NMI Holdings, Inc.
Form 10-Q
May 06, 2015

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

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended March 31, 2015

OR

o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from to

Commission file number 001-36174
NMI Holdings, Inc.
(Exact name of registrant as specified in its charter)

DELAWARE	45-4914248
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2100 Powell Street, Emeryville, CA	94608
(Address of principal executive offices)	(Zip Code)

(855) 530-6642
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES x NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES x NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO x

The number of shares of common stock, $0.01 par value per share, of the registrant outstanding on May 1, 2015 was 58,686,375 shares.

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CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

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

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

For more information regarding these risks and uncertainties as well as certain additional risks that we face, you should refer to the Risk Factors detailed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014, and in our subsequent quarterly and other reports, including Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report on Form

10-Q, including the exhibits hereto, filed from time to time with the U.S. Securities and Exchange Commission (SEC).

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

PART I

Item 1. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS

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

	March 31, 2015	December 31, 2014
Assets	(In Thousands, except for share data)	
Fixed maturities, available-for-sale, at fair value (amortized cost of $365,674 and $337,718 as of March 31, 2015 and December 31, 2014, respectively)	$367,947	$336,501
Cash and cash equivalents	66,420	103,021
Premiums receivable	1,663	1,048
Accrued investment income	1,732	1,707
Prepaid expenses	2,091	2,054
Deferred policy acquisition costs, net	5,283	2,985
Software and equipment, net	12,913	11,806
Intangible assets and goodwill	3,634	3,634
Other assets	56	509
Total assets	$461,739	$463,265
Liabilities		
Unearned premiums	$28,054	$22,069
Reserve for insurance claims and claim expenses	187	83
Accounts payable and accrued expenses	6,845	10,646
Warrant liability, at fair value	2,124	3,372
Current tax payable	1,190	—
Deferred tax liability	137	137
Total liabilities	38,537	36,307
Commitments and contingencies		
Shareholders' equity		
Common stock - class A shares, $0.01 par value; 58,519,558 and 58,428,548 shares issued and outstanding as of March 31, 2015 and December 31, 2014, respectively (250,000,000 shares authorized)	585	584
Additional paid-in capital	564,915	562,911
Accumulated other comprehensive loss, net of tax	(1,548)	(3,607)
Accumulated deficit	(140,750)	(132,930)
Total shareholders' equity	423,202	426,958
Total liabilities and shareholders' equity	$461,739	$463,265

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)

	For the three months ended March 31,	
	2015	2014
Revenues	(In Thousands, except for share data)	
Net premiums written	$12,921	$5,178
Increase in unearned premiums	(5,985)	(3,274)
Net premiums earned	6,936	1,904
Net investment income	1,596	1,489
Net realized investment gains	613	—
Gain from change in fair value of warrant liability	1,248	817
Gain from settlement of warrants	—	37
Total revenues	10,393	4,247
Expenses		
Insurance claims and claims expenses	104	—
Underwriting and operating expenses	18,350	19,302
Total expenses	18,454	19,302
Loss before income taxes	(8,061)	(15,055)
Income tax benefit	(241)	—
Net loss	(7,820)	(15,055)
Other comprehensive income, net of tax:		
Net unrealized holding gains for the period included in accumulated other comprehensive loss, net of tax expense of $1,431, and $0 for the three months ended March 31, 2015 and 2014, respectively	2,672	3,035
Reclassification adjustment for gains included in net loss, net of tax expense of $0, and $0 for the three months ended March 31, 2015 and 2014, respectively	(613)	—
Other comprehensive income, net of tax	2,059	3,035
Total comprehensive loss	$(5,761)	$(12,020)
Loss per share		
Basic and diluted loss per share	$(0.13)	$(0.26)
Weighted average common shares outstanding	58,485,899	58,061,299

See accompanying notes to consolidated financial statements.

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

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
	Class A	Class B				
	(In Thousands)					
Balances, January 1, 2014	$581	$—	$553,707	$ (7,047)	$(84,024)	$463,217
Common stock: class A shares issued under related to warrants	*	—	13	—	—	13
Common stock: class A shares issued under stock plans, net of shares withheld for employee taxes	3	—	11	—	—	14
Share-based compensation expense	—	—	9,180	—	—	9,180
Change in unrealized investment gains/losses, net of tax of $2,390	—	—	—	3,440	—	3,440
Net loss	—	—	—	—	(48,906)	(48,906)
Balances, December 31, 2014	$584	$—	$562,911	$ (3,607)	$(132,930)	$426,958
Common stock: class A shares issued under stock plans, net of shares withheld from employee taxes	1	—	(1)	—	—	—
Share-based compensation expense	—	—	2,005	—	—	2,005
Change in unrealized investment gains/losses, net of tax of $1,431	—	—	—	2,059	—	2,059
Net loss	—	—	—	—	(7,820)	(7,820)
Balances, March 31, 2015	$585	$—	$564,915	$ (1,548)	$(140,750)	$423,202

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

See accompanying notes to consolidated financial statements.

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NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	For the three months ended March 31,	
	2015	2014
Cash flows from operating activities	(In Thousands)	
Net loss	$(7,820)	$(15,055)
Adjustments to reconcile net loss to net cash used in operating activities:		
Net realized investment gains	(613)	—
Gain from change in fair value of warrant liability	(1,248)	(817)
Gain from settlement of warrants	—	(37)
Depreciation and other amortization	1,099	1,952
Share-based compensation expense	2,005	2,333
Noncash intraperiod tax allocation	(241)	—
Changes in operating assets and liabilities:		
Accrued investment income	(25)	210
Premiums receivable	(615)	(110)
Prepaid expenses	(37)	(183)
Deferred policy acquisition costs, net	(2,298)	(887)
Other assets	453	7
Unearned premiums	5,985	3,274
Reserve for insurance claims and claims expenses	104	—
Accounts payable and accrued expenses	(4,291)	(2,678)
Net cash used in operating activities	(7,542)	(11,991)
Cash flows from investing activities		
Purchase of fixed-maturity investments, available-for-sale	(61,676)	(110)
Proceeds from redemptions, maturities and sale of fixed-maturity investments, available-for-sale	33,935	718
Purchase of software and equipment	(1,317)	(1,664)
Net cash used in investing activities	(29,058)	(1,056)
Cash flows from financing activities		
Taxes paid related to net share settlement of equity awards	(334)	(90)
Issuance of common stock	333	—
Net cash used in financing activities	(1)	(90)
Net decrease in cash and cash equivalents	(36,601)	(13,137)
Cash and cash equivalents, beginning of period	103,021	55,929
Cash and cash equivalents, end of period	$66,420	$42,792

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Organization and Basis of Presentation

NMI Holdings, Inc. (NMIH) is a Delaware corporation, incorporated in May 2011, to provide private mortgage guaranty insurance (which we refer to as mortgage insurance or MI) through its wholly owned insurance subsidiaries, National Mortgage Insurance Corporation (NMIC) and National Mortgage Reinsurance Inc One (Re One). In April 2013, NMIC, our primary insurance subsidiary, wrote our first mortgage insurance policy. As of March 31, 2015, we had $4.8 billion of primary insurance in force (IIF) and $4.6 billion of pool IIF, with $1.1 billion of primary risk-in-force (RIF) and $93.1 million of pool RIF.

Freddie Mac and Fannie Mae each approved NMIC as an eligible mortgage insurer, on January 15, 2013 and January 16, 2013, respectively, which approvals are conditioned upon NMIC maintaining certain conditions (GSE Approval).

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, which include the results of NMIH and its wholly owned subsidiaries, have been prepared in accordance with the instructions to Form 10-Q as prescribed by the SEC for interim reporting and include other information and disclosures required by accounting principles generally accepted in the U.S. (GAAP). Our accounts are maintained in U.S. dollars. These statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2014 included in our Annual Report on Form 10-K. All intercompany transactions have been eliminated. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities as of the balance sheet date. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates. The results of operations for the interim period may not be indicative of the results that may be expected for the full year ending December 31, 2015.

Earnings per Share

Basic net loss per share is based on the weighted-average number of common shares outstanding, while diluted net loss per share is based on the weighted-average number of common shares outstanding and common stock equivalents that would be issuable upon the exercise of stock options, other stock-based compensation arrangements, and the dilutive effect of outstanding warrants. As a result of our net losses for the three months ended March 31, 2015 and 2014, 7,137,901 shares and 6,159,735 shares, respectively, of our common stock equivalents issued under stock-based compensation arrangements and warrants, respectively, were not included in the calculation of diluted net loss per share as of such dates because they were anti-dilutive.

Deferred Policy Acquisition Costs

Costs directly associated with the successful acquisition of mortgage insurance policies, consisting of certain selling expenses and other policy issuance and underwriting expenses, are initially deferred and reported as deferred policy acquisition costs (DAC). For each book year of business, these costs are amortized to expense in proportion to estimated gross profits over the estimated life of the policies. Total amortization of DAC for the three months ended March 31, 2015 and 2014 were $356 thousand and $19 thousand, respectively.

Premium Deficiency Reserves

We consider whether a premium deficiency exists at each fiscal quarter using best estimate assumptions as of the testing date. Per Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 944, a premium deficiency reserve shall be recognized if the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs, and maintenance costs exceeds related unearned premiums and anticipated investment income. We have determined that no premium deficiency reserves were necessary for the three months ended March 31, 2015 or 2014.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606). This update is intended to provide a consistent approach in recognizing revenue. In accordance with the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The provisions of this update are effective for interim and annual periods beginning after December 15, 2016. The Company is currently evaluating the impact the adoption of this ASU will have on the consolidated financial statements.

NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2. Investments

We have designated our investment portfolio as available-for-sale and report it at fair value. The related unrealized gains and losses are, after considering the related tax expense or benefit, recognized as a component of accumulated other comprehensive loss in shareholders' equity. Net realized investment gains and losses are reported in income based upon specific identification of securities sold.

Fair Values and Gross Unrealized Gains and Losses on Investments

	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
As of March 31, 2015	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	$86,605	$115	$(127)	$86,593
Municipal debt securities	12,008	21	(34)	11,995
Corporate debt securities	198,125	2,311	(308)	200,128
Asset-backed securities	68,936	397	(102)	69,231
Total investments	$365,674	$2,844	$(571)	$367,947

	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
As of December 31, 2014	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	$68,911	$7	$(573)	$68,345
Municipal debt securities	12,009	27	(73)	11,963
Corporate debt securities	200,358	883	(1,456)	199,785
Asset-backed securities	56,440	222	(254)	56,408
Total investments	$337,718	$1,139	$(2,356)	$336,501

Scheduled Maturities

The amortized cost and fair values of available for sale securities at March 31, 2015 and December 31, 2014, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Because most asset-backed securities provide for periodic payments throughout their lives, they are listed below in separate categories.

As of March 31, 2015	Amortized Cost	Fair Value
	(In Thousands)	
Due in one year or less	$19,617	$19,662
Due after one through five years	180,613	181,103
Due after five through ten years	79,706	81,044
Due after ten years	16,802	16,907
Asset-backed securities	68,936	69,231
Total investments	$365,674	$367,947

NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

As of December 31, 2014	Amortized Cost	Fair Value
	(In Thousands)	
Due in one year or less	$6,110	$6,125
Due after one through five years	195,492	194,472
Due after five through ten years	54,360	53,891
Due after ten years	25,316	25,605
Asset-backed securities	56,440	56,408
Total investments	$337,718	$336,501

Net Realized Investment Gains (Losses) on Investments

Gross realized gains and losses were $0.8 million and $0.2 million, respectively, for the three months ended March 31, 2015. There were no realized investment gains or losses for the three months ended March 31, 2014.

Aging of Unrealized Losses

At March 31, 2015, the investment portfolio had gross unrealized losses of $0.6 million, $0.5 million of which has been in an unrealized loss position for a period of 12 months or greater. We did not consider these securities to be other-than-temporarily impaired as of March 31, 2015. We based our conclusion that these investments were not other-than-temporarily impaired at March 31, 2015 on the following facts: (i) the unrealized losses were primarily caused by interest rate movements since the purchase date; (ii) we do not intend to sell these investments; and (iii) we do not believe that it is more likely than not that we will be required to sell these investments before recovery of our amortized cost basis, which may not occur until maturity. For those securities in an unrealized loss position, the length of time the securities were in such a position is as follows:

	Less Than 12 Months			12 Months or Greater			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
As of March 31, 2015	(Dollars in Thousands)								
U.S. Treasury securities and obligations of U.S. government agencies	2	$7,307	$(17)	6	$22,448	$(110)	8	$29,755	$(127)
Municipal debt securities	1	3,240	(10)	1	1,726	(24)	2	4,966	(34)
Corporate debt securities	5	10,774	(38)	7	21,276	(270)	12	32,050	(308)
Assets-backed securities	5	13,452	(34)	4	10,782	(68)	9	24,234	(102)
Total investments	13	$34,773	$(99)	18	$56,232	$(472)	31	$91,005	$(571)

	Less Than 12 Months			12 Months or Greater			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
As of December 31, 2014	(Dollars in Thousands)								
U.S. Treasury securities and obligations of U.S. government agencies	4	$7,228	$(33)	10	$49,884	$(540)	14	$57,112	$(573)
Municipal debt securities	1	3,232	(18)	1	1,695	(55)	2	4,927	(73)
	26	60,334	(559)	22	65,806	(897)	48	126,140	(1,456)

Corporate debt securities									
Assets-backed securities	3	10,614	(57)	4	20,047	(197)	7	30,661	(254)
Total investments	34	$81,408	$(667)	37	$137,432	$(1,689)	71	$218,840	$(2,356)

Net Investment Income

For the three months ended March 31, 2015, net investment income was comprised of $1.7 million of investment income from fixed maturities and $0.1 million of investment expenses, compared to $1.6 million of investment income from fixed maturities and $0.1 million of investment expenses for the three months ended March 31, 2014.

As of March 31, 2015 and December 31, 2014, there were approximately $7.0 million of cash and investments in the form

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NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

of U.S. Treasury securities on deposit with various state insurance departments to satisfy regulatory requirements.

3. Fair Value of Financial Instruments

The following is a list of those assets and liabilities that are measured at fair value by hierarchy level:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
As of March 31, 2015	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	$57,238	$29,355	$—	$86,593
Municipal debt securities	—	11,995	—	11,995
Corporate debt securities	—	200,128	—	200,128
Asset-backed securities	—	69,231	—	69,231
Cash and cash equivalents	66,420	—	—	66,420
Total assets	$123,658	$310,709	$—	$434,367
Warrant liability	$—	$—	$2,124	$2,124
Total liabilities	$—	$—	$2,124	$2,124

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
As of December 31, 2014	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	$39,176	$29,169	$—	$68,345
Municipal debt securities	—	11,963	—	11,963
Corporate debt securities	—	199,785	—	199,785
Asset-backed securities	—	56,408	—	56,408
Cash and cash equivalents	103,021	—	—	103,021
Total assets	$142,197	$297,325	$—	$439,522
Warrant liability	$—	$—	$3,372	$3,372
Total liabilities	$—	$—	$3,372	$3,372

The following is a roll-forward of Level 3 liabilities measured at fair value:

	For the three months ended March 31,	
Warrant Liability	2015	2014
	(In Thousands)	
Balance, January 1	$3,372	$6,371
Change in fair value of warrant liability included in earnings	(1,248)	(817)
Issuance of common stock on warrant exercise	—	(13)
Gain on settlement of warrants	—	(37)
Balance, March 31	$2,124	$5,504

We revalue the warrant liability quarterly using a Black-Scholes option-pricing model, in combination with a binomial model, and we value the pricing protection features within the warrants using a Monte-Carlo simulation model. As of March 31, 2015, the assumptions used in the option pricing model were as follows: a common stock price as of

March 31, 2015 of $7.49, risk free interest rate of 1.65%, expected life of 6.67 years, expected volatility of 34.4% and a dividend yield of 0%. The change in fair value is primarily attributable to a decline in the price of our common stock from December 31, 2014 to March 31, 2015.

NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. Reserves for Insurance Claims and Claims Expenses

We establish claim reserves to recognize the estimated liability for insurance claims and claim expenses related to defaults on insured mortgage loans. Our method, consistent with industry practice, is to establish claim reserves only for loans in default. Our claim reserves also include amounts for estimated claims incurred on loans that have been in default for at least 60 days that have not yet been reported to us by the servicers, often referred to as IBNR. We did not establish reserves for insurance claims within our primary insurance book until the second quarter of 2014. In 2013, we entered into a pool insurance agreement with Fannie Mae. We only establish claim or IBNR reserves for pool risk if we expect claims to exceed the deductible under the pool agreement, which represents the amount of claims absorbed by Fannie Mae before we are obligated to pay any claims. At March 31, 2015, thirty-five loans in the pool were past due by sixty days or more. These thirty-five loans represent approximately $1.9 million in RIF. Due to the deductible of $10.3 million, the level of notices of default (NODs) reported through March 31, 2015 and the expected severity (all loans in the pool have LTVs under 80%), we have not established any pool reserves for claims or IBNR for the three months ended March 31, 2015 and 2014. We have not paid any claims to date.

The following table provides a reconciliation of the beginning and ending reserve balances for insurance claims and claims expenses:

	For the three months ended March 31,	
	2015	2014
	(In Thousands)	
Reserve at beginning of period	$83	$—
Claims incurred:		
Claims and claim expenses incurred:		
Current year	80	—
Prior years	24	—
Total claims incurred	104	—
Claims paid:		
Claims and claim expenses paid:		
Current year	—	—
Prior years	—	—
Total claims paid	—	—
Reserve at end of period	$187	$—

There was a $24 thousand unfavorable prior year development during the three months ended March 31, 2015. Reserves remaining as of March 31, 2015 for prior years are $107 thousand as a result of re-estimation of unpaid claims and claim adjustment expenses. The increase in the period is generally the result of ongoing analysis of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

5. Warrants

In April 2012, we issued 992,000 warrants with an aggregate fair value of $5.1 million upon the completion of a private placement of our securities and in conjunction with the acquisition of our insurance subsidiaries. Each warrant gives the holder thereof the right to purchase one share of common stock at an exercise price equal to $10.00. Upon exercise of these warrants, the amounts are reclassified from warrant liability to additional paid-in capital. During the first quarter of 2014, 7,790 warrants were exercised and we issued 1,115 Class A common shares via a cashless exercise. Upon exercise we recognized a gain of approximately $37 thousand. No warrants were exercised during the first quarter of 2015.

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

NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

6. Share Based Compensation
The following table provides a summary of option activity:

For the three months ended March 31, 2015	Shares	Weighted Average Grant Date Fair Value per Share	Weighted Average Exercise Price
	(Shares in Thousands)		
Options outstanding at December 31, 2014	3,630	$4.16	$10.66
Options granted	755	3.06	8.50
Options forfeited	(12)	4.34	11.07
Options outstanding at March 31, 2015	4,373	$3.97	$10.29

For the three months ended March 31, 2014	Shares	Weighted Average Grant Date Fair Value per Share	Weighted Average Exercise Price
	(Shares in Thousands)		
Options outstanding at December 31, 2013	3,063	$3.98	$10.31
Options granted	693	4.97	12.32
Options exercised	(2)	3.84	10.00
Options forfeited	(28)	4.15	10.71
Options outstanding at March 31, 2014	3,726	$4.17	$10.68

At March 31, 2015, there were no options exercised and 2.1 million options were fully vested and exercisable. The weighted average exercise price for the fully vested and exercisable options was $10.53. The remaining weighted average contractual life of options fully vested and exercisable as of March 31, 2015 was 7.5 years. The aggregate intrinsic value for fully vested and exercisable options was $0 as of March 31, 2015. The fair value of option grants to employees is determined based on a Black-Scholes simulation model at the date of grant.
The following table provides a summary of restricted stock unit (RSU) activity:

For the three months ended March 31, 2015	Shares	Weighted Average Grant Date Fair Value per Share
	(Shares in Thousands)	
Non-vested restricted stock units at December 31, 2014	1,209	$8.90
Restricted stock units granted	677	7.57
Restricted stock units vested and exercised	(91)	12.21
Restricted stock units forfeited	(15)	10.82
Non-vested restricted stock units at March 31, 2015	1,780	$8.21

For the three months ended March 31, 2014	Shares	Weighted Average Grant Date Fair Value per Share
	(Shares in Thousands)	
Non-vested restricted stock units at December 31, 2013	1,242	$7.75
Restricted stock units granted	239	12.32
Restricted stock units vested and exercised	(19)	11.31
Restricted stock units forfeited	(14)	6.98
Non-vested restricted stock units at March 31, 2014	1,448	$8.46

At March 31, 2015, the 1.8 million shares of non-vested RSUs consisted of 0.5 million shares that are subject to both a market and service condition and 1.3 million shares that are subject only to service conditions. The non-vested RSUs subject to both a market and service condition vest in one-half increments upon the achievement of certain market price goals and continued service.

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Non-vested RSUs subject only to a service condition vest over a service period ranging from 1 to 3 years. The fair value of RSUs subject to market and service conditions is determined based on a Monte Carlo simulation model at the date of grant. The fair value of RSUs subject only to service conditions are valued at our stock price on the date of grant less the present value of anticipated dividends, which is $0.

7. Income Taxes

We are a U.S. taxpayer and are subject to a statutory U.S. federal corporate income tax rate of 35%. Our holding company files a consolidated U.S. federal and various state income tax returns on behalf of itself and its subsidiaries. Our effective income tax rate on our pre-tax loss was 3.0% for the three months ended March 31, 2015, compared to 0.0% for the comparable 2014 period.

The income tax benefit of $0.2 million for the three months ended March 31, 2015 is related to the tax effects of unrealized gains credited to other comprehensive income (OCI). Generally, the amount of tax expense or benefit allocated to continuing operations is determined without regard to the tax effects of other categories of income or loss, such as OCI. However, an exception to the general rule is provided in ASC 740-20-45-7 when there is a pre-tax loss from continuing operations and there are items charged or credited to other categories, including OCI, in the current year. The intraperiod tax allocation rules related to items charged or credited directly to OCI can result in disproportionate tax effects that remain in OCI until certain events occur. As a result of net unrealized gains credited directly to OCI during the three months ended March 31, 2015, approximately $1.4 million of tax provision expense has been netted with current year unrealized gains in OCI, and $0.2 million of tax provision benefit was allocated to the income tax provision for continuing operations. Other benefits from income taxes were eliminated or reduced by the recognition of a full valuation allowance which was recorded to reflect the amount of the deferred taxes that may not be realized.

8. Statutory Information

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

Certain states limit the amount of risk a mortgage insurer may retain on a single loan to 25% of the indebtedness to the insured and, as a result, the portion of such insurance in excess of 25% must be reinsured. NMIC cedes premiums, loss reserves and claims to Re One on an excess share basis for any primary or pool policy which offers coverage greater than 25% on any loan insured thereunder solely for purposes of compliance with these state statutory coverage limits. Currently, NMIC has no other reinsurance agreements.

NMIC and Re One's combined statutory net loss, statutory surplus and contingency reserve were as follows: