Essent Group Ltd.
Form 10-Q
November 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the period ended September 30, 2015

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 001-36157

ESSENT GROUP LTD.
(Exact name of registrant as specified in its charter)

Bermuda (State or other jurisdiction of incorporation or organization)	Not Applicable (I.R.S. Employer Identification Number)

Clarendon House
2 Church Street
Hamilton HM11, Bermuda
(Address of principal executive offices and zip code)

(441) 297-9901
(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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232-405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes ý 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.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	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 ý

The number of the registrant's common shares outstanding as of November 2, 2015 was 92,653,075.

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Essent Group Ltd. and Subsidiaries

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Unless the context otherwise indicates or requires, the terms “we,” “our,” “us,” “Essent,” and the “Company,” as used in this Quarterly Report on Form 10-Q, refer to Essent Group Ltd. and its directly and indirectly owned subsidiaries, including our primary operating subsidiary, Essent Guaranty, Inc., as a combined entity, except where otherwise stated or where it is clear that the terms mean only Essent Group Ltd. exclusive of its subsidiaries.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, or Quarterly Report, includes forward-looking statements pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts or present facts or conditions, such as statements regarding our future financial condition or results of operations, our prospects and strategies for future growth, the introduction of new merchandise, and the implementation of our marketing and branding strategies. In many cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates, “predicts,” “potential” or the negative of these terms or other comparable terminology.

The forward-looking statements contained in this Quarterly Report reflect our views as of the date of this Quarterly Report about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause events or our actual activities or results to differ significantly from those expressed in any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future events, results, actions, levels of activity, performance or achievements. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including, but not limited to, those factors described below, factors described in Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Quarterly Report, and factors described in Part I, Item 1A “Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission. These factors include, without limitation, the following:

- changes in or to Fannie Mae and Freddie Mac, which we refer to collectively as the GSEs, whether through Federal legislation, restructurings or a shift in business practices;
- failure to continue to meet the mortgage insurer eligibility requirements of the GSEs;
- competition for our customers;
- decline in new insurance written, or NIW, and franchise value due to loss of a significant customer;
- lenders or investors seeking alternatives to private mortgage insurance;
- increase in the number of loans insured through Federal government mortgage insurance programs, including those offered by the Federal Housing Administration;
- decline in the volume of low down payment mortgage originations;
- uncertainty of loss reserve estimates;
- decrease in the length of time our insurance policies are in force;
- deteriorating economic conditions;

- the definition of “Qualified Mortgage” reducing the size of the mortgage origination market or creating incentives to use government mortgage insurance programs;
- the definition of “Qualified Residential Mortgage” reducing the number of low down payment loans or lenders and investors seeking alternatives to private mortgage insurance;
- the implementation of the Basel III Capital Accord, which may discourage the use of private mortgage insurance;
- management of risk in our investment portfolio;

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- fluctuations in interest rates;
- inadequacy of the premiums we charge to compensate for our losses incurred;
- dependence on management team and qualified personnel;
- disturbance to our information technology systems;
- change in our customers’ capital requirements discouraging the use of mortgage insurance;
- declines in the value of borrowers’ homes;
- limited availability of capital;
- unanticipated claims arise under and risks associated with our contract underwriting program;
- industry practice that loss reserves are established only upon a loan default;
- disruption in mortgage loan servicing;
- risk of future legal proceedings;
- customers’ technological demands;
- our non-U.S. operations becoming subject to U.S. Federal income taxation;
- becoming considered a passive foreign investment company for U.S. Federal income tax purposes;
- scope of recently enacted legislation is uncertain; and
- potential inability of our insurance subsidiaries to pay dividends.

Readers are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on these forward-looking statements. All of the forward-looking statements we have included in this Quarterly Report are based on information available to us on the date of this Quarterly Report. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as otherwise required by law.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Essent Group Ltd. and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

(In thousands, except per share amounts)	September 30, 2015	December 31, 2014
Assets		
Investments available for sale, at fair value		
Fixed maturities (amortized cost: 2015 — $1,111,701; 2014 — $840,213)	$1,118,914	$846,925
Short-term investments (amortized cost: 2015 — $121,599; 2014 — $210,688)	121,600	210,688
Total investments	1,240,514	1,057,613
Cash	18,723	24,411
Accrued investment income	7,372	5,748
Accounts receivable	17,053	15,810
Deferred policy acquisition costs	11,229	9,597
Property and equipment (at cost, less accumulated depreciation of $41,646 in 2015 and $39,260 in 2014)	8,126	5,841
Prepaid federal income tax	107,412	59,673
Other assets	1,505	2,768
Total assets	$1,411,934	$1,181,461
Liabilities and Stockholders' Equity		
Liabilities		
Reserve for losses and LAE	$14,548	$8,427
Unearned premium reserve	191,989	156,948
Accrued payroll and bonuses	12,213	14,585
Net deferred tax liability	77,291	37,092
Securities purchases payable	28,115	227
Other accrued liabilities	11,542	8,444
Total liabilities	335,698	225,723
Commitments and contingencies		
Stockholders' Equity		
Common shares, $0.015 par value:		
Authorized - 233,333; issued — 92,653 shares in 2015 and 92,546 shares in 2014	1,390	1,388
Additional paid-in capital	900,549	893,285
Accumulated other comprehensive income	5,047	4,667
Retained earnings	169,250	56,398
Total stockholders' equity	1,076,236	955,738
Total liabilities and stockholders' equity	$1,411,934	$1,181,461

See accompanying notes to condensed consolidated financial statements.

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Essent Group Ltd. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(In thousands, except per share amounts)	Three Months Ended September 30, 2015	2014	Nine Months Ended September 30, 2015	2014
Revenues:				
Net premiums written	$97,478	$77,862	$272,134	$193,559
Increase in unearned premiums	(13,784)	(17,539)	(35,041)	(38,144)
Net premiums earned	83,694	60,323	237,093	155,415
Net investment income	5,322	3,405	14,322	8,383
Realized investment gains, net	548	151	1,765	619
Other income	2,172	742	2,634	2,308
Total revenues	91,736	64,621	255,814	166,725
Losses and expenses:				
Provision for losses and LAE	3,393	1,391	7,706	3,259
Other underwriting and operating expenses	28,714	24,469	83,360	71,576
Total losses and expenses	32,107	25,860	91,066	74,835
Income before income taxes	59,629	38,761	164,748	91,890
Income tax expense	18,808	13,691	51,896	32,259
Net income	$40,821	$25,070	$112,852	$59,631
Earnings per share:				
Basic	$0.45	$0.30	$1.25	$0.72
Diluted	0.44	0.29	1.23	0.70
Weighted average shares outstanding:				
Basic	90,418	83,640	90,317	83,263
Diluted	91,841	85,028	91,678	84,811
Net income	$40,821	$25,070	$112,852	$59,631
Other comprehensive income (loss):				
Change in unrealized appreciation (depreciation) of investments, net of tax expense (benefit) of $2,013 and ($494) in the three months ended September 30, 2015 and 2014 and $121 and $1,971 in the nine months ended September 30, 2015 and 2014	4,260	(1,405)	380	3,989
Total other comprehensive income (loss)	4,260	(1,405)	380	3,989
Comprehensive income	$45,081	$23,665	$113,232	$63,620

See accompanying notes to condensed consolidated financial statements.

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Essent Group Ltd. and Subsidiaries

Condensed Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

(In thousands)	Common Shares	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2014	$1,297	$754,390	$ (1,447)	$ (32,099)	$—	$722,141
Net income				88,497		88,497
Other comprehensive income (loss)			6,114			6,114
Issuance of common shares net of issuance cost of $6,761	90	126,649				126,739
Issuance of management incentive shares	2	414				416
Forfeiture of management incentive shares	—	—				—
Stock-based compensation expense		12,520				12,520
Excess tax benefits from stock-based compensation expense		1,809				1,809
Treasury stock acquired					(2,498)	(2,498)
Cancellation of treasury stock	(1)	(2,497)			2,498	—
Balance at December 31, 2014	$1,388	$893,285	$ 4,667	$ 56,398	$—	$955,738
Net income				112,852		112,852
Other comprehensive income (loss)			380			380
Issuance of management incentive shares	6	(6)				—
Forfeiture of management incentive shares	(1)	1				—
Stock-based compensation expense		9,959				9,959
Excess tax benefits from stock-based compensation expense		2,390				2,390
Treasury stock acquired					(5,135)	(5,135)
Cancellation of treasury stock	(3)	(5,132)			5,135	—
Other equity transactions		52				52
Balance at September 30, 2015	$1,390	$900,549	$ 5,047	$ 169,250	$—	$1,076,236

See accompanying notes to condensed consolidated financial statements.

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Essent Group Ltd. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine Months Ended September 30,	
(In thousands)	2015	2014
Operating Activities		
Net income	$112,852	$59,631
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on the sale of investments, net	(1,765)	(619)
Depreciation and amortization	2,386	1,834
Amortization of discount on payments due under Asset Purchase Agreement	—	44
Stock-based compensation expense	9,959	9,408
Amortization of premium on investment securities	7,244	4,722
Deferred income tax provision	40,077	30,412
Excess tax benefits from stock-based compensation	(2,390)	(1,729)
Change in:		
Accrued investment income	(1,624)	(3,056)
Accounts receivable	(2,821)	(3,160)
Deferred policy acquisition costs	(1,632)	(2,611)
Prepaid federal income tax	(47,739)	(34,673)
Other assets	1,263	830
Reserve for losses and LAE	6,121	2,611
Unearned premium reserve	35,041	38,145
Accrued liabilities	2,214	(223)
Net cash provided by operating activities	159,186	101,566
Investing Activities		
Net change in short-term investments	89,088	(92,181)
Purchase of investments available for sale	(587,878)	(570,341)
Proceeds from maturity of investments available for sale	7,525	18,832
Proceeds from sales of investments available for sale	332,853	88,695
Purchase of property and equipment, net	(3,232)	(2,623)
Net cash used in investing activities	(161,644)	(557,618)
Financing Activities		
Treasury stock acquired	(5,135)	(2,421)
Payment of offering costs	(537)	(837)
Excess tax benefits from stock-based compensation	2,390	1,729
Payments under Asset Purchase Agreement	—	(2,500)
Other financing activities	52	—
Net cash used in financing activities	(3,230)	(4,029)
Net decrease in cash	(5,688)	(460,081)
Cash at beginning of year	24,411	477,655
Cash at end of period	$18,723	$17,574

Supplemental Disclosure of Cash Flow Information

Income tax (payments) refunds	$(8,500)	$(500)
Noncash Transactions		
Issuance of management incentive shares	$—	$416

See accompanying notes to condensed consolidated financial statements.

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

In these notes to condensed consolidated financial statements, “Essent”, “Company”, “we”, “us”, and “our” refer to Essent Gro Ltd. and its subsidiaries, unless the context otherwise requires.

Note 1. Nature of Operations and Basis of Presentation

Essent Group Ltd. (“Essent Group”) is a Bermuda-based holding company, which, through its wholly-owned subsidiaries, offers private mortgage insurance and reinsurance for mortgages secured by residential properties located in the United States. Mortgage insurance facilitates the sale of low-down payment (generally less than 20%) mortgage loans into the secondary mortgage market, primarily to two government-sponsored enterprises (“GSEs”), Fannie Mae and Freddie Mac. Essent Group was incorporated in Bermuda in July 2008. In March 2014, Essent Group formed Essent Irish Intermediate Holdings Limited (“Essent Irish Intermediate”) as a wholly-owned subsidiary. In April 2014, Essent Group contributed all of the outstanding stock of Essent US Holdings, Inc. (“Essent Holdings”) to Essent Irish Intermediate. The primary mortgage insurance operations are conducted through Essent Holdings’ regulated and licensed wholly-owned subsidiaries, Essent Guaranty, Inc. (“Essent Guaranty”) and Essent Guaranty of PA, Inc. (“Essent PA”). Essent Group also has a wholly-owned Bermuda domiciled Class 3A Insurer licensed pursuant to Section 4 of the Bermuda Insurance Act 1978, Essent Reinsurance Ltd. (“Essent Re”), which offers mortgage-related insurance and reinsurance.

We have prepared the condensed consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). We have condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) pursuant to such rules and regulations. In the opinion of management, the statements include all adjustments (which include normal recurring adjustments) required for a fair statement of financial position, results of operations and cash flows for the interim periods presented. These statements should be read in conjunction with the consolidated financial statements and notes thereto, including Note 1 and Note 2 to the consolidated financial statements, included in our Annual Report on Form 10-K for the year ended December 31, 2014, which discloses the principles of consolidation and a summary of significant accounting policies. The results of operations for the interim periods are not necessarily indicative of the results for the full year. We evaluated the need to recognize or disclose events that occurred subsequent to September 30, 2015 prior to the issuance of these condensed consolidated financial statements.

Certain amounts in prior years have been reclassified to conform to the current year presentation.

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 2. Investments Available for Sale

Investments available for sale consist of the following:

September 30, 2015 (In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$186,740	$1,681	$(109)	$188,312
U.S. agency securities	3,171	14	—	3,185
U.S. agency mortgage-backed securities	126,406	1,985	(166)	128,225
Municipal debt securities(1)	273,217	5,050	(732)	277,535
Corporate debt securities	371,110	2,201	(1,691)	371,620
Mortgage-backed securities	55,639	439	(817)	55,261
Asset-backed securities	124,917	182	(823)	124,276
Money market funds	92,100	—	—	92,100
Total investments available for sale	$1,233,300	$11,552	$(4,338)	$1,240,514

December 31, 2014 (In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$73,432	$927	$(143)	$74,216
U.S. agency securities	4,491	29	—	4,520
U.S. agency mortgage-backed securities	82,190	1,564	(214)	83,540
Municipal debt securities(1)	191,723	4,147	(324)	195,546
Corporate debt securities	295,507	2,123	(801)	296,829
Mortgage-backed securities	66,396	574	(884)	66,086
Asset-backed securities	126,474	136	(422)	126,188
Money market funds	210,688	—	—	210,688
Total investments available for sale	$1,050,901	$9,500	$(2,788)	$1,057,613

(1) The following table summarizes municipal debt securities as of :	September 30, 2015	December 31, 2014
Special revenue bonds	70.5 %	59.7 %
General obligation bonds	24.6	37.5
Certificate of participation bonds	3.8	0.8
Tax allocation bonds	1.1	1.5
Special assessment bonds	—	0.5
Total	100.0 %	100.0 %

The amortized cost and fair value of investments available for sale at September 30, 2015, 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 mortgage-backed securities and asset-backed securities provide for periodic payments throughout their lives, they are listed below in separate categories.

(In thousands)	Amortized Cost	Fair Value
U.S. Treasury securities:		
Due in 1 year	$48,643	$48,660
Due after 1 but within 5 years	47,910	48,239
Due after 5 but within 10 years	90,187	91,413
Subtotal	186,740	188,312
U.S. agency securities:		
Due in 1 year	3,171	3,185
Subtotal	3,171	3,185
Municipal debt securities:		
Due in 1 year	545	545
Due after 1 but within 5 years	65,582	66,103
Due after 5 but within 10 years	92,831	95,016
Due after 10 years	114,259	115,871
Subtotal	273,217	277,535
Corporate debt securities:		
Due in 1 year	10,567	10,604
Due after 1 but within 5 years	261,142	261,318
Due after 5 but within 10 years	99,128	99,412
Due after 10 years	273	286
Subtotal	371,110	371,620
U.S. agency mortgage-backed securities	126,406	128,225
Mortgage-backed securities	55,639	55,261
Asset-backed securities	124,917	124,276
Money market funds	92,100	92,100
Total investments available for sale	$1,233,300	$1,240,514

Essent realized gross gains and losses on the sale of investments available for sale as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2015	2014	2015	2014
Realized gross gains	$663	$151	$2,790	$991
Realized gross losses	115	—	1,025	372

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

The fair value of investments in an unrealized loss position and the related unrealized losses were as follows:

	Less than 12 months		12 months or more		Total	
September 30, 2015 (In thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Treasury securities	$37,713	$(109)	$—	$—	$37,713	$(109)
U.S. agency mortgage-backed securities	15,578	(108)	1,771	(58)	17,349	(166)
Municipal debt securities	63,934	(629)	6,532	(103)	70,466	(732)
Corporate debt securities	139,947	(1,457)	6,988	(234)	146,935	(1,691)
Mortgage-backed securities	6,449	(79)	27,861	(738)	34,310	(817)
Asset-backed securities	79,060	(664)	12,117	(159)	91,177	(823)
Total	$342,681	$(3,046)	$55,269	$(1,292)	$397,950	$(4,338)

	Less than 12 months		12 months or more		Total	
December 31, 2014 (In thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Treasury securities	$16,543	$(34)	$5,155	$(109)	$21,698	$(143)
U.S. agency mortgage-backed securities	2,334	—	8,566	(214)	10,900	(214)
Municipal debt securities	39,902	(229)	8,684	(95)	48,586	(324)
Corporate debt securities	113,717	(701)	12,659	(100)	126,376	(801)
Mortgage-backed securities	28,091	(264)	16,092	(620)	44,183	(884)
Asset-backed securities	100,248	(405)	2,201	(17)	102,449	(422)
Total	$300,835	$(1,633)	$53,357	$(1,155)	$354,192	$(2,788)

The gross unrealized losses on these investment securities are principally associated with the changes in the interest rate environment subsequent to their purchase. Each issuer is current on its scheduled interest and principal payments. We assess our intent to sell these securities and whether we will be required to sell these securities before the recovery of their amortized cost basis when determining whether an impairment is other-than-temporary. There were no other-than-temporary impairments of investments in the nine months ended September 30, 2015 or year ended December 31, 2014.

The fair value of investments deposited with insurance regulatory authorities to meet statutory requirements was $8.5 million as of September 30, 2015 and December 31, 2014. In connection with its insurance and reinsurance activities, Essent Re is required to maintain assets in trusts for the benefit of its contractual counterparties. The fair value of the required investments on deposit in these trusts were $221.4 million at September 30, 2015 and $66.7 million at December 31, 2014.

Net investment income consists of:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2015	2014	2015	2014

Fixed maturities	$5,774	$3,737	$15,542	$9,115
Short-term investments	19	14	48	45
Gross investment income	5,793	3,751	15,590	9,160
Investment expenses	(471)	(346)	(1,268)	(777)
Net investment income	$5,322	$3,405	$14,322	$8,383

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Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 3. Accounts Receivable

Accounts receivable consists of the following:

(In thousands)	September 30, 2015	December 31, 2014
Premiums receivable	$15,693	$13,210
Other receivables	1,360	2,600
Total accounts receivable	17,053	15,810
Less: Allowance for doubtful accounts	—	—
Accounts receivable, net	$17,053	$15,810

Premiums receivable consists of premiums due on our mortgage insurance policies. If mortgage insurance premiums are unpaid for more than 90 days, the receivable is written off against earned premium and the related insurance policy is cancelled. For all periods presented, no provision or allowance for doubtful accounts was required.

Note 4. Reserve for Losses and Loss Adjustment Expenses

The following table provides a reconciliation of the beginning and ending reserve balances for losses and loss adjustment expenses ("LAE") for the nine months ended September 30:

($ in thousands)	2015	2014
Reserve for losses and LAE at beginning of period	$8,427	$3,070
Less: Reinsurance recoverables	—	—
Net reserve for losses and LAE at beginning of period	8,427	3,070
Add provision for losses and LAE, net of reinsurance, occurring in:		
Current period	10,356	3,954
Prior years	(2,650)	(695)
Net incurred losses during the current period	7,706	3,259
Deduct payments for losses and LAE, net of reinsurance, occurring in:		
Current period	262	1
Prior years	1,323	646
Net loss and LAE payments during the current period	1,585	647
Net reserve for losses and LAE at end of period	14,548	5,682
Plus: Reinsurance recoverables	—	—
Reserve for losses and LAE at end of period	$14,548	$5,682
Loans in default at end of period	814	312

For the nine months ended September 30, 2015, $1.3 million was paid for incurred claims and claim adjustment expenses attributable to insured events of prior years. There has been a $2.7 million favorable prior-year development during the nine months ended September 30, 2015. Reserves remaining as of September 30, 2015 for prior years are $4.5 million as a result of re-estimation of unpaid losses and loss adjustment expenses. For the nine months ended September 30, 2014, $0.6 million was paid for incurred claims and claim adjustment expenses attributable to insured events of prior years. There had been a $0.7 million favorable prior-year development during the nine months ended September 30, 2014. Reserves remaining as of September 30, 2014 for prior years were $1.7 million as a result of re-estimation of unpaid losses and loss adjustment expenses. The decreases in both periods are 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.

Note 5. Commitments and Contingencies

Obligations under Guarantees

Under the terms of CUW Solutions LLC's contract underwriting agreements with lenders and subject to contractual limitations on liability, we agree to indemnify certain lenders against losses incurred in the event that we make an error in determining whether loans processed meet specified underwriting criteria, to the extent that such error materially restricts or impairs the salability of such loan, results in a material reduction in the value of such loan or results in the lender repurchasing the loan. The indemnification may be in the form of monetary or other remedies. We paid $16,903 and $10,317 related to remedies for the nine months ended September 30, 2015 and 2014, respectively. As of September 30, 2015, management believes any potential claims for indemnification related to contract underwriting services through September 30, 2015 are not material to our financial position or results of operations.

In addition to the indemnifications discussed above, in the normal course of business, we enter into agreements or other relationships with third parties pursuant to which we may be obligated under specified circumstances to indemnify the counterparties with respect to certain matters. Our contractual indemnification obligations typically arise in the context of agreements entered into by us to, among other things, purchase or sell services, finance our business and business transactions, lease real property and license intellectual property. The agreements we enter into in the normal course of business generally require us to pay certain amounts to the other party associated with claims or losses if they result from our breach of the agreement, including the inaccuracy of representations or warranties. The agreements we enter into may also contain other indemnification provisions that obligate us to pay amounts upon the occurrence of certain events, such as the negligence or willful misconduct of our employees, infringement of third-party intellectual property rights or claims that performance of the agreement constitutes a violation of law. Generally, payment by us under an indemnification provision is conditioned upon the other party making a claim, and typically we can challenge the other party's claims. Further, our indemnification obligations may be limited in time and/or amount, and in some instances, we may have recourse against third parties for certain payments made by us under an indemnification agreement or obligation. As of September 30, 2015, contingencies triggering material indemnification obligations or payments have not occurred historically and are not expected to occur. The nature of the indemnification provisions in the various types of agreements and relationships described above are believed to be low risk and pervasive, and we consider them to have a remote risk of loss or payment. We have not recorded any provisions on the condensed consolidated balance sheets related to indemnifications.

Note 6. Stock-Based Compensation

The following table summarizes nonvested common share and nonvested common share unit activity for the nine months ended September 30, 2015:

	Time and Performance-Based Share Awards		Time-Based Share Awards		Share Units	
(Shares in thousands)	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value	Number of Share Units	Weighted Average Grant Date Fair Value
Outstanding at beginning of year	1,290	$14.83	1,472	$9.04	664	$18.32

Granted	50	24.58	109	24.51	117	24.45
Vested	—	N/A	(609)	7.04	(238)	18.17
Forfeited	(46)	16.40	(45)	16.18	(8)	17.28
Outstanding at September 30, 2015	1,294	$15.15	927	$11.83	535	$19.74

In February 2015, certain members of senior management were granted nonvested common shares under the Essent Group Ltd. 2013 Long-Term Incentive Plan that were subject to time-based and performance-based vesting. The time-based share awards granted in February 2015 vest in three equal installments on March 1, 2016, 2017 and 2018. The performance-based share awards granted in February 2015 vest based upon our compounded annual book value per share growth percentage during a three-year performance period that commenced on January 1, 2015 and vest on March 1, 2018.

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In May 2015, nonvested common shares were granted to an employee in connection with an employment agreement that are subject to time-based and performance-based vesting. The time-based share award vests in four equal installments on July 1, 2016, 2017, 2018 and 2019. The performance-based share award vests based upon our compounded annual book value per share growth percentage during a three-year performance period that commenced on January 1, 2015 and vests on July 1, 2019.

The portion of the nonvested performance-based share awards that will be earned based upon the achievement of compounded annual book value per share growth is as follows:

Performance level	Compounded Annual Book Value Per Share Growth		Nonvested Common Shares Earned	
	<11	%	0	%
Threshold	11	%	10	%
	12	%	36	%
	13	%	61	%
	14	%	87	%
Maximum	≥15	%	100	%

In the event that the compounded annual book value per share growth falls between the performance levels shown above, the nonvested common shares earned will be determined on a straight-line basis between the respective levels shown.

In connection with our incentive program covering bonus awards for performance year 2014, in February 2015, time-based share awards and share units were issued to certain employees that vest in three equal installments on March 1, 2016, 2017 and 2018. In May 2015, time-based share units were granted to non-employee directors that vest one year from the date of grant.

The total fair value of nonvested shares or share units that vested was $21.5 million and $29.5 million for the nine months ended September 30, 2015 and 2014, respectively. As of September 30, 2015, there was $24.1 million of total unrecognized compensation expense related to nonvested shares or share units outstanding at September 30, 2015 and we expect to recognize the expense over a weighted average period of 2.1 years.

Employees have the option to tender shares to Essent Group to pay the minimum employee statutory withholding taxes associated with shares upon vesting. Common shares tendered by employees to pay employee withholding taxes totaled 200,199 in the nine months ended September 30, 2015. The tendered shares were recorded at cost, included in treasury stock and have been cancelled as of September 30, 2015.

Compensation expense, net of forfeitures, and related tax effects recognized in connection with nonvested shares were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2015	2014	2015	2014
Compensation expense	$3,363	$3,260	$9,959	$9,408
Income tax benefit	1,072	1,141	3,197	3,293

Note 7. Earnings per Share (EPS)

The following table reconciles the net income and the weighted average common shares outstanding used in the computations of basic and diluted earnings per common share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	2015	2014	2015	2014
Net income	$40,821	$25,070	$112,852	$59,631
Less: dividends declared	—	—	—	—
Net income available to common shareholders	$40,821	$25,070	$112,852	$59,631
Basic earnings per share	$0.45	$0.30	$1.25	$0.72
Diluted earnings per share	$0.44	$0.29	$1.23	$0.70
Basic weighted average shares outstanding	90,418	83,640	90,317	83,263
Dilutive effect of nonvested shares	1,423	1,388	1,361	1,548
Diluted weighted average shares outstanding	91,841	85,028	91,678	84,811

There were 905 and 180,664 antidilutive shares for the three months ended September 30, 2015 and 2014, respectively and 100,232 and 132,756 antidilutive shares for the nine months ended September 30, 2015 and 2014, respectively.

The nonvested performance-based share awards are considered contingently issuable for purposes of the EPS calculation. Based on the compounded annual book value per share growth as of September 30, 2015, 100% of the performance-based share awards would be issuable under the terms of the arrangements if September 30, 2015 was the end of the performance period. Based on the compounded annual book value per share growth as of September 30, 2014, 48.5% of the performance-based share awards would have been issuable under the terms of the arrangements if September 30, 2014 was the end of the performance period.

Note 8. Accumulated Other Comprehensive Income (Loss)

The following table presents the rollforward of accumulated other comprehensive income (loss) for the three and nine months ended September 30, 2015 and 2014:

	Three Months Ended September 30, 2015		
(In thousands)	Before Tax	Tax Effect	Net of Tax
Balance at beginning of period	$940	$(153)	$787
Other comprehensive income (loss):			
Unrealized holding gains arising during the period	6,821	(2,144)	4,677
Less: Reclassification adjustment for gains included in net income (1)	(548)	131	(417)
Net unrealized gains on investments	6,273	(2,013)	4,260
Other comprehensive income (loss)	6,273	(2,013)	4,260
Balance at end of period	$7,213	$(2,166)	$5,047

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(In thousands)	Nine Months Ended September 30, 2015 Before Tax	Tax Effect	Net of Tax
Balance at beginning of period	$6,712	$(2,045)	$4,667
Other comprehensive income (loss):			
Unrealized holding gains arising during the period	2,266	(593)	1,673
Less: Reclassification adjustment for gains included in net income (1)	(1,765)	472	(1,293)
Net unrealized gains on investments	501	(121)	380
Other comprehensive income (loss)	501	(121)	380
Balance at end of period	$7,213	$(2,166)	$5,047

(In thousands)	Three Months Ended September 30, 2014 Before Tax	Tax Effect	Net of Tax
Balance at beginning of period	$5,632	$(1,685)	$3,947
Other comprehensive income (loss):			
Unrealized holding losses arising during the period	(1,748)	449	(1,299)
Less: Reclassification adjustment for gains included in net income (1)	(151)	45	(106)
Net unrealized losses on investments	(1,899)	494	(1,405)
Other comprehensive income (loss)	(1,899)	494	(1,405)
Balance at end of period	$3,733	$(1,191)	$2,542

(In thousands)	Nine Months Ended September 30, 2014 Before Tax	Tax Effect	Net of Tax
Balance at beginning of period	$(2,227)	$780	$(1,447)
Other comprehensive income (loss):			
Unrealized holding gains arising during the period	6,579	(2,178)	4,401
Less: Reclassification adjustment for gains included in net income (1)	(619)	207	(412)
Net unrealized gains on investments	5,960	(1,971)	3,989
Other comprehensive income (loss)	5,960	(1,971)	3,989
Balance at end of period	$3,733	$(1,191)	$2,542

(1) Included in net realized investment gains on our condensed consolidated statements of comprehensive income.

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 9. Fair Value of Financial Instruments

The estimated fair values and related carrying amounts of our financial instruments were as follows:

September 30, 2015 (In thousands)	Carrying Amount	Fair Value
Financial Assets:		
U.S. Treasury securities	$188,312	$188,312
U.S. agency securities	3,185	3,185
U.S. agency mortgage-backed securities	128,225	128,225
Municipal debt securities	277,535	277,535
Corporate debt securities	371,620	371,620
Mortgage-backed securities	55,261	55,261
Asset-backed securities	124,276	124,276
Money market funds	92,100	92,100
Total investments	$1,240,514	$1,240,514
Financial Liabilities:		
Derivative liabilities	$1,833	$1,833

December 31, 2014 (In thousands)	Carrying Amount	Fair Value
Financial Assets:		
U.S. Treasury securities	$74,216	$74,216
U.S. agency securities	4,520	4,520
U.S. agency mortgage-backed securities	83,540	83,540
Municipal debt securities	195,546	195,546
Corporate debt securities	296,829	296,829
Mortgage-backed securities	66,086	66,086
Asset-backed securities	126,188	126,188
Money market funds	210,688	210,688
Total investments	$1,057,613	$1,057,613
Financial Liabilities:		
Derivative liabilities	$661	$661

Fair Value Hierarchy

ASC No. 820 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 our market assumptions. The level within the fair value hierarchy to measure the financial instrument shall be determined based on the lowest level input that is significant to the fair value measurement. The three levels of the fair value hierarchy are as follows:

- Level 1 — Quoted prices for identical instruments in active markets accessible at the measurement date.

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Level 2 — Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and valuations in which all significant inputs are observable in active markets. Inputs are observable for substantially the full term of the financial instrument.

- Level 3 — Valuations derived from one or more significant inputs that are unobservable.

Determination of Fair Value

When available, we generally use quoted market prices to determine fair value and classify the financial instrument in Level 1. In cases where quoted market prices for similar financial instruments are available, we utilize these inputs for valuation techniques and classify the financial instrument in Level 2. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flows, present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rates and estimates of future cash flows and we classify the financial instrument in Level 3. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

We used the following methods and assumptions in estimating fair values of financial instruments:

- Investments available for sale — Investments available for sale are valued using quoted market prices in active markets, when available, and those investments are classified as Level 1 of the fair value hierarchy. Level 1 investments available for sale include investments such as U.S. Treasury securities, U.S. agency securities, U.S. agency mortgage-backed securities, certain mortgage-backed securities and money market funds. Investments available for sale are classified as Level 2 of the fair value hierarchy if quoted market prices are not available and fair values are estimated using quoted prices of similar securities or recently executed transactions for the securities. Municipal debt securities, corporate debt securities, certain mortgage-backed securities and asset-backed securities are classified as Level 2 investments.

We use independent pricing sources to determine the fair value of securities available for sale in Level 1 and Level 2 of the fair value hierarchy. We use one primary pricing service to provide individual security pricing based on observable market data and receive one quote per security. To ensure securities are appropriately classified in the fair value hierarchy, we review the pricing techniques and methodologies of the independent pricing service and believe that their policies adequately consider market activity, either based on specific transactions for the issue valued or based on modeling of securities with similar credit quality, duration, yield and structure that were recently traded. We review the reasonableness of prices received from our primary pricing service by comparison to prices obtained from additional pricing sources. We have not made any adjustments to the prices obtained from our primary pricing service.

- Derivative liabilities — We define fair value as the current amount that would be exchanged to sell an asset or transfer a liability, other than in a forced liquidation. Certain of our Freddie Mac Agency Credit Insurance Structure ("ACIS") contracts are accounted for as derivatives. In determining an exit market, we consider the fact that there is not a principal market for these contracts. In the absence of a principal market, we value these ACIS contracts in a hypothetical market where market participants, and potential counterparties, include other mortgage guaranty insurers or reinsurers with similar credit quality to us. We believe that in the absence of a principal market, this hypothetical market provides the most relevant information with respect to fair value estimates. These ACIS contracts are classified as Level 3 of the fair value hierarchy.

We determine the fair value of our derivative instruments primarily using internally-generated models. We utilize market observable inputs, such as the performance of the underlying pool of mortgages, mortgage prepayment speeds and pricing spreads on the reference STACR notes, whenever they are available. There is a high degree of uncertainty about our fair value estimates since our contracts are not traded or exchanged, which makes external validation and corroboration of our estimates difficult. Considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates may not be indicative of amounts we could realize in a current market exchange or negotiated termination. The use of different market assumptions or estimation methodologies may have a material effect on the estimated fair value amounts.

Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Assets and Liabilities Measured at Fair Value

All assets measured at fair value are categorized in the table below based upon the lowest level of significant input to the valuations. All fair value measurements at the reporting date were on a recurring basis.

September 30, 2015 (In thousands)	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Recurring fair value measurements				
Financial Assets:				
U.S. Treasury securities	$188,312	$—	$—	$188,312
U.S. agency securities	3,185	—	—	3,185
U.S. agency mortgage-backed securities	128,225	—	—	128,225
Municipal debt securities	—	277,535	—	277,535
Corporate debt securities	—	371,620	—	371,620
Mortgage-backed securities	3,883	51,378	—	55,261
Asset-backed securities	—	124,276	—	124,276
Money market funds	92,100	—	—	92,100
Total assets at fair value	$415,705	$824,809	$—	$1,240,514
Financial Liabilities:				
Derivative liabilities	$—	$—	$1,833	$1,833
Total liabilities at fair value	$—	$—	$1,833	$1,833

December 31, 2014 (In thousands)	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Recurring fair value measurements				
Financial Assets:				
U.S. Treasury securities	$74,216	$—	$—	$74,216
U.S. agency securities	4,520	—	—	4,520
U.S. agency mortgage-backed securities	83,540	—	—	83,540
Municipal debt securities	—	195,546	—	195,546
Corporate debt securities	—	296,829	—	296,829
Mortgage-backed securities	4,882	61,204	—	66,086
Asset-backed securities	—	126,188	—	126,188
Money market funds				