Research Update:

Various Outlook Revisions Taken On U.S. Mortgage Insurers; Ratings Affirmed On Economic Recovery

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Overview

- Massive fiscal and monetary stimulus, along with the ramp-up in vaccinations, is helping boost the U.S. economic recovery. Forbearance relief is providing time for borrowers to recover as the economy picks up and the employment picture improves.
- Strong housing demand and historically low interest rates continue to support the housing market and maintain healthy origination volumes, despite the anticipated drop from 2020 highs.
- Reinsurance supply is returning, aiding mortgage insurers to manage their net exposures and maintain adequate risk-adjusted capitalization.
- Our view of the U.S. mortgage insurance sector is now stable. While risks persist, we expect that the insured losses will likely be contained within earnings and capitalization will likely remain sufficiently redundant at the 'BBB' stress level.
- We are taking various outlook revisions on U.S. mortgage insurers and affirmed our ratings on the companies and their subsidiaries.

Rating Action

On April 28, 2021, S&P Global Ratings revised its outlook to stable from negative on three private U.S. mortgage insurers (MIs): Essent Guaranty Inc., MGIC Investment Corp., and Radian Group Inc. We also revised our outlook to positive from negative on NMI Holdings Inc. Our negative outlook on Arch Capital Group Ltd. is unchanged. At the same time, S&P Global Ratings affirmed its issuer credit ratings on each holding company and its subsidiaries and its financial strength ratings on all insurance operating subsidiaries (see Ratings List).

Rationale

The revision of the U.S. mortgage insurance sector outlook to stable from negative reflects the economic recovery supported by massive stimulus and broad roll-out of vaccinations, borrower

relief through forbearance, robust housing market, and supportive sector capitalization aided by debt/equity capital raises and reinsurance capacity that is coming back since last year. While risks persists, we believe that pandemic-related stresses are an earnings event for the sector rather than a capital one.

The U.S. economy is in a much different place from March 2020, when we revised our sector view of the U.S. private mortgage insurers to negative. The economic recovery has been accelerating, employment gains have been strong, and the housing market has remained robust. The massive fiscal and monetary stimulus, along with the widening roll-out of vaccinations across the country, has improved the economic outlook considerably. We are expecting real GDP growth of 6.5% for 2021 and 3.1% in 2022. Although we believe risks to the economy remain, in view of the resurgence of the coronavirus in various regions, the economy is still on the mend. S&P Global Economics now estimates the risk of recession in the next 12 months to be much lower, at 10%-15%.

While S&P Global Economics expects the U.S. economy will recover to 2019 levels by mid-2021 and the unemployment rate will fall to 5.5% (compared with 14.75% at its peak), the jobs outlook is more nuanced, needing a longer runway. We expect payroll employment would likely recover to about 150.7 million by 2022, close to 2019's level of 150.9 million. As a result, we believe the forbearance relief is proving to be a critical bridge in helping borrowers recover as the economy rebounds and the employment picture improves. The U.S. government is aware of this dynamic, as highlighted by additional forbearance relief and the ban on foreclosures. As a result, we believe delinquency levels will continue to improve in 2021-2022. Early forbearance exits have shown large reinstatement rates via either full repayment or no missed payments at all in forbearance, although the reinstatement share might fall in 2021. Mortgage workout solutions will additionally help borrowers to manage their mortgages as they exit forbearance.

For the borrowers that still find themselves unable to make their mortgage payments, higher house prices than pre-pandemic levels could provide some equity cushion for the borrowers and potentially help reduce the losses for MIs. According to the Federal Housing Finance Agency purchase-only index, housing prices rose about 11% from fourth-quarter 2019 to fourth-quarter 2020, a trend that has continued into 2021. Along with sustained demand (in part due to the desire for larger homes outside city centers), constrained housing supply, and higher construction costs, house price gains could continue, although at a more modest pace. Premium rate increases of 10%-15% in 2020 will help offset some of the losses and drag on the operating margins as well, although rate declines in recent months point to a reversal of the rate gains. The mortgage insurance sector's move to a dynamic pricing engine in 2018-2019 allowed it to respond quickly to the developing situation by pushing rates and managing portfolio attributes, a key risk management tool.

We expect the mortgage insurance industry's prospective capitalization will remain supportive of the ratings through 2022, helped by earnings accrual and improving reinsurance availability. As of year-end 2020, the sector's capitalization was sufficiently redundant at the 'BBB' stress level under S&P Global Ratings' mortgage insurance capital model. During 2020, MIs strengthened their capital positions by issuing debt and equity to deal with the uncertainty, address reinsurance scarcity, and to benefit from the housing market strength. A high level of refinancing mortgage originations caused mortgage portfolio persistency to drop significantly, which reduced the benefit of pre-existing reinsurance programs (both insurance-linked notes [ILN] and traditional reinsurance) (certain MIs benefited from pre-arranged quota-share for the 2020 vintage). In addition, elevated delinquencies and high origination volumes in 2020 increased risk-adjusted capital requirements. We believe reinsurance availability has improved; various MIs tapped the ILN market starting in second-half 2020 and traditional capacity is coming back as well, albeit at higher costs. Therefore, we believe the sector will be able to continue with its hedging programs,

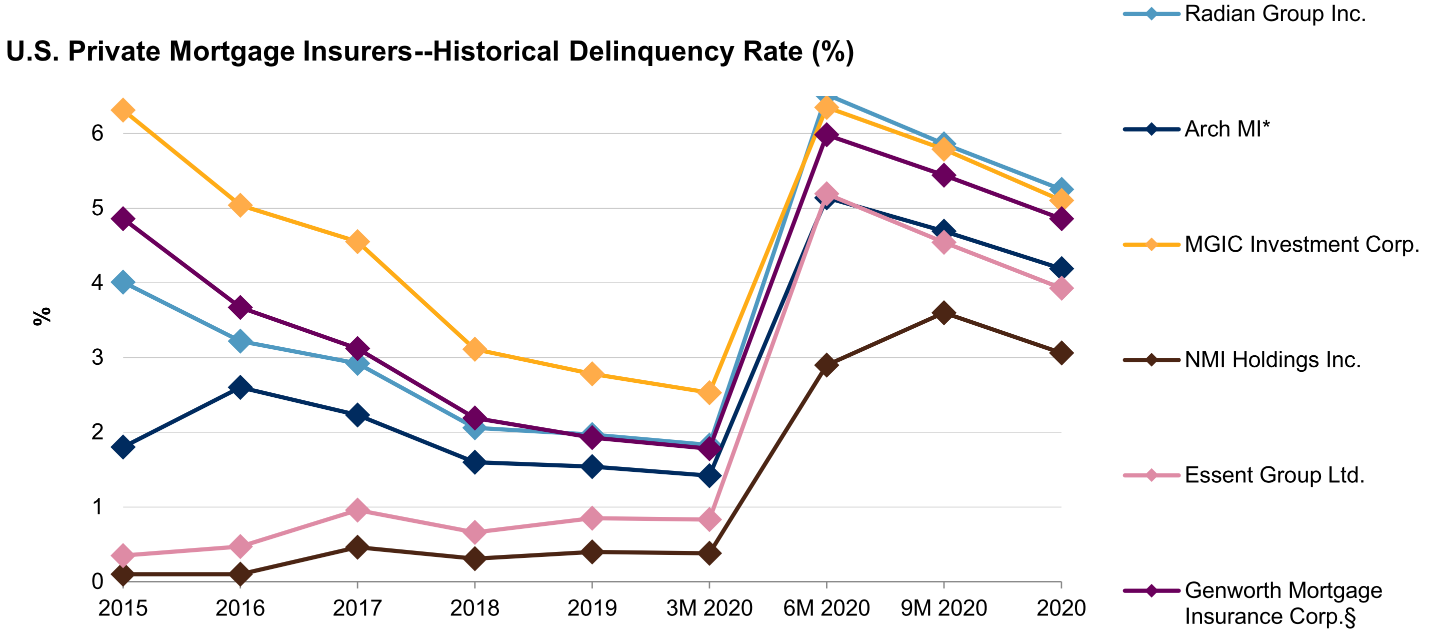
which along with improving earnings, should support risk-adjusted capitalization, which is materially redundant at the 'BBB' stress level.

In 2020, mortgage insurance sector's new insurance written (NIW) was significantly higher at about $600 billion ($384 billion for 2019), out of total 1-4 family mortgage originations of $3,828 billion. Robust housing markets and low interest rates resulted in improved loan-to-values and debt service ratios for a high volume of refinanced loans that made their way back to the insured portfolios, which supported strong credit quality for the vintage but also contributed to a lower average premium rates. MIs' top line will remain supported by a robust insured mortgage originations outlook in the next two years. As per the Mortgage Bankers Association, total 1-4 family mortgage originations are projected to be $3,284 billion and $2,313 billion for 2021 and 2022 respectively, higher than $2,253 billion for 2019. Even though the volumes will be lower than 2020's record NIW, contribution from purchase originations will be higher, propelled by strength in housing demand and still historically low interest rates. Purchase originations usually carry higher premium rates than refinancing, partially offsetting declining volumes. Nevertheless, we expect the average premium rate for the insured portfolio will decline in 2021, which will affect MIs' earned premiums despite anticipated growth in insurance-in-force (IIF) aided by increase in persistency, although to varying degrees. Due to anticipated increase in interest rates, we expect persistency to increase to about 70% for 2021 and the mid-70% area for 2022.

New business volumes and the recovering economy support our improving earnings outlook. We expect the sector's combined ratio will be 45%-50% in 2021 and 40%-45% in 2022. However, we temper our earnings expectation due to the potential for elevated losses depending on the sustainability of the economic recovery, the sensitivity around the transition period when payment forbearance subsides, and the extent of the latter's impact on cure rates. While there may be some volatility, we expect the losses will be contained within the sector's earnings. Furthermore, in view of house prices gains in the past 12 months, especially in suburbs, valuations in certain pockets of the country are overvalued. This can reduce affordability, which can stretch new borrowers, and could dampen mortgage originations.

MIs' operating company dividends will likely remain constrained due to government-sponsored entities' (Fannie Mae and Freddie Mac) guidance at the onset of pandemic that requires permission to upstream dividends. The constraints on dividends could potentially continue as long as the forbearance relief remains in effect. Although, with various MIs having accessed debt and equity capital markets in 2020, holding company liquidity positions remain adequate.

Chart 1



*Arch Capital Group Ltd.'s U.S. mortgage insurance business. §Genworth Financial Inc.'s U.S. primary mortgage insurance business. M--Months. Source: Company public filings.

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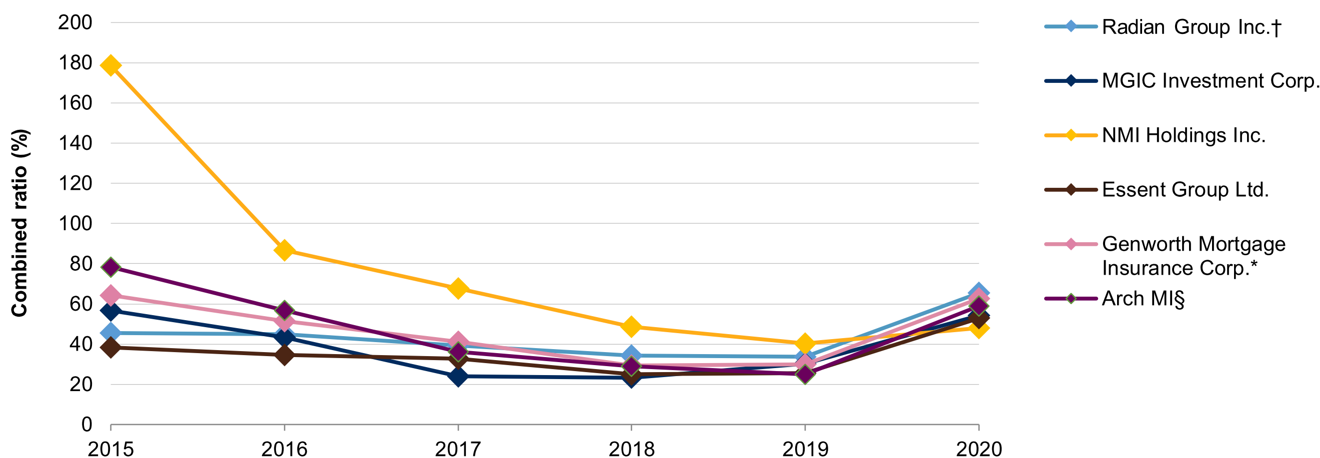
Chart 2



Note: Based on GAAP financials. *Genworth Financial Inc.'s U.S. mortgage insurance business based on generally accepted accounting principles (GAAP) segment data. §Arch Capital Group Ltd.'s mortgage insurance business based on GAAP segment data. †Radian's mortgage insurance business. Source: Company public filings and S&P Global Ratings.

Essent: In 2020, Essent reported a combined ratio of 52.9% compared with 63.3% in the first half of the year, helped by cure activity and the decline in new defaults, a trend we expect will continue. In first-quarter 2021, the primary default inventory fell to 29,080 loans, a 24% drop since its peak in second-quarter 2020. In fourth-quarter 2020, Essent increased its claim rate assumption for new defaults to pre-pandemic levels, indicating a return to a normalized level of claims rate, which pushed up the loss ratios in the quarter. In 2020, the company moved to take advantage of the market opportunity and increased its NIW to $108 billion (a 70% year-over-year increase), resulting in a market share gain. In 2021, Essent might give some of the market share gain back. We anticipate that, despite the increase in IIF, the company's premium growth in 2021 will be flat-to-slightly positive due to the lower average premium rate caused by the large 2020 vintage, before potentially increasing to mid-to-high single-digits in 2022. Overall, we expect the combined ratio will be 40%-45% for 2021-2022. Post the COVID-19 outbreak, Essent accessed equity markets in May 2020 for about $440 million and reinsurance markets (through ILN) in October 2020 for a total limit of $399 million. These capital initiatives support its growth and offsets some of the reduction in pre-existing reinsurance coverages due to a material decline in the portfolio persistency rate in 2020 to 60.1% (77.5% in 2019).

MGIC: In 2020, MGIC reported a combined ratio of 54.2% compared with 73.4% in the first half of the year, helped by cure activity and the decline in new defaults, a trend we expect will continue. In first-quarter 2021, the primary default inventory fell to 52,775 loans, a 24% drop since its peak in second-quarter 2020. MGIC still has an exposure to 2008 and previous legacy vintages, albeit decreasing, which contributed approximately 36% to the delinquent inventory in 2020. As a result, the company's loss ratio was slightly more elevated than that of some peers, which are relatively

newer entrants and have no exposure to legacy vintages. MGIC's market share in 2020 grew nearly 200 basis points (bps) from a record level of NIWs of $112 billion, an increase of 77% from the previous year, primarily due to higher refinancing volumes. In 2021, we expect that despite the modest increase in IIF, MGIC's top line will decline by mid-single digits due to a lower average premium rate, before potentially increasing low-to-mid single digits in 2022. Overall, we expect the combined ratio to be 45%-50% and 40%-45% for 2021 and 2022, respectively. In August 2020, MGIC issued $650 million in senior debt primarily to refinance its existing securities. It also accessed the ILN markets twice; in October 2020 and February 2021 for combined reinsurance coverage of approximately $811 million covering business written in 2020, in support of its capitalization. In addition, the company has forward-reinsurance treaties with traditional reinsurers covering for the business written in 2020 till 2022. We believe these capital initiatives helped support new business and offset some of the reduction in pre-existing reinsurance coverages due to a material decline in the portfolio persistency rate in 2020 to 60.5% (75.8% for 2019).

Radian: In 2020, Radian reported a combined ratio of 65.4% compared with 86% in the first half of the year, helped by cure activity and a decline in new defaults, a trend we expect will continue. In first-quarter 2021, the primary default inventory fell to 50,106 loans, a 28% drop since its peak in second-quarter 2020. The company's loss ratio was higher than the sector average, in part due to pre-2009 vintages, which account for about 25% of the company's reserves, and a claims rate assumption underlying loss reserves that is slightly higher than pre-pandemic. In 2021, we expect that, despite a slight increase in IIF, Radian's top line will decline by high single digits due to lower average premium rates and lower benefit from single premium cancellations, before potentially increasing to low single digits in 2022. Overall, we expect the combined ratio to be 45%-50% and 43%-47% for 2021 and 2022, respectively. In addition to its $525 million debt issuance in May 2020, Radian accessed ILN markets (in October 2020 and April 2021) for combined reinsurance coverage of $888 million for the 2020 vintage in support of its capitalization. These initiatives support new business and offset some of the reduction in pre-existing reinsurance coverages due to a material decline in the portfolio persistency rate in 2020 to 61.2% (78.2% for 2019).

NMI: In 2020, NMI reported a combined ratio of 48.1% compared with 51.9% in the first half of the year, helped by cure activity and a decline in new defaults, a trend we expect will continue. In first-quarter 2021, the primary default inventory fell to 11,090 loans, a 19.4% drop since its peak in third-quarter 2020. NMI has the lowest delinquency rate of its peers, which reflects the relatively low risk of portfolios underwritten, and no exposure to pre-2009 legacy vintages. Its loss ratio of 14.9% in 2020 is the lowest of its peer group. However, the company's expense ratio of 33.1% is the highest, though it is declining as the company is building scale. Our positive outlook on the company reflects our expectation that NMI will continue to expand and enhance its market presence. We expect it will maintain strong risk controls, pricing, and underwriting discipline, which will enable it to generate sustainable earnings supporting further improvement in capitalization. NMI wrote $62.7 billion of NIW in 2020, a 39% increase from the previous year. This was in part due to higher refinance origination volumes that comprised 33.6% of NIW in 2020, compared with 17.1% in 2019. In 2021, we anticipate that despite an increase in IIF, NMI's top line will remain flat due to the lower average premium rate, before potentially increasing by low double digits in 2022 due to higher persistency. Overall, we expect the combined ratio to be 50%-55% and 45%-50% for 2021 and 2022, respectively, with further reduction in the expense ratio. In 2020, NMI issued $400 million in debt and $230 million in equity; it also accessed the ILN markets twice for combined reinsurance coverage of approximately $564.5 million covering business written in

2020 in support of its capitalization. We believe these capital initiatives helped support new business and offset some of the reduction in pre-existing reinsurance coverages due to a material decline in the portfolio persistency rate in 2020 to 55.9% (76.8% in 2019).

Arch: In 2020, Arch reported an overall group combined ratio of 92.9% compared with 79.6% in 2019. The mortgage segment reported a combined ratio of 59.0% for full-year 2020, which improved from 62.9% in second-quarter 2020 when the mortgage delinquencies peaked, helped by improvement in the cure activity and lower levels of new defaults, a trend we expect will continue. The mortgage segment contributed significantly to the overall group's underwriting profitability. Despite the improvement in the mortgage segment, our negative outlook on Arch is unchanged, highlighting pressures from the continued underperformance in the company's insurance operations, and its rising risk profile volatility (as highlighted in our analysis published July 27, 2020). The insurance segment reported a combined ratio of 104.5% in 2020, affected by elevated natural catastrophe losses and COVID-19-related losses. The segment's average five-year (2016-2020) combined ratio was 102.7%, with underwriting losses reported in each of the past four years. However, we recognize that underwriting actions taken in the recent past along with the better pricing environment are aiding performance improvement, as reflected in the company's accident year loss ratio in 2020 and through the first quarter of 2021. Arch's combined property-casualty operations (insurance and reinsurance segments) grew solidly in 2019-2020, benefitting from the hardening rate environment and more business opportunities. This has, however, resulted in increased severity risk from higher net exposure to the property catastrophe and property lines of business. Although these lines could be sources of increased risk-reward payoffs, we believe they add to the earnings and capital volatility for the group.

Outlook (Essent, MGIC, and Radian)

The outlook is stable. Although risks persist, we believe that the insured losses will be contained within earnings, and capitalization will likely remain sufficiently redundant at the 'BBB' stress level, helped by access to reinsurance protection.

Downside scenario

We could lower our ratings during the next two years if:

- Losses are higher than anticipated such that they become a capital event or the operating performance is significantly worse than its peer group;
- Capitalization is not materially redundant at the 'BBB' stress level; or
- The company intends to manage its financial leverage above 30%.

Upside scenario

We do not anticipate raising our ratings during the next two years. However, we could raise the ratings if the U.S. economic and housing fundamentals are supportive and if:

- Risk-adjusted capitalization sustainably strengthens to a level that is sufficiently redundant at the 'A' stress level; or
- The company demonstrates strong underwriting discipline and risk controls supporting

sustainable risk-adjusted returns through the cycle that are better than those of peers.

Outlook (NMI)

The positive outlook reflects our expectations that NMI will continue to enhance its market presence while maintaining pricing and underwriting discipline and will generate strong risk-adjusted returns in line with those of peers. We expect the company will continue to successfully execute its capital strategy and strengthen its capitalization level to support its expanding underwriting portfolio.

Upside scenario

We could raise our ratings by one notch in the next two years if the U.S. economic and housing fundamentals are supportive and:

- NMI achieves scale by maintaining a sizable market presence supporting its business growth, and its portfolio seasons;
- It demonstrates strong underwriting discipline and risk controls supporting sustainable risk-adjusted returns through the cycle that are in line with those of peers; and
- It strengthens its capital adequacy at the 'BBB' confidence level in line with that of peers.

Downside scenario

We could affirm the ratings and revise the outlook to stable in the next two years if NMI does not perform as per our expectations. We could also lower the ratings, contrary to our expectations, if:

- Losses are higher than anticipated such that they weaken NMI's risk-adjusted capitalization,
- Portfolio growth is aggressive and underwriting discipline loosens, resulting in weakening of portfolio credit quality, or
- The company intends to manage its financial leverage above 30%.

Outlook (Arch)

The negative outlook reflects pressures on the company's competitive position and its volatility profile. The pressures emanate from the insurance segment's underperformance and increasing exposure to property-catastrophe risks.

Downside scenario

We could lower the ratings in the next 12 months if:

- The company's insurance segment performance fails to improve to a mid-90s combined ratio, or mortgage re/insurance exposure increases to the point that we view Arch primarily as an MI, weakening its competitive position;
- Arch's business mix continues to shift more toward severity risk, resulting in a higher capital and earnings volatility profile; or

- Significant underwriting losses stemming from mortgage or P/C re/insurance operations materially weaken capital adequacy at the 'A' confidence level.

Upside scenario

We could revise our outlook to stable and affirm the ratings in the next 12 months if the underwriting performance of the insurance segment improves as expected, and is in line with that of peers, supporting the company's strong competitive position.

Ratings Score Snapshot

U.S. Private Mortgage Insurers

	Arch Capital Group Ltd.	Essent Guaranty Inc.	MGIC Investment Corp.	Radian Group Inc.	NMI Holdings Inc.
Business Risk Profile	**Strong**	**Satisfactory**	**Satisfactory**	**Satisfactory**	**Satisfactory**
Competitive position	Strong	Satisfactory	Satisfactory	Satisfactory	Satisfactory
IICRA	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate
Financial Risk Profile	**Very Strong**	**Satisfactory**	**Satisfactory**	**Satisfactory**	**Fair**
Capital and earnings	Very Strong	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Risk exposure	Moderately low	Moderately low	Moderately low	Moderately low	Moderately high
Funding structure	Neutral	Neutral	Neutral	Neutral	Neutral
Anchor	a+	bbb+	bbb+	bbb+	bbb
Modifiers					
Governance	Neutral	Neutral	Neutral	Neutral	Neutral
Liquidity	Exceptional	Exceptional	Exceptional	Exceptional	Exceptional
Comparable ratings analysis	0	0	0	0	0
Financial Strength Rating	**A+/Negative**	**BBB+/Stable**	**BBB+/Stable**	**BBB+/Stable**	**BBB/Positive**
Holding Company - Issuer Credit Rating	**A-/Negative**	**NR**	**BB+/Stable**	**BB+/Stable**	**BB/Positive**

IICRA--Insurance Industry and Country Risk Assessment. NR--Not rated.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Insurance | General: Methodology: Mortgage Insurer Capital Adequacy, March 2, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Related Research

- Economic Outlook U.S. Q2 2021: Let The Good Times Roll, March 24, 2021
- U.S. Private Mortgage Insurers Benefit From Massive Stimulus And A Strong Housing Market While Risks Remain, Nov. 10, 2020
- Arch Capital Group Ltd., July 27, 2020
- Outlooks On Five U.S. Private Mortgage Insurers Revised To Negative Due To Elevated Credit Risk From COVID-19, March 26, 2020

Ratings List

**************** Arch Capital Group Ltd. ************	
Ratings Affirmed	
Arch Capital Group Ltd.	
Issuer Credit Rating	A-/Negative/--
Arch Excess & Surplus Insurance Co.	
Arch Specialty Insurance Co.	
Arch Reinsurance Ltd.	
Arch Reinsurance Europe Underwriting Designated Activity Co.	
Arch Reinsurance Co.	
Arch Insurance Co.	
Arch Insurance Canada Ltd.	
Arch Insurance (UK) Ltd	
Issuer Credit Rating	
Local Currency	A+/Negative/--
Arch Excess & Surplus Insurance Co.	
Arch Specialty Insurance Co.	
Arch Reinsurance Ltd.	
Arch Reinsurance Europe Underwriting Designated Activity Co.	
Arch Reinsurance Co.	
Arch Insurance Co.	
Arch Insurance Canada Ltd.	
Arch Insurance (UK) Ltd	
Arch Indemnity Insurance Co.	
Financial Strength Rating	
Local Currency	A+/Negative/--

Arch Indemnity Insurance Co.		
Issuer Credit Rating	A+/Negative/--	
Arch Insurance (EU) Designated Activity Co		
United Guaranty Residential Insurance Co.		
Arch Mortgage Insurance Co.		
Arch Mortgage Guaranty Co.		
Arch MI Asia Ltd.		
Issuer Credit Rating		
Local Currency	A/Negative/--	
Financial Strength Rating		
Local Currency	A/Negative/--	
Arch Capital Group Ltd.		
Senior Unsecured	A-	
Senior Unsecured	BBB+	
Preferred Stock	BBB	
Arch Capital Finance LLC		
Senior Unsecured	A-	
Arch Capital Group (U.S) Inc.		
Senior Unsecured	A-	
*** * * * * * * * * * * * * * Essent Guaranty Inc. * * * * * * * * * * * * ***		
Ratings Affirmed; Outlook Action		
	To	**From**
Essent Guaranty Inc.		
Issuer Credit Rating		
Local Currency	BBB+/Stable/--	BBB+/Negative/--
Essent Guaranty Inc.		
Essent Reinsurance Ltd.		
Financial Strength Rating		
Local Currency	BBB+/Stable/--	BBB+/Negative/--
Essent Reinsurance Ltd.		
Issuer Credit Rating	BBB+/Stable/--	BBB+/Negative/--
*** * * * * * * * * * * * * MGIC Investment Corp. * * * * * * * * * * * * ***		
Ratings Affirmed		
MGIC Investment Corp.		
Senior Unsecured	BB+	
Junior Subordinated	BB-	

Ratings Affirmed; Outlook Action		
	To	**From**
MGIC Investment Corp.		
Issuer Credit Rating		
Local Currency	BB+/Stable/--	BB+/Negative/--
MGIC Indemnity Corp		
Mortgage Guaranty Insurance Corp.		
Issuer Credit Rating		
Local Currency	BBB+/Stable/--	BBB+/Negative/--
Financial Strength Rating		
Local Currency	BBB+/Stable/--	BBB+/Negative/--
*** * * * * * * * * * * * * * NMI Holdings, Inc * * * * * * * * * * * * * ***		
Ratings Affirmed		
NMI Holdings, Inc		
Senior Secured	BB	
Ratings Affirmed; Outlook Action		
	To	**From**
NMI Holdings, Inc		
Issuer Credit Rating		
Local Currency	BB/Positive/--	BB/Negative/--
National Mortgage Insurance Corp.		
Issuer Credit Rating		
Local Currency	BBB/Positive/--	BBB/Negative/--
Financial Strength Rating		
Local Currency	BBB/Positive/--	BBB/Negative/--
*** * * * * * * * * * * * * * Radian Group Inc. * * * * * * * * * * * * * ***		
Ratings Affirmed		
Radian Group Inc.		
Senior Unsecured	BB+	
Ratings Affirmed; Outlook Action		
	To	**From**
Radian Group Inc.		
Issuer Credit Rating		
Local Currency	BB+/Stable/--	BB+/Negative/--
Radian Guaranty Inc.		
Radian Reinsurance Inc.		
Issuer Credit Rating		
Local Currency	BBB+/Stable/--	BBB+/Negative/--

Financial Strength Rating		
Local Currency	BBB+/Stable/--	BBB+/Negative/--

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