficiency reserve on Wall Street bulk transactions declined by \$757 million from \$1,211 million, as of December 31, 2007, to \$454 million as of December 31, 2008. The \$454 million premium deficiency reserve as of December 31, 2008 reflects the present value of expected future losses and expenses that exceeded the present value of expected future premium and already established loss reserves.

- Underwriting and other expenses

Underwriting and other expenses for 2008 decreased when compared to 2007. The decrease reflects our lower volumes of new insurance written as well as a focus on expenses in difficult market conditions. Also, 2007 included \$12.3 million in one-time expenses associated with a terminated merger.

- Interest expense

Interest expense for 2008 increased when compared to 2007. The increase primarily reflects the issuance of our convertible debentures in March and April of 2008.

- Income from joint ventures

Income from joint ventures, net of tax, was \$24.5 million in 2008 compared to a loss from joint ventures, net of tax, of \$269.3 million for 2007. The income from joint ventures in 2008 is related to our remaining interest in Sherman that was sold in the third quarter of 2008. The gain on the sale of our interest is included in realized gains on our statements of operations. The loss from joint venture in 2007 was due primarily to the impairment of our investment in C-BASS.

- (Credit) provision for income tax

The effective tax rate credit on our pre-tax loss was (42.1%) in 2008, compared to (37.3%) in 2007. During those periods, the rate reflected the benefits recognized from tax-preferenced investments. Our tax-preferenced investments that impact the effective tax rate consist almost entirely of tax-exempt municipal bonds. The difference in the rate was primarily the result of a smaller loss from underwriting operations during 2008, compared to 2007.

Management's Discussion and Analysis (continued)

Results of Consolidated Operations

New insurance written

The amount of our primary new insurance written during the years ended December 31, 2008, 2007 and 2006 was as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(\$ billions)		
NIW — Flow Channel	\$46.6	\$69.0	\$39.3
NIW — Bulk Channel	1.6	7.8	18.9
Total Primary NIW	<u>\$48.2</u>	<u>\$76.8</u>	<u>\$58.2</u>
Refinance volume as a% of primary flow NIW	26%	24%	23%

The decrease in new insurance written on a flow basis in 2008, compared to 2007, was primarily due to changes in our underwriting guidelines discussed below, as well as a decrease in the total mortgage origination market and greater usage of FHA insurance programs as an alternative to mortgage insurance. For a discussion of new insurance written through the bulk channel, see "Bulk transactions" below.

We anticipate our flow new insurance written for 2009 will be significantly below the level written in 2008, due to changes in our underwriting guidelines discussed below as well as premium rate increases implemented during 2008, neither of which were fully implemented at the beginning of 2008. We believe our changes in guidelines and premium rates have led to greater usage of FHA insurance programs as an alternative to private mortgage insurance. Additionally, both GSEs have implemented adverse market charges on all loans and credit risk-based loan level price adjustments on loans with certain risk characteristics which include loans that qualify for private mortgage insurance. The application of these loan level price adjustments results in a materially higher monthly payment for the borrower, which we also believe has led to greater usage of FHA insurance programs as an alternative to private mortgage insurance. Our level of new insurance written could also be affected by other items, as noted under "Risk Factors" below, which are an integral part of this Management's Discussion and Analysis.

The percentage of our volume written on a flow basis that includes segments we view as having a higher probability of claim continued to increase through 2007. In particular, the percentage of our flow new insurance written with loan-to-value ratios greater than 95% grew to 42% in 2007, compared to 34% in 2006. For 2008 the percentage of our flow new insurance written with loan-to-value ratios greater than 95% declined to 18%, and was only 3% for the fourth quarter of 2008.

We have implemented a series of changes to our underwriting guidelines that are designed to improve the credit risk profile of our new insurance written. The changes primarily affect borrowers who have multiple risk factors such as a high loan-to-value ratio, a lower FICO score and limited documentation or are financing a home in a market we categorize as higher risk. We also implemented premium rate increases. Several underwriting guidelines and premium rate changes were implemented during 2008, although a significant portion of our new business in the first quarter of 2008 was committed to prior to the effective date of these changes. The chart below shows, for the years ended December 31, 2007 and 2008, as well as each quarter ended in 2008, our flow new insurance written and the percentage of our flow new insurance written that would have qualified with our underwriting guidelines in place as of December 31, 2008.

<u>Year Ended</u>	<u>Flow NIW (\$ in billions)</u>				<u>Year Ended</u>
	<u>Quarter Ended</u>				
Dec. 31, 2007	March 31, 2008	June 30, 2008	Sept. 30, 2008	Dec. 31, 2008	Dec. 31, 2008
\$69.0	\$18.1	\$13.4	\$9.7	\$5.4	\$46.6

Percentage of Flow NIW that Qualified with our Underwriting Guidelines in Place as of December 31, 2008

<u>Year Ended</u>	<u>Quarter Ended</u>				<u>Year Ended</u>
	Dec. 31, 2007	March 31, 2008	June 30, 2008	Sept. 30, 2008	
21.1%	31.8%	59.1%	80.1%	89.1%	55.9%

Management's Discussion and Analysis *(continued)*

We regularly review our underwriting guidelines. Additional changes to our guidelines, which include further limitations on the types of refinance loans we will insure, have been announced and will be effective in the first quarter of 2009.

Cancellations and insurance in force

New insurance written and cancellations of primary insurance in force during the years ended December 31, 2008, 2007 and 2006 were as follows:

	2008	2007	2006
	(\$ billions)		
NIW	\$ 48.2	\$ 76.8	\$ 58.2
Cancellations	<u>(32.9)</u>	<u>(41.6)</u>	<u>(51.7)</u>
Change in primary insurance in force	<u>\$ 15.3</u>	<u>\$ 35.2</u>	<u>\$ 6.5</u>
Direct primary insurance in force as of December 31,	<u>\$227.0</u>	<u>\$211.7</u>	<u>\$176.5</u>

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. Our persistency rate (percentage of insurance remaining in force from one year prior) was 84.4% at December 31, 2008, an increase from 76.4% at December 31, 2007 and 69.6% at December 31, 2006. These persistency rate improvements 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.

Bulk transactions

New insurance written for bulk transactions was \$1.6 billion for 2008 compared to \$7.8 billion for 2007 and \$18.9 billion for 2006. The decrease in bulk writings was primarily due to our decision in the fourth quarter of 2007 to stop insuring Wall Street bulk transactions. The majority of the bulk business in 2008 was lender paid transactions that included a higher percentage of prime loans (we have consistently classified as "prime" all loans with FICO scores of 620 and above) than was typically present in Wall Street bulk transactions and the remainder was bulk business with the GSEs, which also included a similar percentage of prime loans. Wall Street bulk transactions represented approximately 41%, 66% and 89% of our new insurance written for bulk transactions during 2007, 2006 and 2005, respectively, and at December 31, 2008 included approximately 118,000 loans with insurance in force of approximately \$19.8 billion and risk in force of approximately \$5.8 billion, which is approximately 72% of our bulk risk in force.

We wrote no new business through the bulk channel during the second half of 2008. We expect the volume of any future business written through the bulk channel will be insignificant.

Pool insurance

In addition to providing primary insurance coverage, we have also insured pools of mortgage loans. New pool risk written during 2008, 2007 and 2006 was \$145 million, \$211 million and \$240 million, respectively. Our direct pool risk in force was \$1.9 billion, \$2.8 billion and \$3.1 billion at December 31, 2008, 2007 and 2006, respectively. These risk amounts represent pools of loans with contractual aggregate loss limits and in some cases those without these limits. For pools of loans without these limits, risk is estimated based on the amount that would credit enhance the loans in the pool to a "AA" level based on a rating agency model. Under this model, at December 31, 2008, 2007 and 2006 for \$2.5 billion, \$4.1 billion and \$4.4 billion, respectively, of risk without these limits, risk in force is calculated at \$150 million, \$475 million and \$473 million, respectively. For the years ended December 31, 2008, 2007 and 2006 for \$23 million, \$32 million

Management's Discussion and Analysis (*continued*)

and \$56 million, respectively, of risk without contractual aggregate loss limits, new risk written under this model was \$1 million, \$2 million and \$4 million, respectively.

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

Net premiums written and earned

Net premiums written and earned during 2008 increased compared to 2007. The average insurance in force continued to increase; however the effect of the higher in force has been somewhat offset by lower average premium yields due to a shift in the mix of new writings to loans with lower loan-to-value ratios, higher FICO scores and full documentation, which carry lower premium rates. We expect our average insurance in force to continue to be higher in 2009, compared to 2008, with our insurance in force balance stabilizing or decreasing slightly throughout 2009.

We expect our premium yields (net premiums written or earned, expressed on an annual basis, divided by the average insurance in force) to continue at approximately the level experienced during 2008. We expect a reduction in business in 2009 that has higher premiums (we are no longer insuring new Wall Street Bulk transactions; as a result of our underwriting changes, our future volume of loans with loan-to-value ratios greater than 95%, loans classified as A-minus and reduced documentation loans, which carry higher premium rates should be insignificant), will be offset by lower ceded premium due to captive terminations and run-offs. In a termination, the arrangement is cancelled, with no future premium ceded and funds for any incurred but unpaid losses transferred to us. 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.

Net premium written and earned during 2007 increased compared to 2006 due to a higher average insurance in force, offset by lower average premium yields.

Risk sharing arrangements

For the nine months ended September 30, 2008, approximately 34.4% of our flow new insurance written was subject to arrangements with captives or risk sharing arrangements with the GSEs compared to 47.7% for the year ended December 31, 2007 and 47.5% for the year ended December 31, 2006. We expect the percentage of new insurance written subject to risk sharing arrangements to continue to decline in 2009 for the reasons discussed below. The percentage of new insurance written covered by these arrangements is shown only for the nine months ended September 30, 2008 because this percentage normally increases after the end of a quarter. Such increases can be caused by, among other things, the transfer of a loan in the secondary market, which can result in a mortgage insured during a quarter becoming part of a risk sharing arrangement in a subsequent quarter. New insurance written through the bulk channel is not subject to risk sharing arrangements. Premiums ceded in these arrangements are reported in the period in which they are ceded regardless of when the mortgage was insured.

Effective on and after June 1, 2008, Freddie Mac-approved private mortgage insurers, including MGIC, may not cede new risk if the gross risk or gross premium ceded to captive reinsurers is greater than 25%. Freddie Mac stated that it made this change to allow mortgage insurers to retain more insurance premiums to pay current claims and rebuild their capital bases. Fannie Mae made similar changes to its requirements. Effective June 1, 2008, we made appropriate changes to the terms of our arrangements with those captives that had exceeded the 25% limit.

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 will run off pursuant to the terms of the particular captive arrangement. New business will continue to be ceded under quota share reinsurance arrangements. During 2008, many of our captive arrangements were either terminated or placed into run-off.

Management's Discussion and Analysis (*continued*)

We anticipate that our ceded premiums related to risk sharing agreements will be significantly less in 2009 compared to amounts ceded in 2008.

See discussion under “-Losses” regarding losses assumed by captives.

In June 2008 we entered into a reinsurance agreement with an affiliate of HCC Insurance Holdings, Inc. The reinsurance agreement is effective on the risk associated with up to \$50 billion of qualifying new insurance written each calendar year. The term of the reinsurance agreement began on April 1, 2008 and ends on December 31, 2010, subject to two one-year extensions that may be exercised by HCC. We believe that substantially all of our insurance committed to subsequent to April 1, 2008 will qualify under the reinsurance agreement. The reinsurance agreement is expected to provide additional claims-paying resources when loss ratios exceed 100% for insurance written beginning April 1, 2008.

The agreement is accounted for under deposit accounting rather than reinsurance accounting, because under the guidance of SFAS 113 “Accounting for Reinsurance Contracts”, we concluded that the reinsurance agreement does not result in the reasonable possibility that the reinsurer will suffer a significant loss.

When our financial strength rating as determined by two rating agencies is in the “A” category or higher the agreement provides for a 20% quota share agreement, but allows us to retain 80% of the ceded premium (“profit commission”). The profit commission is used to cover losses that otherwise would be ceded to the reinsurer until the profit commission is exhausted. The premium ceded to the reinsurer and the brokerage commission paid to an affiliate of the reinsurer, net of a profit commission retained by us, is recorded as reinsurance fee expense on our statement of operations. In loss environments where loss ratios are less than 80% for the insurance covered by this agreement we expect the net expense will be approximately 5% of net premiums earned on business covered by the agreement. Under the terms of the agreement, if our financial strength rating as determined by two rating agencies falls below the “A” category, we are no longer entitled to the profit commission and our net expense will increase to reflect we no longer receive this profit commission, but this increase will be partially offset by an increase of reinsured losses. In February 2009, Moody's Investors Service reduced MGIC's financial strength rating to Ba2 with a developing outlook. The financial strength of MGIC is rated A-, with a negative outlook, by both Standard and Poor's Rating Services and Fitch Ratings. The reinsurance fee for the year ended December 31, 2008 is separately shown in the statements of operations.

Investment income

Investment income for 2008 increased when compared to 2007 due to an increase in the average amortized cost of invested assets, offset by 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 3.87% at December 31, 2008 and 4.69% at December 31, 2007. The portfolio's average after-tax investment yield was 3.49% at December 31, 2008 and 4.18% at December 31, 2007. Assuming shorter-term yields remain at their current levels, we expect the investment yield on our portfolio as a whole will continue to decline because we are investing available funds in shorter maturities so that they will be available for claim payments without the need to obtain the necessary funds through sales of our fixed income investments.

Investment income for 2007 increased when compared to 2006 due to an increase in the average investment yield, as well as an increase in the average amortized cost of invested assets.

Realized (losses) gains

Realized losses for 2008 included “other than temporary” impairments on our investment portfolio of approximately \$62.5 million on our fixed income investments including debt instruments issued by Fannie Mae, Freddie Mac, Lehman Brothers and AIG, and realized losses on the sales of investments of approximately \$12.8 million, offset by a \$62.8 million gain from the sale of our remaining interest in Sherman.

Management's Discussion and Analysis (*continued*)

Realized gains in 2007 included a \$162.9 million pre-tax gain on the sale of a portion our interest in Sherman. There were no "other than temporary" impairments in 2007 or 2006.

Other revenue

Other revenue for 2008 increased when compared to 2007. The increase in other revenue was primarily the result of other non-insurance operations.

Other revenue for 2007 decreased when compared to 2006. The decrease was primarily the results of other non-insurance operations and a decrease in revenue from contract underwriting.

Losses

As discussed in "— Critical Accounting Policies", 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 our estimate of the number of loans in our inventory of delinquent loans that will not cure their delinquency and thus result in a claim, which is referred to as the claim rate (historically, a substantial majority of delinquent loans have eventually cured), and further estimating the amount that we will pay in claims on the loans that do not cure, which is referred to as claim severity.

Estimation of losses that we will pay in the future is inherently judgmental. The conditions that affect the claim rate and claim severity include the current and future state of the domestic economy 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 leading to a reduction in borrowers' income and thus their ability to make mortgage payments, and a drop in housing values that could materially reduce our ability to mitigate potential losses through property acquisition and resale or expose us to greater losses on resale of properties obtained through the claim settlement process. 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 loan instruments, assisting delinquent borrowers and lenders in modifying their mortgage notes into something more affordable, and forestalling foreclosures. In addition private company efforts may have a positive impact on our loss development. However, all of these efforts are in their early stages and therefore we are unsure of their magnitude or the benefit to us or our industry, and as a result are not factored into our current reserving. For additional information about the potential impact that any plans and programs enacted by legislation may have on us, see the risk factor titled "Loan modification and other similar programs may not provide material benefits to us" under "Risk Factors" below.

Our estimates could also be positively affected by the extent of fraud that we uncover in the loans we have insured; higher rates of fraud should lead to higher rates of rescission, although the relationship may not be linear. Rescissions and denials totaled \$85 million in the fourth quarter of 2008 and \$171 million for the year ending December 31, 2008. Rescissions and denials totaled only \$7 million in the fourth quarter of 2007 and totaled only \$28 million for the year ended December 31, 2007.

Losses incurred

In 2008, net losses incurred were \$3,071 million, of which \$2,684 million related to current year loss development and \$387 million related to unfavorable prior years' loss development. In 2007, net losses incurred were \$2,365 million, of which \$1,846 million related to current year loss development and

Management's Discussion and Analysis (*continued*)

\$519 million related to unfavorable prior years' loss development. See Note 8 to our consolidated financial statements included below.

The amount of losses incurred pertaining to current year loss development represents the estimated amount to be ultimately paid on default notices received in the current year. Losses incurred pertaining to the current year increased in 2008, compared to 2007, primarily due to a significant increase in the default inventory offset by a smaller increase in estimated severity, as well as a slight decrease in estimated claim rate, when each are compared to the same period in 2007. The default inventory increased by 75,068 delinquencies in 2008, compared to an increase of 28,492 in 2007. The continued increase in estimated severity was primarily the result of the default inventory containing higher loan exposures with expected higher average claim payments as well as our inability to mitigate losses through the sale of properties due to home price declines. The increase in estimated severity was less substantial than the increase experienced during 2007. The slight decrease in estimated claim rate for 2008 was primarily due to an increase in our loss mitigation efforts that resulted in an increased number of rescissions and claim denials for misrepresentation, ineligibility and policy exclusions. The estimated claim rate is based on recent historical experience and does not take into account any potential benefits of third party and governmental mitigation programs that are in their early stages for which we have no data on historical performance. Losses incurred pertaining to the current year increased in 2007, compared to 2006, primarily due to significant increases in the default inventory and estimated severity and claim rate, when each are compared to 2006.

Our loss estimates are established based upon historical experience. We continue to experience increases in delinquencies in certain markets with higher than average loan balances, such as Florida and California. In California we have experienced an increase in delinquencies, from 6,900 as of December 31, 2007 to 14,960 as of December 31, 2008. Our Florida delinquencies increased from 12,500 as of December 31, 2007 to 29,380 as of December 31, 2008. The average claim paid on California loans in 2008 was more than twice as high as the average claim paid for the remainder of the country.

The amount of losses incurred relating to prior year loss development represents actual claim payments that were higher or lower than what was estimated by us at the end of the prior year as well as a re-estimation of amounts to be ultimately paid on defaults remaining in our default inventory from the end of the prior year. This re-estimation is the result of our review of current trends in default inventory, such as defaults that have resulted in a claim, the amount of the claim, the change in relative level of defaults by geography and the change in average loan exposure. The \$387 million addition to losses incurred relating to prior years in 2008 was due primarily to the significant increases in severity during the year, as compared to our estimates when originally establishing the reserves at December 31, 2007. The increase in losses incurred in 2008 related to prior years is also a result of more defaults remaining in inventory at December 31, 2008 from a year prior. These defaults have a higher estimated claim rate when compared to a year prior. The \$518.9 million increase in losses incurred in 2007 related to prior years was due primarily to the significant increases in severity and the significant deterioration in cure rates experienced during the year, as compared to our estimates when originally establishing the reserves at December 31, 2006.

We believe that the foregoing trends will likely continue into 2009. These trends may also continue beyond 2009.

As discussed under “— Risk Sharing Arrangements”, a portion of our flow new insurance written is subject to reinsurance arrangements with lender captives. The majority of these reinsurance arrangements are aggregate excess of loss reinsurance agreements, and the remainder are quota share agreements. As discussed under “Risk Sharing Arrangements” effective January 1, 2009 we will no longer cede new business under excess of loss reinsurance treaties with lender captive reinsurers. Loans reinsured through December 31, 2008 will run off pursuant to the terms of the particular captive arrangement. Under the aggregate excess of loss agreements, we are responsible for the first aggregate layer of loss, which is typically between 4% and 5%, the captives are responsible for the second aggregate layer of loss, which is 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

Management's Discussion and Analysis *(continued)*

an annual book of business reinsured by the captive. The premium cessions on these agreements typically ranged 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 captives' portion of both premiums and losses typically ranging from 25% to 50%. As noted under "Risk Sharing Arrangements" based on changes to the GSE requirements, beginning June 1, 2008 our captive arrangements, both aggregate excess of loss and quota share, are limited to a 25% cede rate.

Under these agreements 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 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 which case no new business would be ceded to the captive. In the event that the captives' incurred but unpaid losses exceed the funds in the trust account, and the captive does not deposit adequate funds, we may also be allowed to terminate the captive agreement, assume the captives obligations, transfer the assets in the trust accounts to us, and retain all future premium payments. We intend to exercise this additional remedy when it is available to us. However, if the captive would challenge our right to do so, the matter would be determined by arbitration. The total fair value of the trust fund assets under these agreements at December 31, 2008 was approximately \$582 million. During 2008, \$265 million of trust fund assets were transferred to us as a result of captive terminations. There were no material captive terminations in 2007. The transferred funds resulted in an increase in our investment portfolio (including cash and cash equivalents) and there was a corresponding decrease in our reinsurance recoverable on loss reserves, which is offset by a decrease in our net losses paid.

In 2008 the captive arrangements reduced our losses incurred by approximately \$476 million. We anticipate that the reduction in losses incurred will be lower in 2009, compared to 2008, as some of our captive arrangements have been terminated.

Information about the composition of the primary insurance default inventory at December 31, 2008, 2007 and 2006 appears in the table below.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Total loans delinquent(1)	182,188	107,120	78,628
Percentage of loans delinquent (default rate)	12.37%	7.45%	6.13%
Prime loans delinquent(2)	95,672	49,333	36,727
Percentage of prime loans delinquent (default rate).	7.90%	4.33%	3.71%
A-minus loans delinquent(2)	31,907	22,863	18,182
Percentage of A-minus loans delinquent (default rate).	30.19%	19.20%	16.81%
Subprime credit loans delinquent(2)	13,300	12,915	12,227
Percentage of subprime credit loans delinquent (default rate)	43.30%	34.08%	26.79%
Reduced documentation loans delinquent(3)	41,309	22,009	11,492
Percentage of reduced doc loans delinquent (default rate)	32.88%	15.48%	8.19%

(1) At December 31, 2008 and 2007, 45,482 and 39,704 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

Management's Discussion and Analysis *(continued)*

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.

- (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 us 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.

The pool notice inventory increased from 25,224 at December 31, 2007 to 33,884 at December 31, 2008; the pool notice inventory was 20,458 at December 31, 2006.

The average primary claim paid for 2008 was \$52,239 compared to \$37,165 for 2007 and \$28,228 for 2006. We expect the average primary claim paid to continue to increase in 2009, although we do not expect the increase in 2009 to be as sizeable as the increase experienced during 2008. We expect these increases will be driven by our higher average insured loan sizes as well as decreases in our ability to mitigate losses through the sale of properties in some geographical regions, as certain housing markets, like California and Florida, continue to be weak.

The average claim paid for the top 5 states (based on 2008 losses paid) for the years ended December 31, 2008, 2007 and 2006 appears in the table below.

<u>Average Claim Paid</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
California	\$115,409	\$96,196	\$55,540
Florida	69,061	56,846	23,158
Michigan	37,020	35,607	31,181
Arizona	67,058	58,211	19,048
Ohio	32,638	31,859	29,172
Other states	<u>42,985</u>	<u>33,651</u>	<u>27,532</u>
All states	\$ 52,239	\$37,165	\$28,228

The average loan size of our insurance in force at December 31, 2008, 2007 and 2006 appears in the table below.

<u>Average Loan Size</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Total insurance in force	\$154,100	\$147,308	\$137,574
Prime (FICO 620 & >)	151,240	141,690	129,696
A-Minus (FICO 575-619)	132,380	133,460	129,116
Subprime (FICO < 575)	121,230	124,530	127,298
Reduced doc (All FICOs)	208,020	209,990	202,984

Management's Discussion and Analysis *(continued)*

The average loan size of our insurance in force at December 31, 2008, 2007 and 2006 for the top 5 states (based on 2008 losses paid) appears in the table below.

<u>Average Loan Size</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
California	\$293,442	\$291,578	\$274,984
Florida	180,261	178,063	163,573
Michigan	121,001	119,428	117,126
Arizona	190,339	185,518	163,619
Ohio	116,046	113,276	110,162
All other states	148,523	141,297	131,247

Information about net paid claims during the years ended December 31, 2008, 2007 and 2006 appears in the table below.

<u>Net Paid Claims (\$ millions)</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Prime (FICO 620 & >)	\$ 547	\$332	\$251
A-Minus (FICO 575-619)	250	161	125
Subprime (FICO < 575)	132	101	68
Reduced doc (All FICOs)	395	190	81
Other	<u>48</u>	<u>45</u>	<u>50</u>
Direct losses paid	1,372	829	575
Reinsurance	<u>(19)</u>	<u>(12)</u>	<u>(8)</u>
Net losses paid	<u>\$1,353</u>	<u>\$817</u>	<u>\$567</u>
LAE	<u>48</u>	<u>53</u>	<u>44</u>
Net losses and LAE paid before terminations	<u>\$1,401</u>	<u>\$870</u>	<u>\$611</u>
Reinsurance terminations	<u>(265)</u>	<u>—</u>	<u>—</u>
Net losses and LAE paid	<u>\$1,136</u>	<u>\$870</u>	<u>\$611</u>

Management's Discussion and Analysis *(continued)*

Primary claims paid for the top 15 states (based on 2008 losses paid) and all other states for the years ended December 31, 2008, 2007 and 2006 appear in the table below.

<u>Primary Paid Claims by State (\$ millions)</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
California	\$ 315.8	\$ 81.7	\$ 2.8
Florida	129.3	37.6	4.4
Michigan	98.9	98.0	73.8
Arizona	60.8	10.5	0.7
Ohio	58.3	73.2	71.5
Illinois	52.0	34.9	20.5
Georgia	50.4	35.4	39.6
Texas	47.7	51.1	48.9
Nevada	45.1	12.3	1.4
Minnesota	43.2	33.6	16.0
Colorado	32.5	31.6	30.1
Virginia	32.3	12.7	1.8
Massachusetts	28.9	24.3	6.5
Indiana	26.0	33.3	34.8
New York	23.9	13.2	9.2
Other states	<u>278.8</u>	<u>201.0</u>	<u>162.6</u>
	<u>\$1,323.9</u>	<u>\$784.4</u>	<u>\$524.6</u>

The default inventory in those same states at December 31, 2008, 2007 and 2006 appears in the table below.

<u>Default Inventory by State</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
California	14,960	6,925	3,000
Florida	29,384	12,548	4,526
Michigan	9,853	7,304	6,522
Arizona	6,338	2,169	800
Ohio	8,555	6,901	6,395
Illinois	9,130	5,435	4,092
Georgia	7,622	4,623	3,492
Texas	10,540	7,103	6,490
Nevada	3,916	1,337	530
Minnesota	3,642	2,478	1,820
Colorado	2,328	1,534	1,354
Virginia	3,360	1,761	981
Massachusetts	2,634	1,596	1,027
Indiana	5,497	3,763	3,392
New York	4,493	3,153	2,458
Other states	<u>59,936</u>	<u>38,490</u>	<u>31,749</u>
	<u>182,188</u>	<u>107,120</u>	<u>78,628</u>

Our 2008 paid claims were lower than we anticipated at the beginning of the year due to a combination of reasons that have slowed the rate at which claims are received and paid, including foreclosure moratoriums,

Management's Discussion and Analysis *(continued)*

servicing delays, court delays, loan modifications, our fraud investigations and our claim rescissions and denials. Due to the uncertainty regarding how these and other factors will affect our net paid claims in 2009, it is difficult to estimate our 2009 claims paid. However, we believe that paid claims in 2009 will exceed, perhaps significantly, the \$1.4 billion paid in 2008. See "Contractual Obligations" below.

As of December 31, 2008, 66% of our primary insurance in force was written subsequent to December 31, 2005. On our flow business, the highest claim frequency years have typically been the third and fourth year after the year of loan origination. However, the pattern of claims frequency can be affected by many factors, including low persistency and deteriorating economic conditions. Low persistency can have the effect of accelerating 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. On our bulk business, the period of highest claims frequency has generally occurred earlier than in the historical pattern on our flow business.

Premium deficiency

Historically all of our insurance risks were included in a single grouping and the calculations to determine if a premium deficiency existed were performed on our entire in force book. As of September 30, 2007, based on these calculations there was no premium deficiency on our total in force book. During the fourth quarter of 2007, we experienced significant increases in our default inventory, and severities and claim rates on loans in default. We further examined the performance of our in force book and determined that the performance of loans included in Wall Street bulk transactions was significantly worse than we experienced for loans insured through the flow channel or loans insured through the remainder of our bulk channel. As a result we began separately measuring the performance of Wall Street bulk transactions and decided to stop writing this business. Consequently, as of December 31, 2007, we performed separate premium deficiency calculations on the Wall Street bulk transactions and on the remainder of our in force book to determine if premium deficiencies existed. As a result of those calculations, we recorded a premium deficiency reserve of \$1,211 million in the fourth quarter of 2007 to reflect the present value of expected future losses and expenses that exceeded the present value of expected future premium and already established loss reserves on the Wall Street bulk transactions. The discount rate used in the calculation of the premium deficiency reserve, 4.70%, was based upon our pre-tax investment yield at December 31, 2007. As of December 31, 2007 there was no premium deficiency related to the remainder of our in force business.

During 2008 the premium deficiency reserve on Wall Street bulk transactions declined by \$757 million from \$1,211 million, as of December 31, 2007, to \$454 million as of December 31, 2008. The \$454 million premium deficiency reserve as of December 31, 2008 reflects the present value of expected future losses and expenses that exceeded the present value of expected future premium and already established loss reserves. The discount rate used in the calculation of the premium deficiency reserve at December 31, 2008 was 4.0%.

The components of the premium deficiency reserve at December 31, 2008 and 2007 appears in the table below.

	December 31,	
	2008	2007
	(\$ millions)	
Present value of expected future premium	\$ 712	\$ 901
Present value of expected future paid losses and expenses	<u>(3,063)</u>	<u>(3,561)</u>
Net present value of future cash flows	(2,351)	(2,660)
Established loss reserves	<u>1,897</u>	<u>1,449</u>
Net deficiency	<u>\$ (454)</u>	<u>\$ (1,211)</u>

Management's Discussion and Analysis *(continued)*

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 year ended December 31, 2008 was \$757 million, as shown in the chart below, which represents the net result of actual premiums, losses and expenses offset by \$134 million change in assumptions primarily related to higher estimated ultimate losses.

	(\$ in millions)
Premium Deficiency Reserve at December 31, 2007	\$(1,211)
Paid Claims and LAE	770
Increase in loss reserves	448
Premium earned	(234)
Effects of present valuing on future premiums, losses and expenses	<u>(93)</u>
Change in premium deficiency reserve to reflect actual premium, losses and expenses recognized	891
Change in premium deficiency reserve to reflect change in assumptions relating to premiums, losses, expenses and discount rate(1)	<u>(134)</u>
Premium Deficiency Reserve at December 31, 2008	<u>\$ (454)</u>

(1) A negative number for changes in assumptions relating to premiums, losses, expenses and discount rate indicates a deficiency of prior premium deficiency reserves.

At the end of 2008, we performed a premium deficiency analysis on the portion of our book of business not covered by the premium deficiency described above. That analysis concluded that, as of December 31, 2008, 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 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. 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. 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 estimate will affect future period earnings and could be material.

Management's Discussion and Analysis (*continued*)

Underwriting and other expenses

Underwriting and other expenses for 2008 decreased when compared to 2007. The decrease reflects our lower volumes of new insurance written as well as a focus on expenses in difficult market conditions. Also, 2007 included \$12.3 million in one-time expenses associated with a terminated merger.

Underwriting and other expenses for 2007 increased when compared to 2006 primarily due to one-time expenses associated with a terminated merger, as well as international expansion.

Ratios

The table below presents our loss, expense and combined ratios for our combined insurance operations for the years ended December 31, 2008, 2007 and 2006.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Loss ratio	220.4%	187.3%	51.7%
Expense ratio	14.2%	15.8%	17.0%
Combined ratio	<u>234.6%</u>	<u>203.1%</u>	<u>68.7%</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 2008, compared to 2007, is due to an increase in losses incurred, partially offset by an increase in premiums earned. The expense ratio is the ratio, expressed as a percentage, of underwriting expenses to net premiums written. The decrease in 2008, compared to 2007, is due to a decrease in underwriting and other expenses as well as an increase in premiums written. The combined ratio is the sum of the loss ratio and the expense ratio.

Interest expense

Interest expense for 2008 increased compared to 2007. The increase primarily reflects the issuance of the \$390 million of convertible debentures in March and April of 2008. See discussion of our future interest expense as it relates to our convertible debentures in Note 2 to our consolidated financial statements included below.

Interest expense for 2007 increased slightly when compared to 2006 due to higher average amounts outstanding under our commercial paper program and credit facility.

Income taxes

The effective tax rate credit on our pre-tax loss was (42.1%) in 2008, compared to (37.3%) in 2007. During those periods, the rate reflected the benefits recognized from tax-preferenced investments. Our tax-preferenced investments that impact the effective tax rate consist almost entirely of tax-exempt municipal bonds. The difference in the rate was primarily the result of a smaller loss from underwriting operations during 2008, compared to 2007.

The effective tax rate credit on our pre-tax loss was (37.3%) in 2007, compared to an effective tax rate on our pre-tax income of 24.8% in 2006. During those periods, the rate reflected the benefits recognized from tax-preferenced investments. Our tax-preferenced investments that impact the effective tax rate consist almost entirely of tax-exempt municipal bonds. The difference in the rate was primarily the result of a pre-tax loss during 2007, compared to pre-tax income during 2006.

At December 31, 2008 we had net deferred tax assets of \$307 million and made an assessment of the need to establish a valuation allowance for these assets. In periods prior to 2008, we deducted significant amounts of statutory contingency reserves on our federal income tax returns. The reserves were deducted to the extent we purchased tax and loss bonds in an amount equal to the tax benefit of the deduction. The reserves are included in taxable income in future years when they are released for statutory accounting

Management's Discussion and Analysis (*continued*)

purposes (see "Liquidity and Capital Resources — Risk-to-Capital") or when the taxpayer elects to redeem the tax and loss bonds that were purchased in connection with the deduction for the reserves. Since the tax effect on these reserves exceeds the gross deferred tax assets less deferred tax liabilities, we believe that all gross deferred tax assets at December 31, 2008 are fully realizable. Therefore, we established no valuation reserve.

In 2009, since we have redeemed the remaining balance of our tax and loss bonds the remaining contingency reserves will be released and will no longer be available to support any net deferred tax assets. Therefore, any credit for income taxes, relating to future operating losses, will be reduced or eliminated by the establishment of a valuation allowance. We estimate that the total amount of tax benefits we will be able to recognize in 2009 will be limited to between \$50 million and \$100 million.

Joint ventures

Our equity in the earnings from Sherman and C-BASS and certain other joint ventures and investments, accounted for in accordance with the equity method of accounting, is shown separately, net of tax, on our consolidated statement of operations. Income from joint ventures, net of tax, was \$24.5 million in 2008 compared to a loss from joint ventures, net of tax, of \$269.3 million for 2007. The loss from joint ventures in 2007 was due primarily to the impairment of our investment in C-BASS, which is discussed below. In the third quarter of 2008, we sold our remaining interest in Sherman to Sherman. As a result, beginning in the fourth quarter of 2008, we no longer have income or loss from joint ventures.

C-BASS

Beginning in February 2007 and continuing through approximately the end of March 2007, the subprime mortgage market experienced significant turmoil. After a period of relative stability that persisted during April, May and through approximately late June, market dislocations recurred and then accelerated to unprecedented levels beginning in approximately mid-July 2007. As described in Note 10 to our consolidated financial statements included below, in the third quarter of 2007, we concluded that our total equity interest in C-BASS was impaired. In addition, during the fourth quarter of 2007 due to additional losses incurred by C-BASS, we reduced the carrying value of our \$50 million note from C-BASS to zero under equity method accounting.

Sherman

In August 2008 we sold our entire interest in Sherman to Sherman. Our interest sold represented approximately 24.25% of Sherman's equity. The sale price was paid \$124.5 million in cash and by delivery of Sherman's unsecured promissory note in the principal amount of \$85 million. The scheduled maturity of the Note is February 13, 2011 and it bears interest, payable monthly, at the annual rate equal to three-month LIBOR plus 500 basis points. The Note is issued under a Credit Agreement, dated August 13, 2008, between Sherman and MGIC.

At the time of sale the Note had a fair value of \$69.5 million (18.25% discount to par). The fair value was determined by comparing the terms of the note to the discounts and yields on comparable bonds. The value was also discounted for illiquidity and lack of ratings. The discount will be amortized to interest income over the life of the note. The gain recognized on the sale was \$62.8 million, and is included in realized investment gains on the statement of operations for the year ended December 31, 2008.

The sale of our interest in Sherman was effected as a repurchase of our interest by Sherman. We believe that Sherman will repay the Note in accordance with its terms. If in the future Sherman were to experience financial distress, there is a risk that Sherman would be unable to meet its obligations under the Note or, if Sherman were unable to meet its obligations generally, that creditors of Sherman would seek to set aside the entire transaction and obtain the return to Sherman of the consideration received by us in the transaction. We cannot predict Sherman's future performance but its business is sensitive to its ability to purchase receivable portfolios on favorable terms and to service those receivables such that it meets its return targets. In addition, the volume of credit card originations and the related returns on the credit card portfolio are impacted by

Management's Discussion and Analysis *(continued)*

general economic conditions and consumer behavior. Sherman's operations are principally financed with debt under credit facilities.

For some time there has been significant tightening in credit markets, which have become even tighter beginning in September 2008 with the onset of the credit crisis, with the result that lenders are generally becoming more restrictive in the amount of credit they are willing to provide and in the terms of credit that is provided. Credit tightening could adversely impact Sherman's ability to obtain sufficient funding to maintain or expand its business and could increase the cost of funding that is obtained.

For additional information regarding the sale of our interest please refer to our Current Report on Form 8-K filed with the Securities and Exchange Commission on August 14, 2008.

Summary Sherman income statements for the periods indicated appear below. The year ended December 31, 2008 only reflects Sherman's results and our share of income from Sherman through July 31, 2008 as a result of the sale of our interest in August 2008. Prior to the sale of our interest, we did not consolidate Sherman with us for financial reporting purposes, and we did not control Sherman. Sherman's internal controls over its financial reporting were not part of our internal controls over our financial reporting. However, our internal controls over our financial reporting include processes to assess the effectiveness of our financial reporting as it pertains to Sherman. We believe those processes are effective in the context of our overall internal controls.

Sherman Summary Income Statement:

	Year Ended December 31,		
	2008*	2007	2006
	(\$ in millions)		
Revenues from receivable portfolios	\$660.3	\$ 994.3	\$1,031.6
Portfolio amortization	<u>264.8</u>	<u>488.1</u>	<u>373.0</u>
Revenues, net of amortization	395.5	506.2	658.6
Credit card interest income and fees	475.6	692.9	357.3
Other revenue	<u>35.3</u>	<u>60.8</u>	<u>35.6</u>
Total revenues	906.4	1,259.9	1,051.5
Total expenses	<u>740.1</u>	<u>991.5</u>	<u>702.0</u>
Income before tax	<u>\$166.3</u>	<u>\$ 268.4</u>	<u>\$ 349.5</u>
Company's income from Sherman	<u>\$ 35.6</u>	<u>\$ 81.6</u>	<u>\$ 121.9</u>

* The year ended December 31, 2008 only reflects Sherman's results and our income from Sherman through July 31, 2008 as a result of the sale of our remaining interest in August 2008.

The "Company's income from Sherman" line item in the table above includes \$3.6 million, \$15.6 million and \$12.0 million of additional amortization expense in 2008, 2007 and 2006, respectively, above Sherman's actual amortization expense, related to additional interests in Sherman that we purchased during the third quarter of 2006 at a price in excess of book value.

In September 2007 we sold a portion of our interest in Sherman to an entity owned by Sherman's senior management. The interest sold by us represented approximately 16% of Sherman's equity. We received a cash payment of \$240.8 million in the sale and recorded a \$162.9 million pre-tax gain, which is reflected in our results of operations for 2007 as a realized gain.

Management's Discussion and Analysis (continued)

Financial Condition

As of December 31, 2008, 81% of our investment portfolio was invested in tax-preferenced securities. In addition, at December 31, 2008, based on book value, approximately 94% of our fixed income securities were invested in 'A' rated and above, readily marketable securities, concentrated in maturities of less than 15 years. Approximately 24% of our investment portfolio is covered by the financial guaranty industry. We evaluate the credit risk of securities through analysis of the underlying fundamentals of each issuer. A breakdown of the portion of our investment portfolio covered by the financial guaranty industry by credit rating, including the rating without the guarantee is shown below.

<u>Underlying Rating</u>	<u>Guarantor Rating</u>				
	<u>AAA</u>	<u>BBB+</u>	<u>B</u>	<u>Caa1</u>	<u>All</u>
	(\$ millions)				
AAA	\$ 2	\$ 27	\$—	\$—	\$ 29
AA	278	627	3	2	910
A	166	523	4	12	705
BBB	<u>9</u>	<u>57</u>	<u>15</u>	<u>—</u>	<u>81</u>
	\$455	\$1,234	\$22	\$14	\$1,725

If all of the companies in the financial guaranty industry lose their 'AAA' ratings, the percentage of our fixed income portfolio rated 'A' or better will decline by 1% to 93% 'A' or better. Our maximum exposure to any individual financial guarantor is 11%.

At December 31, 2008, derivative financial instruments in our investment portfolio were immaterial. We primarily place our investments in instruments that meet high credit quality standards, as specified in our investment policy guidelines. The policy also limits the amount of our credit exposure to any one issue, issuer and type of instrument. At December 31, 2008, the modified duration of our fixed income investment portfolio was 4.3 years, which means that an instantaneous parallel shift in the yield curve of 100 basis points would result in a change of 4.3% 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 market value would increase.

At December 31, 2008, the investment portfolio had gross unrealized losses of \$256.6 million. 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>December 31, 2008</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>
	(\$ thousands)					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 13,106	\$ 245	\$ 1,242	\$ 160	\$ 14,348	\$ 405
Obligations of U.S. states and political subdivisions	1,640,406	102,437	552,191	135,138	2,192,597	237,575
Corporate debt securities	72,711	4,127	1,677	126	74,388	4,253
Mortgage-backed securities	41,867	14,251	—	—	41,867	14,251
Debt issued by foreign sovereign governments	—	—	—	—	—	—
Equity securities	<u>227</u>	<u>10</u>	<u>2,062</u>	<u>135</u>	<u>2,289</u>	<u>145</u>
Total investment portfolio	<u>\$1,768,317</u>	<u>\$121,070</u>	<u>\$557,172</u>	<u>\$135,559</u>	<u>\$2,325,489</u>	<u>\$256,629</u>

During 2008, the municipal bond market experienced historically poor performance, and resulted in approximately one-third of our securities (580 issues) being in an unrealized loss position as of December 31, 2008. The unrealized losses in all categories of our investments were primarily caused by widening spreads. Of those securities in an unrealized loss position greater than 12 months, 101 securities had a fair value greater

Management's Discussion and Analysis (*continued*)

than 80% of amortized cost and 65 securities had a fair value less than 80% of amortized cost. We do not believe the unrealized losses are related to specific issuer defaults and because we have the ability and intent to hold those investments until a recovery of fair value, which may be maturity, we do not consider those investments to be other-than-temporarily impaired at December 31, 2008.

We held approximately \$524 million in auction rate securities ("ARS") backed by student loans at December 31, 2008. ARS are intended to behave like short-term debt instruments because their interest rates are reset periodically through an auction process, most commonly at intervals of 7, 28 and 35 days. The same auction process has historically provided a means by which we may rollover the investment or sell these securities at par in order to provide us with liquidity as needed. The ARS we hold are collateralized by portfolios of student loans, all of which are ultimately guaranteed by the United States Department of Education. At December 31, 2008, our ARS portfolio was 100% AAA/Aaa-rated by one or more of the following major rating agencies: Moody's, Standard & Poor's and Fitch Ratings. We carry our ARS portfolio at par. For additional information on our investment portfolio and our ARS portfolio see Notes 4 and 5 to our consolidated financial statements included below.

At December 31, 2008, our total assets included \$1.1 billion of cash and cash equivalents as shown on our consolidated balance sheet included below. In addition, included in "Other assets" on our consolidated balance sheet at December 31, 2008 is \$32.9 million in real estate acquired as part of the claim settlement process. The properties, which are held for sale, are carried at fair value. Also included in "Other assets" is \$72.1 million of principal and interest receivable related to the sale of our remaining interest in Sherman.

At December 31, 2008 we had \$200 million, 5.625% Senior Notes due in September 2011 and \$300 million, 5.375% Senior Notes due in November 2015, as well as \$200 million outstanding under a credit facility, with a total fair value of \$538.3 million. The credit facility is scheduled to expire in March 2010. This credit facility is discussed under "Liquidity and Capital Resources" below.

At December 31, 2008, we also had \$390 million principal amount of 9% Convertible Junior Subordinated Debentures due in 2063. At issuance, within the \$390 million principal amount was an embedded derivative with a value of \$16.9 million. The amount of the derivative is treated as a discount on issuance and is being amortized over the expected life of five years to interest expense. The fair value of the convertible debentures was approximately \$145.7 million at December 31, 2008.

In February 2009, the Internal Revenue Service informed us that it plans to conduct an examination of our federal income tax returns for 2005 through 2007. We believe that income taxes related to these years have been properly provided for in our financial statements.

On June 1, 2007, as a result of an examination by the Internal Revenue Service ("IRS") for taxable years 2000 through 2004, we received a Revenue Agent Report ("RAR"). The adjustments reported on the RAR substantially increase taxable income for those tax years and resulted in the issuance of an assessment for unpaid taxes totaling \$189.5 million in taxes and accuracy-related penalties, plus applicable interest. We have agreed with the IRS on certain issues and paid \$10.5 million in additional taxes and interest. The remaining open issue relates to our treatment of the flow through income and loss from an investment in a portfolio of residual interests of Real Estate Mortgage Investment Conduits ("REMICS"). The IRS has indicated that it does not believe that, for various reasons, we have established sufficient tax basis in the REMIC residual interests to deduct the losses from taxable income. We disagree with this conclusion and believe that the flow through income and loss from these investments was properly reported on our federal income tax returns in accordance with applicable tax laws and regulations in effect during the periods involved and have appealed these adjustments. The appeals process may take some time and a final resolution may not be reached until a date many months or years into the future. On July 2, 2007, we made a payment of \$65.2 million with the United States Department of the Treasury to eliminate the further accrual of interest. Although the resolution of this issue is uncertain, we believe that sufficient provisions for income taxes have been made for potential liabilities that may result. If the resolution of this matter differs materially from our estimates, it could have a material impact on our effective tax rate, results of operations and cash flows.

Management's Discussion and Analysis (*continued*)

The total amount of unrecognized tax benefits as of December 31, 2008 is \$87.9 million. Included in that total are \$76.0 million in benefits that would affect our effective tax rate. We recognize interest accrued and penalties related to unrecognized tax benefits in income taxes. We have accrued \$21.4 million for the payment of interest as of December 31, 2008. The establishment of this liability required estimates of potential outcomes of various issues and required significant judgment. Although the resolutions of these issues are uncertain, we believe that sufficient provisions for income taxes have been made for potential liabilities that may result. If the resolutions of these matters differ materially from these estimates, it could have a material impact on our effective tax rate, results of operations and cash flows.

Our principal exposure to loss is our obligation to pay claims under MGIC's mortgage guaranty insurance policies. At December 31, 2008, 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 \$63.2 billion. In addition, as part of our contract underwriting activities, we are responsible for the quality of our underwriting decisions in accordance with the terms of the contract underwriting agreements with customers. Through December 31, 2008, the cost of remedies provided by us to customers for failing to meet the standards of the contracts has not been material. However, a generally positive economic environment for residential real estate that continued through a portion of 2007 may have mitigated the effect of some of these costs, the claims for which may lag, by as much as several years, deterioration in the economic environment for residential real estate. There can be no assurance that contract underwriting remedies will not be material in the future.

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,
- premiums that we will receive from our existing insurance in force as well as policies that we write in the future,
- amounts, if any, remaining available under our credit facility expiring in March 2010,
- amounts received from the redemption of U.S. government non-interest bearing tax and loss bonds (which are discussed below),
- amounts that we expect to recover from captives (which are discussed in "Results of Consolidated Operations — Risk-Sharing Arrangements" and "Results of Consolidated Operations — Losses — Losses Incurred" above) and
- amounts we may recover under our reinsurance agreement with HCC (which are discussed in "Results of Consolidated Operations — Risk-Sharing Arrangements" above).

Our obligations consist primarily of:

- claims payments under MGIC's mortgage guaranty insurance policies,
- the amount outstanding under our credit facility that expires in March 2010,
- our \$200 million of 5.625% Senior Notes due in September 2011,
- our \$300 million of 5.375% Senior Notes due in November 2015,
- our \$390 million of convertible debentures due in 2063,
- interest on the foregoing debt instruments and
- the other costs and operating expenses of our business.

Management's Discussion and Analysis (*continued*)

Historically cash inflows from premiums have exceeded claim payments. When this is the case, we invest positive cash flows pending future payments of claims and other expenses. However, we anticipate that in the full year 2009, and in accordance with the assumptions underlying the table under "Contractual obligations" below, also in 2010, claim payments will exceed premiums received. As discussed under "— Losses incurred" above, due to the uncertainty regarding how certain factors, such as foreclosure moratoriums, servicing and court delays, loan modifications, fraud investigations and claim rescissions and denials, 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. Substantially all of the investment portfolio securities are held by our insurance subsidiaries.

During 2008, we redeemed in exchange for cash from the US Treasury approximately \$972 million of tax and loss bonds. In January of 2009, we redeemed \$398 million of tax and loss bonds. We plan to redeem an additional \$34 million in the first quarter of 2009. After the first quarter redemption, we will no longer hold any tax and loss bonds. Tax and loss bonds that we purchased were not assets on our balance sheet but were recorded as payments of current federal taxes. For further information about tax and loss bonds, see Note 2 to our consolidated financial statements included below.

To increase our capital position, late in the first quarter and early in the second quarter of 2008, we raised net proceeds of approximately \$840 million through the sale of our common stock and junior convertible debentures. In the second quarter of 2008, we further enhanced our claims paying resources by entering into the reinsurance agreement with HCC discussed under "Results of Consolidated Operations-Risk sharing arrangements." In the third quarter of 2008 we sold our remaining interest in Sherman and recognized a gain of \$62.8 million. As discussed under "Overview — Outlook — Capital," we may need additional capital in 2009 to continue to write new business.

Debt at Our Holding Company and Holding Company Capital Resources

For information about debt at our holding company, see Notes 6 and 7 to our consolidated financial statements included below. You should also review "Overview — Debt at our Holding Company and Holding Company Capital Resources" above.

The credit facility, senior notes and convertible debentures described in these notes are obligations of MGIC Investment Corporation and not of its subsidiaries. We are a holding company and the payment of dividends from our insurance subsidiaries, which historically has been the principal source of our holding company cash inflow, is restricted by insurance regulation. MGIC is the principal source of dividend-paying capacity. During 2008, MGIC paid three quarterly dividends of \$15 million each to our holding company, which increased the cash resources of our holding company. As has been the case for the past several years, as a result of extraordinary dividends paid, MGIC cannot currently pay any dividends without regulatory approval. In light of the matters discussed under "Overview — Outlook — Capital," we do not anticipate seeking approval in 2009 for any additional dividends from MGIC that would increase our cash resources at the holding company.

The credit facility requires us to maintain Consolidated Net Worth of no less than \$2.00 billion at all times. However, if as of June 30, 2009, Consolidated Net Worth equals or exceeds \$2.75 billion, then the minimum Consolidated Net Worth under the facility will be increased to \$2.25 billion at all times from and after June 30, 2009. Consolidated Net Worth is generally defined in our credit agreement as the sum of our consolidated shareholders' equity plus the aggregate outstanding principal amount of our 9% Convertible Junior Subordinated Debentures due 2063, currently \$390 million. The credit facility also requires MGIC to maintain a statutory risk-to-capital ratio of not more than 22:1 and maintain policyholders' position (which includes MGIC's statutory surplus and its contingency reserve) of not less than the amount required by

Management's Discussion and Analysis (*continued*)

Wisconsin insurance regulations. At December 31, 2008, these requirements were met. Our Consolidated Net Worth at December 31, 2008 was approximately \$2.7 billion. At December 31, 2008 MGIC's risk-to-capital was 12.9:1 and MGIC exceeded MPP by more than \$1.5 billion. See additional discussion of risk-to-capital and MPP under "Overview — Outlook — Capital". You should also review our risk factor titled "The amounts that we owe under our revolving credit facility and Senior Notes could be accelerated" under "Risk Factors" below.

As of December 31, 2008, we had a total of approximately \$394 million in short-term investments at our holding company. These investments are virtually all of our holding company's liquid assets. Our holding company's obligations include \$400 million of debt which is scheduled to mature before the end of 2011. Our use of funds at the holding company includes interest payments on our Senior Notes, credit facility and junior convertible debentures. On an annual basis, in aggregate, these uses total approximately \$74 million, based on the current rate in effect on our credit facility and assuming a full year of interest on the entire \$390 million of debentures. In October 2008 we eliminated the dividend on our common stock. See Note 7 to our consolidated financial statements included below for a discussion of our rights to defer payment of interest on our junior convertible debentures. The annual interest payments on these debentures approximate \$35 million.

We may from time to time 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 consider our risk-to-capital ratio an important indicator of our financial strength and our ability to write new business. Some states that regulate us have provisions that limit the risk-to-capital ratio of a mortgage guaranty insurance company to 25:1 (see "Outlook — Capital"). 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.

This ratio is computed on a statutory basis for our combined insurance operations and is our net risk in force divided by our policyholders' position. Our net risk in force included both primary and pool risk in force. The risk amount represents pools of loans or bulk deals with contractual aggregate loss limits and in some cases without these limits. For pools of loans without such limits, risk is estimated based on the amount that would credit enhance the loans in the pool to a "AA" level based on a rating agency model. Policyholders' position consists primarily of statutory policyholders' surplus (which increases as a result of statutory net income and decreases as a result of statutory net loss and dividends paid), plus the statutory contingency reserve. The statutory contingency reserve is reported as a liability on the statutory balance sheet. A mortgage insurance company is required to make annual contributions to the contingency reserve of approximately 50% of net earned premiums. These contributions must generally be maintained for a period of ten years. However, with regulatory approval a mortgage insurance company may make early withdrawals from the contingency reserve when incurred losses exceed 35% of net earned premium in a calendar year.

The premium deficiency reserve discussed under "Results of Operations — Losses — Premium deficiency" above 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, so no deficiency is recorded on a statutory basis.

Management's Discussion and Analysis *(continued)*

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

	December 31,	
	2008	2007
	(\$ in millions)	
Risk in force — net(1)	\$54,496	\$57,527
Statutory policyholders' surplus	1,613	1,351
Statutory contingency reserve	2,086	3,464
Statutory policyholders' position	\$ 3,699	\$ 4,815
Risk-to-capital:	14.7:1	11.9:1

(1) *Risk in force — net at December 31, 2008, as shown in the table above, is net of reinsurance and established loss reserves as discussed under "Capital" above. Risk in force — net at December 31, 2007 is net of reinsurance.*

The increase in risk-to-capital during 2008 is the result of a decrease in statutory policyholders' position. Statutory policyholders' position decreased in 2008, primarily due to losses incurred, offset by a capital contribution to our subsidiary, MGIC, from the proceeds raised by the sale of our common stock and convertible debentures. If our insurance in force continues to grow, our risk in force would also grow. To the extent our statutory policyholders' position does not increase at the same rate as our growth in risk in force, our risk-to-capital ratio will increase. Similarly, if our statutory policyholders' position decreases at a greater rate than our risk in force, then our risk-to-capital ratio will increase.

We expect that our risk-to-capital ratio will increase above its level at December 31, 2008. See further discussion under "Overview-Capital" above as well as our risk factor titled "Because our policyholders position could decline and our risk-to-capital could increase beyond the levels necessary to meet regulatory requirements we are considering options to obtain additional capital" under "Risk Factors" below.

Financial Strength Ratings

At the time this annual report was finalized, the financial strength of MGIC, our principal mortgage insurance subsidiary, was rated Ba2 by Moody's Investors Service and the outlook of this rating was considered, by Moody's, to be developing; Standard and Poor's Rating Services' insurer financial strength rating of MGIC was A- with a negative outlook; and the financial strength of MGIC was rated A- by Fitch Ratings with a negative outlook.

For further information about the importance of MGIC's ratings, see our Risk Factor titled "Our financial strength rating has been downgraded below Aa3/AA-, which could reduce the volume of our new business writings" under "Risk Factors" below.

Management's Discussion and Analysis *(continued)*

Contractual Obligations

At December 31, 2008, the approximate future payments under our contractual obligations of the type described in the table below are as follows:

<u>Contractual Obligations (\$ millions):</u>	<u>Total</u>	<u>Less than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>More than 5 Years</u>
Long-term debt obligations	\$3,148	\$ 74	\$ 524	\$102	\$2,448
Operating lease obligations	16	6	7	3	—
Purchase obligations	—	—	—	—	—
Pension, SERP and other post-retirement benefit plans	141	8	19	25	89
Other long-term liabilities	<u>4,776</u>	<u>2,436</u>	<u>2,245</u>	<u>95</u>	<u>—</u>
Total	<u>\$8,081</u>	<u>\$2,524</u>	<u>\$2,795</u>	<u>\$225</u>	<u>\$2,537</u>

Our long-term debt obligations at December 31, 2008 include our \$300 million of 5.375% Senior Notes due in November 2015, \$200 million of 5.625% Senior Notes due in September 2011, \$200 million outstanding under a credit facility expiring in March 2010 and \$390 million in convertible debentures due in 2063, including related interest, as discussed in Notes 6 and 7 to our consolidated financial statements included below and under “— Liquidity and Capital Resources” above. For discussions related to our debt covenants see “-Liquidity and Capital Resources” and our risk factor titled “The amounts that we owe under our revolving credit facility and Senior Notes could be accelerated” under “Risk Factors” below. Our operating lease obligations include operating leases on certain office space, data processing equipment and autos, as discussed in Note 14 to our consolidated financial statements included below. See Note 11 to our consolidated financial statements included below 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. We are including these liabilities because we agreed to do so in 2005 to resolve a comment from the staff of the SEC. 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. As discussed under “— Losses incurred” above, due to the uncertainty regarding how certain factors, such as foreclosure moratoriums, servicing and court delays, loan modifications, fraud investigations and claim rescissions and denials 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 8 to our consolidated financial statements included below 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.

The table above does not reflect the liability for unrecognized tax benefits due to uncertainties in the timing of the effective settlement of tax positions. We can not make a reasonably reliable estimate of the timing of payment for the liability for unrecognized tax benefits, net of payments on account, of \$19.7 million. See Note 12 to our consolidated financial statement included below for additional discussion on unrecognized tax benefits.

Management's Discussion and Analysis (*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. In accordance with GAAP for the mortgage insurance industry, we do not establish loss reserves for future claims on insured loans which are not currently in default.

We establish reserves using estimated claims rates and claims amounts in estimating the ultimate loss. Amounts for salvage recoverable are considered in the determination of the reserve estimates. 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 claims rates and claims amounts for the estimated number of defaults not reported. As of December 31, 2008 and 2007, we had IBNR reserves of \$480 million and \$368 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 claims rates and claims amounts represent what we believe best reflect the estimate of what will actually be paid on the loans in default as of the reserve date. The estimate of claims rates and claims amounts are based on our review of recent trends in the default inventory. We review recent trends in the rate at which defaults resulted in a claim, or the claim rate, the amount of the claim, or 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 claims rate 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 claims rate and claims 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 in one economic condition can not 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 \$184 million as of December 31, 2008. Historically, it has not been uncommon for us to experience variability in the development

Management's Discussion and Analysis (*continued*)

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)	
2008	\$(387,104)	\$2,642,479
2007	(518,950)	1,125,715
2006	90,079	1,124,454
2005	126,167	1,185,594
2004	13,451	1,061,788

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

Estimation of losses that we will pay in the future is inherently judgmental. The conditions that affect the claim rate and claim severity include the current and future state of the domestic economy 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 leading to a reduction in borrowers' income and thus their ability to make mortgage payments, and a drop in housing values that could materially reduce our ability to mitigate potential losses through property acquisition and resale or expose us to greater losses on resale of properties obtained through the claim settlement process. 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 loan instruments, assisting delinquent borrowers and lenders in modifying their mortgage notes into something more affordable, and forestalling foreclosures. In addition private company efforts may have a positive impact on our loss development. However, all of these efforts are in their early stages and therefore we are unsure of their magnitude or the benefit to us or our industry, and as a result are not factored into our current reserving.

Our estimates could also be positively affected by the extent of fraud that we uncover in the loans we have insured; higher rates of fraud should lead to higher rates of rescission, although the relationship may not be linear. Rescissions and denials totaled \$85 million in the fourth quarter of 2008 and \$171 million for the year ending December 31, 2008. In the fourth quarter of 2007 rescissions and denials totaled only \$7 million and totaled only \$28 million for the year ended December 31, 2007.

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

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. 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.

Management's Discussion and Analysis (*continued*)

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. 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 \$125 million. Additionally, a 5% change in the persistency of the underlying loans could change the Wall Street bulk premium deficiency reserve amount by approximately \$22 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 and will have no effect on earned premium. 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 associated with the 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 is 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.

Management's Discussion and Analysis (*continued*)

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, 2008, the persistency rate of our primary mortgage insurance was 84.4%, compared to 76.4% at December 31, 2007. This change did not significantly affect the amortization of deferred insurance policy acquisition costs for the period ended December 31, 2008. 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.

Fair Value Measurements

Effective January 1, 2008, we adopted the fair value measurement provisions of SFAS No. 157, "Fair Value Measurements." SFAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities. This statement defines fair value, expands disclosure requirements about fair value and specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect a company's market assumptions. Fair value is used on a recurring basis for assets and liabilities in which fair value is the primary basis of accounting (i.e., available-for-sale securities). Additionally, fair value is used on a nonrecurring basis to evaluate assets or liabilities for impairment or for disclosure purposes.

Fair value is defined as the price that would be received in a sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, we use various valuation techniques and assumptions when estimating fair value. In accordance with SFAS No. 157, 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 include certain U.S. Treasury securities and obligations of the U.S. government.

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 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, corporate, auction rate (backed by student loans) and mortgage-backed securities. Non-financial assets which utilize Level 3 inputs include real estate acquired through claim settlement. Additionally, financial liabilities utilizing Level 3 inputs consist of derivative financial instruments.

To determine the fair value of securities available-for-sale in Level 1 and Level 2 of the fair value hierarchy 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.

Management's Discussion and Analysis (*continued*)

The values generated by this model are also reviewed for reasonableness and, in some cases, further analyzed for accuracy, which includes the review of other publicly available information. Securities whose fair value is primarily based on the use of our multidimensional pricing model are classified in Level 2 and include certain municipal and corporate bonds.

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. Our investments in auction-rate securities were classified as Level 3 beginning in the fourth quarter of 2008 as quoted prices were unavailable due to events described in Note 4 to our consolidated financial statements and as there became increased doubt as to the liquidity of the securities. In particular, announced settlements in the fourth quarter of 2008 specified that re-marketers of the ARS provide liquidity to retail investors prior to providing liquidity to institutional investors and we did not observe a majority of issuers replacing these securities with another form of financing. Due to limited market information, we utilized a discounted cash flow ("DCF") model to derive an estimate of fair value at December 31, 2008. The assumptions used in preparing the DCF model included estimates with respect to the amount and timing of future interest and principal payments, forward projections of the interest rate benchmarks, the probability of full repayment of the principal considering the credit quality and guarantees in place, and the rate of return required by investors to own such securities given the current liquidity risk associated with auction-rate securities. The DCF model is based on the following key assumptions:
 - Nominal credit risk as the securities are ultimately guaranteed by the United States Department of Education
 - Five years to liquidity
 - Continued receipt of contractual interest; and
 - Discount rates incorporating a 1.50% spread for liquidity risk

A 1.00% change in the discount rate would change the value of our ARS by approximately \$17 million. A two year change to the years to liquidity assumption would change the value of our ARS by approximately \$1 million. The remainder of our level 3 securities are valued based on the present value of expected cash flows utilizing data provided by the 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.
- As discussed in Note 7 to our consolidated financial statements included below the derivative related to the outstanding debentures was valued using the Black-Scholes model. Remaining derivatives were valued internally, based on the present value of expected cash flows utilizing data provided by the trustees.

Investment Portfolio

We categorize our investment portfolio according to our ability and intent to hold the investments to maturity. Investments which we do not have the ability and intent to hold to maturity are considered to be available-for-sale and are reported at fair value and 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. Our entire investment portfolio is classified as available-for-sale. Realized investment gains and losses are reported in income based upon specific identification of securities sold.

We complete a quarterly review of invested assets for evidence of "other than temporary" impairments. A cost basis adjustment and realized loss will be taken on invested assets whose value decline is deemed to be

Management's Discussion and Analysis (*continued*)

“other than temporary”. Additionally, for investments written down, income accruals will be stopped absent evidence that payment is likely and an assessment of the collectibility of previously accrued income is made. Factors used in determining investments whose value decline may be considered “other than temporary” include, among others, the following:

- Investments with a market value less than 80% of amortized costs
- For fixed income and preferred stocks, declines in credit ratings to below investment grade from appropriate rating agencies
- Other securities which are under pressure due to market constraints or event risk
- Intention and ability to hold fixed income securities to recovery
- Length of time in a unrealized loss position

For the year ended December 31, 2008 we recognized “other than temporary” impairment charges of approximately \$63 million on our fixed income investments, including Fannie Mae, Freddie Mac, Lehman Brothers and AIG. There were no “other than temporary” asset impairment charges on our investment portfolio for the years ending December 31, 2007 and 2006.

Risk Factors

Forward-Looking Statements and Risk Factors

Our revenues and losses may be affected by the risk factors discussed below. These risk factors are an integral part of this annual report.

These factors may also cause actual results to differ materially from the results contemplated by forward looking statements that we may make. Forward looking statements consist of statements which relate to matters other than historical fact, including matters that inherently refer to future events. Among others, statements that include words such as we “believe”, “anticipate”, or “expect”, or words of similar import, are forward looking statements. We are not undertaking any obligation to update any forward looking statements 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 the fact that such statements are current at any time other than the time at which our Annual Report on Form 10-K for the year ended December 31, 2008 was filed with the Securities and Exchange Commission.

Because our policyholders position could decline and our risk-to-capital could increase beyond the levels necessary to meet regulatory requirements we are considering options to obtain additional capital.

The Office of the Commissioner of Insurance of Wisconsin is our 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 prescribed formula. If a mortgage guaranty insurer does not meet the minimum required by the formula it cannot write new business until its policyholders position meets the minimum. Some other states that regulate our mortgage guaranty insurance companies have similar regulations.

Some states that regulate us have provisions that limit the risk-to-capital ratio of a mortgage guaranty insurance company to 25:1. 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.

The mortgage insurance industry is experiencing 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 in California, Florida and other distressed markets, 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. Our view of potential losses on these books has trended upward since the first quarter of 2008, including since the time at which we finalized our Quarterly Report on Form 10-Q for the third quarter of 2008. Unless recent loss trends materially mitigate, MGIC’s policyholders position could decline and its risk-to-capital could increase beyond the levels necessary to meet regulatory requirements to write new business and this could occur before the end of 2009. As a result, we are considering options to obtain capital to write new business, which could occur through the sale of equity or debt securities, from reinsurance and/or through the use of claims paying resources that should not be needed to cover obligations on our existing insurance in force. While we have not pursued raising capital from private sources, we initiated discussions with the US Treasury late in October 2008 to seek a capital investment and/or reinsurance under the Troubled Assets Relief Program (“TARP”). We understand there is intense competition for TARP and other government assistance. We cannot predict whether we will be successful in obtaining capital from any source but any sale of additional securities could dilute substantially the interest of existing shareholders and other forms of capital relief could also result in additional costs.

Risk Factors *(continued)*

Changes in the business practices of Fannie Mae and Freddie Mac could reduce our revenues or increase our losses.

The majority of our insurance written is for loans sold to Fannie Mae and Freddie Mac, each of which is a government sponsored entity, or GSE. As a result, the business practices of the GSEs affect the entire relationship between them and mortgage insurers and include:

- the level of private mortgage insurance coverage, subject to the limitations of Fannie Mae and Freddie Mac's 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 Fannie Mae or Freddie Mac assess on loans that require mortgage insurance,
- whether Fannie Mae or Freddie Mac 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 Fannie Mae or Freddie Mac, 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, and
- the circumstances in which mortgage servicers must perform activities intended to avoid or mitigate loss on insured mortgages that are delinquent.

In September 2008, the Federal Housing Finance Agency ("FHFA") was appointed as the conservator of Fannie Mae and Freddie Mac. As their conservator, FHFA controls and directs the operations of Fannie Mae and Freddie Mac. The appointment of FHFA as conservator, the increasing role that the federal government has assumed in the residential mortgage market, our industry's inability, due to capital constraints, to write sufficient business to meet the needs of Fannie Mae and Freddie Mac or other factors may increase the likelihood that the business practices of Fannie Mae and Freddie Mac change in ways that may have a material adverse effect on us. In addition, these factors may increase the likelihood that the charters of Fannie Mae and Freddie Mac are changed by new federal legislation. Such changes may allow Fannie Mae and Freddie Mac to reduce or eliminate the level of private mortgage insurance coverage that they use as credit enhancement.

In addition, both Fannie Mae and Freddie Mac have policies which provide guidelines on terms under which they can conduct business with mortgage insurers with financial strength ratings below Aa3/AA-. For information about how these policies could affect us, see the risk factor titled "Our financial strength rating has been downgraded below Aa3/AA-, which could reduce the volume of our new business writings."

A downturn in the domestic economy or a decline 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 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 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 mortgage credit due to

Risk Factors *(continued)*

more stringent underwriting standards, liquidity issues affecting lenders or other factors. The residential mortgage market in the United States has for some time experienced a variety of worsening economic conditions and housing values in many areas continue to decline. The credit crisis that began in September 2008 may result in further deterioration in economic conditions and home values.

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

Even when housing values are stable or rising, certain types of mortgages have higher probabilities of claims. These segments include loans with loan-to-value ratios over 95% (including loans with 100% loan-to-value ratios or in certain markets that have experienced declining housing values, over 90%), FICO credit scores below 620, limited underwriting, including limited borrower documentation, or total debt-to-income ratios of 38% or higher, as well as loans having combinations of higher risk factors. As of December 31, 2008, approximately 60% of our primary risk in force consisted of loans with loan-to-value ratios equal to or greater than 95%, 9.3% had FICO credit scores below 620, and 13.7% had limited underwriting, including limited borrower documentation. A material portion of these loans were written in 2005 — 2007 and through 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 (3) 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, 2008.)

Beginning in the fourth quarter of 2007 we made a series of changes to our underwriting guidelines in an effort to improve the risk profile of our new business. Requirements imposed by new guidelines, however, only affect business written under commitments to insure loans that are issued after those guidelines become effective. Business for which commitments are issued after new guidelines are announced and before they become effective is insured by us in accordance with the guidelines in effect at time of the commitment even if that business would not meet the new guidelines. For commitments we issue for loans that close and are insured by us, a period longer than a calendar quarter can elapse between the time we issue a commitment to insure a loan and the time we receive the payment of the first premium and report the loan in our risk in force, although this period is generally shorter.

As of December 31, 2008, approximately 3.7% of our primary risk in force written through the flow channel, and 46.0% 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”). 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. We believe that when the reset interest rate significantly exceeds the interest rate at loan origination, claims on ARMs would be substantially higher than for fixed rate loans. Moreover, even if interest rates remain unchanged, claims on ARMs with a “teaser rate” (an initial interest rate that does not fully reflect the index which determines subsequent rates) may also be substantially higher because of the increase in the mortgage payment that will occur when the fully indexed rate becomes effective. In addition, we believe the volume of “interest-only” loans, which may also be ARMs, and loans with negative amortization features, such as pay option ARMs, increased in 2005 and 2006 and remained at these levels during the first half of 2007, before beginning to decline in the second half of 2007. We believe claim rates on certain of 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 prove 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 are effective in 2008, our 2008 book (which consists of loans we committed to insure in 2008 that closed and become insured by us) will generate underwriting profit, although as economic conditions have continued to deteriorate the amount of such profit has declined over the amount we were expecting at the end of the third quarter of 2008.

Risk Factors *(continued)*

Because we establish loss reserves only upon a loan default rather than based on estimates of our ultimate losses, our earnings may be adversely affected by losses disproportionately in certain periods.

In accordance with GAAP for the mortgage insurance industry, 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 what is referred to as “IBNR” in the mortgage insurance industry). We establish reserves using estimated claims rates and claims 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 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 what we believe best reflect the estimate of what will actually be paid on the loans in default as of the reserve date.

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 leading to a reduction in borrowers’ income and thus their ability to make mortgage payments, and a drop in housing values that could materially reduce our ability to mitigate potential loss through property acquisition and resale or expose us to greater loss on resale of properties obtained through the claim settlement process. 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.

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. 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 which are included in Wall Street securitizations because the performance of loans included in such securitizations 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 channel. As of December 31, 2007 we established a premium deficiency reserve of approximately \$1.2 billion. As of December 31, 2008, the premium deficiency reserve was \$454 million. At each date, the premium deficiency reserve is the present value of expected future losses and expenses that exceeded the present value of expected future premium and already established loss reserves on these bulk transactions.

Risk Factors *(continued)*

The mortgage insurance industry is experiencing 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 in California, Florida and other distressed markets, 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. Our view of potential losses on these books has trended upward since the first quarter of 2008, including since the time at which we finalized our Quarterly Report on Form 10-Q for the third quarter of 2008. There can be no assurance that additional premium deficiency reserves on Wall Street Bulk or on other portions of our insurance portfolio will not be required.

The amounts that we owe under our revolving credit facility and Senior Notes could be accelerated.

We have a \$300 million bank revolving credit facility that matures in March 2010 under which \$200 million is currently outstanding, \$200 million of Senior Notes due in September 2011 and \$300 million of Senior Notes due in November 2015.

Our revolving credit facility includes three financial covenants. First, it requires that we maintain Consolidated Net Worth of no less than \$2.00 billion at all times. However, if as of June 30, 2009, our Consolidated Net Worth equals or exceeds \$2.75 billion, then the minimum Consolidated Net Worth under the facility will be increased to \$2.25 billion at all times from and after June 30, 2009. Consolidated Net Worth is generally defined in our credit agreement as the sum of our consolidated stockholders' equity (determined in accordance with GAAP) plus the aggregate outstanding principal amount of our 9% Convertible Junior Subordinated Debentures due 2063. The current aggregate outstanding principal amount of our 9% Convertible Junior Subordinated Debentures due 2063 is \$390 million.

At December 31, 2008, our Consolidated Net Worth was approximately \$2.7 billion. We expect we will have a net loss in 2009, with the result that we expect our Consolidated Net Worth to decline. There can be no assurance that losses in or after 2009 will not reduce our Consolidated Net Worth below the minimum amount required.

In addition, regardless of our results of operations, our Consolidated Net Worth would be reduced to the extent the carrying value of our investment portfolio declines from its carrying value at December 31, 2008 due to market value adjustments. At December 31, 2008, the modified duration of our fixed income portfolio was 4.3 years, which means that an instantaneous parallel upward shift in the yield curve of 100 basis points would result in a decline of 4.3% (approximately \$340 million) in the market value of this portfolio. Market value adjustments could also occur as a result of changes in credit spreads.

The other two financial covenants require that MGIC's risk-to-capital ratio not exceed 22:1 and that MGIC maintain policyholders position of not less than the amount required by Wisconsin insurance regulations. We discuss MGIC's risk-to-capital ratio and its policyholders position in the risk factor titled "Because our policyholders position could decline and our risk-to-capital could increase beyond the levels necessary to meet regulatory requirements we are exploring options to obtain additional capital."

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 their corporate existence, rights and franchises unless we or 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 shareholder's equity of at least 15% of our consolidated shareholders equity.

Risk Factors *(continued)*

We currently have sufficient liquidity at our holding company to repay the amounts owed under our revolving credit facility. If (i) we fail to maintain any of the requirements under the credit facility discussed above, (ii) we fail to make a payment of principal when due under the credit facility or a payment of interest within five days after due under the credit facility, (iii) we fail to make an interest payment when due under either series of our Senior Notes or (iv) our payment obligations under our Senior Notes are declared due and payable (including for one of the reasons noted in the following paragraph) and we are not successful in obtaining an agreement from banks holding a majority of the debt outstanding under the facility to change (or waive) the applicable requirement, then banks holding a majority of the debt outstanding under the facility would have the right to declare the entire amount of the outstanding debt due and payable.

If (i) we fail to meet any of the covenants of the Senior Notes discussed above, (ii) we fail to make a payment of principal of the Senior Notes when due or a payment of interest on the Senior Notes within thirty days after due or (iii) the debt under our bank facility is declared due and payable (including for one of the reasons noted in the previous paragraph) and we are not successful in obtaining an agreement from holders of a majority of the applicable series of Senior Notes to change (or waive) the applicable requirement or payment default, then the holders of 25% or more of either series of our Senior Notes each would have the right to accelerate the maturity of that debt. In addition, the Trustee of these two issues of Senior Notes, which is also a lender under our bank credit facility, could, independent of any action by holders of Senior Notes, accelerate the maturity of the Senior Notes.

In the event the amounts owing under our credit facility or Senior Notes are accelerated, we may not have sufficient funds to repay such amounts.

Our financial strength rating has been downgraded below Aa3/AA-, which could reduce the volume of our new business writings.

The financial strength of MGIC, our principal mortgage insurance subsidiary, is rated Ba2 by Moody's Investors Service and the outlook for this rating is considered, by Moody's, to be developing. Standard & Poor's Rating Services' insurer financial strength rating of MGIC is BB and is considered, by S&P, to be on "watch negative." The financial strength of MGIC is rated BBB by Fitch Ratings with a negative outlook.

The mortgage insurance industry historically viewed a financial strength rating of Aa3/AA- as critical to writing new business. In part this view has resulted from the mortgage insurer eligibility requirements of the GSEs, which each year purchase the majority of loans insured by us and the rest of the mortgage insurance industry, along with the risk-based capital stress test for the GSEs which provided incentives for the GSEs to use private mortgage insurance provided by insurers with the highest ratings.

At the beginning of 2007, all of the eight private mortgage insurers then writing new insurance had ratings of at least Aa3/AA- and all of them were treated the same under the risk-based capital stress test applicable to the GSEs. Since then, one of the eight private mortgage insurers ceased writing new insurance and six of the other seven private mortgage insurers have been downgraded below Aa3/AA-. The only private mortgage insurer that has maintained a rating of at least Aa3/AA- has an insignificant market share.

In February 2008, after several private mortgage insurers were downgraded below Aa3/AA-, Freddie Mac and Fannie Mae announced that they were temporarily suspending the portion of their eligibility requirements that impose additional restrictions on a mortgage insurer that is downgraded below Aa3/AA- if the affected insurer commits to submitting a written remediation plan for their approval. After Freddie Mac and Fannie Mae suspended this portion of their eligibility requirements, we were downgraded below Aa3/AA-. We have submitted written remediation plans to both Freddie Mac and Fannie Mae. We believe that both Freddie Mac and Fannie Mae view their processes of reviewing remediation plans as continuing processes that should continue until the party submitting the remediation plan has regained a rating of at least Aa3/AA-. Our remediation plans include projections of our future financial performance. There can be no assurance that we will be able to successfully complete our remediation plans. In addition, there can be no assurance that Freddie Mac and Fannie Mae will continue the positions described above with respect to mortgage insurers that have been downgraded below Aa3/AA-.

Risk Factors *(continued)*

Apart from the effect of the eligibility requirements of the GSEs, we believe lenders who hold mortgages in portfolio and choose to obtain mortgage insurance on the loans assess a mortgage insurer's financial strength rating as one element of the process through which they select mortgage insurers. As a result of these considerations, including MGIC's ratings downgrades since the beginning of 2008, MGIC may be competitively disadvantaged.

Loan modification and other similar programs may not provide material benefits to us.

Beginning in the fourth quarter of 2008, the federal government, including through the FDIC 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. All of these programs are being rolled out or in their early stages and it is unclear whether they will result in a significant number of loan modifications. In February 2009, the Obama Administration announced the Homeowner Affordability and Stability Plan that has the intent of helping millions of homeowners receive more favorable mortgage terms. Full details of the plan were not available at the time that our Annual Report on Form 10-K for the year ended December 31, 2008 was finalized. One or more of these programs may be implemented in a manner that eliminates the need for mortgage insurance for groups of loans that our industry has traditionally insured. Even if a loan is modified, we do not know how many modified loans will subsequently re-default, resulting in losses for us that could be greater than we would have paid had the loan not been modified. As a result, we cannot ascertain with confidence whether these programs will provide material benefits to us. 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 qualifying loans are inherently uncertain. If legislation is enacted to permit a mortgage balance to be reduced in bankruptcy, we would still be responsible to pay the original balance if the borrower re-defaulted on that mortgage after its balance had been reduced. Various government entities and private parties have enacted foreclosure moratoriums. A moratorium does not affect the accrual of interest and other expenses on a loan. Unless a loan is modified during a moratorium to cure the default, at the expiration of the moratorium additional interest and expenses would be due which could result on our losses on loans subject to the moratorium being higher than if there had been no moratorium.

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.

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. At December 31, 2008 persistency was at 84.4%, compared to the record low of 44.9% at September 30, 2003. Since the 1990s, refinancing has become easier to accomplish and less costly for many consumers. Hence, even in an interest rate and house price environment favorable to persistency improvement, persistency may not reach its December 31, 1990 level. Recently, mortgage interest rates have reached historic lows by some measures, and we expect to see an increase in the portion of our business attributable to refinances.

Risk Factors *(continued)*

The amount of insurance we write could be adversely affected if lenders and investors select alternatives to private mortgage insurance.

These alternatives to private mortgage insurance include:

- lenders using government mortgage insurance programs, including those of the Federal Housing Administration and the Veterans Administration,
- lenders and other investors holding mortgages in portfolio and self-insuring,
- investors using credit enhancements other than private mortgage insurance, using other credit enhancements 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.

We believe the Federal Housing Administration, which until 2008 was not viewed by us as a significant competitor, substantially increased its market share in 2008.

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

Competition for private mortgage insurance premiums occurs not only among private mortgage insurers but also with mortgage lenders through captive mortgage reinsurance transactions. In these transactions, a lender's affiliate reinsures a portion of the insurance written by a private mortgage insurer on mortgages originated or serviced by the lender. As discussed under "We are subject to risk from private litigation and regulatory proceedings" below, we provided information to the New York Insurance Department and the Minnesota Department of Commerce about captive mortgage reinsurance arrangements and the Department of Housing and Urban Development, commonly referred to as HUD, issued a subpoena covering similar information. Other insurance departments or other officials, including attorneys general, may also seek information about or investigate captive mortgage reinsurance.

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. Our private mortgage insurance competitors include:

- PMI Mortgage Insurance Company,
- Genworth Mortgage Insurance Corporation,
- United Guaranty Residential Insurance Company,
- Radian Guaranty Inc.,
- Republic Mortgage Insurance Company, whose parent, based on information filed with the SEC through February 20, 2009, is our largest shareholder, and
- CMG Mortgage Insurance Company.

Our relationships with our customers could be adversely affected by a variety of factors, including continued tightening of our underwriting guidelines, which have resulted in our declining to insure some of the loans originated by our customers, and our decision to discontinue ceding new business under excess of loss reinsurance programs. We believe the Federal Housing Administration, which in recent years was not viewed by us as a significant competitor, substantially increased its market share in 2008.

Risk Factors *(continued)*

While the mortgage insurance industry has not had new entrants in many years, the perceived increase in credit quality of loans that are being insured today combined with the deterioration of the financial strength ratings of the existing mortgage insurance companies could encourage new entrants.

Our common stock could be delisted from the NYSE.

The listing of our common stock on the NYSE is subject to compliance with NYSE's continued listing standards, including that the average closing price of our common stock during any 30 trading day period equal or exceed \$1.00 and that our average market capitalization for any such period equal or exceed \$25 million. The NYSE can also, in its discretion, discontinue listing a company's common stock if the company discontinues a substantial portion of its operations. If we do not satisfy any of NYSE's continued listing standards or 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.

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 and liquidity issues affecting lenders,
- the level of home mortgage interest rates,
- the health of the domestic economy as well as conditions in regional and local economies,
- housing affordability,
- 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.

We are subject to the risk of private litigation and regulatory proceedings.

Consumers are bringing a growing number of lawsuits against home mortgage lenders and settlement service providers. Seven 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 late December 2004 following denial of class certification in June 2004. Since December 2006, class action litigation was separately brought against a number of large lenders alleging that their captive mortgage reinsurance arrangements violated RESPA. While we are not a defendant in any of these cases, there can be no assurance that we will not be subject to future litigation under RESPA or FCRA or that the outcome of any such litigation would not have a material adverse effect on us.

In June 2005, in response to a letter from the New York Insurance Department, we provided information regarding captive mortgage reinsurance arrangements and other types of arrangements in which lenders receive

Risk Factors *(continued)*

compensation. In February 2006, the New York Insurance Department requested MGIC to review its premium rates in New York and to file adjusted rates based on recent years' experience or to explain why such experience would not alter rates. In March 2006, MGIC advised the New York Insurance Department that it believes its premium rates are reasonable and that, given the nature of mortgage insurance risk, premium rates should not be determined only by the experience of recent years. In February 2006, in response to an administrative subpoena from the Minnesota Department of Commerce, which regulates insurance, we provided the Department with information about captive mortgage reinsurance and certain other matters. We subsequently provided additional information to the Minnesota Department of Commerce, and beginning in March 2008 that Department has sought additional information as well as answers to questions regarding captive mortgage reinsurance on several occasions. In June 2008, we received a subpoena from the Department of Housing and Urban Development, commonly referred to as HUD, seeking information about captive mortgage reinsurance similar to that requested by the Minnesota Department of Commerce, but not limited in scope to the state of Minnesota. Other insurance departments or other officials, including attorneys general, may also seek information about or investigate captive mortgage reinsurance.

The anti-referral fee provisions of RESPA provide that the Department of Housing and Urban Development as well as the insurance commissioner or attorney general of any state may bring an action to enjoin violations of these provisions 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 outcome of any such reviews or investigations nor is it possible to predict their effect on us or the mortgage insurance industry.

In October 2007, the Division of Enforcement of the Securities and Exchange Commission requested that we voluntarily furnish documents and information primarily relating to C-BASS, the now-terminated merger with Radian and the subprime mortgage assets "in the Company's various lines of business." We are providing responsive documents and/or other information to the Securities and Exchange Commission. As part of its initial information request, the SEC staff informed us that this investigation should not be construed as an indication by the SEC or its staff that any violation of the securities laws has occurred, or as a reflection upon any person, entity or security.

In 2008, complaints in five separate purported stockholder class action lawsuits were filed against us, several of our officers and an officer of C-BASS. The allegations in the complaints are generally that through these individuals we violated the federal securities laws by failing to disclose or misrepresenting C-BASS's liquidity, the impairment of our investment in C-BASS, the inadequacy of our loss reserves and that we were not adequately capitalized. The collective time period covered by these lawsuits begins on October 12, 2006 and ends on February 12, 2008. The complaints seek damages based on purchases of our stock during this time period at prices that were allegedly inflated as a result of the purported misstatements and omissions. With limited exceptions, our bylaws provide that our officers are entitled to indemnification from us for claims against them of the type alleged in the complaints. We believe, among other things, that the allegations in the complaints are not sufficient to prevent their dismissal and intend to defend against them vigorously. However, we are unable to predict the outcome of these cases or estimate our associated expenses or possible losses.

Other lawsuits alleging violations of the securities laws could be brought against us. In December 2008, a holder of a class of certificates in a publicly offered securitization for which C-BASS was the sponsor brought a purported class action under the federal securities laws against C-BASS; the issuer of such securitization, which was an affiliate of a major Wall Street underwriter; and the underwriters alleging material misstatements in the offering documents. The complaint describes C-BASS as a venture of MGIC, Radian Group and the management of C-BASS and refers to Doe defendants who are unknown to the plaintiff but who the complaint says are legally responsible for the events described in the complaint. The complaint also says that the plaintiff will seek to amend the complaint when the identities of these additional defendants have been ascertained.

Risk Factors (continued)

Two law firms have issued press releases to the effect that they are investigating whether the fiduciaries of our 401(k) plan breached their fiduciary duties regarding the plan's investment in or holding of our common stock. With limited exceptions, our bylaws provide that the plan fiduciaries are entitled to indemnification from us for claims against them. We intend to defend vigorously any proceedings that may result from these investigations.

The Internal Revenue Service has proposed significant adjustments to our taxable income for 2000 through 2004.

The Internal Revenue Service conducted an examination of our federal income tax returns for taxable years 2000 through 2004. On June 1, 2007, as a result of this examination, we received a revenue agent report. The adjustments reported on the revenue agent report would substantially increase taxable income for those tax years and resulted in the issuance of an assessment for unpaid taxes totaling \$189.5 million in taxes and accuracy related penalties, plus applicable interest. We have agreed with the Internal Revenue Service on certain issues and paid \$10.5 million in additional taxes and interest. The remaining open issue relates 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, or REMICs. This portfolio has been managed and maintained during years prior to, during and subsequent to the examination period. The Internal Revenue Service has indicated that it does not believe, for various reasons, that we have established sufficient tax basis in the REMIC residual interests to deduct the losses from taxable income.

We disagree with this conclusion and believe that the flow through income and loss from these investments was properly reported on our federal income tax returns in accordance with applicable tax laws and regulations in effect during the periods involved and have appealed these adjustments. The appeals process may take some time and a final resolution may not be reached until a date many months or years into the future. In July 2007, we made a payment on account of \$65.2 million with the United States Department of the Treasury to eliminate the further accrual of interest. We believe, after discussions with outside counsel about the issues raised in the revenue agent report and the procedures for resolution of the disputed adjustments, that an adequate provision for income taxes has been made for potential liabilities that may result from these notices. If the outcome of this matter results in payments that differ materially from our expectations, it could have a material impact on our effective tax rate, results of operations and cash flows.

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 II capital accord may discourage the use of mortgage insurance.

In 1988, the Basel Committee on Banking Supervision developed the Basel Capital Accord (the 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 2008 and may be implemented by the remaining banks in the United States and many other countries in 2009. Basel II affects the capital treatment provided to mortgage insurance by domestic and international banks in both their origination and securitization activities.

The Basel II provisions related to residential mortgages and mortgage insurance may provide incentives to certain of our bank customers not to insure mortgages having a lower risk of claim and to insure mortgages

Risk Factors *(continued)*

having a higher risk of claim. The Basel II provisions may also alter the competitive positions and financial performance of mortgage insurers in other ways, including reducing our ability to successfully establish or operate our planned international operations.

We may not be able to recover the capital we invested in our Australian operations for many years and may not recover all of such capital.

We have committed significant resources to begin international operations, primarily in Australia, where we started to write business in June 2007. In view of our need to dedicate capital to our domestic mortgage insurance operations, we have been exploring alternatives for our Australian activities which may include a sale of our Australian operations. As a result, we have reduced our Australian headcount and suspended writing new business in Australia. Unless we are successful in a sale in the first half of 2009, we may place our existing Australian book of business into runoff. In addition to the general economic and insurance business-related factors discussed above, 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.

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. A recent trend in the mortgage lending and mortgage loan servicing industry has been towards consolidation of loan servicers. This 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. Future housing market conditions could lead to additional such increases. Managing a substantially higher volume of non-performing loans could lead to disruptions in the servicing of mortgage loans covered by our insurance policies. Disruptions in servicing, in turn, could contribute to a rise in delinquencies among those loans and could have a material adverse effect on our business, financial condition and operating results.

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 Rules 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, 2008.

The effectiveness of our internal control over financial reporting, as of December 31, 2008, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Report of Independent Registered Public Accounting Firm

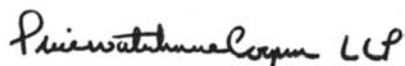
To the Board of Directors and Shareholders of
MGIC Investment Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, 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, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2), present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, 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 and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, 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
February 27, 2009

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
Years Ended December 31, 2008, 2007 and 2006
(Audited)

Consolidated Statements of Operations

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(In thousands of dollars, except per share data)		
Revenues:			
Premiums written:			
Direct	\$1,661,544	\$ 1,513,395	\$1,357,107
Assumed	12,221	3,288	2,052
Ceded (note 9)	<u>(207,718)</u>	<u>(170,889)</u>	<u>(141,923)</u>
Net premiums written	1,466,047	1,345,794	1,217,236
Increase in unearned premiums	<u>(72,867)</u>	<u>(83,404)</u>	<u>(29,827)</u>
Net premiums earned (note 9)	1,393,180	1,262,390	1,187,409
Investment income, net of expenses (note 4)	308,517	259,828	240,621
Realized investment (losses) gains, net (note 4)	(12,486)	142,195	(4,264)
Other revenue	<u>32,315</u>	<u>28,793</u>	<u>45,403</u>
Total revenues	<u>1,721,526</u>	<u>1,693,206</u>	<u>1,469,169</u>
Losses and expenses:			
Losses incurred, net (notes 8 and 9)	3,071,501	2,365,423	613,635
Change in premium deficiency reserves (note 8)	(756,505)	1,210,841	—
Underwriting and other expenses	271,314	309,610	290,858
Reinsurance fee (note 9)	1,781	—	—
Interest expense (notes 6 and 7)	<u>71,164</u>	<u>41,986</u>	<u>39,348</u>
Total losses and expenses	<u>2,659,255</u>	<u>3,927,860</u>	<u>943,841</u>
(Loss) income before tax and joint ventures	(937,729)	(2,234,654)	525,328
(Credit) provision for income tax (note 12)	(394,329)	(833,977)	130,097
Income (loss) from joint ventures, net of tax (note 10)	<u>24,486</u>	<u>(269,341)</u>	<u>169,508</u>
Net (loss) income	<u>\$ (518,914)</u>	<u>\$ (1,670,018)</u>	<u>\$ 564,739</u>
(Loss) earnings per share (note 13):			
Basic	<u>\$ (4.55)</u>	<u>\$ (20.54)</u>	<u>\$ 6.70</u>
Diluted	<u>\$ (4.55)</u>	<u>\$ (20.54)</u>	<u>\$ 6.65</u>
Weighted average common shares outstanding — basic (shares in thousands, note 2)	<u>113,962</u>	<u>81,294</u>	<u>84,332</u>
Weighted average common shares outstanding — diluted (shares in thousands, note 2)	<u>113,962</u>	<u>81,294</u>	<u>84,950</u>
Dividends per share	<u>\$ 0.075</u>	<u>\$ 0.775</u>	<u>\$ 1.000</u>

See accompanying notes to consolidated financial statements.

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
December 31, 2008 and 2007
(Audited)

Consolidated Balance Sheets

	<u>2008</u>	<u>2007</u>
	<u>(In thousands of dollars)</u>	
ASSETS		
Investment portfolio (note 4):		
Securities, available-for-sale, at fair value:		
Fixed maturities (amortized cost, 2008-\$7,120,690; 2007-\$5,791,562) . .	\$7,042,903	\$ 5,893,591
Equity securities (cost, 2008-\$2,778; 2007-\$2,689)	<u>2,633</u>	<u>2,642</u>
Total investment portfolio	7,045,536	5,896,233
Cash and cash equivalents	1,097,334	288,933
Accrued investment income	90,856	72,829
Reinsurance recoverable on loss reserves (note 9)	232,988	35,244
Prepaid reinsurance premiums (note 9)	4,416	8,715
Premiums receivable	97,601	107,333
Home office and equipment, net	32,255	34,603
Deferred insurance policy acquisition costs	11,504	11,168
Investments in joint ventures (note 10)	—	143,694
Income taxes recoverable	406,568	865,665
Other assets	<u>163,771</u>	<u>251,944</u>
Total assets	<u>\$9,182,829</u>	<u>\$ 7,716,361</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Loss reserves (notes 8 and 9)	\$4,775,552	\$ 2,642,479
Premium deficiency reserves (note 8)	454,336	1,210,841
Unearned premiums (note 9)	336,098	272,233
Short- and long-term debt (note 6)	698,446	798,250
Convertible debentures (note 7)	375,593	—
Other liabilities	<u>175,604</u>	<u>198,215</u>
Total liabilities	<u>6,815,629</u>	<u>5,122,018</u>
Contingencies (note 15)		
Shareholders' equity (note 13):		
Common stock, \$1 par value, shares authorized 460,000,000; shares issued 2008 — 130,118,744; 2007 — 123,067,426 outstanding 2008 — 125,068,350; 2007 — 81,793,185	130,119	123,067
Paid-in capital	367,067	316,649
Treasury stock (shares at cost 2008 — 5,050,394; 2007 — 41,274,241) . . .	(276,873)	(2,266,364)
Accumulated other comprehensive (loss) income, net of tax (note 2)	(106,789)	70,675
Retained earnings	<u>2,253,676</u>	<u>4,350,316</u>
Total shareholders' equity	<u>2,367,200</u>	<u>2,594,343</u>
Total liabilities and shareholders' equity	<u>\$9,182,829</u>	<u>\$ 7,716,361</u>

See accompanying notes to consolidated financial statements.

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
Years Ended December 31, 2008, 2007 and 2006
(Audited)

Consolidated Statements of Shareholders' Equity

	Common Stock	Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income (Loss) (Note 2)	Retained Earnings	Comprehensive Income (Loss)
	(In thousands of dollars)					
Balance, December 31, 2005	\$122,549	\$280,052	\$(1,834,434)	\$ 77,499	\$ 5,519,389	
Net income	—	—	—	—	564,739	\$ 564,739
Change in unrealized investment gains and losses, net	—	—	—	5,796	—	5,796
Unrealized gain (loss) on derivatives, net	—	—	—	777	—	777
Dividends declared	—	—	—	—	(85,497)	
Common stock shares issued	480	24,386	—	—	—	
Repurchase of outstanding common shares	—	—	(385,629)	—	—	
Reissuance of treasury stock	—	(25,074)	18,097	—	—	
Equity compensation	—	31,030	—	—	—	
Defined benefit plan adjustments, net . .	—	—	—	(17,786)	—	
Other	—	—	—	(497)	—	(497)
Comprehensive income	—	—	—	—	—	<u>\$ 570,815</u>
Balance, December 31, 2006	\$123,029	\$310,394	\$(2,201,966)	\$ 65,789	\$ 5,998,631	
Net loss	—	—	—	—	(1,670,018)	\$(1,670,018)
Change in unrealized investment gains and losses, net	—	—	—	(17,767)	—	(17,767)
Dividends declared	—	—	—	—	(63,819)	
Common stock shares issued	38	2,205	—	—	—	
Repurchase of outstanding common shares	—	—	(75,659)	—	—	
Reissuance of treasury stock	—	(14,187)	11,261	—	—	
Equity compensation	—	18,237	—	—	—	
Defined benefit plan adjustments, net . .	—	—	—	14,561	—	14,561
Change in the liability for unrecognized tax benefits	—	—	—	—	85,522	
Unrealized foreign currency translation adjustment	—	—	—	8,456	—	8,456
Other	—	—	—	(364)	—	(364)
Comprehensive loss	—	—	—	—	—	<u>\$(1,665,132)</u>
Balance, December 31, 2007	\$123,067	\$316,649	\$(2,266,364)	\$ 70,675	\$ 4,350,316	
Net loss	—	—	—	—	(518,914)	(518,914)
Change in unrealized investment gains and losses, net (note 4)	—	—	—	(116,939)	—	(116,939)
Dividends declared (note 13)	—	—	—	—	(8,159)	
Common stock shares issued(13)	7,052	68,706	—	—	—	
Reissuance of treasury stock(13)	—	(41,686)	1,989,491	—	(1,569,567)	
Equity compensation (note 13)	—	20,562	—	—	—	
Defined benefit plan adjustments, net (note 11)	—	—	—	(44,649)	—	(44,649)
Unrealized foreign currency translation adjustment	—	—	—	(16,354)	—	(16,354)
Other	—	2,836	—	478	—	478
Comprehensive loss	—	—	—	—	—	<u>\$ (696,378)</u>
Balance, December 31, 2008	<u>\$130,119</u>	<u>\$367,067</u>	<u>\$ (276,873)</u>	<u>\$ (106,789)</u>	<u>\$ 2,253,676</u>	

See accompanying notes to consolidated financial statements.

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
Years Ended December 31, 2008, 2007 and 2006
(Audited)

Consolidated Statements of Cash Flows

	2008	2007	2006
	(In thousands of dollars)		
Cash flows from operating activities:			
Net (loss) income	\$ (518,914)	\$(1,670,018)	\$ 564,739
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of deferred insurance policy acquisition costs	10,024	12,922	14,202
Capitalized deferred insurance policy acquisition costs	(10,360)	(11,321)	(8,555)
Depreciation and other amortization	34,304	25,177	22,317
(Increase) decrease in accrued investment income	(18,027)	(8,183)	1,723
(Increase) decrease in reinsurance recoverable on loss reserves	(197,744)	(21,827)	1,370
Decrease (increase) in prepaid reinsurance premiums	4,299	905	(12)
Decrease (increase) in premium receivable	9,732	(19,262)	3,476
Decrease (increase) in real estate acquired	112,340	(25,992)	(44,652)
Increase in loss reserves	2,133,073	1,516,764	1,261
(Decrease) increase in premium deficiency reserve	(756,505)	1,210,841	—
Increase in unearned premiums	63,865	82,572	29,838
Decrease (increase) in income taxes recoverable	459,097	(814,624)	(32,465)
Equity (earnings) losses from joint ventures	(33,794)	424,346	(249,473)
Distributions from joint ventures	22,195	51,512	150,549
Realized loss (gain)	12,486	(142,195)	4,264
Other	38,837	20,354	37,215
Net cash provided by operating activities	<u>1,364,908</u>	<u>631,971</u>	<u>495,797</u>
Cash flows from investing activities:			
Purchase of equity securities	(89)	(95)	(90)
Purchase of fixed maturities	(3,592,600)	(2,721,294)	(1,841,293)
Additional investment in joint ventures	(546)	(3,903)	(75,948)
Sale of investment in joint ventures	150,316	240,800	—
Note receivable from joint ventures	—	(50,000)	—
Proceeds from sale of fixed maturities	1,724,780	1,690,557	1,563,889
Proceeds from maturity of fixed maturities	413,328	331,427	311,604
Other	19,547	(1,262)	1,881
Net cash used in investing activities	<u>(1,285,264)</u>	<u>(513,770)</u>	<u>(39,957)</u>
Cash flows from financing activities:			
Dividends paid to shareholders	(8,159)	(63,819)	(85,495)
(Repayment of) proceeds from note payable	(100,000)	300,000	—
Proceeds from issuance of long-term debt	—	—	199,958
Repayment of long-term debt	—	(200,000)	—
Repayment of short-term debt	—	(87,110)	(110,908)
Net proceeds from convertible debentures	377,199	—	—
Proceeds from reissuance of treasury stock	383,959	1,484	1,677
Payments for repurchase of common stock	—	(75,659)	(385,629)
Common stock shares issued	75,758	2,098	18,100
Excess tax benefits from share-based payment arrangements	—	—	4,939
Net cash provided by (used in) financing activities	<u>728,757</u>	<u>(123,006)</u>	<u>(357,358)</u>
Net increase (decrease) in cash and cash equivalents	808,401	(4,805)	98,482
Cash and cash equivalents at beginning of year	288,933	293,738	195,256
Cash and cash equivalents at end of year	<u>\$ 1,097,334</u>	<u>\$ 288,933</u>	<u>\$ 293,738</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”) 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. In 2007, we began providing mortgage insurance to lenders in Australia. Our Australian operations are included in our consolidated financial statements; however they are not material to our consolidated results. 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. Our principal product is primary mortgage insurance. Primary mortgage insurance may be written through the flow market channel, in which loans are insured in individual, loan-by-loan transactions. Primary mortgage insurance may also be written through the bulk market 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 expect any future business written through the bulk channel will be insignificant to us. Prior to 2009, we also wrote pool mortgage insurance. We do not expect we will write any significant pool mortgage insurance in the future.

At December 31, 2008, our direct domestic primary insurance in force (representing the principal balance in our records of all mortgage loans that we insure) and direct domestic primary risk in force (representing the insurance in force multiplied by the insurance coverage percentage) was approximately \$227.0 billion and \$59.0 billion, respectively. Our direct pool risk in force at December 31, 2008 was approximately \$1.9 billion. Our risk in force in Australia at December 31, 2008 was approximately \$1.0 billion; this represents the risk associated with 100% coverage on the insurance in force. However the mortgage insurance we provide in Australia only covers the unpaid loan balance after the sale of the underlying property. In view of our need to dedicate capital to our domestic mortgage insurance operations, we have been exploring alternatives for our Australian activities which may include a sale of our Australian operations. As a result, we have reduced our Australian headcount and suspended writing new business in Australia. We do not expect to write new business in Australia unless required in connection with an agreed upon sale of this business.

Historically a significant portion of the mortgage insurance provided by us through the bulk channel has been used as a credit enhancement for securitizations. During the fourth quarter of 2007, the performance of loans included in Wall Street bulk transactions deteriorated materially 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 channel. Therefore, during the fourth quarter of 2007, we decided to stop writing that portion of our bulk business. A Wall Street bulk transaction is any bulk transaction where we had knowledge that the loans would serve as collateral in a home equity securitization. In general, loans included in Wall Street bulk transactions had lower average FICO scores and a higher percentage of ARMs or adjustable rate mortgages, compared to our remaining business. We continue to provide mortgage insurance on bulk transactions with the GSEs or for portfolio transactions where the lender will hold the loans.

2. Basis of presentation and summary of significant accounting policies

The accompanying financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America (GAAP). 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.

Notes (continued)

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. Historically, our investments in joint ventures and related loss or income from joint ventures principally consisted of our investment and related earnings in two less than majority owned joint ventures, Credit-Based Asset Servicing and Securitization LLC (C-BASS), and Sherman Financial Group LLC (Sherman). In 2007, joint venture losses included an impairment charge equal to our entire equity interest in C-BASS, as well as equity losses incurred by C-BASS in the fourth quarter that reduced the carrying value of our \$50 million note from C-BASS to zero. As a result, beginning in 2008, our joint venture income principally consisted of income from Sherman. In August of 2008, we sold our entire interest in Sherman to Sherman. We review our investments in joint ventures for evidence of “other than temporary” impairments, such as an inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment. There were no “other than temporary” equity investment impairment charges for the years ending December 31, 2008 and 2006. Our equity in the earnings of joint ventures is shown separately, net of tax, on the statement of operations. (See note 10.)

Fair Value Measurements

Effective January 1, 2008, we adopted the fair value measurement provisions of SFAS No. 157, “Fair Value Measurements.” SFAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities. This statement defines fair value, expands disclosure requirements about fair value and specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect a company’s market assumptions. Fair value is used on a recurring basis for assets and liabilities in which fair value is the primary basis of accounting (i.e., available-for-sale securities). Additionally, fair value is used on a nonrecurring basis to evaluate assets or liabilities for impairment or for disclosure purposes.

Fair value is defined as the price that would be received in a sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, we use various valuation techniques and assumptions when estimating fair value. In accordance with SFAS No. 157, 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 include certain U.S. Treasury securities and obligations of the U.S. government.
- 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 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, corporate, auction rate (backed by student loans) and mortgage-backed securities. Non-financial assets which utilize Level 3 inputs include real estate acquired through claim settlement. Additionally, financial liabilities utilizing Level 3 inputs consist of derivative financial instruments.

The adoption of SFAS No. 157 resulted in no changes to January 1, 2008 retained earnings. (See note 5.)

Notes (continued)

Investments

We categorize our investment portfolio according to our ability and intent to hold the investments to maturity. Investments which we do not have the ability and intent to hold to maturity are considered to be available-for-sale and are reported at fair value and 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. Our entire investment portfolio is classified as available-for-sale. Realized investment gains and losses are reported in income based upon specific identification of securities sold. (See note 4.)

We complete a quarterly review of invested assets for evidence of "other than temporary" impairments. A cost basis adjustment and realized loss will be taken on invested assets whose value decline is deemed to be "other than temporary". Factors used in determining investments whose value decline may be considered "other than temporary" include, among others, the following:

- Investments with a fair value less than 80% of amortized costs
- For fixed income and preferred stocks, declines in credit ratings to below investment grade from appropriate rating agencies
- Other securities which are under pressure due to market constraints or event risk
- Intention and ability to hold fixed income securities to recovery
- Length of time in an unrealized loss position

Fair Value Option

In conjunction with the adoption of SFAS No. 157, we have adopted SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement provides companies with an option to report selected financial assets and liabilities at fair value on an instrument-by-instrument basis. After the initial adoption, the election to report a financial asset or liability at fair value is made at the time of acquisition and it generally may not be revoked. The objective of this statement is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The adoption of SFAS No. 159 resulted in no changes to January 1, 2008 retained earnings as we elected not to apply the fair value option to financial instruments not currently carried at fair value.

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 \$56.3 million, \$51.7 million and \$47.6 million at December 31, 2008, 2007 and 2006, respectively. Depreciation expense for the years ended December 31, 2008, 2007 and 2006 was \$4.5 million, \$4.4 million and \$4.4 million, respectively.

Deferred insurance policy acquisition costs

Costs associated with the 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 book 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

Notes (continued)

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.

During 2008, 2007 and 2006, we amortized \$10.0 million, \$12.9 million and \$14.2 million, respectively, of deferred insurance policy acquisition costs.

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. 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 to us. In accordance with GAAP for the mortgage insurance industry, we do not establish loss reserves for future claims on insured loans which are not currently in default. Loss reserves are established by our estimate of the number of loans in our inventory of delinquent loans that will not cure their delinquency and thus result in a claim, which is referred to as the claim rate, and further estimating the amount that we will pay in claims on the loans that do not cure, which is referred to as claim severity. Our loss estimates are established based upon historical experience. Amounts for salvage recoverable are considered in the determination of the reserve estimates. 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 claims rates and claims amounts for the estimated number of defaults not reported.

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 8.)

Premium deficiency reserves

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 December 31, 2008 and 2007, respectively. 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 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 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. Assumptions used in calculating the deficiency reserves can be affected by volatility in the current housing and mortgage lending industries and these affects 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 8.)

Notes (continued)

Revenue recognition

Our insurance subsidiaries write policies which are guaranteed renewable contracts at the insured's option on a single, annual or monthly premium basis. The insurance subsidiaries 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 and will have no effect on earned premium. 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.

Income taxes

We file a consolidated federal income tax return with our domestic subsidiaries. Our foreign subsidiaries file separate tax returns in their respective jurisdictions. A formal tax sharing agreement exists between us and our domestic subsidiaries. Each subsidiary determines income taxes based upon the utilization of all tax deferral elections available. This assumes tax and loss bonds are purchased and held to the extent they would have been purchased and held on a separate company basis since the tax sharing agreement provides that the redemption or non-purchase of such bonds shall not increase such member's separate taxable income and tax liability on a separate company basis.

Federal tax law permits mortgage guaranty insurance companies to deduct from taxable income, subject to certain limitations, the amounts added to contingency loss reserves, which are recorded for regulatory purposes. Generally, the amounts so deducted must be included in taxable income in the tenth subsequent year. However, to the extent incurred losses exceed 35% of net premiums earned in a calendar year, early withdrawals may be made from the contingency reserves with regulatory approval, which would lead to amounts being included in taxable income earlier than the tenth year. The deduction is allowed only to the extent that U.S. government non-interest bearing tax and loss bonds are purchased and held in an amount equal to the tax benefit attributable to such deduction. We account for these purchases as a payment of current federal 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 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 upon examination of taxing authorities. (See note 12.)

Benefit plans

We have a non-contributory defined benefit pension plan covering substantially all domestic 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.

Notes (continued)

We offer both medical and dental benefits for retired domestic employees and their spouses. Under the plan retirees pay a premium for these benefits. In October 2008 we amended our postretirement benefit plan. The amendment, which is effective January 1, 2009, terminates the benefits provided to retirees once they reach the age of 65. This amendment reduces our accumulated postretirement benefit obligation by \$59.2 million as of December 31, 2008. The amendment will also reduce our net periodic benefit cost in future periods beginning with calendar year 2009. We accrue the estimated costs of retiree medical and life benefits over the period during which employees render the service that qualifies them for benefits. Historically benefits were generally funded as they were due. The cost to us has not been significant. In 2008, approximately \$1.3 million benefits were paid from the fund, and approximately \$0.5 million were funded by us. (See note 11.)

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 reflected as "Prepaid reinsurance premiums". We remain liable for all reinsurance ceded. (See note 9.)

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

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment," under the modified prospective method. This statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". The fair value recognition provisions of SFAS No. 123 were voluntarily adopted by us in 2003 prospectively to all employee awards granted or modified on or after January 1, 2003. Under SFAS 123R, we are required to record compensation expense for all awards granted after the date of adoption and for all the unvested portion of previously granted awards that remained outstanding at the date of adoption. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period which generally corresponds to the vesting period. Awards under our plans generally vest over periods ranging from one to five years. (See note 13.)

Earnings per share

Our basic and diluted earnings per share ("EPS") have been calculated in accordance with SFAS No. 128, "Earnings Per Share". Basic EPS is based on the weighted average number of common shares outstanding. Typically, diluted EPS is based on the weighted average number of common shares outstanding plus common stock equivalents which include stock awards, stock options and the dilutive effect of our convertible debentures. In accordance with SFAS 128, if we report a net loss from continuing operations then our diluted EPS is computed in the same manner as the basic EPS. For the years ended December 31, 2008, 2007 and 2006 our net loss (income) is the same for both basic and diluted EPS. The following is a reconciliation of the weighted average number of shares; however for the years ended December 31, 2008 and 2007 common stock equivalents of 23.1 million and 0.3 million, respectively, were not included because they were anti-dilutive. For 2008 the 23.1 million of common stock equivalents includes 22.7 million share equivalents related to our

Notes (continued)

convertible debentures and 0.4 million related to restricted shares or share units. For 2007 the 0.3 million of common stock equivalents related to restricted shares or share units.

	Years Ended December 31,		
	2008	2007	2006
	(Shares in Thousands)		
Weighted-average shares — Basic	113,692	81,294	84,332
Common stock equivalents	—	—	618
Weighted-average shares — Diluted	<u>113,692</u>	<u>81,294</u>	<u>84,950</u>

For the years ended December 31, 2008 and 2007, 2.5 million shares and 2.6 million shares, respectively, attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive. For the year ended December 31, 2006, 1.3 million shares attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the exercise prices of the stock options were greater than or equal to the average price of the common shares, and therefore their inclusion would have been anti-dilutive and 0.4 million shares of performance stock awards have been excluded from the calculation of diluted earnings per share because the number of shares ultimately issued is contingent on performance measures established for a specific performance period. (See note 13.)

Comprehensive income

Our total comprehensive income, as calculated per SFAS No. 130, "Reporting Comprehensive Income", was as follows:

	Years Ended December 31,		
	2008	2007	2006
	(In thousands of dollars)		
Net (loss) income	\$(518,914)	\$(1,670,018)	\$564,739
Other comprehensive (loss) income	<u>(177,464)</u>	<u>4,886</u>	<u>6,076</u>
Total comprehensive (loss) income	<u>\$(696,378)</u>	<u>\$(1,665,132)</u>	<u>\$570,815</u>
Other comprehensive (loss) income (net of tax):			
Change in unrealized net derivative gains and losses	\$ —	\$ —	\$ 777
Change in unrealized gains and losses on investments	(116,939)	(17,767)	5,796
Change related to benefit plans	(44,649)	14,561	—
Unrealized foreign currency translation adjustment	(16,354)	8,456	—
Other	<u>478</u>	<u>(364)</u>	<u>(497)</u>
Other comprehensive (loss) income	<u>\$(177,464)</u>	<u>\$ 4,886</u>	<u>\$ 6,076</u>

At December 31, 2008, accumulated other comprehensive loss of (\$106.8) million included (\$51.0) million of net unrealized losses on investments, (\$47.9) million relating to defined benefit plans and (\$7.9) million related to foreign currency translation adjustment. At December 31, 2007, accumulated other comprehensive income of \$70.7 million included \$65.9 million of net unrealized gains on investments, (\$3.2) million relating to defined benefit plans, \$8.5 million related to foreign currency translation adjustment and (\$0.5) million relating to the accumulated other comprehensive loss of our joint venture investment. (See notes 4 and 11.)

Notes (continued)

Recent accounting pronouncements

In December 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) 132R-1 which amends FASB Statement No. 132R, "Employers' Disclosures about Pensions and Other Postretirement Benefits", to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. The FSP is effective for fiscal years ending after December 15, 2009. We are currently evaluating the provisions of this statement and the impact, if any, this statement will have on our disclosures.

In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active." The FSP clarifies the application of FASB Statement No. 157, "Fair Value Measurements" in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. Our fair value policies are consistent with the guidance in this FSP.

In June 2008, the FASB issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." This FSP clarifies that share-based payment awards that entitle holders to receive nonforfeitable dividends before vesting should be considered participating securities. As participating securities, these instruments should be included in the calculation of basic earnings per share. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. We are currently evaluating the provisions of this FSP and do not believe it will have a material impact on our calculations of basic and diluted earnings per share.

In May 2008, the FASB issued FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)." FSP APB 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008 on a retroactive basis. The adoption will result in a net-of-tax increase to our shareholders' equity of approximately \$63 million on January 1, 2009 and will result in a net-of-tax increase to interest expense of approximately \$11 million for the year ended December 31, 2008 and \$15 million annually thereafter, through April 1, 2013. These increases result from our Convertible Junior Subordinated Debentures discussed in Note 7.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities." The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the provisions of this statement and the impact, if any, this statement will have on our disclosures.

In February 2008, the FASB issued FSP FAS 157-2, "Effective date of FASB Statement No. 157". This statement defers the effective date of FAS 157 for all non-financial assets and non-financial liabilities measured on a non-recurring basis to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. We are currently evaluating the requirements of this statement and the impact, if any, this statement will have on our financial position and results of operations.

Cash and cash equivalents

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

Notes (continued)

Reclassifications

Certain reclassifications have been made in the accompanying financial statements to 2007 and 2006 amounts to allow for consistent financial reporting.

3. Related party transactions

We provided certain services to C-BASS and Sherman in 2007 and 2006 in exchange for fees. In addition, C-BASS provided certain services to us during 2008, 2007 and 2006 in exchange for fees. The net impact of these transactions was not material to us.

4. Investments

The amortized cost, gross unrealized gains and losses and fair value of the investment portfolio at December 31, 2008 and 2007 are shown below. Debt securities consist of fixed maturities and short-term investments.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands of dollars)			
December 31, 2008:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 168,917	\$ 21,297	\$ (405)	\$ 189,809
Obligations of U.S. states and political subdivisions	6,401,903	141,612	(237,575)	6,305,940
Corporate debt securities	314,648	6,278	(4,253)	316,673
Mortgage-backed securities	151,774	3,307	(14,251)	140,830
Debt securities issued by foreign sovereign governments	83,448	6,203	—	89,651
Total debt securities	7,120,690	178,697	(256,484)	7,042,903
Equity securities	2,778	—	(145)	2,633
Total investment portfolio	\$7,123,468	\$178,697	\$(256,629)	\$7,045,536

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands of dollars)			
December 31, 2007:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 128,708	\$ 3,462	\$ (804)	\$ 131,366
Obligations of U.S. states and political subdivisions	4,958,994	132,094	(26,109)	5,064,979
Corporate debt securities	449,380	4,625	(8,206)	445,799
Mortgage-backed securities	164,974	1,118	(1,486)	164,606
Debt securities issued by foreign sovereign governments	89,506	57	(2,722)	86,841
Total debt securities	5,791,562	141,356	(39,327)	5,893,591
Equity securities	2,689	1	(48)	2,642
Total investment portfolio	\$5,794,251	\$141,357	\$(39,375)	\$5,896,233

Notes (continued)

The amortized cost and fair values of debt securities at December 31, 2008, 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.

	Amortized Cost	Fair Value
(In thousands of dollars)		
Due in one year or less	\$ 432,727	\$ 435,045
Due after one year through five years	1,606,915	1,630,086
Due after five years through ten years	1,230,379	1,283,317
Due after ten years	3,174,995	3,029,725
	6,445,016	6,378,173
Auction rate securities	523,900	523,900
Mortgage-backed securities	151,774	140,830
Total at December 31, 2008	\$7,120,690	\$7,042,903

At December 31, 2008 and 2007, the investment portfolio had gross unrealized losses of \$256.6 million and \$39.4 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:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands of dollars)						
December 31, 2008						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 13,106	\$ 245	\$ 1,242	\$ 160	\$ 14,348	\$ 405
Obligations of U.S. states and political subdivisions	1,640,406	102,437	552,191	135,138	2,192,597	237,575
Corporate debt securities	72,711	4,127	1,677	126	74,388	4,253
Mortgage-backed securities	41,867	14,251	—	—	41,867	14,251
Debt issued by foreign sovereign governments	—	—	—	—	—	—
Equity securities	227	10	2,062	135	2,289	145
Total investment portfolio	\$1,768,317	\$121,070	\$557,172	\$135,559	\$2,325,489	\$256,629

Notes (continued)

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands of dollars)						
December 31, 2007						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 14,453	\$ 569	\$ 24,937	\$ 235	\$ 39,390	\$ 804
Obligations of U.S. states and political subdivisions	829,595	23,368	206,723	2,741	1,036,318	26,109
Corporate debt securities	70,347	8,197	2,701	9	73,048	8,206
Mortgage-backed securities	15,401	64	96,167	1,422	111,568	1,486
Debt issued by foreign sovereign governments	82,835	2,722	—	—	82,835	2,722
Equity securities	110	1	2,166	47	2,276	48
Total investment portfolio	<u>\$1,012,741</u>	<u>\$34,921</u>	<u>\$332,694</u>	<u>\$4,454</u>	<u>\$1,345,435</u>	<u>\$39,375</u>

Our investment portfolio consists primarily of tax-exempt municipal bonds. During 2008, the municipal bond market experienced historically poor performance, and resulted in approximately one-third of our securities (580 issues) being in an unrealized loss position as of December 31, 2008. The unrealized losses in all categories of our investments were primarily caused by widening spreads. Of those securities in an unrealized loss position greater than 12 months, 101 securities had a fair value greater than 80% of amortized cost and 65 securities had a fair value less than 80% of amortized cost. We do not believe the unrealized losses are related to specific issuer defaults and because we have the ability and intent to hold those investments until a recovery of fair value, which may be maturity, we do not consider those investments to be other-than-temporarily impaired at December 31, 2008.

For the year ended December 31, 2008 we recognized “other than temporary” impairment charges of approximately \$63 million on our fixed income investments, including debt instruments issued by Fannie Mae, Freddie Mac, Lehman Brothers and AIG. There were no “other than temporary” asset impairment charges on our investment portfolio for the years ending December 31, 2007 and 2006.

We held approximately \$524 million in auction rate securities (ARS) backed by student loans at December 31, 2008. ARS are intended to behave like short-term debt instruments because their interest rates are reset periodically through an auction process, most commonly at intervals of 7, 28 and 35 days. The same auction process has historically provided a means by which we may rollover the investment or sell these securities at par in order to provide us with liquidity as needed. The ARS we hold are collateralized by portfolios of student loans, all of which are ultimately guaranteed by the United States Department of Education. At December 31, 2008, our ARS portfolio was 100% AAA/Aaa-rated by one or more of the following major rating agencies: Moody’s, Standard & Poor’s and Fitch Ratings.

In mid-February 2008, auctions began to fail due to insufficient buyers, as the amount of securities submitted for sale in auctions exceeded the aggregate amount of the bids. For each failed auction, the interest rate on the security moves to a maximum rate specified for each security, and generally resets at a level higher than specified short-term interest rate benchmarks. At December 31, 2008, our entire ARS portfolio, consisting of 47 investments in ARS, was subject to failed auctions; however, we had redeemed at par \$16.7 million in ARS from the period when the auctions began to fail through the end of 2008. Subsequent to December 31, 2008, and through January 27, 2009, we redeemed an additional \$2.0 million in ARS at par. To date, we have collected all interest due on our ARS and expect to continue to do so in the future.

As a result of the persistent failed auctions, and the uncertainty of when these investments could be liquidated at par, the investment principal associated with failed auctions will not be accessible until successful auctions occur, a buyer is found outside of the auction process, the issuers establish a different form of

Notes (continued)

financing to replace these securities, or final payments come due according to the contractual maturities of the debt issues. We believe that issuers and financial markets are exploring alternatives that may improve liquidity, although it is not yet clear when or if such efforts will be successful. We intend to hold our ARS until we can recover the full principal amount through one of the means described above, and have the ability to do so based on our other sources of liquidity.

We evaluated our entire ARS portfolio for temporary or other-than-temporary impairment at December 31, 2008. As a result of this review, we determined that the fair value of our ARS portfolio at December 31, 2008, approximates par value, and accordingly, we have not recorded any impairment. Since the estimated fair values could change significantly based on future market conditions, we will continue to assess the fair value of our ARS for substantive changes in relevant market conditions or other changes that may alter our estimates described above. We may be required to record an unrealized holding loss or an impairment charge to earnings if we determine that our investment portfolio has incurred a decline in fair value that is temporary or other-than-temporary, respectively.

Net investment income is comprised of the following:

	2008	2007	2006
	(In thousands of dollars)		
Fixed maturities	\$287,869	\$244,126	\$228,805
Equity securities	2,162	391	1,598
Cash equivalents	15,487	15,900	11,535
Other	6,552	2,675	1,872
Investment income	312,070	263,092	243,810
Investment expenses	(3,553)	(3,264)	(3,189)
Net investment income	\$308,517	\$259,828	\$240,621

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

	2008	2007	2006
	(In thousands of dollars)		
Net realized investment gains (losses) on investments:			
Fixed maturities	\$ (76,397)	\$ (18,575)	\$ (5,526)
Equity securities	107	(820)	1,262
Joint ventures	61,877	162,860	—
Other	1,927	(1,270)	—
	\$ (12,486)	\$142,195	\$(4,264)
Change in net unrealized appreciation (depreciation):			
Fixed maturities	\$(179,816)	\$ (26,751)	\$ 8,929
Equity securities	(98)	(21)	(10)
Other	(710)	(254)	—
	\$(180,624)	\$ (27,026)	\$ 8,919

Notes (continued)

The reclassification adjustment relating to the change in investment gains and losses is as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(In thousands of dollars)		
Unrealized holding (losses) gains arising during the period, net of tax	\$ (75,464)	\$ (4,633)	\$ 8,833
Less: reclassification adjustment for net gains included in net income, net of tax	<u>(41,475)</u>	<u>(13,134)</u>	<u>(3,037)</u>
Change in unrealized investment gains and losses, net of tax	<u><u>\$ (116,939)</u></u>	<u><u>\$ (17,767)</u></u>	<u><u>\$ 5,796</u></u>

The gross realized gains and the gross realized losses on securities were \$22.5 million and \$96.9 million, respectively, in 2008, \$7.1 million and \$27.8 million, respectively, in 2007 and \$2.9 million and \$7.2 million, respectively, in 2006.

The tax (benefit) expense related to the changes in net unrealized (depreciation) appreciation was (\$63.7) million, (\$9.3) million and \$3.1 million for 2008, 2007 and 2006, respectively.

We had \$22.9 million and \$21.5 million of investments on deposit with various states at December 31, 2008 and 2007, respectively, due to regulatory requirements of those state insurance departments.

5. Fair value measurements

As discussed in Note 2, we adopted SFAS No. 157 and SFAS No. 159 effective January 1, 2008. Both standards address aspects of the expanding application of fair-value accounting. SFAS No. 157 defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements regarding fair-value measurements. SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value with changes in fair value reported in earnings. The option to account for selected financial assets and liabilities at fair value is made on an instrument-by-instrument basis at the time of acquisition. For the year ended December 31, 2008, 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 SFAS No. 157, 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 include certain U.S. Treasury securities and obligations of the U.S. government.

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 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, corporate, auction rate (backed by student loans) and mortgage-backed securities. Non-financial assets which utilize Level 3 inputs include real estate acquired through claim settlement. Additionally, financial liabilities utilizing Level 3 inputs consisted of derivative financial instruments.

To determine the fair value of securities available-for-sale in Level 1 and Level 2 of the fair value hierarchy 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

Notes (continued)

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.

The values generated by this model are also reviewed for reasonableness and, in some cases, further analyzed for accuracy, which includes the review of other publicly available information. Securities whose fair value is primarily based on the use of our multidimensional pricing model are classified in Level 2 and include certain municipal and corporate bonds.

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. Our investments in auction rate securities were classified as Level 3 beginning in the fourth quarter of 2008 as quoted prices were unavailable due to events described in Note 4 and as there became increased doubt as to the liquidity of the securities. In particular, announced settlements in the fourth quarter of 2008 specified that re-marketers of the ARS provide liquidity to retail investors prior to providing liquidity to institutional investors and we did not observe a majority of issuers replacing these securities with another form of financing. Due to limited market information, we utilized a discounted cash flow (“DCF”) model to derive an estimate of fair value at December 31, 2008. The assumptions used in preparing the DCF model included estimates with respect to the amount and timing of future interest and principal payments, the probability of full repayment of the principal considering the credit quality and guarantees in place, and the rate of return required by investors to own such securities given the current liquidity risk associated with auction rate securities. The DCF model is based on the following key assumptions.
 - Nominal credit risk as securities are ultimately guaranteed by the United States Department of Education
 - 5 years to liquidity
 - Continued receipt of contractual interest; and
 - Discount rates incorporating a 1.50% spread for liquidity risk

The remainder of our level 3 securities are valued based on the present value of expected cash flows utilizing data provided by the 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.
- As discussed in Note 7 the derivative related to the outstanding debentures was valued using the Black-Scholes model. Remaining derivatives were valued internally, based on the present value of expected cash flows utilizing data provided by the trustees.

Notes (continued)

Fair value measurements for items measured at fair value included the following as of December 31, 2008 (in thousands of dollars):

	<u>Total</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>
Assets				
Securities available-for-sale	\$7,045,536	\$281,248	\$6,218,338	\$545,950
Real estate acquired(1)	32,858	—	—	32,858
Liabilities				
Other liabilities (derivatives)	\$ —	\$ —	\$ —	\$ —

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

For assets and liabilities measured at fair value using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances for the year ended December 31, 2008 is as follows (in thousands of dollars):

	<u>Securities Available- for-Sale</u>	<u>Real Estate Acquired</u>	<u>Other Liabilities</u>
Balance at January 1, 2008	\$ 37,195	\$145,198	\$(12,132)
Total realized/unrealized gains (losses):			
Included in earnings and reported as realized investment gains (losses), net	(20,226)	—	—
Included in earnings and reported as other revenue	—	—	(6,823)
Included in earnings and reported as losses incurred, net	—	(19,126)	—
Included in other comprehensive income	2,455	—	—
Purchases, issuances and settlements	2,626	(93,214)	18,955
Transfers in/and or out of Level 3	<u>523,900</u>	<u>—</u>	<u>—</u>
Balance at December 31, 2008	<u>\$545,950</u>	<u>\$ 32,858</u>	<u>\$ —</u>
Amount of total gains (losses) included in earnings for the year ended			
December 31, 2008 attributable to the change in unrealized gains (losses) on assets (liabilities) still held at December 31, 2008	<u>\$ (16,838)</u>	<u>\$ (8,011)</u>	<u>\$ —</u>

Additional fair value disclosures related to our investment portfolio are included in Note 4. Fair value disclosures related to our debt are included in Notes 6 and 7.

6. Short- and long-term debt, excluding convertible debentures discussed in Note 7.

We have a \$300 million bank revolving credit facility, expiring in March 2010 that was amended most recently in June 2008. In 2007, we drew the entire amount available under this facility. In July 2008, we repaid \$100 million borrowed under this facility. The amount that we repaid remains available for re-borrowing pursuant to the terms of our credit agreement. At December 31, 2008 and 2007, \$200 million and \$300 million, respectively, was outstanding under this facility.

The credit facility requires us to maintain Consolidated Net Worth of no less than \$2.00 billion at all times. However, if as of June 30, 2009, Consolidated Net Worth equals or exceeds \$2.75 billion, then the minimum Consolidated Net Worth under the facility will be increased to \$2.25 billion at all times from and after June 30, 2009. Consolidated Net Worth is generally defined in our credit agreement as the sum of our

Notes (continued)

consolidated shareholders' equity plus the aggregate outstanding principal amount of our 9% Convertible Junior Subordinated Debentures due 2063, currently \$390 million. The credit facility also requires Mortgage Guaranty Insurance Corporation ("MGIC") to maintain a statutory risk-to-capital ratio of not more than 22:1 and maintain policyholders' position (which includes MGIC's statutory surplus and its contingency reserve) of not less than the amount required by Wisconsin insurance regulations ("MPP"). At December 31, 2008, these requirements were met. Our Consolidated Net Worth at December 31, 2008 was approximately \$2.7 billion. At December 31, 2008 MGIC's risk-to-capital was 12.9:1 and MGIC exceeded MPP by more than \$1.5 billion. (See note 13 — "Statutory Capital".)

At December 31, 2008 and 2007 we had \$200 million, 5.625% Senior Notes due in September 2011 and \$300 million, 5.375% Senior Notes due in November 2015. 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 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 shareholder's equity of at least 15% of our consolidated shareholders equity.

The credit facility is filed as an exhibit to our March 31, 2005 Quarterly Report on Form 10-Q and the Indenture governing the Senior Notes is filed as an exhibit to our Current Report on Form 8-K filed on October 19, 2000. Amendments to our credit facility were filed as exhibits to our December 31, 2007 10-K/A and to our Current Report on Form 8-K filed on June 25, 2008. At December 31, 2008 and 2007, the fair value of the amount outstanding under the credit facility and Senior Notes was \$538.3 million and \$772.0 million, respectively. The fair value of our credit facility was approximated at par and the fair value of our Senior Notes was determined using publicly available trade information.

Interest payments on all long-term and short-term debt, excluding convertible debentures, were \$40.7 million, \$42.6 million and \$36.5 million for the years ended December 31, 2008, 2007 and 2006, respectively.

If (i) we fail to maintain any of the requirements under the credit facility discussed above, (ii) we fail to make a payment of principal when due under the credit facility or a payment of interest within five days after due under the credit facility or (iii) our payment obligations under our Senior Notes are declared due and payable (including for one of the reasons noted in the following paragraph) and we are not successful in obtaining an agreement from banks holding a majority of the debt outstanding under the facility to change (or waive) the applicable requirement, then banks holding a majority of the debt outstanding under the facility would have the right to declare the entire amount of the outstanding debt due and payable.

If (i) we fail to meet any of the covenants of the Senior Notes discussed above, (ii) we fail to make a payment of principal of the Senior Notes when due or a payment of interest on the Senior Notes within thirty days after due or (iii) the debt under our bank facility is declared due and payable (including for one of the reasons noted in the previous paragraph) and we are not successful in obtaining an agreement from holders of a majority of the applicable series of Senior Notes to change (or waive) the applicable requirement or payment default, then the holders of 25% or more of either series of our Senior Notes each would have the right to accelerate the maturity of that debt. In addition, the Trustee of these two issues of Senior Notes, which is also a lender under our bank credit facility, could, independent of any action by holders of Senior Notes, accelerate the maturity of the Senior Notes.

7. Convertible debentures and related derivatives

In March 2008 we completed the sale of \$365 million principal amount of 9% Convertible Junior Subordinated Debentures due in 2063. The debentures have an effective interest rate of 19% after consideration of the value associated with the convertible feature. In April 2008, the initial purchasers exercised an option to purchase an additional \$25 million aggregate principal amount of these debentures. The debentures

Notes (continued)

were sold in private placements to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. Interest on the debentures is payable semi-annually in arrears on April 1 and October 1 of each year, beginning on October 1, 2008. 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. 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 in Note 6 would not allow the acceleration of amounts that we owe under the debentures. However, violations of the events of default under the Indenture, including a failure to pay principal when due under the debentures and certain events of bankruptcy, insolvency or receivership involving our holding company would allow acceleration of amounts that we owe under the debentures.

The debentures rank junior to all of our existing and future senior indebtedness. The net proceeds of the debentures were approximately \$377 million. A portion of the net proceeds of the debentures and a concurrent offering of common stock (see Note 13) was used to increase the capital of MGIC, our principal insurance subsidiary, in order to enable us to expand the volume of our new insurance written, and a portion is available for our general corporate purposes. Debt issuance costs are being amortized over the expected life of five years to interest expense.

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.

Interest payments on the convertible debentures were \$17.8 million for the year ended December 31, 2008.

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. The initial conversion price represents a 20% conversion premium based on the \$11.25 per share price to the public in our concurrent common stock offering. (See Note 13.)

In lieu of issuing shares of common stock upon conversion of the debentures occurring after April 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.

Our common stock is listed on the New York Stock Exchange, or NYSE. One of the NYSE's rules limits the number of shares of our common stock that the convertible debentures may be converted into to less than 20% of the number of shares outstanding immediately before the issuance of the convertible debentures unless shareholders approve the issuance of the shares that would exceed the limit. We closed a sale of our common stock immediately prior to the sale of the convertible debentures, which resulted in approximately 124.9 million shares of our common stock outstanding prior to the debentures being issued. At the initial conversion rate the outstanding debentures are convertible into approximately 23.1% of our common stock outstanding, 3.9 million

Notes (continued)

shares above the NYSE limit. At a special shareholders' meeting held in June 2008, we received shareholder approval on the issuance of shares of our common stock sufficient to convert all of the convertible debentures.

At issuance approximately \$52.8 million in face value of the convertible debentures could not be settled in our common shares without prior shareholder approval and thus required bifurcation of the embedded derivative related to those convertible debentures. The derivative value of \$16.9 million was determined using the Black-Scholes model, and is treated as a discount on issuance of the convertible debentures and amortized over the expected life of five years to interest expense. Prior to shareholder approval, changes in the fair value of the derivative were reflected in our results of operations. Since the changes in fair value corresponded to changes in our stock price, a decrease in our stock price resulted in a decrease in the derivative liability. On the date of shareholder approval, June 27, 2008, the value of the derivative had decreased to \$5.9 million. On this date the amount was re-classified from a liability to shareholders' equity on the consolidated balance sheet, and subsequent changes in the fair value of the derivative will not be reflected on our financial statements. The change in fair value of the derivative from issuance to shareholder approval of approximately \$11.0 million is included in other revenue on our statement of operations for the year ended December 31, 2008.

The Indenture governing the Convertible Debentures is filed as an exhibit to our March 31, 2008 Quarterly Report on Form 10-Q. The fair value of the convertible debentures was approximately \$145.7 million at December 31, 2008, as determined using available pricing for these debentures or similar instruments.

8. Loss reserves and premium deficiency reserves

Loss reserves

As described in Note 2, we establish reserves to recognize the estimated liability for losses and loss adjustment expenses related to defaults on insured mortgage loans. Loss reserves are established by our estimate of the number of loans in our inventory of delinquent loans that will not cure their delinquency and thus result in a claim, which is referred to as the claim rate, and further estimating the amount that we will pay in claims on the loans that do not cure, which is referred to as claim severity. Estimation of losses that we will pay in the future is inherently judgmental. The conditions that affect the claim rate and claim severity include the current and future state of the domestic economy 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 leading to a reduction in borrowers' income and thus their ability to make mortgage payments, and a drop in housing values that could materially reduce our ability to mitigate potential losses through property acquisition and resale or expose us to greater losses on resale of properties obtained through the claim settlement process. 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 loan instruments, assisting delinquent borrowers and lenders in modifying their mortgage notes into something more affordable, and forestalling foreclosures. In addition private company efforts may have a positive impact on our loss development. However, all of these efforts are in their early stages and therefore we are unsure of their magnitude or the benefit to us or our industry, and as a result are not factored into our current reserving.

Our estimates could also be positively affected by the extent of fraud that we uncover in the loans we have insured; higher rates of fraud should lead to higher rates of rescissions, although the relationship may not be linear. Rescissions and denials totaled \$85 million in the fourth quarter of 2008 and \$171 million for the year ending December 31, 2008. Rescissions and denials totaled only \$7 million in the fourth quarter of 2007 and totaled only \$28 million for the year ended December 31, 2007.

Notes (continued)

The following table provides a reconciliation of beginning and ending loss reserves for each of the past three years:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(In thousands of dollars)		
Reserve at beginning of year	\$2,642,479	\$1,125,715	\$1,124,454
Less reinsurance recoverable	<u>35,244</u>	<u>13,417</u>	<u>14,787</u>
Net reserve at beginning of year	2,607,235	1,112,298	1,109,667
Losses incurred:			
Losses and LAE incurred in respect of default notices received in:			
Current year	2,684,397	1,846,473	703,714
Prior years(1)	<u>387,104</u>	<u>518,950</u>	<u>(90,079)</u>
Subtotal	<u>3,071,501</u>	<u>2,365,423</u>	<u>613,635</u>
Losses paid:			
Losses and LAE paid in respect of default notices received in:			
Current year	68,397	51,535	27,114
Prior years	1,332,579	818,951	583,890
Reinsurance terminations(2)	<u>(264,804)</u>	<u>—</u>	<u>—</u>
Subtotal	<u>1,136,172</u>	<u>870,486</u>	<u>611,004</u>
Net reserve at end of year	4,542,564	2,607,235	1,112,298
Plus reinsurance recoverables	<u>232,988</u>	<u>35,244</u>	<u>13,417</u>
Reserve at end of year	<u>\$4,775,552</u>	<u>\$2,642,479</u>	<u>\$1,125,715</u>

(1) 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.

(2) 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 there is a corresponding decrease in reinsurance recoverable on loss reserves, which is offset by a decrease in net losses paid. (See note 9.)

The top portion of the table above shows losses incurred on default notices received in the current year and in prior years, respectively. 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 actual claim payments that were higher or lower than what we estimated at the end of the prior year, 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 is the result of our review of current trends in 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.

Current year losses incurred significantly increased in 2008 compared to 2007 primarily due to significant increases in the default inventory, offset by a smaller increase in estimated severity and a slight decrease in the estimated claim rate. The continued increase in estimated severity was primarily the result of the default inventory containing higher loan exposures with expected higher average claim payments as well as our inability to mitigate losses through the sale of properties due to home price declines. The increase was less substantial than the increase experienced during 2007. The slight decrease in estimated claim rate for the year was in part due to an increase in our mitigation efforts, including rescissions and denials for misrepresentation, ineligibility and policy exclusions. This decrease in estimated claim rate is based on recent historical

Notes (continued)

experience and does not take into account any potential benefits of third party and governmental mitigation programs that are in their early stages for which we have no data on historical performance. Current year losses incurred significantly increased in 2007 compared to 2006 primarily due to significant increases in the default inventory and estimated severity and claim rate, when each are compared to the same period in 2006. The primary insurance notice inventory increased from 107,120 at December 31, 2007 to 182,188 at December 31, 2008. The primary insurance notice inventory was 78,628 at December 31, 2006. Pool insurance notice inventory increased from 25,224 at December 31, 2007 to 33,884 at December 31, 2008. The pool insurance notice inventory was 20,458 at December 31, 2006. The average primary claim paid for 2008 was \$52,239, compared to \$37,165 in 2007 and \$28,228 in 2006.

The development of the reserves in 2008, 2007 and 2006 is reflected in the prior year line. The \$387.1 million increase in losses incurred in 2008 related to prior years was primarily related to the significant increase in severity during the year, as compared to our estimates when originally establishing the reserves at December 31, 2007. The increase in losses incurred in 2008 related to prior years is also a result of more defaults remaining in inventory at December 31, 2008 from a year prior. These defaults have a higher estimated claim rate when compared to a year prior. The \$518.9 million increase in losses incurred in 2007 related to prior years was due primarily to the significant increases in severity and the significant deterioration in cure rates experienced during the year, as compared to our estimates when originally establishing the reserves at December 31, 2006. The \$90.1 million reduction in losses incurred related to prior years in 2006 was due primarily to more favorable loss trends experienced during that year, when compared to our estimates when originally establishing the reserves at December 31, 2005.

The lower portion of the table above shows the breakdown between claims paid on default notices received in the current year and default notices received in prior years. Since historically it has taken, on average, about twelve months for a default which is not cured to develop into a paid claim, most losses paid relate to default notices received in prior years. Due to a combination of reasons that have slowed the rate at which claims are received and paid, including foreclosure moratoriums, servicing delays, court delays, loan modifications, our fraud investigations and our claim rescissions and denials for misrepresentation there is increased uncertainty regarding how long it may take for current and future defaults that do not cure to develop into a paid claim. The lower portion of the table also includes a decrease in losses paid related to terminated reinsurance agreements as noted in footnote (2) of the table above.

Information about the composition of the primary insurance default inventory at December 31, 2008 and 2007 appears in the table below.

	December 31,	
	2008	2007
Total loans delinquent	182,188	107,120
Percentage of loans delinquent (default rate)	12.37%	7.45%
Prime loans delinquent*	95,672	49,333
Percentage of prime loans delinquent (default rate)	7.90%	4.33%
A-minus loans delinquent*	31,907	22,863
Percent of A-minus loans delinquent (default rate)	30.19%	19.20%
Subprime credit loans delinquent*	13,300	12,915
Percentage of subprime credit loans delinquent (default rate)	43.30%	34.08%
Reduced documentation loans delinquent**	41,309	22,009
Percentage of reduced documentation loans delinquent (default rate)	32.88%	15.48%

* 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

Notes (continued)

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 “sub-prime” loan.

** 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.

Premium deficiency reserves

Historically all of our insurance risks were included in a single grouping and the calculations to determine if a premium deficiency existed were performed on our entire in force book. As of September 30, 2007, based on these calculations there was no premium deficiency on our total in force book. During the fourth quarter of 2007, we experienced significant increases in our default inventory, and severities and claim rates on loans in default. We further examined the performance of our in force book and determined that the performance of loans included in Wall Street bulk transactions was significantly worse than we experienced for loans insured through the flow channel or loans insured through the remainder of our bulk channel. As a result we began separately measuring the performance of Wall Street bulk transactions and decided to stop writing this business. Consequently, as of December 31, 2007, we performed separate premium deficiency calculations on the Wall Street bulk transactions and on the remainder of our in force book to determine if premium deficiencies existed. As a result of those calculations, we recorded premium deficiency reserves of \$1,211 million in the fourth quarter of 2007 to reflect the present value of expected future losses and expenses that exceeded the present value of expected future premium and already established loss reserves on the Wall Street bulk transactions. The discount rate used in the calculation of the premium deficiency reserve, 4.70%, was based upon our pre-tax investment yield at December 31, 2007. As of December 31, 2007 there was no premium deficiency related to the remainder of our in force business.

During 2008 the premium deficiency reserve on Wall Street bulk transactions declined by \$757 million from \$1,211 million, as of December 31, 2007, to \$454 million as of December 31, 2008. The \$454 million premium deficiency reserve as of December 31, 2008 reflects the present value of expected future losses and expenses that exceeded the present value of expected future premium and already established loss reserves. The discount rate used in the calculation of the premium deficiency reserve at December 31, 2008 was 4.0%.

The components of the premium deficiency reserve at December 31, 2008 and 2007 appears in the table below.

	December 31,	
	2008	2007
	(\$ millions)	
Present value of expected future premium	\$ 712	\$ 901
Present value of expected future paid losses and expenses	<u>(3,063)</u>	<u>(3,561)</u>
Net present value of future cash flows	(2,351)	(2,660)
Established loss reserves	<u>1,897</u>	<u>1,449</u>
Net deficiency	<u>\$ (454)</u>	<u>\$ (1,211)</u>

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

Notes (continued)

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 year ended December 31, 2008 was \$757 million, as shown in the chart below, which represents the net result of actual premiums, losses and expenses offset by \$134 million change in assumptions primarily related to higher estimated ultimate losses.

	<u>(\$ in millions)</u>
Premium Deficiency Reserve at December 31, 2007	\$(1,211)
Paid claims and LAE	770
Increase in loss reserves	448
Premium earned	(234)
Effects of present valuing on future premiums, losses and expenses	<u>(93)</u>
Change in premium deficiency reserve to reflect actual premium, losses and expenses recognized	891
Change in premium deficiency reserve to reflect change in assumptions relating to premiums, losses, expenses and discount rate(1)	<u>(134)</u>
Premium Deficiency Reserve at December 31, 2008	<u>\$ (454)</u>

(1) A negative number for changes in assumptions relating to premiums, losses, expenses and discount rate indicates a deficiency of prior premium deficiency reserves.

At the end of 2008 we performed a premium deficiency analysis on the portion of our book of business not covered by the premium deficiency described above. That analysis concluded that, as of December 31, 2008, 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 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. 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. 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.

9. 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 of certain mortgage lenders ("captives"). The majority of ceded premiums relates to these agreements. Historically, most

Notes (continued)

of these reinsurance arrangements are 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 captives' portion of both premiums and losses typically ranging from 25% to 50%. Beginning June 1, 2008 our captive arrangements, both aggregate excess of loss and quota share, are limited to a 25% cede rate.

Under these agreements 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 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 captives' incurred but unpaid losses exceed the funds in the trust account, and the captive does not deposit adequate funds, we may also be allowed to terminate the captive agreement, assume the captives' obligations, transfer the assets in the trust accounts to us, and retain all future premium payments. We intend to exercise this additional remedy when it is available to us. The total fair value of the trust fund assets under these agreements at December 31, 2008 approximated \$582 million. During 2008, \$265 million of trust fund assets were transferred to us as a result of captive terminations. There were no material captive terminations in 2007. The transferred funds resulted in an increase in our investment portfolio (including cash and cash equivalents) and there was a corresponding decrease in our reinsurance recoverable on loss reserves, which is offset by a decrease in our net losses paid.

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 will run off pursuant to the terms of the particular captive arrangement. New business will continue to be ceded under quota share reinsurance arrangements. During 2008, many of our captive arrangements have either been terminated or placed into run-off.

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. The remaining amount of ceded risk in force at December 31, 2008 was approximately \$50.6 million. Additionally, certain pool policies written by us have been reinsured with one domestic reinsurer. We receive a ceding commission under certain reinsurance agreements.

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

Notes (continued)

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

	2008	2007	2006
	(In thousands of dollars)		
Premiums earned:			
Direct	\$1,601,610	\$1,430,964	\$1,327,270
Assumed	3,588	3,220	2,049
Ceded	(212,018)	(171,794)	(141,910)
Net premiums earned	\$1,393,180	\$1,262,390	\$1,187,409
Losses incurred:			
Direct	\$3,553,029	\$2,399,233	\$ 621,298
Assumed	1,456	517	203
Ceded	(482,984)	(34,327)	(7,866)
Net losses incurred	\$3,071,501	\$2,365,423	\$ 613,635

In June 2008 we entered into a reinsurance agreement with an affiliate of HCC Insurance Holdings, Inc. (“HCC”). The reinsurance agreement is effective on the risk associated with up to \$50 billion of qualifying new insurance written each calendar year. The term of the reinsurance agreement began April 1, 2008 and ends on December 31, 2010, subject to two one-year extensions that may be exercised by HCC.

The reinsurance agreement is expected to provide additional claims-paying resources when loss ratios exceed 100% for new insurance written beginning April 1, 2008.

The agreement is accounted for under deposit accounting rather than reinsurance accounting, because under the guidance of SFAS 113 “Accounting for Reinsurance Contracts”, we concluded that the reinsurance agreement does not result in the reasonable possibility that the reinsurer will suffer a significant loss.

When our financial strength rating as determined by two rating agencies is in the “A” category or higher the agreement provides for a 20% quota share agreement, but allows us to retain 80% of the ceded premium (“profit commission”). The profit commission is used to cover losses that otherwise would be ceded to the reinsurer until the profit commission is exhausted. The premium ceded to the reinsurer and the brokerage commission paid to an affiliate of the reinsurer, net of a profit commission retained by us, is recorded as reinsurance fee expense on our statement of operations. In loss environments where loss ratios are less than 80% for the insurance covered by this agreement, we expect the net expense will be approximately 5% of net premiums earned on business covered by the agreement. Under the terms of the agreement, if our financial strength rating as determined by two rating agencies falls below the “A” category, we are no longer entitled to the profit commission and our net expense will increase to reflect we no longer receive this profit commission, but will be partially offset by an increase of reinsured losses. In February 2009, Moody’s Investors Service reduced MGIC’s financial strength rating to Ba2 with a developing outlook. The financial strength of MGIC is rated A-, with a negative outlook, by both Standard and Poor’s Rating Services and Fitch Ratings. The reinsurance fee for the year ended December 31, 2008 was approximately \$1.8 million.

10. Investments in joint ventures

C-BASS

C-BASS, a limited liability company, is an unconsolidated, less than 50%-owned investment of ours that is not controlled by us. Historically, C-BASS was principally engaged in the business of investing in the credit risk of subprime single-family residential mortgages. In 2007, C-BASS ceased its operations and is managing its portfolio pursuant to a consensual, non-bankruptcy restructuring, under which its assets are to be paid out over time to its secured and unsecured creditors. As discussed below, in the third quarter of 2007, we concluded that our total equity interest in C-BASS was impaired. In addition, during the fourth quarter of

Notes (continued)

2007 due to additional losses incurred by C-BASS, we reduced the carrying value of our \$50 million note from C-BASS to zero under equity method accounting. At December 31, 2008 our current book value of C-BASS, including our note receivable from C-BASS, remains at zero.

Beginning in February 2007 and continuing through approximately the end of March 2007, the subprime mortgage market experienced significant turmoil. After a period of relative stability that persisted during April, May and through approximately late June, market dislocations recurred and then accelerated to unprecedented levels beginning in approximately mid-July 2007. As a result of margin calls from lenders that C-BASS was not able to meet, C-BASS's purchases of mortgages and mortgage securities and its securitization activities ceased.

On July 30, 2007, we announced that we had concluded that the value of our investment in C-BASS had been materially impaired and that the amount of the impairment could be our entire investment. In connection with the determination of our results of operations for the quarter ended September 30, 2007, we wrote down our entire equity investment in C-BASS through an impairment charge of \$466 million. This impairment charge is reflected in our results of operations for year ended December 31, 2007.

We measured the value of our investment based upon the potential market for the equity interest in C-BASS and expected future cash flows of C-BASS, including a consensual, non-bankruptcy restructuring, which, subsequently occurred on November 16, 2007 through an override agreement with C-BASS's creditors. The override agreement provides that C-BASS's assets are to be paid out over time to its secured and unsecured creditors. The information used in our valuation was provided by C-BASS. We believe there is a high degree of uncertainty surrounding the amounts and timing of C-BASS's cash flows and our analysis of them involved significant management judgment based upon currently available facts and circumstances, which are subject to change. The market analysis as well as our analysis of the cash flow projections reflected little or no value for our equity interest in C-BASS. Based on these analyses our entire equity interest in C-BASS was written down through an impairment charge under the guidance of APB 18 — Equity Method of Accounting.

In mid-July 2007 we lent C-BASS \$50 million under an unsecured credit facility. At September 30, 2007 this note was carried at face value on our consolidated balance sheet. During the fourth quarter of 2007 C-BASS incurred additional losses that caused us to reduce the carrying value of the note to zero under equity method accounting. A third party has an option that expires in December 2014 to purchase 22.5% of C-BASS' equity from us for an exercise price of \$2.5 million.

A summary C-BASS balance sheet and income statements at the date and for the periods indicated appear below.

C-BASS Summary Balance Sheet:

	December 31, 2007
	(In millions of dollars)
Total assets	\$5,833
Debt	\$2,468
Total liabilities	\$6,761
Owners' deficit	\$ (928)

Notes (continued)

C-BASS Summary Income Statement:

	Year Ended December 31,	
	2007	2006
	(In millions of dollars)	
Total net revenue	\$(1,647.8)	\$572.9
Total expense	259.3	282.4
Net (loss) income	\$(1,907.1)	\$290.5
Company's (loss) income from C-BASS	\$ (499.6)	\$133.7

Sherman

During the period in which we held an equity interest in Sherman, Sherman was principally engaged in the business of purchasing and collecting for its own account delinquent consumer assets which are primarily unsecured, and in originating and servicing subprime credit card receivables. The borrowings used to finance these activities are included in Sherman's balance sheet. A substantial portion of Sherman's consolidated assets are investments in consumer receivable portfolios that do not have readily ascertainable market values. Sherman's results of operations are sensitive to estimates by Sherman's management of ultimate collections on these portfolios.

In August 2008 we sold our entire interest in Sherman to Sherman. Our interest sold represented approximately 24.25% of Sherman's equity. The sale price paid was \$124.5 million in cash and by delivery of Sherman's unsecured promissory note in the principal amount of \$85 million (the "Note"). The scheduled maturity of the Note is February 13, 2011 and it bears interest, payable monthly, at the annual rate equal to three-month LIBOR plus 500 basis points. The Note is issued under a Credit Agreement, dated August 13, 2008, between Sherman and MGIC.

At the time of sale the note had a fair value of \$69.5 million (18.25% discount to par). The fair value was determined by comparing the terms of the Note to the discounts and yields on comparable bonds. The fair value was also discounted for illiquidity and lack of ratings. The discount will be amortized to interest income over the life of the Note. The gain recognized on the sale was \$62.8 million, and is included in realized investment gains (losses) on the statement of operations for the year ended December 31, 2008.

As a result of the sale we are entitled to an additional cash payment if by approximately early March 2009 Sherman or certain of its management affiliates enter into a definitive agreement covering a transaction involving the sale or purchase of interests in Sherman in which the fair value of the consideration reflects a value of Sherman over \$1 billion plus an additional amount. The additional amount was \$33 million if a definitive agreement had been entered into by early September 2008 and increases by \$11 million for each monthly period that elapses after early September 2008 until a monthly period beginning in early February 2009, when the additional amount is \$100 million. A qualifying purchase or sale transaction must close for us to be entitled to an additional payment.

In connection with the sale we waived, effective at the time at which the Note is paid in full, our right to any contingent consideration for the sale of the interests in Sherman that we sold in September 2007 to an entity owned by the management of Sherman. Under that sale, we are entitled to an additional cash payment if the purchaser's after-tax rate of return on the interests purchased exceeds a threshold that equates to an annual return of 16%.

For additional information regarding the sale of our interest please refer to our Current Report on Form 8-K filed on August 14, 2008. Our investment in Sherman on an equity basis at December 31, 2008 and 2007 was zero and \$115.3 million, respectively.

Notes (continued)

Sherman Summary Balance Sheet:

	December 31, 2007
	(In million of dollars)
Total assets	\$2,242
Debt	\$1,611
Total liabilities	\$1,821
Members' equity	\$ 421

Sherman Summary Income Statement:

	Year Ended December 31,		
	2008*	2007	2006
	(In millions of dollars)		
Revenues from receivable portfolios	\$ 660.3	\$ 994.3	\$1,031.6
Portfolio amortization	264.8	488.1	373.0
Revenues, net of amortization	395.5	506.2	658.6
Credit card interest income and fees	475.6	692.9	357.3
Other revenue	35.3	60.8	35.6
Total revenues	906.4	1,259.9	1,051.5
Total expenses	740.1	991.5	702.0
Income before tax	\$ 166.3	\$ 268.4	\$ 349.5
Company's income from Sherman	\$ 35.6	\$ 81.6	\$ 121.9

* The year ended December 31, 2008 only reflects Sherman's results and our income from Sherman through July 31, 2008 as a result of the sale of our remaining interest in August 2008.

The "Company's income from Sherman" line item in the table above includes \$3.6 million, \$15.6 million and \$12.0 million of additional amortization expense in 2008, 2007 and 2006, respectively, above Sherman's actual amortization expense, related to additional interests in Sherman that we purchased during the third quarter of 2006 at a price in excess of book value.

In September 2007, we sold a portion of our interest in Sherman to an entity owned by Sherman's senior management. The interest sold by us represented approximately 16% of Sherman's equity. We received a cash payment of \$240.8 million in the sale. We recorded a \$162.9 million pre-tax gain on this sale, which is reflected in our results of operations for the year ended December 31, 2007 as a realized gain.

11. 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. In October 2008 we amended our postretirement benefit plan. The amendment, which is effective January 1, 2009, terminates the benefits provided to retirees once they reach the age of 65. This amendment reduces our accumulated postretirement benefit obligation as of December 31, 2008 as shown in the charts below. The amendment will also reduce our net periodic benefit cost in future periods beginning with calendar year 2009. The following tables provide the components of aggregate annual net periodic benefit cost, the amounts recognized in the consolidated balance

Notes (continued)

sheet, changes in the benefit obligation and the funded status of the pension, supplemental executive retirement and other postretirement benefit plans:

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
	(In thousands of dollars)			
Components of Net Periodic Benefit Cost for fiscal year ending				
1. Company Service Cost	\$ 8,677	\$ 10,047	\$ 3,886	\$ 3,377
2. Interest Cost	13,950	12,225	4,966	3,874
3. Expected Return on Assets	(19,348)	(17,625)	(3,766)	(3,269)
4. Other Adjustments	—	—	—	—
<i>Subtotal</i>	3,279	4,647	5,086	3,982
5. Amortization of :				
a. Net Transition Obligation/(Asset)	—	—	283	283
b. Net Prior Service Cost/(Credit)	684	564	—	—
c. Net Losses/(Gains)	510	552	—	—
<i>Total Amortization</i>	1,194	1,116	283	283
6. Net Periodic Benefit Cost	4,473	5,763	5,369	4,265
7. Cost of SFAS 88 Events	—	—	—	—
8. Total Expense for Year	\$ 4,473	\$ 5,763	\$ 5,369	\$ 4,265
Reconciliation of Net Balance Sheet (Liability)/Asset				
1. Net Balance Sheet (Liability)/Asset at End of Prior Year	51,106	31,918	(23,143)	(31,218)
2. Amount Recognized in AOCI at End of Prior Year	2,247	16,667	2,737	10,696
3. (Accrued)/Prepaid Benefit Cost (before Adjustment) at End of Prior Year	53,353	48,585	(20,406)	(20,522)
4. Net Periodic Benefit (Cost)/Income for Fiscal Year	(4,473)	(5,762)	(5,369)	(4,267)
5. (Cost)/Income of SFAS 88 Events	—	—	—	—
6. Employer Contributions	33,000	10,300	—	3,400
7. Benefits Paid Directly by Company	230	230	(43)	983
8. Other Adjustment	—	—	—	—
9. (Accrued)/Prepaid Benefit Cost (before Adjustment) at End of Year	82,110	53,353	(25,818)	(20,406)
10. Amount Recognized in AOCI at End of Year	(104,420)	(2,247)	30,726	(2,737)
11. Net Balance Sheet (Liability)/Asset at End of Year	(22,310)	51,106	4,908	(23,143)

Notes (continued)

Development of Funded Status

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
	(In thousands of dollars)			
Actuarial Value of Benefit Obligations				
1. Measurement Date	12/31/2008	12/31/2007	12/31/2008	12/31/2007
2. Accumulated Benefit Obligation	202,475	177,285	25,282	73,358
3. Projected Benefit Obligation	229,039	207,431	—	—
Funded Status				
1. Projected Accumulated Benefit Obligation	(229,039)	(207,431)	(25,282)	(73,358)
2. Plan Assets at Fair Value	206,729	258,536	30,190	50,215
3. Funded Status — Overfunded	N/A	51,105	4,908	N/A
4. Funded Status — Underfunded	(22,310)	N/A	N/A	(23,143)
Accumulated Other Comprehensive Income				
1. Net Actuarial (Gain)/Loss	\$ 101,646	\$ (1,210)	\$ 27,319	\$ 1,320
2. Net Prior Service Cost/(Credit)	2,774	3,457	(58,045)	—
3. Net Transition Obligation/(Asset)	—	—	—	1,417
4. Total at Year End	104,420	2,247	(30,726)	2,737
Information for Plans with PBO / APBO in Excess of Plan Assets				
1. Projected Benefit Obligation/ Accumulated Postretirement Benefit Obligation	\$ 229,039	\$ 13,375	\$ —	\$ —
2. Accumulated Benefit Obligation/Accumulated Postretirement Benefit Obligation	202,475	5,675	—	73,358
3. Fair Value of Plan Assets	206,729	—	—	50,215
Information for Plans with PBO / APBO Less Than Plan Assets				
1. Projected Benefit Obligation/ Accumulated Postretirement Benefit Obligation	\$ —	\$ 194,056	\$ —	\$ —
2. Accumulated Benefit Obligation / Accumulated Postretirement Benefit Obligation	—	171,610	25,282	—
3. Fair Value of Plan Assets	—	258,536	30,190	—

Notes (continued)

The changes in the projected benefit obligation are as follows:

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	<u>12/31/2008</u>	<u>12/31/2007</u>	<u>12/31/2008</u>	<u>12/31/2007</u>
	(In thousands of dollars)			
Change in Projected Benefit Obligation				
1. Benefit Obligation at Beginning of Year	\$207,431	\$202,950	\$ 73,357	\$74,807
2. Company Service Cost	8,677	10,047	3,886	3,377
3. Interest Cost	13,950	12,225	4,966	3,875
4. Plan Participants' Contributions	—	—	539	495
5. Net Actuarial (Gain)/Loss due to Assumption Changes . . .	(7,725)	(14,922)	3,523	(4,644)
6. Net Actuarial (Gain)/Loss due to Plan Experience	11,317	2,816	(49)	(3,074)
7. Benefit Payments from Fund	(4,381)	(5,455)	(1,265)	—
8. Benefit Payments Directly by Company	(230)	(230)	(496)	(1,479)
9. Plan Amendments	—	—	(59,179)	—
10. Benefit Obligation at End of Year	\$229,039	\$207,431	\$ 25,282	\$73,357

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

Change in Plan Assets

	<u>12/31/2008</u>	<u>12/31/2007</u>	<u>12/31/2008</u>	<u>12/31/2007</u>
	(In thousands of dollars)			
1. Fair Value of Plan Assets at Beginning of Year	\$258,536	\$234,868	\$ 50,215	\$43,590
2. Company Contributions	33,230	10,530	—	4,383
3. Plan Participants' Contributions	—	—	539	495
4. Benefit Payments from Fund	(4,381)	(5,455)	(1,265)	—
5. Benefit Payments paid directly by Company	(230)	(230)	(496)	(1,479)
6. Actual Return on Assets	(80,426)	18,823	(18,760)	3,226
7. Adjustment	—	—	(43)	—
8. Fair Value of Plan Assets at End of Year	206,729	258,536	30,190	50,215

Notes (continued)

Change in Net Actuarial Loss/(Gain)

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
	(In thousands of dollars)			
1. Net Actuarial Loss/(Gain) at end of prior year	\$ (1,211)	\$ 12,645	\$ 1,320	\$ 8,995
2. Amortization Credit/(Cost) For Year	(510)	(552)	—	—
3. Liability Loss/(Gain)	3,593	(12,106)	3,473	(7,718)
4. Asset Loss/(Gain)	99,774	(1,198)	22,526	43
5. Net Actuarial Loss/(Gain) at year end	\$101,646	\$ (1,211)	\$ 27,319	\$ 1,320

Change in Accumulated Other Comprehensive Income (AOCI)

1. AOCI in Prior Year	\$ 2,247	\$ 16,667	\$ 2,737	\$10,696
2. Increase/(Decrease) in AOCI				
a. Recognized during year — Net Recognized Transition Transition (Obligation)/Asset	—	—	(283)	(283)
b. Recognized during year — Prior Service (Cost)/Credit . .	(683)	(564)	—	—
c. Recognized during year — Net Actuarial (Losses)/Gains	(510)	(552)	—	—
d. Occurring during year — Prior Service Cost	—	—	(59,179)	—
e. Occurring during year — Net Actuarial Losses/(Gains) . .	103,366	(13,304)	25,999	(7,676)
f. Increase (decrease) due to adoption of SFAS 158	N/A	N/A	N/A	N/A
g. Other adjustments	—	—	—	—
3. AOCI in Current Year	\$104,420	\$ 2,247	\$(30,726)	\$ 2,737

Amortizations Expected to be Recognized During Next Fiscal Year

1. Amortization of Net Transition Obligation/(Asset)	\$ —	\$ —	\$ —	\$ 283
2. Amortization of Prior Service Cost/(Credit)	632	684	(6,509)	—
3. Amortization of Net Losses/(Gains)	6,876	456	1,888	—

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	
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
Weighted-Average Assumptions Used to Determine Benefit Obligations at year end				
1. Discount Rate	6.50%	6.50%	6.50%	6.50%
2. Rate of Compensation Increase	3.00%	4.50%	N/A	N/A
3. Social Security Increase	N/A	N/A	N/A	N/A
4. Pension Increases for Participants In-Payment Status . . .	N/A	N/A	N/A	N/A
Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost for Year				
1. Discount Rate	6.50%	6.00%	6.50%	6.00%
2. Expected Long-term Return on Plan Assets	7.50%	7.50%	7.50%	7.50%
3. Rate of Compensation Increase	4.50%	4.50%	N/A	N/A
4. Social Security Increase	N/A	N/A	N/A	N/A
5. Pension Increases for Participants In-Payment Status . . .	N/A	N/A	N/A	N/A
Assumed Health Care Cost Trend Rates at year end				
1. Health Care Cost Trend Rate Assumed for Next Year . .	N/A	N/A	8.00%	8.50%
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	2015	2015

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 \$25 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.

Notes (continued)

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

	Pension Plan		Other Postretirement Benefits	
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
Plan Assets				
Allocation of Assets at year end				
1. Equity Securities	70%	77%	100%	100%
2. Debt Securities	19%	20%	0%	0%
3. Real Estate	2%	3%	0%	0%
4. Other	9%	0%	0%	0%
5. Total	100%	100%	100%	100%
Target Allocation of Assets				
1. Equity Securities	77%	80%	100%	100%
2. Debt Securities	20%	17%	0%	0%
3. Real Estate	3%	3%	0%	0%
4. Other	0%	0%	0%	0%
5. Total	100%	100%	100%	100%

Our pension plan portfolio returns are expected 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
- Provide consistent investment returns
- Meet or exceed the actuarial return assumption

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 was, as of December 31, 2008:

	Minimum	Maximum
Fixed Income	0%	30%
Equity	70%	100%
Cash equivalents	0%	10%

Investment in international oriented funds is limited to a maximum of 20% of the equity range.

In 2009, we decided to substantially increase the allocation range for fixed income securities.

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

- Total return should exceed growth in CPI
- Achieve competitive investment results

Notes (continued)

The primary focus in developing asset allocation ranges for the account is the assessment of the account'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 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 18% of the portfolio.

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

	Pension and Supplemental Executive Retirement Plans		Other Postretirement Benefits	
	<u>12/31/2008</u>	<u>12/31/2007</u>	<u>12/31/2008</u>	<u>12/31/2007</u>
	(In thousands of dollars)			
Company Contributions				
Company Contributions for the Year Ending:				
1. Current-1	\$10,530	\$10,036	\$ 4,383	\$ 4,379
2. Current	33,230	10,530	—	4,383
3. Current + 1	10,000	9,262	—	3,000
Benefits Paid Directly by the Company				
Benefits Paid Directly by the Company for the Year Ending:				
1. Current-1	\$ 230	\$ 36	\$ 1,478	\$ 1,440
2. Current	230	230	1,761	1,479
3. Current + 1	284	262	1,817	2,114
Plan Participants' Contributions				
Plan Participants' Contributions for the Year Ending:				
1. Current-1	\$ —	\$ —	\$ 495	\$ 361
2. Current	—	—	539	495
3. Current + 1	—	—	436	533
Benefit Payments (Total)				
Actual Benefit Payments for the Year Ending:				
1. Current-1	\$ 5,685	\$ 2,869	\$ 983	\$ 1,440
2. Current	4,611	5,685	1,222	1,479
Expected Benefit Payments for the Year Ending:				
3. Current + 1	6,169	4,761	1,380	1,581
4. Current + 2	7,256	5,530	1,608	1,851
5. Current + 3	8,444	6,603	1,920	2,167
6. Current + 4	9,655	7,567	2,140	2,548
7. Current + 5	10,895	8,892	2,224	2,890
8. Current + 6-10	75,028	66,628	14,354	20,177

Notes (continued)

The following other postretirement benefit payments, which reflect future service, are expected to be paid in the following fiscal years:

Fiscal Year	Other Postretirement Benefits		
	Gross Benefits	Medicare Part D Subsidy	Net Benefits
	(In thousands of dollars)		
2009	\$ 1,380	—	\$ 1,380
2010	1,608	—	1,608
2011	1,920	—	1,920
2012	2,140	—	2,140
2013	2,224	—	2,224
Years 2014 - 2018	14,354	—	14,354

Health care sensitivities

For measurement purposes, an 8.5% health care trend rate was used for pre-65 benefits for 2008. In 2009, the rate is assumed to be 8.0%, decreasing to 5.0% by 2015 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 of dollars)	
	Effect on total service and interest cost components	\$1,920
Effect on postretirement benefit obligation	2,608	(2,295)

We have a profit sharing and 401(k) savings plan for employees. At the discretion of the Board of Directors, we may make a profit sharing 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 profit sharing expense and 401(k) savings plan expense of \$4.5 million, \$2.7 million and \$5.6 million in 2008, 2007 and 2006, respectively.

12. Income taxes

Net deferred tax assets and liabilities as of December 31, 2008 and 2007 are as follows:

	2008	2007
	(In thousands of dollars)	
Deferred tax assets	\$396,024	\$681,858
Deferred tax liabilities	(88,808)	(56,008)
Net deferred tax asset	\$307,216	\$625,850

We have deducted contingency reserves on our federal income tax returns in prior periods and purchased tax and loss bonds, which we account for as a payment of federal income tax. These reserves can be released into taxable income in future years. Since the tax effect on these reserves exceeds the gross deferred tax assets less deferred tax liabilities, we believe that all gross deferred tax assets at December 31, 2008 are fully realizable and no valuation reserve was established. In 2009, the remainder of these reserves will be released and will no longer be available to support any net deferred tax assets. This would likely have a material

Notes (continued)

impact on our results from operations in future periods, as any credit for income taxes, relating to future operating losses, will be reduced or eliminated by the valuation allowance.

The components of the net deferred tax asset as of December 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
	(In thousands of dollars)	
Unearned premium reserves	\$ 32,769	\$ 25,951
Deferred policy acquisition costs	(3,763)	(3,775)
Loss reserves	69,875	54,399
Unrealized depreciation (appreciation) in investments	27,521	(35,547)
Alternative minimum tax credit carryforward	27,719	—
Mortgage investments	17,765	31,391
Benefit plans	8,606	(6,794)
Deferred compensation	18,605	21,858
Investments in joint ventures	(74,560)	114,522
Premium deficiency reserves	159,018	423,794
Loss due to “other than temporary” impairments	16,669	—
Other, net	<u>6,992</u>	<u>51</u>
Net deferred tax asset	<u>\$307,216</u>	<u>\$625,850</u>

The following summarizes the components of the (credit) provision for income tax:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(In thousands of dollars)		
Current	\$(654,245)	\$(369,507)	\$133,998
Deferred	254,409	(465,580)	(6,784)
Other	<u>5,507</u>	<u>1,110</u>	<u>2,883</u>
(Credit) provision for income tax	<u>\$(394,329)</u>	<u>\$(833,977)</u>	<u>\$130,097</u>

We (received) paid (\$938.1) million, (\$176.3) million and \$227.3 million in federal income tax in 2008, 2007 and 2006, respectively. At December 31, 2008, 2007 and 2006, we owned \$431.5 million, \$1,319.6 million and \$1,686.5 million, respectively, of tax and loss bonds.

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal statutory income tax (credit) rate	(35.0)%	(35.0)%	35.0%
Tax exempt municipal bond interest	(7.5)	(2.6)	(10.7)
Other, net	<u>0.4</u>	<u>0.3</u>	<u>0.5</u>
Effective income tax (credit) rate	<u>(42.1)%</u>	<u>(37.3)%</u>	<u>24.8%</u>

On June 1, 2007, as a result of an examination by the Internal Revenue Service (“IRS”) for taxable years 2000 through 2004, we received a Revenue Agent Report (“RAR”). The adjustments reported on the RAR substantially increase taxable income for those tax years and resulted in the issuance of an assessment for unpaid taxes totaling \$189.5 million in taxes and accuracy-related penalties, plus applicable interest. We have agreed with the IRS on certain issues and paid \$10.5 million in additional taxes and interest. The remaining open issue relates to our treatment of the flow through income and loss from an investment in a portfolio of residual interests of Real Estate Mortgage Investment Conduits (“REMICS”). The IRS has indicated that it

Notes (continued)

does not believe that, for various reasons, we have established sufficient tax basis in the REMIC residual interests to deduct the losses from taxable income. We disagree with this conclusion and believe that the flow through income and loss from these investments was properly reported on our federal income tax returns in accordance with applicable tax laws and regulations in effect during the periods involved and have appealed these adjustments. The appeals process may take some time and a final resolution may not be reached until a date many months or years into the future. On July 2, 2007, we made a payment of \$65.2 million with the United States Department of the Treasury to eliminate the further accrual of interest. Although the resolution of this issue is uncertain, we believe that sufficient provisions for income taxes have been made for potential liabilities that may result. If the resolution of this matter differs materially from our estimates, it could have a material impact on our effective tax rate, results of operations and cash flows.

In February 2009, the Internal Revenue Service informed us that it plans to conduct an examination of our federal income tax returns for 2005 through 2007. We believe that income taxes related to these years have been properly provided for in the financial statements.

Effective January 1, 2007, we adopted FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." The Interpretation seeks to reduce the significant diversity in practice associated with recognition and measurement in the accounting for income taxes. The interpretation applies to all tax positions accounted for in accordance with SFAS No. 109, "Accounting for Income Taxes." 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. As a result of the adoption, we recognized a decrease of \$85.5 million in the liability for unrecognized tax benefits, which was accounted for as an increase to the January 1, 2007 balance of retained earnings. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	Unrecognized Tax Benefits
	<u>(In millions of dollars)</u>
Balance at December 31, 2007	\$86.1
Additions based on tax positions related to the current year	0.7
Additions for tax positions of prior years	1.1
Reductions for tax positions of prior years	—
Settlements	—
Balance at December 31, 2008	<u>\$87.9</u>

The total amount of unrecognized tax benefits that would affect our effective tax rate is \$76.0 million and \$74.8 million as of December 31, 2008 and 2007, respectively. We recognize interest accrued and penalties related to unrecognized tax benefits in income taxes. During 2008, we recognized \$1.1 million in interest. As of December 31, 2008 and 2007 we had \$21.4 million and \$20.3 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 tax years prior to 2000.

The establishment of this liability requires estimates of potential outcomes of various issues and requires significant judgment. Although the resolutions of these issues are uncertain, we believe that sufficient provisions for income taxes have been made for potential liabilities that may result. If the resolutions of these matters differ materially from our estimates, it could have a material impact on our effective tax rate, results of operations and cash flows.

Notes (continued)

13. Shareholders' equity, dividend restrictions and statutory capital

In March 2008 we completed the public offering and sale of 42.9 million shares of our common stock at a price of \$11.25 per share. We received net proceeds of approximately \$460 million, after deducting underwriting discount and offering expenses. Of the 42.9 million shares of common stock sold, 7.1 million were newly issued shares and 35.8 million were common shares issued out of treasury. The cost of the treasury shares issued exceeded the proceeds from the sale by approximately \$1.6 billion, which resulted in a deficiency. The deficiency was charged to paid-in capital related to previous treasury share transactions, and the remainder was charged to retained earnings.

A portion of the net proceeds of the offering along with the net proceeds of the debentures (See Note 7.) was used to increase the capital of MGIC, our principal insurance subsidiary, in order to enable us to expand the volume of our new insurance written and a portion is available for our general corporate purposes.

In June 2008 our shareholders approved an amendment to our Articles of Incorporation that increased the number of authorized shares of common stock from 300 million to 460 million. We have 28.9 million authorized shares reserved for conversion under our convertible debentures. (See Note 7.)

Dividends

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 ("OCI") is the lesser of adjusted statutory net income or 10% of statutory policyholders' surplus as of the preceding calendar year end. Adjusted statutory net income is defined for this purpose to be the greater of statutory net income, net of realized investment gains, for the calendar year preceding the date of the dividend or statutory net income, net of realized investment gains, for the three calendar years preceding the date of the dividend less dividends paid within the first two of the preceding three calendar years.

The credit facility, senior notes and convertible debentures, discussed in Notes 6 and 7, are obligations of MGIC Investment Corporation and not of its subsidiaries. We are a holding company and the payment of dividends from our insurance subsidiaries, which historically has been the principal source of our holding company cash inflow, is restricted by insurance regulation. MGIC is the principal source of dividend-paying capacity. During 2008, MGIC paid three quarterly dividends of \$15 million each to our holding company, which increased the cash resources of our holding company. As has been the case for the past several years, as a result of extraordinary dividends paid, MGIC cannot currently pay any dividends without regulatory approval. We do not anticipate seeking approval in 2009 for any additional dividends from MGIC that would increase our cash resources at the holding company. Our other insurance subsidiaries can pay \$3.6 million of dividends to us without such regulatory approval.

Certain of our non-insurance subsidiaries also have requirements as to maintenance of net worth.

In 2008, 2007 and 2006, we paid dividends of \$8.2 million, \$63.8 million and \$85.5 million, respectively, or \$0.075 per share in 2008, \$0.775 per share in 2007 and \$1.00 per share in 2006. In the fourth quarter of 2008, we suspended the payment of dividends.

Accounting Principles

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

Under statutory accounting practices, 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

Notes (continued)

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.

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 (credit) 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.

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

Under statutory accounting practices, our share of the net income or loss of our investments in joint ventures is credited directly to statutory surplus. Under GAAP, income from joint ventures is shown separately, net of tax, on the statement of operations.

The statutory net income, surplus and the contingency reserve liability of the insurance subsidiaries (excluding the non-insurance companies), as well as the surplus contributions made to MGIC and other insurance subsidiaries and dividends paid by MGIC to us, are as follows:

<u>Year Ended December 31,</u>	<u>Net (loss) Income</u>	<u>Surplus</u>	<u>Contingency Reserve(1)</u>
	(In thousands of dollars)		
2008	\$(172,196)	\$1,612,953	\$2,087,265
2007	\$ 467,928	\$1,352,455	\$3,465,428
2006	\$ 398,059	\$1,592,040	\$4,851,083

(1) Decreases in contingency reserves in 2007 and 2008 reflect early withdrawals for incurred losses that exceeded 35% of net premiums earned in a calendar year, in accordance with insurance regulations.

<u>Year Ended December 31,</u>	<u>Surplus Contributions Made to MGIC by the Parent Company</u>	<u>Surplus Contributions Made to Other Insurance Subsidiaries by the Parent Company</u>	<u>Dividends Paid by MGIC to the Parent Company</u>
	(In thousands of dollars)		
2008	\$550,000	\$175,000	\$170,000
2007	—	35,000	320,000
2006	—	—	570,001

Notes (continued)

Statutory capital

The mortgage insurance industry is experiencing 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 in California, Florida and other distressed markets, 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. Our view of potential losses on these books has trended upward since the first quarter of 2008, including since the time at which we finalized our Quarterly Report on Form 10-Q for the third quarter of 2008.

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. 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 ("MPP") 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 cannot write 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 25:1. This ratio is computed on a statutory basis for our combined insurance operations and is our net risk in force divided by our policyholders' position. Policyholders' position consists primarily of statutory policyholders' surplus, 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. 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.

In February 2009, we received clarification from the OCI regarding the methodology used in calculating the excess of our policyholders position over the MPP. The clarification effectively reduces the required MPP by our reserves established for delinquent loans, beginning with our December 31, 2008 calculations. It is also our understanding that certain states have clarified their calculation of risk-to-capital to reduce risk in force for established loss reserves. We have used this methodology beginning with our December 31, 2008 calculations.

At December 31, 2008, MGIC exceeded MPP by more than \$1.5 billion, and we exceeded MPP by \$1.6 billion on a combined basis. At December 31, 2008 MGIC's risk-to-capital was 12.9:1 and was 14.7:1 on a combined basis.

In addition to the uncertainties that could result in increased losses, there are other items that could favorably impact our future losses. For example, our estimated loss reserves reflect loss mitigation from rescissions using only the rate at which we have rescinded claims during recent periods, as discussed in Note 8. In light of the number of claims investigations we are pursuing and our perception that books of insurance we wrote before 2008 contain a significant number of loans involving fraud, we expect our rescission rate during future periods to increase. The insured can dispute our right to rescind coverage, and whether the requirements to rescind are met ultimately would be determined by arbitration or judicial proceedings. Also, our estimated loss reserves do not take account of the effect of potential benefits that might be realized from third party and governmental loan modification programs.

Notes (continued)

Because the factors that will affect our future losses are subject to significant uncertainty, there is significant uncertainty regarding the level of our future losses. However, if recent loss trends continue MGIC's policyholders position would decline and its risk-to-capital would increase beyond the levels necessary to meet regulatory requirements. Depending on the level of future losses, this could occur before the end of 2009.

An inability to write new business does not mean that we do not have sufficient resources to pay claims. We believe we have more than adequate resources to pay claims on our insurance in force, even in scenarios in which losses materially exceed those that would result in not meeting MPP and risk-to-capital requirements. Our claims paying resources principally consist of our investment portfolio, captive reinsurance trust funds and future premiums on our insurance in force, net of premiums ceded to captive and other reinsurers.

We are considering options to obtain capital to write new business, which could occur through the sale of equity or debt securities, from reinsurance and/or through the use of claims paying resources that should not be needed to cover obligations on our existing insurance in force. While we have not pursued raising capital from private sources, we initiated discussions with the US Treasury late in October 2008 to seek a capital investment and/or reinsurance under the Troubled Assets Relief Program ("TARP"). We understand there is intense competition for TARP and other government assistance. We cannot predict whether we will be successful in obtaining capital from any source but any sale of additional securities could dilute substantially the interest of existing shareholders and other forms of capital relief could also result in additional costs.

Our senior management believes that one of the capital generating options referred to above will be feasible or that the uncertainties described above will develop in a manner such that we will be able to continue to write new business through the end of 2009. We can, however, give no assurance in this regard, and higher losses, adverse changes in our relationship with the GSEs, or reduced benefits from loss mitigation, among other factors, could result in senior management's belief not being realized.

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. Awards under our plans generally vest over periods ranging from one to five years.

The compensation cost that has been charged against income for the share-based plans was \$17.4 million, \$19.3 million and \$33.4 million for the years ended December 31, 2008, 2007 and 2006, respectively. The related income tax benefit recognized for the share-based compensation plans was \$6.1 million, \$6.8 million and \$11.7 million for the years ended December 31, 2008, 2007 and 2006, respectively.

We have stock incentive plans that were adopted in 1991 and 2002. When the 2002 plan was adopted, no further awards could be made under the 1991 plan. The maximum number of shares covered by awards under the 2002 plan is the total of 7.1 million shares plus the number of shares that must be purchased at a purchase price of not less than the fair market value of the shares as a condition to the award of restricted stock under the 2002 plan. The maximum number of shares of restricted stock that can be awarded under the 2002 plan is 5.9 million shares. Both plans provide for the award of stock options with maximum terms of 10 years and for the grant of restricted stock or restricted stock units. The 2002 plan also provides for the grant of stock appreciation rights. 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. Newly issued shares are used for exercises under the 1991 plan and treasury shares are used for exercises under the 2002 plan. Directors may receive awards under the 2002 plan and were eligible for awards of restricted stock under the 1991 plan.

Notes (continued)

A summary of option activity in the stock incentive plans during 2008 is as follows:

	<u>Weighted Average Exercise Price</u>	<u>Shares Subject to Option</u>
Outstanding, December 31, 2007	\$56.26	2,587,880
Granted	—	—
Exercised	—	—
Forfeited or expired	<u>64.26</u>	<u>(73,730)</u>
Outstanding, December 31, 2008	<u>\$56.03</u>	<u>2,514,150</u>

There were no options granted in 2008, 2007 or 2006. For the years ended December 31, 2007 and 2006, the total intrinsic value of options exercised (i.e., the difference in the market price at exercise and the price paid by the employee to exercise the option) was \$0.7 million and \$13.1 million, respectively. The total amount of value received from exercise of options was \$2.9 million and \$24.5 million, and the related net tax benefit realized from the exercise of those stock options was \$0.3 million and \$4.6 million for the years ended December 31, 2007 and 2006, respectively. There were no options exercised in 2008.

The following is a summary of stock options outstanding at December 31, 2008:

<u>Exercise Price Range</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>		
	<u>Shares</u>	<u>Remaining Average Life (years)</u>	<u>Weighted Average Exercise Price</u>	<u>Shares</u>	<u>Remaining Average Life (years)</u>	<u>Weighted Average Exercise Price</u>
\$35.75 — 47.31	1,062,100	1.9	\$44.80	747,370	2.3	\$44.55
\$53.70 — 68.20	<u>1,452,050</u>	3.5	\$64.24	<u>1,341,400</u>	3.4	\$63.92
Total	<u>2,514,150</u>	2.8	\$56.03	<u>2,088,770</u>	3.0	\$56.99

The aggregate intrinsic value of options outstanding and options exercisable at December 31, 2008 was zero. The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price of \$3.48 as of December 31, 2008 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, 2008 was below all exercise prices, none of the outstanding options had any intrinsic value.

A summary of restricted stock or restricted stock units during 2008 is as follows:

	<u>Weighted Average Grant Date Fair Market Value</u>	<u>Shares</u>
Restricted stock outstanding at December 31, 2007	\$62.74	1,415,970
Granted	15.38	1,258,315
Vested	63.40	(204,102)
Forfeited	<u>51.69</u>	<u>(99,253)</u>
Restricted stock outstanding at December 31, 2008	<u>\$37.89</u>	<u>2,370,930</u>

At December 31, 2008, the 2.4 million shares of restricted stock outstanding consisted of 1.4 million shares that are subject to performance conditions (“performance shares”) and 1.0 million shares that are subject only to service conditions (“time vested shares”). The weighted-average grant date fair value of restricted stock granted during 2007 and 2006 was \$62.17 and \$64.67, 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.

Notes (continued)

At December 31, 2008, 3,004,229 shares were available for future grant under the 2002 stock incentive plan. Of the shares available for future grant, 2,905,609 are available for restricted stock awards. The total fair value of restricted stock vested during 2008, 2007 and 2006 was \$3.3 million, \$20.7 million and \$17.4 million, respectively.

As of December 31, 2008, there was \$49.0 million of total unrecognized compensation cost related to nonvested share-based compensation agreements granted under the Plan. Of this total, \$33.8 million of unrecognized compensation costs relate to performance shares and \$15.2 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 1.4 years.

Under terms of our Shareholder Rights Agreement each outstanding share of our Common Stock is accompanied by one Right. The "Distribution Date" occurs ten days after an announcement that a person has become the beneficial owner (as defined in the Agreement) of the Designated Percentage of our Common Stock (the date on which such an acquisition occurs is the "Shares Acquisition Date" and a person who makes such an acquisition is 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 ownership by a person of 15 percent or more of the Common Stock. The Designated Percentage is 15% or more, except that for certain investment advisers and investment companies advised by such advisers, the Designated Percentage is 20% or more if certain conditions are met. 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 \$225 per full share (equivalent to \$112.50 for each one-half share), subject to adjustment. If there is an Acquiring Person, then each 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 July 22, 2009, subject to extension. 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.

14. 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 \$8.1 million, \$7.7 million and \$6.9 million in 2008, 2007 and 2006, respectively.

At December 31, 2008, minimum future operating lease payments are as follows (in thousands of dollars):

2009	\$ 6,054
2010	4,830
2011	2,277
2012	1,448
2013 and thereafter	<u>1,054</u>
Total	<u>\$15,663</u>

15. Litigation and contingencies

We are involved in litigation in the ordinary course of business. In our opinion, the ultimate resolution of this pending litigation will not have a material adverse effect on our financial position or results of operations.

Notes (continued)

Consumers are bringing a growing number of lawsuits against home mortgage lenders and settlement service providers. In recent years, seven 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 late December 2004 following denial of class certification in June 2004. Since December 2006, class action litigation was separately brought against a number of large lenders alleging that their captive mortgage reinsurance arrangements violated RESPA. While we are not a defendant in any of these cases, there can be no assurance that we will not be subject to future litigation under RESPA or FCRA or that the outcome of any such litigation would not have a material adverse effect on us.

In June 2005, in response to a letter from the New York Insurance Department, we provided information regarding captive mortgage reinsurance arrangements and other types of arrangements in which lenders receive compensation. In February 2006, the New York Insurance Department requested MGIC to review its premium rates in New York and to file adjusted rates based on recent years' experience or to explain why such experience would not alter rates. In March 2006, MGIC advised the New York Insurance Department that it believes its premium rates are reasonable and that, given the nature of mortgage insurance risk, premium rates should not be determined only by the experience of recent years. In February 2006, in response to an administrative subpoena from the Minnesota Department of Commerce, which regulates insurance, we provided the Department with information about captive mortgage reinsurance and certain other matters. We subsequently provided additional information to the Minnesota Department of Commerce, and beginning in March 2008 that Department has sought additional information as well as answers to questions regarding captive mortgage reinsurance on several occasions. In June 2008, we received a subpoena from the Department of Housing and Urban Development, commonly referred to as HUD, seeking information about captive mortgage reinsurance similar to that requested by the Minnesota Department of Commerce, but not limited in scope to the state of Minnesota. Other insurance departments or other officials, including attorneys general, may also seek information about or investigate captive mortgage reinsurance.

The anti-referral fee provisions of RESPA provide that the Department of Housing and Urban Development as well as the insurance commissioner or attorney general of any state may bring an action to enjoin violations of these provisions 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 outcome of any such reviews or investigations nor is it possible to predict their effect on us or the mortgage insurance industry.

In October 2007, the Division of Enforcement of the Securities and Exchange Commission requested that we voluntarily furnish documents and information primarily relating to C-BASS, the now-terminated merger with Radian and the subprime mortgage assets "in the Company's various lines of business." We are in the process of providing responsive documents and information to the Securities and Exchange Commission. As part of its initial information request, the SEC staff informed us that this investigation should not be construed as an indication by the SEC or its staff that any violation of the securities laws has occurred, or as a reflection upon any person, entity or security.

In 2008, complaints in five separate purported stockholder class action lawsuits were filed against us, several of our officers and an officer of C-BASS. The allegations in the complaints are generally that through these individuals we violated the federal securities laws by failing to disclose or misrepresenting C-BASS's liquidity, the impairment of our investment in C-BASS, the inadequacy of our loss reserves and that we were not adequately capitalized. The collective time period covered by these lawsuits begins on October 12, 2006 and ends on February 12, 2008. The complaints seek damages based on purchases of our stock during this time period at prices that were allegedly inflated as a result of the purported misstatements and omissions. With limited exceptions, our bylaws provide that our officers are entitled to indemnification from us for claims

Notes (continued)

against them of the type alleged in the complaints. We believe, among other things, that the allegations in the complaints are not sufficient to prevent their dismissal and intend to defend against them vigorously. However, we are unable to predict the outcome of these cases or estimate our associated expenses or possible losses.

Other lawsuits alleging violations of the securities laws could be brought against us. In December 2008, a holder of a class of certificates in a publicly offered securitization for which C-BASS was the sponsor brought a purported class action under the federal securities laws against C-BASS; the issuer of such securitization, which was an affiliate of a major Wall Street underwriter; and the underwriters alleging material misstatements in the offering documents. The complaint describes C-BASS as a venture of MGIC, Radian Group and the management of C-BASS and refers to Doe defendants who are unknown to the plaintiff but who the complaint says are legally responsible for the events described in the complaint.

Two law firms have issued press releases to the effect that they are investigating whether the fiduciaries of our 401(k) plan breached their fiduciary duties regarding the plan's investment in or holding of our common stock. With limited exceptions, our bylaws provide that the plan fiduciaries are entitled to indemnification from us for claims against them. We intend to defend vigorously any proceedings that may result from these investigations.

Under our contract underwriting agreements, we may be required to provide certain remedies to our customers if certain standards relating to the quality of our underwriting work are not met. The cost of remedies provided by us to customers for failing to meet these standards has not been material to our financial position or results of operations for the years ended December 31, 2008, 2007 and 2006.

See Note 12 for a description of federal income tax contingencies.

16. Unaudited quarterly financial data

<u>2008</u>	<u>Quarter</u>				<u>2008 Year</u>
	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	
	(In thousands of dollars, except per share data)				
Net premiums written	\$ 368,454	\$ 371,797	\$ 365,042	\$ 360,754	\$1,466,047
Net premiums earned	345,488	350,292	342,312	355,088	1,393,180
Investment income, net of expenses	72,482	76,982	78,612	80,441	308,517
Losses incurred, net(a)	691,648	688,143	788,272	903,438	3,071,501
Change in premium deficiency reserves . . .	(263,781)	(158,898)	(204,240)	(129,586)	(756,505)
Underwriting and other expenses	76,986	68,236	62,424	63,668	271,314
Net loss	(34,394)	(97,899)	(113,274)	(273,347)	(518,914)
Loss per share(a):					
Basic	(0.41)	(0.79)	(0.91)	(2.21)	(4.55)
Diluted	(0.41)	(0.79)	(0.91)	(2.21)	(4.55)

(a) Our view of potential losses on the 2006 and 2007 books of business has trended upward since the first quarter of 2008.

Notes (continued)

<u>2007</u>	<u>Quarter</u>				<u>2007 Year</u>
	<u>First</u>	<u>Second</u>	<u>Third(b)</u>	<u>Fourth(c)(d)</u>	
	(In thousands of dollars, except per share data)				
Net premiums written	\$304,034	\$320,988	\$ 340,244	\$ 380,528	\$ 1,345,794
Net premiums earned	299,021	306,451	320,966	335,952	1,262,390
Investment income, net of expenses	62,970	61,927	64,777	70,154	259,828
Losses incurred, net	181,758	235,226	602,274	1,346,165	2,365,423
Change in premium deficiency reserves . .	—	—	—	1,210,841	1,210,841
Underwriting and other expenses	75,072	75,330	86,325	72,883	309,610
Net income (loss)	92,363	76,715	(372,469)	(1,466,627)	(1,670,018)
Earnings (loss) per share(a):					
Basic	1.13	0.94	(4.61)	(18.17)	(20.54)
Diluted	1.12	0.93	(4.61)	(18.17)	(20.54)

- (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 third quarter results included a net-of-tax impairment charge of \$303 million related to our investment in C-BASS. (See Note 10.)
- (c) The fourth quarter results included the establishment of premium deficiency reserves related to our Wall Street bulk business. (See Notes 1 and 8.)
- (d) The fourth quarter results reflect the significant deterioration in the performance of loans insured experienced during that quarter, as reported under losses incurred.

Directors

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

Karl E. Case
Professor of Economics
 Wellesley College
 Wellesley, MA

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

David S. Engelman
Private Investor
 San Diego, CA

Thomas M. Hagerty
Managing Director
 Thomas H. Lee Company
 Boston, MA
 A private investment firm

Kenneth M. Jastrow, II
Non-Executive Chairman
 Forestar Group Inc.
 Austin, TX
 A company engaged in various real estate businesses

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

Michael E. Lehman
Executive Vice President and Chief Financial Officer
 Sun Microsystems, Inc.
 Menlo Park, CA
 A provider of computer systems and professional support services

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

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 Presidents
 James A. Karpowicz
Chief Investment Officer and Treasurer

Joseph J. Komaneci
Controller and Chief Accounting Officer

Joseph J. Ziino, Jr.
Regulatory Relations, Associate General Counsel and Assistant Secretary

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
 Carla A. Gallas
Claims

James A. Karpowicz
Chief Investment Officer and Treasurer

Joseph J. Komaneci
Controller and Chief Accounting Officer

Michael G. Meade
Information Services and Chief Information Officer

Steven T. Snodgrass
Capital Markets

Cheryl L. Webb
Field Operations

Martin F. Wood
International Business Development

Joseph J. Ziino, Jr.
Regulatory Relations, Associate General Counsel and Assistant Secretary

Michael J. Zimmerman
Investor Relations

Vice Presidents
 Gary A. Antonovich
Internal Audit

Stephen L. Blose
Corporate Development

Mark F. Conrad
National Accounts

Stephen M. Dempsey
Managing Director

Sandra K. Dunst
Claims Operations

Edward G. Durant
Analytic Services

Timothy J. Edwards
Capital Markets Sales

David A. Greco
Credit Policy

Ralph J. Gundrum
Securities Law Counsel and Assistant Secretary

Heidi A. Heyrman
Regulatory Relations and Assistant Secretary

Steven F. Himebauch
National Accounts

James J. Hughes
Managing Director

W. Thomas Hughes
Managing Director

Malcom T. Hurst
Sales

Eric B. Klopfer
International Strategic Initiatives and Regulatory Affairs

Mark J. Krauter
National Accounts

Robin D. Mallory
Managing Director

Mark E. Marple
Mortgage Banking Strategies

Salvatore A. Miosi
Marketing

Jeffrey N. Nielsen
Financial Planning/Analysis

Lisa M. Pendergast
Assistant Treasurer

Eric L. Rice
Sales

John R. Schroeder
Risk Management

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

James R. Stirling
Information Services and Chief Technology Officer

Thomas B. Theobald
National Accounts

Kurt J. Thomas
Human Resources

Steven M. Thompson
Risk Management

Kathleen E. Valenti
Loss Mitigation

Bernhard W. Verhoeven
Risk Management

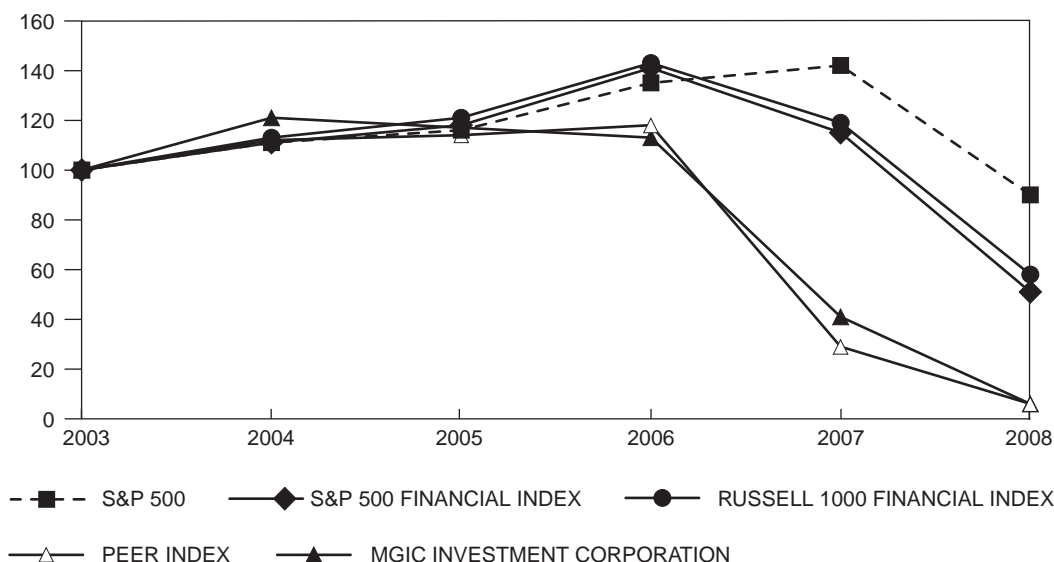
John S. Wiseman
Managing Director

Jerry L. Wormmeester
National Accounts

Performance Graph

The graph below compares the cumulative total return on (a) our Common Stock, (b) the Russell 1000 Financial Index, (c) a new composite peer group index selected by us, (d) the Standard & Poor's 500 Stock Index and (e) the Standard & Poor's 500 Financials Index. Our peer group consists of Radian Group Inc., The PMI Group, Inc. and Triad Guaranty Inc. We selected this peer group because it includes each of the public companies, other than us, for which private mortgage insurance is the primary business. In 2008, Triad Guaranty Inc. ceased writing new private mortgage insurance. We nevertheless included Triad Guaranty Inc. in our peer group because it was writing business during the majority of the period covered by the graph below and because we did not want our peer group to consist of only two companies.

Our prior performance graphs compared the cumulative total return of our Common Stock, the Standard & Poor's 500 Stock Index and the Standard & Poor's 500 Financials Index, in part because our Common Stock was formerly included in both of these indexes. As a result of the decrease in our market capitalization during 2007 and 2008, we are no longer included in either index. As a result, we decided to (i) replace the Standard & Poor's 500 Financials Index with the Russell 1000 Financial Index, which includes companies with market capitalizations more similar to our current market capitalization and (ii) replace the Standard & Poor's 500 Stock Index with a peer group selected by us.



	2003	2004	2005	2006	2007	2008
S&P 500	100	111	116	135	142	90
S&P 500 Financial Index	100	111	118	141	115	51
Russell 1000 Financial Index	100	113	121	143	119	58
Peer Index	100	112	114	118	29	6
MGIC	100	121	117	113	41	6

Shareholder Information

The Annual Meeting

The Annual Meeting of Shareholders of MGIC Investment Corporation will convene at 9 a.m. Central Time on May 14, 2009 at 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, as amended, for the year ended December 31, 2008, 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 2008 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 13, 2009, 125,085,652 shares were outstanding. The following table sets forth for 2007 and 2008 by quarter the high and low sales prices of the Common Stock on the New York Stock Exchange.

Quarters	2007		2008	
	High	Low	High	Low
1st	\$68.96	\$53.90	\$22.72	\$9.60
2nd	66.46	53.61	14.14	5.41
3rd	57.94	27.28	12.50	3.51
4th	36.71	16.18	8.91	1.58

In 2007 and 2008 the Company declared and paid the following cash dividends:

Quarters	2007	2008
1st	\$.25	\$.025
2nd25	.025
3rd25	.025
4th025	—
	<u>\$.775</u>	<u>\$.075</u>

In October 2008, the Company discontinued payment of its dividend.

The Company is a holding company and the payment of dividends from its insurance subsidiaries is restricted by insurance regulation. For a discussion of these restrictions, see "Management's Discussion and Analysis — Liquidity and Capital Resources" and Note 13 of the Notes to the Consolidated Financial Statements.

As of February 15, 2009, the number of shareholders of record was 140. In addition, the Company estimates that there are more than 60,000 beneficial owners of shares held by brokers and fiduciaries.

MGIC INVESTMENT CORPORATION

MGIC Investment Corporation

MGIC Plaza, Milwaukee, Wisconsin 53202 • <http://mtg.mgic.com>