Essent Group Ltd.
Form 10-Q
August 07, 2017
Table of Contents

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 June 30, 2017

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	Not Applicable
(State or other jurisdiction of incorporation or organization)	(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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 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 August 1, 2017 was 93,423,101.

Table of Contents

Essent Group Ltd. and Subsidiaries

Form 10-Q

Index

PART I.	FINANCIAL INFORMATION	1
Item 1.	Financial Statements (Unaudited)	1
	Condensed Consolidated Balance Sheets (Unaudited)	1
	Condensed Consolidated Statements of Comprehensive Income (Unaudited)	2
	Condensed Consolidated Statements of Changes in Stockholders’ Equity (Unaudited)	3
	Condensed Consolidated Statements of Cash Flows (Unaudited)	4
	Notes to Condensed Consolidated Financial Statements (Unaudited)	5
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	39
Item 4.	Controls and Procedures	39
PART II.	OTHER INFORMATION	40
Item 1.	Legal Proceedings	40
Item 1A.	Risk Factors	40
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	40
Item 6.	Exhibits	41
SIGNATURES		42
EXHIBIT INDEX		43

Table of Contents

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 subsidiaries, Essent Guaranty, Inc. and Essent Reinsurance Ltd., 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 products and services, 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, in Part I, Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Quarterly Report, and in Part I, Item 1A "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2016 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 or the 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;
- fluctuations in interest rates;
- inadequacy of the premiums we charge to compensate for our losses incurred;

Table of Contents

- 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; 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.

Table of Contents

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)	June 30, 2017	December 31, 2016
Assets		
Investments available for sale, at fair value		
Fixed maturities (amortized cost: 2017 — $1,705,463; 2016 — $1,497,186)	$1,710,057	$1,482,754
Short-term investments (amortized cost: 2017 — $130,984; 2016 — $132,352)	130,984	132,348
Total investments	1,841,041	1,615,102
Cash	27,670	27,531
Accrued investment income	10,776	9,488
Accounts receivable	26,648	21,632
Deferred policy acquisition costs	14,037	13,400
Property and equipment (at cost, less accumulated depreciation of $48,513 in 2017 and $46,543 in 2016)	7,955	8,119
Prepaid federal income tax	215,357	181,272
Other assets	9,409	6,454
Total assets	$2,152,893	$1,882,998
Liabilities and Stockholders' Equity		
Liabilities		
Reserve for losses and LAE	$29,798	$28,142
Unearned premium reserve	228,762	219,616
Net deferred tax liability	181,206	142,587
Credit facility borrowings (at carrying value, less unamortized deferred costs of $1,808 in 2017 and $0 in 2016)	173,192	100,000
Securities purchases payable	19,770	14,999
Other accrued liabilities	22,268	33,881
Total liabilities	654,996	539,225
Commitments and contingencies (see Note 6)		
Stockholders' Equity		
Common shares, $0.015 par value:		
Authorized - 233,333; issued and outstanding - 93,424 shares in 2017 and 93,105 shares in 2016	1,401	1,397
Additional paid-in capital	920,452	918,296
Accumulated other comprehensive income (loss)	1,065	(12,255)
Retained earnings	574,979	436,335
Total stockholders' equity	1,497,897	1,343,773
Total liabilities and stockholders' equity	$2,152,893	$1,882,998

See accompanying notes to condensed consolidated financial statements.

1

Table of Contents

Essent Group Ltd. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share amounts)	2017	2016	2017	2016
Revenues:				
Net premiums written	$134,063	$108,513	$253,360	$208,979
Increase in unearned premiums	(7,500)	(7,802)	(9,146)	(13,865)
Net premiums earned	126,563	100,711	244,214	195,114
Net investment income	9,400	6,701	17,835	12,884
Realized investment gains, net	544	583	1,199	1,054
Other income	1,099	170	1,950	1,579
Total revenues	137,606	108,165	265,198	210,631
Losses and expenses:				
Provision for losses and LAE	1,770	2,964	5,463	6,695
Other underwriting and operating expenses	35,686	31,409	72,018	62,797
Interest expense	1,189	—	1,905	—
Total losses and expenses	38,645	34,373	79,386	69,492
Income before income taxes	98,961	73,792	185,812	141,139
Income tax expense	26,843	21,534	47,096	40,930
Net income	$72,118	$52,258	$138,716	$100,209
Earnings per share:				
Basic	$0.79	$0.57	$1.52	$1.10
Diluted	0.77	0.57	1.49	1.09
Weighted average shares outstanding:				
Basic	91,381	90,912	91,320	90,848
Diluted	93,162	92,138	93,093	91,999
Net income	$72,118	$52,258	$138,716	$100,209
Other comprehensive income (loss):				
Change in unrealized appreciation of investments, net of tax expense of $3,649 and $5,049 in the three months ended June 30, 2017 and 2016 and $5,710 and $10,763 in the six months ended June 30, 2017 and 2016	8,470	10,702	13,320	24,061
Total other comprehensive income	8,470	10,702	13,320	24,061
Comprehensive income	$80,588	$62,960	$152,036	$124,270

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2016	$ 1,390	$ 904,221	$ (99)	$ 213,729	$ —	$ 1,119,241
Net income				222,606		222,606
Other comprehensive loss			(12,156)			(12,156)
Issuance of management incentive shares	10	(10)				—
Forfeiture of management incentive shares	—	—				—
Stock-based compensation expense		16,881				16,881
Excess tax benefits from stock-based compensation expense		1,083				1,083
Treasury stock acquired					(4,024)	(4,024)
Cancellation of treasury stock	(3)	(4,021)			4,024	—
Other equity transactions		142				142
Balance at December 31, 2016	$ 1,397	$ 918,296	$ (12,255)	$ 436,335	$ —	$ 1,343,773
Net income				138,716		138,716
Other comprehensive income			13,320			13,320
Issuance of management incentive shares	8	(8)				—
Stock-based compensation expense		9,288				9,288
Cumulative effect of ASU 2016-09 adoption		111		(72)		39
Treasury stock acquired					(7,239)	(7,239)
Cancellation of treasury stock	(4)	(7,235)			7,239	—
Balance at June 30, 2017	$ 1,401	$ 920,452	$ 1,065	$ 574,979	$ —	$ 1,497,897

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Essent Group Ltd. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

(In thousands)	Six Months Ended June 30, 2017			2016		
Operating Activities						
Net income	$	138,716		$	100,209	
Adjustments to reconcile net income to net cash provided by operating activities:						
Gain on the sale of investments, net	(1,199		)	(1,054		)
Depreciation and amortization	1,970			2,040		
Stock-based compensation expense	9,288			7,949		
Amortization of premium on investment securities	5,833			5,218		
Deferred income tax provision	32,948			28,264		
Change in:						
Accrued investment income	(1,288		)	(712		)
Accounts receivable	(4,134		)	(2,478		)
Deferred policy acquisition costs	(637		)	(710		)
Prepaid federal income tax	(34,085		)	(30,360		)
Other assets	(1,877		)	(375		)
Reserve for losses and LAE	1,656			4,714		
Unearned premium reserve	9,146			13,865		
Other accrued liabilities	(11,934		)	(3,480		)
Net cash provided by operating activities	144,403			123,090		
Investing Activities						
Net change in short-term investments	1,364			(43,239		)
Purchase of investments available	(396,919		)	(268,024		)

for sale						
Proceeds from maturity of investments available for sale	36,318			9,043		
Proceeds from sales of investments available for sale	151,583			178,719		
Purchase of property and equipment	(1,806		)	(2,049		)
Net cash used in investing activities	(209,460		)	(125,550		)
Financing Activities						
Credit facility borrowings	200,000			—		
Credit facility repayments	(125,000		)	—		
Treasury stock acquired	(7,239		)	(3,876		)
Payment of issuance costs for credit facility	(2,565		)	(2,098		)
Net cash provided by (used in) financing activities	65,196			(5,974		)
Net increase (decrease) in cash	139			(8,434		)
Cash at beginning of year	27,531			24,606		
Cash at end of period	$	27,670		$	16,172	
Supplemental Disclosure of Cash Flow Information						
Income tax payments	$	(16,700	)	$	(10,800	)
Interest payments	(1,772		)	—		

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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.

The primary mortgage insurance operations are conducted through Essent Guaranty, Inc. (“Essent Guaranty”), a wholly-owned subsidiary approved as a qualified mortgage insurer by the GSEs and is licensed to write mortgage insurance in all 50 states and the District of Columbia. Essent Guaranty reinsures 25% of GSE-eligible new insurance written to Essent Reinsurance Ltd. (“Essent Re”), an affiliated Bermuda domiciled Class 3A Insurer licensed pursuant to Section 4 of the Bermuda Insurance Act 1978 that provides insurance and reinsurance coverage of mortgage credit risk. Essent Re also provides insurance and reinsurance to Freddie Mac and Fannie Mae. In 2016, Essent Re formed Essent Agency (Bermuda) Ltd., a wholly-owned subsidiary, which provides underwriting services to third-party reinsurers. In accordance with certain state law requirements, Essent Guaranty also reinsures that portion of the risk that is in excess of 25% of the mortgage balance with respect to any loan insured, after consideration of other reinsurance, to Essent Guaranty of PA, Inc. (“Essent PA”), an affiliate.

In addition to offering mortgage insurance, we provide contract underwriting services on a limited basis through CUW Solutions, LLC ("CUW Solutions"), a Delaware limited liability company, that provides, among other things, mortgage contract underwriting services to lenders and mortgage insurance underwriting services to affiliates.

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, 2016, 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 June 30, 2017 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.

Note 2. Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 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. In July 2015, the FASB delayed the effective date for this update to interim and annual periods beginning after December 15, 2017. In December 2016, the FASB clarified that all contracts that are within the scope of Topic 944, Financial Services-Insurance, are excluded from the scope of ASU 2014-09. Accordingly, this update will not impact the recognition of revenue related to insurance premiums or investments, which represent a significant portion of our total revenues. The adoption of this ASU is not expected to have a material effect on the Company's consolidated operating results or financial position.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This update requires certain equity investments (except those accounted for under the equity method of accounting or result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. A qualitative assessment for impairment is required for equity investments without readily determinable fair values. This update also requires public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. In addition, an entity is required to evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale investment securities in combination with the entity's other deferred tax assets. The provisions of this update are effective for interim and annual periods beginning after December 15, 2017. The Company is evaluating the impact the adoption of this ASU will have on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This update will require organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The new guidance will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. The provisions of this update are effective for annual and interim periods beginning after December 15, 2018. The Company expects a gross-up of its consolidated balance sheets as a result of recognizing lease liabilities and right of use assets. The Company is still evaluating the impact the adoption of this ASU will have on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718). This update is intended to simplify several aspects of the accounting for share-based payment award transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new guidance requires all excess tax benefits and tax deficiencies to be recognized as income tax expense or benefit in the income statement and treated as discrete items in the reporting period. In addition, excess tax benefits are required to be classified along with other income tax cash flows as an operating activity. Further, the new guidance allows for a policy election to account for forfeitures as they occur rather than on an estimated basis. The Company adopted this ASU on January 1, 2017 and recorded a charge of $0.1 million to retained earnings as of that date representing a cumulative-effect adjustment associated with our election to recognize forfeitures as they occur. The classification of excess tax benefits and tax deficiencies as income tax benefit or expense may result in net income volatility in reporting periods subsequent to 2016. Through December 31, 2016, excess tax benefits were recognized in additional paid-in-capital. In the three and six months ended June 30, 2017, the Company recorded excess tax benefits of $0.1 million and $3.1 million, respectively, as a reduction of income tax expense. The amount of excess tax benefits or tax deficiencies in future periods will vary based on the market value of the Company's common stock at the vesting dates of nonvested common share and nonvested common share units.

In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments (Topic 326). This update is intended to provide financial statement users with more information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendments in this ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The new guidance requires financial assets measured at amortized cost to be presented at the net amount expected to be collected through the use of an allowance for credit losses. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance rather than as a write-down of the amortized cost of the securities. The provisions of this update are effective for annual and interim periods beginning after December 15, 2019. While the Company is still evaluating this ASU, we do not expect it to impact our accounting for insurance losses and loss adjustment expenses ("LAE") as these items are not within the scope of this ASU.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 3. Investments Available for Sale

Investments available for sale consist of the following:

June 30, 2017 (In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$205,023	$ 87	$(2,746)	$202,364
U.S. agency securities	26,599	8	(250)	26,357
U.S. agency mortgage-backed securities	402,961	778	(6,137)	397,602
Municipal debt securities(1)	362,363	8,551	(846)	370,068
Corporate debt securities(2)	552,306	5,628	(1,969)	555,965
Residential and commercial mortgage securities	68,421	1,524	(273)	69,672
Asset-backed securities	135,266	451	(212)	135,505
Money market funds	83,508	—	—	83,508
Total investments available for sale	$1,836,447	$ 17,027	$(12,433)	$1,841,041

December 31, 2016 (In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$195,990	$ 55	$(4,497)	$191,548
U.S. agency securities	18,785	—	(344)	18,441
U.S. agency mortgage-backed securities	324,654	335	(8,495)	316,494
Municipal debt securities(1)	334,048	3,649	(3,373)	334,324
Corporate debt securities(2)	457,842	2,343	(3,828)	456,357
Residential and commercial mortgage securities	68,430	488	(582)	68,336
Asset-backed securities	127,359	260	(447)	127,172
Money market funds	102,430	—	—	102,430
Total investments available for sale	$1,629,538	$ 7,130	$(21,566)	$1,615,102

(1) The following table summarizes municipal debt securities as of :	June 30, 2017	December 31, 2016
Special revenue bonds	62.0 %	63.6 %
General obligation bonds	32.2	29.7
Certificate of participation bonds	4.5	4.9
Tax allocation bonds	0.7	1.1
Special tax bonds	0.6	0.7
Total	100.0%	100.0 %

(2) The following table summarizes corporate debt securities as of :	June 30, 2017	December 31, 2016
Financial	44.3 %	40.6 %
Consumer, non-cyclical	15.1	18.6
Energy	9.3	9.3
Communications	7.0	6.0
Utilities	6.4	6.0

Industrial	5.8	5.6
Consumer, cyclical	5.2	6.3
Technology	4.4	4.3
Basic materials	2.5	3.3
Total	100.0%	100.0 %

7

Table of Contents
Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

The amortized cost and fair value of investments available for sale at June 30, 2017, 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 U.S. agency mortgage-backed securities, residential and commercial mortgage 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	$59,647	$59,629
Due after 1 but within 5 years	47,536	47,379
Due after 5 but within 10 years	67,560	65,544
Due after 10 years	30,280	29,812
Subtotal	205,023	202,364
U.S. agency securities:		
Due in 1 year	—	—
Due after 1 but within 5 years	26,599	26,357
Subtotal	26,599	26,357
Municipal debt securities:		
Due in 1 year	13,933	13,949
Due after 1 but within 5 years	107,518	108,063
Due after 5 but within 10 years	141,366	146,278
Due after 10 years	99,546	101,778
Subtotal	362,363	370,068
Corporate debt securities:		
Due in 1 year	62,114	62,132
Due after 1 but within 5 years	300,591	302,093
Due after 5 but within 10 years	186,284	188,435
Due after 10 years	3,317	3,305
Subtotal	552,306	555,965
U.S. agency mortgage-backed securities	402,961	397,602
Residential and commercial mortgage securities	68,421	69,672
Asset-backed securities	135,266	135,505
Money market funds	83,508	83,508
Total investments available for sale	$1,836,447	$1,841,041

Gross gains and losses realized on the sale of investments available for sale were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2017	2016	2017	2016
Realized gross gains	$749	$624	$1,430	$1,772

Realized gross losses	205	41	231	711

8

Table of Contents
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:

June 30, 2017 (In thousands)	Less than 12 months Fair Value	Less than 12 months Gross Unrealized Losses	12 months or more Fair Value	12 months or more Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
U.S. Treasury securities	$162,420	$(2,746)	$—	$ —	$162,420	$(2,746)
U.S. agency securities	20,232	(250)	—	—	20,232	(250)
U.S. agency mortgage-backed securities	310,680	(6,063)	2,208	(74)	312,888	(6,137)
Municipal debt securities	70,885	(816)	4,017	(30)	74,902	(846)
Corporate debt securities	192,204	(1,943)	7,564	(26)	199,768	(1,969)
Residential and commercial mortgage securities	12,218	(264)	1,547	(9)	13,765	(273)
Asset-backed securities	32,371	(108)	19,080	(104)	51,451	(212)
Total	$801,010	$(12,190)	$34,416	$ (243)	$835,426	$(12,433)

December 31, 2016 (In thousands)	Less than 12 months Fair Value	Less than 12 months Gross Unrealized Losses	12 months or more Fair Value	12 months or more Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
U.S. Treasury securities	$160,018	$(4,497)	$—	$ —	$160,018	$(4,497)
U.S. agency securities	18,441	(344)	—	—	18,441	(344)
U.S. agency mortgage-backed securities	289,282	(8,402)	1,812	(93)	291,094	(8,495)
Municipal debt securities	149,368	(3,351)	6,015	(22)	155,383	(3,373)
Corporate debt securities	213,965	(3,704)	8,344	(124)	222,309	(3,828)
Residential and commercial mortgage securities	18,026	(434)	14,014	(148)	32,040	(582)
Asset-backed securities	28,294	(57)	47,597	(390)	75,891	(447)
Total	$877,394	$(20,789)	$77,782	$ (777)	$955,176	$(21,566)

The gross unrealized losses on these investment securities are principally associated with the changes in market interest rates and credit spreads 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 in the three and six months ended June 30, 2017. We recorded an other-than-temporary impairment of $7 thousand in the six months ended June 30, 2016 on a security in an unrealized loss position. The impairment resulted from our intent to sell the security subsequent to the reporting date.

The fair value of investments deposited with insurance regulatory authorities to meet statutory requirements was $8.6 million as of June 30, 2017 and $8.5 million as of December 31, 2016. 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 investments on deposit in these trusts was $487.4 million at June 30, 2017 and $349.6 million at December 31, 2016.

Net investment income consists of:

	Three Months Ended June 30,	Six Months Ended June 30,

(In thousands)	2017	2016	2017	2016
Fixed maturities	$9,963	$7,197	$18,982	$13,852
Short-term investments	74	30	133	63
Gross investment income	10,037	7,227	19,115	13,915
Investment expenses	(637)	(526)	(1,280)	(1,031)
Net investment income	$9,400	$6,701	$17,835	$12,884

9

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 six months ended June 30:

($ in thousands)	2017	2016
Reserve for losses and LAE at beginning of period	$28,142	$17,760
Less: Reinsurance recoverables	—	—
Net reserve for losses and LAE at beginning of period	28,142	17,760
Add provision for losses and LAE, net of reinsurance, occurring in:		
Current period	12,116	9,568
Prior years	(6,653)	(2,873)
Net incurred losses during the current period	5,463	6,695
Deduct payments for losses and LAE, net of reinsurance, occurring in:		
Current period	97	112
Prior years	3,710	1,869
Net loss and LAE payments during the current period	3,807	1,981
Net reserve for losses and LAE at end of period	29,798	22,474
Plus: Reinsurance recoverables	—	—
Reserve for losses and LAE at end of period	$29,798	$22,474
Loans in default at end of period	1,776	1,174

For the six months ended June 30, 2017, $3.7 million was paid for incurred claims and claim adjustment expenses attributable to insured events of prior years. There has been a $6.7 million favorable prior year development during the six months ended June 30, 2017. Reserves remaining as of June 30, 2017 for prior years are $17.8 million as a result of re-estimation of unpaid losses and loss adjustment expenses. For the six months ended June 30, 2016, $1.9 million was paid for incurred claims and claim adjustment expenses attributable to insured events of prior years. There was a $2.9 million favorable prior year development during the six months ended June 30, 2016. Reserves remaining as of June 30, 2016 for prior years were $13.0 million as a result of re-estimation of unpaid losses and loss adjustment expenses. In both periods, the favorable prior years' loss development was the result of a re-estimation of amounts ultimately to be paid on prior year defaults in the default inventory, including the impact of previously identified defaults that cured. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

Note 5. Debt Obligations

Revolving Credit Facility

On May 17, 2017, Essent Group and its subsidiaries, Essent Irish Intermediate Holdings Limited and Essent US Holdings, Inc. (collectively, the "Borrowers"), entered into an amended and restated four-year, secured credit facility with a committed capacity of $375 million (the “Credit Facility”). The Credit Facility amends and restates the three-year, secured revolving credit facility entered into on April 19, 2016, and provides for (i) an increase in the revolving credit facility from $200 million to $250 million, (ii) the issuance of term loans of $125 million, the proceeds of which were used at closing to pay down borrowings outstanding under the revolving credit facility, and (iii) a $75 million uncommitted line that may be exercised at the Borrowers’ option so long as the Borrowers receive commitments from the lenders. Borrowings under the Credit Facility may be used for working capital and general corporate purposes, including, without limitation, capital contributions to Essent’s insurance and reinsurance subsidiaries. Borrowings accrue interest at a floating rate tied to a standard short-term borrowing index, selected at the Company’s option, plus an applicable margin. A commitment fee is due quarterly on the average daily amount of the undrawn revolving commitment. The applicable margin and the commitment fee are based on the senior unsecured debt rating or long-term issuer rating of Essent Group to the extent available, or the insurer financial strength rating of Essent Guaranty. The current annual commitment fee rate is 0.35%. The obligations under the Credit Facility are secured by certain assets of the Borrowers, excluding the stock and assets of its insurance and reinsurance subsidiaries. The Credit Facility contains several covenants, including financial covenants relating to minimum net worth, capital and liquidity levels, maximum debt to capitalization level and Essent Guaranty's compliance with the PMIERS (see Note 11). The $125 million term loans contractually mature on May 17, 2021. This description is not intended to be complete in all respects and is qualified in its entirety by the terms of the Credit Facility, including its covenants. As of June 30, 2017, the Company was in compliance with the covenants and $175 million had been borrowed under the Credit Facility with a weighted average interest rate of 3.21%.

Note 6. Commitments and Contingencies

Obligations under Guarantees

Under the terms of CUW Solutions' 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 $68,018 and $42,173 related to remedies for the six months ended June 30, 2017 and 2016, respectively. As of June 30, 2017, management believes any potential claims for indemnification related to contract underwriting services through June 30, 2017 are not material to our consolidated 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 June 30, 2017, 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.

Table of Contents

Note 7. Stock-Based Compensation

The following table summarizes nonvested common share and nonvested common share unit activity for the six months ended June 30, 2017:

(Shares in thousands)	Time and Performance-Based Share Awards		Time-Based Share Awards		Share Units	
	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	1,503	$ 15.41	605	$ 16.32	493	$ 19.24
Granted	140	36.29	91	36.29	387	33.40
Vested	(48)	22.48	(272)	16.06	(303)	18.67
Forfeited	—	N/A	—	N/A	(18)	30.24
Outstanding at June 30, 2017	1,595	$ 17.03	424	$ 20.75	559	$ 28.98

In February 2017, certain members of senior management were granted nonvested common shares under the Essent Group Ltd. 2013 Long-Term Incentive Plan ("2013 Plan") that were subject to time-based and performance-based vesting. The time-based share awards granted in February 2017 vest in three equal installments on March 1, 2018, 2019 and 2020. The performance-based share awards granted in February 2017 vest based upon our compounded annual book value per share growth percentage during a three-year performance period that commenced on January 1, 2017 and vest on March 1, 2020. The portion of these 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
	<16 %	0 %
Threshold	16 %	25 %
	17 %	50 %
	18 %	75 %
Maximum	≥19 %	100 %