S&P Global Ratings

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Research Update:

Outlooks On Five U.S. Private Mortgage Insurers Revised To Negative Due To Elevated Credit Risk From COVID-19

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Overview

- A sudden shock to the U.S. economy will raise mortgage delinquencies, potentially leading to private mortgage insurers recognizing higher credit losses.
- Strong underwriting and pricing since the 2008 financial crisis, and better capitalization supported by higher utilization of reinsurance heading into 2020, provide some cushion.
- However, there is still uncertainty on the level of delinquencies and ultimate losses in the case of a prolonged recession.
- Increased mortgage refinancing and potential higher reinsurance costs, on whatever capacity that may be available, would further squeeze margins and pressure capitalization.
- As a result, we are revising our outlook to negative from stable on the U.S. private mortgage insurance sector and its key insurers.

Rating Action

On March 26, 2020, S&P Global Ratings revised its outlook to negative from stable on four U.S. private mortgage insurers and their subsidiaries: Arch Capital Group Ltd.; Essent Guaranty Inc.; MGIC Investment Corp.; and Radian Group Inc. S&P Global Ratings revised its outlook to negative from positive on NMI Holdings Inc.

At the same time, we have affirmed our issuer credit ratings (ICR) on each holding company and its subsidiaries, and financial strength ratings (FSR) on insurance operating subsidiaries (see Ratings List):

- Arch Capital Group Ltd.: A-/Negative
- Essent Guaranty Inc.: BBB+/Negative FSR and ICR (the holding company is not rated)
- MGIC Investment Corp.: BB+/Negative

- NMI Holdings Inc.: BB/Negative
- Radian Group Inc.: BB+/Negative

The ratings on Genworth Mortgage Insurance Corp. remain on CreditWatch with developing implications, where they were placed Sept. 26, 2018.

Rationale

The U.S. private mortgage insurers (PMIs) are facing the prospect of much higher losses as uncertainty abounds with the current state of the U.S. economy. S&P Global Ratings is projecting a sharp GDP contraction in the second quarter of 2020 of almost double the 6% from last week's estimate and a contraction in the first quarter as well, due to containment measures undertaken to stop the outbreak of COVID-19. There is a high degree of uncertainty about the size of the downside risk and the path of recovery will depend on the outbreak containment, the government's policy responses, and any resulting lasting damage to the economy.

The focus on containment and lockdown of large swaths of the population is leading to a sudden slump in consumer spending, leading to a jump in unemployment, which could be higher than originally anticipated in our economic projections. Higher mortgage payment delinquencies would naturally follow. PMIs would have to recognize these delinquencies through their earnings and loss reserves. Although, in considering the unique nature of the economic crisis, we do not know the level of delinquencies that may come through, the ultimate cure activity on these delinquencies, and the severity on the defaulted loans. In general, mortgage vintages reach peak loss in three to four years after origination, so the robust mortgage originations of recent years (2017-2019 constituted 63% of the total portfolio on average) are particularly at risk because first-time home buyers are usually a bigger proportion of a PMI's portfolio, and they usually have not built up their savings. Certain PMIs with lingering exposures from pre-2009 vintages would also be more exposed. We believe that, unlike in the 2008 Great Recession, this time the housing market is fairly valued and any possible negative impact on house prices due to curtailment of purchase originations activity may not be as material, at least in the near term. This would provide less of an incentive for the borrowers to walk away, partially offsetting our view of these risks.

The forbearance plan in the works by the government-sponsored enterprises (GSEs) will help borrowers manage through the difficult situation, which is, best case, a transient phase, in which case the losses recognized by the PMIs on borrowers becoming delinquent can be cured. However, it also raises the possibility that the proportion of borrowers willing to exercise the option available to defer payments to preserve their savings in this highly unusual and uncertain environment could increase the delinquencies more than what may have been the case in a general recessionary environment. Furthermore, in the case of a prolonged recession, these delinquencies may not cure at the rate assumed and could convert to actual losses at a higher rate.

The current portfolios are protected to varying degrees by reinsurance, with most of the PMIs relying on a mix of traditional reinsurance and insurance linked notes (ILNs), although ILNs have become an increasingly important part of PMIs' capital management due to cheaper costs. Of the asset requirements as calculated under GSEs' PMIERs (Private Mortgage Insurers Eligibility Requirements) framework, about 40% on average was met by reinsurance/ILNs as of year-end 2019 (includes internal group reinsurance). In view of the current market volatility, we believe the credit spreads in the ILN markets have widened and traditional reinsurance capacity could be scarce as well. If there is any appetite, the reinsurance capacity will come at an increased cost, and for excess covers, would likely attach higher compared with previous transactions. While a few PMIs have traditional reinsurance covers for 2020-2021, because of constrained reinsurance availability and higher loss costs, PMIs would face pressure not only on earnings, but on risk-adjusted capitalization too--both under S&P Global Ratings' capital model and GSEs' PMIERs framework. To the extent PMIs breach the PMIERs threshold, they may find themselves preserving and possibly raising capital to ensure they can maintain their approved status with the GSEs.

The drop in interest rates has increased refinancing volumes, although mortgage rates have not moved correspondingly due to the increase in spreads and lenders trying to manage the increased volumes due to the operational challenges of remote-work policies. But to the extent the refinance volumes are significantly higher, a portion of these loans, especially from recent vintages, will come back onto PMIs' portfolios. A refinanced loan can price lower, say, if the loan benefits from house price appreciation over the past few years and pre-payments reducing loan-to-value on an updated appraisal, which will reduce the benefit a PMI would have received from natural seasoning had the loan not refinanced. This dynamic can potentially further add to the earnings pressure.

Although the uncertainty remains, if the economy rebounds in the second half of the year, the risks highlighted above would start to abate, especially as the new delinquencies start to slow down and cure activity increases. Mortgage insurers entered 2020 with a fairly robust position. Mortgage portfolio credit quality was still strong, supported by tight underwriting subsequent to the 2008 financial crisis, which has been reflected in better performance than for the pre-crisis vintages. Despite the decline in the insurance premium rates in recent years, our expected return on equity for this year was in the mid-teens. During the past five years (2015-2019), on a generally accepted accounting principles basis and excluding Arch, the sector's aggregate combined ratio was approximately 38%, and the return on equity 19% (combined ratio of 37.5% including Arch's MI segment). Furthermore, PMIs have been strengthening their reinsurance programs over the past couple of years. PMIs have become increasingly reliant on reinsurance--both traditional and ILNs, providing a level of earnings and capital protection for their current exposures, which may help contain the losses within their earnings. From a capitalization perspective, PMIs were materially redundant at the 'BBB' confidence level and carried a decent buffer on top of the GSEs' PMIERs ratio (the weighted-average PMIERs sufficiency ratio was about 140%). The widespread adoption of the dynamic pricing engine also provides the PMIs the flexibility to move quickly on pricing to reflect some of the risks. Furthermore, investment portfolios are not an area of major risk for most PMIs (see table 1). These portfolios are typically composed of high credit quality fixed-income securities, balancing higher volatility inherent in the underwriting mortgage exposure. On average, high-risk assets constituted approximately 4.8% as of year-end 2019. Therefore, PMIs, on a net basis, are fundamentally in a better place now than during the 2008 financial crisis, which will help them navigate through the current crisis and the subsequent recovery. The U.S. fiscal stimulus would provide some support to the broader economy but it is still early to assess the impact on the housing and the mortgage sectors.

Investment Portfolio Allocation*

Dec. 31, 2019

(% unless otherwise noted)	Arch Capital Group Ltd.§	Essent Group Ltd.	MGIC Investment Corp.	Radian Group Inc.	NMI Holdings Inc.	Genworth Mortgage Insurance Corp.
Total invested assets including cash and cash equivalents (Mil. $)	22,347	3,501	5,920	5,758	1,182	4,373

Investment Portfolio Allocation* (cont.)

Dec. 31, 2019

(% unless otherwise noted)	Arch Capital Group Ltd.§	Essent Group Ltd.	MGIC Investment Corp.	Radian Group Inc.	NMI Holdings Inc.	Genworth Mortgage Insurance Corp.
Fixed income by ratings distribution						
'A-' ratings and above	65.2	71.8	73.2	74.5	83.0	52.0
'BBB' ratings	6.7	13.1	23.5	13.1	13.5	34.0
Non-investment-grade	3.7	1.8	0.3	1.2	0.0	1.0
Equities	11.1	0.0	0.3	0.9	0.0	0.0
Alternative investments (private equity, hedge fund, real estate, and others)	6.0	2.3	0.1	0.1	0.0	0.0
Cash and cash equivalents	7.3	11.0	2.7	10.1	3.5	13.0

Source: Company-provided information and filings. *Generally accepted accounting principles basis; % of total invested assets including cash and cash equivalents. §Excludes Watford Holdings Ltd.; equities include investments accounted for using the equity method.

Outlook

The negative outlook reflects the impact economic and market uncertainty could have on the loss experience and risk-adjusted capitalization of the PMIs. We recognize that there is a higher degree of uncertainty and a growing downside risk, which may lead to rating actions over the next two quarters.

Downside scenario

We could lower our ratings on the PMIs during the next two quarters if the COVID-19 impact drives a significant increase in unemployment resulting in higher mortgage delinquencies. This could become a capital event, which could ultimately weaken the PMIs' risk-adjusted capitalization relative to our ratings expectations, exacerbated by the potential scarcity of reinsurance capacity (including ILN).

Upside scenario

We could affirm the ratings and revise the outlooks back to stable if:

- Losses are largely contained within PMIs' earnings;
- Reinsurance structures and risk management perform as expected; and
- Risk-adjusted capitalization remains supportive of our current ratings.

Ratings Score Snapshot

U.S. Private Mortgage Insurers

	Arch Capital Group Ltd.	Essent Guaranty Inc.	MGIC Investment Corp.	Radian Group Inc.	NMI Holdings Inc.	Genworth Mortgage Insurance Corp.
Business Risk Profile	Strong	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Competitive position	Strong	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
IICRA	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate
Financial Risk Profile	Very Strong	Satisfactory	Satisfactory	Satisfactory	Fair	Satisfactory
Capital and earnings	Very Strong	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Risk exposure	Moderately low	Moderately low	Moderately low	Moderately low	Moderately high	Moderately low
Funding structure	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral
Anchor	a+	bbb+	bbb+	bbb+	bbb	bbb
Modifiers						
Governance	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral
Liquidity	Exceptional	Exceptional	Exceptional	Exceptional	Exceptional	Exceptional
Comparable ratings analysis	0	0	0	0	0	0
Financial Strength Rating	A+/Negative	BBB+/Negative	BBB+/Negative	BBB+/Negative	BBB/Negative	BB+/Watch Dev

IICRA--Insurance Industry and Country Risk Assessment.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Insurance | General: Methodology: Mortgage Insurer Capital Adequacy, March 2, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria - Insurance - General: Methodology For Assessing Capital Charges For U.S. RMBS And CMBS Securities Held By Insurance Companies, Aug. 29, 2014
- Criteria | Insurance | General: Methodology For Assessing Capital Charges For Commercial Mortgage Loans Held By U.S. Insurance Companies, May 31, 2012

- Criteria | Insurance | General: Methodology For Calculating The Convexity Risk In U.S. Insurance Risk-Based Capital Model, April 27, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Macroeconomic Update, March 24: A Massive Hit To World Economic Growth, March 24, 2020
- A U.S. Recession Takes Hold As Fallout From The Coronavirus Spreads, March 17, 2020

Ratings List

************* Arch Capital Group Ltd. ************		
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Arch Capital Group Ltd.		
Issuer Credit Rating	A-/Negative/--	A-/Stable/--
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/--	A+/Stable/--
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/--	A+/Stable/--
Arch Indemnity Insurance Co.		
Issuer Credit Rating	A+/Negative/--	A+/Stable/--
Arch Insurance (EU) Designated Activity Co		
United Guaranty Residential Insurance Co.		
Arch Mortgage Insurance Co.		
Arch Mortgage Guaranty Company		
Arch MI Asia Limited		
Issuer Credit Rating		
Local Currency	A/Negative/--	A/Stable/--
Financial Strength Rating		
Local Currency	A/Negative/--	A/Stable/--
*** * * * * * * * * * * * * * Essent Guaranty Inc. * * * * * * * * * * * * * ***		
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Essent Guaranty Inc.		
Issuer Credit Rating		
Local Currency	BBB+/Negative/--	BBB+/Stable/--
Essent Guaranty Inc.		
Essent Reinsurance Ltd.		
Financial Strength Rating		
Local Currency	BBB+/Negative/--	BBB+/Stable/--
Essent Reinsurance Ltd.		
Issuer Credit Rating	BBB+/Negative/--	BBB+/Stable/--
*** * * * * * * * * * * * * Genworth Financial Inc. * * * * * * * * * * * * ***		
Ratings Remaining on CreditWatch		
Genworth Mortgage Insurance Corp.		
Issuer Credit Rating		
Local Currency	BB+/Watch Dev/--	
Financial Strength Rating		
Local Currency	BB+/Watch Dev/--	
*** * * * * * * * * * * * * MGIC Investment Corp. * * * * * * * * * * * * ***		
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
MGIC Investment Corp.		
Issuer Credit Rating		
Local Currency	BB+/Negative/--	BB+/Stable/--

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