Essent Group Ltd.
Form 10-Q
November 04, 2016
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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, 2016

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 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 1, 2016 was 93,105,055.

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Essent Group Ltd. and Subsidiaries

Form 10-Q

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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 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, 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, 2015 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;

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- 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; 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, 2016	December 31, 2015
Assets		
Investments available for sale, at fair value		
Fixed maturities (amortized cost: 2016 — $1,399,093; 2015 — $1,189,978)	$1,431,673	$1,190,638
Short-term investments (amortized cost: 2016 — $150,483; 2015 — $85,994)	150,483	85,996
Total investments	1,582,156	1,276,634
Cash	16,336	24,606
Accrued investment income	8,858	7,768
Accounts receivable	20,253	16,637
Deferred policy acquisition costs	13,013	11,529
Property and equipment (at cost, less accumulated depreciation of $45,567 in 2016 and $42,479 in 2015)	8,291	9,021
Prepaid federal income tax	163,022	119,412
Other assets	5,799	3,492
Total assets	$1,817,728	$1,469,099
Liabilities and Stockholders' Equity		
Liabilities		
Reserve for losses and LAE	$25,731	$17,760
Unearned premium reserve	219,996	201,045
Net deferred tax liability	140,641	87,964
Revolving credit facility borrowings	50,000	—
Securities purchases payable	45,770	14,996
Other accrued liabilities	25,375	28,093
Total liabilities	507,513	349,858
Commitments and contingencies		
Stockholders' Equity		
Common shares, $0.015 par value:		
Authorized - 233,333; issued - 93,102 shares in 2016 and 92,650 shares in 2015	1,397	1,390
Additional paid-in capital	913,215	904,221
Accumulated other comprehensive income (loss)	21,954	(99)
Retained earnings	373,649	213,729
Total stockholders' equity	1,310,215	1,119,241
Total liabilities and stockholders' equity	$1,817,728	$1,469,099

See accompanying notes to condensed consolidated financial statements.

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Essent Group Ltd. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	2016	2015	2016	2015
Revenues:				
Net premiums written	$115,887	$97,478	$324,866	$272,134
Increase in unearned premiums	(5,086)	(13,784)	(18,951)	(35,041)
Net premiums earned	110,801	83,694	305,915	237,093
Net investment income	6,781	5,322	19,665	14,322
Realized investment gains, net	435	548	1,489	1,765
Other income	3,237	2,172	4,816	2,634
Total revenues	121,254	91,736	331,885	255,814
Losses and expenses:				
Provision for losses and LAE	4,965	3,393	11,660	7,706
Other underwriting and operating expenses	32,848	28,714	95,645	83,360
Total losses and expenses	37,813	32,107	107,305	91,066
Income before income taxes	83,441	59,629	224,580	164,748
Income tax expense	23,730	18,808	64,660	51,896
Net income	$59,711	$40,821	$159,920	$112,852
Earnings per share:				
Basic	$0.66	$0.45	$1.76	$1.25
Diluted	0.65	0.44	1.74	1.23
Weighted average shares outstanding:				
Basic	90,961	90,418	90,886	90,317
Diluted	92,399	91,841	92,133	91,678
Net income	$59,711	$40,821	$159,920	$112,852
Other comprehensive income (loss):				
Change in unrealized (depreciation) appreciation of investments, net of tax (benefit) expense of ($897) and $2,013 in the three months ended September 30, 2016 and 2015 and $9,866 and $121 in the nine months ended September 30, 2016 and 2015	(2,008)	4,260	22,053	380
Total other comprehensive (loss) income	(2,008)	4,260	22,053	380
Comprehensive income	$57,703	$45,081	$181,973	$113,232

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	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2015	$ 1,388	$ 893,285	$ 4,667	$ 56,398	$ —	$ 955,738
Net income				157,331		157,331
Other comprehensive loss			(4,766)			(4,766)
Issuance of management incentive shares	6	(6)				—
Forfeiture of management incentive shares	(1)	1				—
Stock-based compensation expense		13,633				13,633
Excess tax benefits from stock-based compensation expense		2,420				2,420
Treasury stock acquired					(5,168)	(5,168)
Cancellation of treasury stock	(3)	(5,165)			5,168	—
Other equity transactions		53				53
Balance at December 31, 2015	$ 1,390	$ 904,221	$ (99)	$ 213,729	$ —	$ 1,119,241
Net income				159,920		159,920
Other comprehensive income			22,053			22,053
Issuance of management incentive shares	10	(10)				—
Forfeiture of management incentive shares	—	—				—
Stock-based compensation expense		11,902				11,902
Excess tax benefits from stock-based compensation expense		1,062				1,062
Treasury stock acquired					(3,963)	(3,963)
Cancellation of treasury stock	(3)	(3,960)			3,963	—
Balance at September 30, 2016	$ 1,397	$ 913,215	$ 21,954	$ 373,649	$ —	$ 1,310,215

See accompanying notes to condensed consolidated financial statements.

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Essent Group Ltd. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

(In thousands)	Nine Months Ended September 30, 2016		2015	
Operating Activities				
Net income	$ 159,920		$ 112,852	
Adjustments to reconcile net income to net cash provided by operating activities:				
Gain on the sale of investments, net	(1,489	)	(1,765	)
Depreciation and amortization	3,088		2,386	
Stock-based compensation expense	11,902		9,959	
Amortization of premium on investment securities	8,073		7,244	
Deferred income tax provision	42,811		40,077	
Excess tax benefits from stock-based compensation	(1,062	)	(2,390	)
Change in:				
Accrued investment income	(1,090	)	(1,624	)
Accounts receivable	(3,616	)	(2,821	)
Deferred policy acquisition costs	(1,484	)	(1,632	)
Prepaid federal income tax	(43,610	)	(47,739	)
Other assets	118		1,263	
Reserve for losses and LAE	7,971		6,121	
Unearned premium reserve	18,951		35,041	
Accrued liabilities	(1,656	)	2,214	
Net cash provided by operating activities	198,827		159,186	
Investing Activities				
Net change in short-term investments	(64,487	)	89,088	

Purchase of investments available for sale	(451,223)	(587,878)
Proceeds from maturity of investments available for sale	21,868	7,525
Proceeds from sales of investments available for sale	244,429	332,853
Purchase of property and equipment, net	(2,358)	(3,232)
Net cash used in investing activities	(251,771)	(161,644)
Financing Activities		
Revolving credit facility borrowings	50,000	—
Treasury stock acquired	(3,963)	(5,135)
Payment of issuance costs for revolving credit facility	(2,425)	—
Excess tax benefits from stock-based compensation	1,062	2,390
Payment of offering costs	—	(537)
Other financing activities	—	52
Net cash provided by (used in) financing activities	44,674	(3,230)
Net decrease in cash	(8,270)	(5,688)
Cash at beginning of year	24,606	24,411
Cash at end of period	$ 16,336	$ 18,723
Supplemental Disclosure of Cash Flow Information		
Income tax payments	$ (22,800)	$ (8,500)

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.

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 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, 2015, 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, 2016 prior to the issuance of these condensed consolidated financial statements.

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. The Company is currently evaluating the impact the adoption of this ASU will have on the consolidated financial statements; however, this update is not expected to impact the recognition of revenue related to insurance premiums or investments, which represent a significant portion of our total revenues.

In May 2015, the FASB issued ASU 2015-09, Disclosures about Short-Duration Contracts (Topic 944). The amendments in this update require insurance entities to disclose certain information about the liability for unpaid claims and claim adjustment expenses. The additional information required is focused on improvements in disclosures regarding insurance liabilities, including the nature, amount, timing, and uncertainty of cash flows related to those liabilities and the effect of those cash flows on the statement of comprehensive income. The disclosures required by this update are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016, and is to be applied retrospectively. The Company is currently evaluating the new disclosures required by this ASU.

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 is 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 provisions of this update are effective for annual and interim periods beginning after December 15, 2016. The Company expects to elect to recognize forfeitures as they occur and estimates that the initial adoption of this update will not have a material impact on stockholders' equity as of January 1, 2017. 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. To date, realized excess tax benefits have been recognized in additional paid-in-capital. 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.

Note 3. Investments Available for Sale

Investments available for sale consist of the following:

September 30, 2016 (In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$188,547	$ 4,335	$ (113)	$192,769
U.S. agency securities	17,319	78	(12)	17,385

U.S. agency mortgage-backed securities	280,878	3,814	(82)	284,610
Municipal debt securities(1)	318,264	13,908	(109)	332,063
Corporate debt securities(2)	433,824	10,237	(179)	443,882
Mortgage-backed securities	47,569	1,209	(313)	48,465
Asset-backed securities	127,691	447	(640)	127,498
Money market funds	135,484	—	—	135,484
Total investments available for sale	$1,549,576	$ 34,028	$ (1,448)	$1,582,156

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

December 31, 2015 (In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$178,460	$ 235	$ (1,088)	$177,607
U.S. agency securities	13,955	5	(178)	13,782
U.S. agency mortgage-backed securities	160,181	474	(1,053)	159,602
Municipal debt securities(1)	272,733	7,357	(262)	279,828
Corporate debt securities(2)	399,246	1,338	(3,852)	396,732
Mortgage-backed securities	56,380	97	(1,121)	55,356
Asset-backed securities	127,919	29	(1,319)	126,629
Money market funds	67,098	—	—	67,098
Total investments available for sale	$1,275,972	$ 9,535	$ (8,873)	$1,276,634

(1) The following table summarizes municipal debt securities as of :	September 30, 2016	December 31, 2015
Special revenue bonds	65.3 %	70.4 %
General obligation bonds	29.6	24.5
Certificate of participation bonds	3.4	4.0
Tax allocation bonds	0.9	1.1
Special tax bonds	0.8	—
Total	100.0 %	100.0 %

(2) The following table summarizes corporate debt securities as of :	September 30, 2016	December 31, 2015
Financial	39.8 %	44.9 %
Consumer, non-cyclical	20.3	14.8
Energy	8.4	9.0
Consumer, cyclical	6.4	6.2
Communications	6.3	7.1
Utilities	6.0	5.0
Industrial	4.7	5.2
Technology	4.5	3.8
Basic materials	3.6	4.0
Total	100.0 %	100.0 %

The amortized cost and fair value of investments available for sale at September 30, 2016, 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	$29,202	$29,222
Due after 1 but within 5 years	32,161	32,490
Due after 5 but within 10 years	112,209	115,538
Due after 10 years	14,975	15,519
Subtotal	188,547	192,769
U.S. agency securities:		
Due in 1 year	—	—
Due after 1 but within 5 years	17,319	17,385
Subtotal	17,319	17,385
Municipal debt securities:		
Due in 1 year	5,497	5,531
Due after 1 but within 5 years	102,729	103,752
Due after 5 but within 10 years	121,513	128,980
Due after 10 years	88,525	93,800
Subtotal	318,264	332,063
Corporate debt securities:		
Due in 1 year	31,708	31,743
Due after 1 but within 5 years	251,267	254,381
Due after 5 but within 10 years	148,348	155,187
Due after 10 years	2,501	2,571
Subtotal	433,824	443,882
U.S. agency mortgage-backed securities	280,878	284,610
Mortgage-backed securities	47,569	48,465
Asset-backed securities	127,691	127,498
Money market funds	135,484	135,484
Total investments available for sale	$1,549,576	$1,582,156

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Realized gross gains	$520	$663	$2,292	$2,790

Realized gross losses	12	115	723	1,025

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

September 30, 2016 (In thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Treasury securities	$42,619	$ (113)	$—	$ —	$42,619	$ (113)
U.S. agency securities	6,305	(12)	—	—	6,305	(12)
U.S. agency mortgage-backed securities	39,206	(76)	1,681	(6)	40,887	(82)
Municipal debt securities	20,642	(85)	6,515	(24)	27,157	(109)
Corporate debt securities	44,565	(130)	9,560	(49)	54,125	(179)
Mortgage-backed securities	7,173	(41)	18,208	(272)	25,381	(313)
Asset-backed securities	22,759	(44)	57,934	(596)	80,693	(640)
Total	$183,269	$ (501)	$93,898	$ (947)	$277,167	$ (1,448)

December 31, 2015 (In thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Treasury securities	$110,699	$ (1,088)	$—	$—	$110,699	$ (1,088)
U.S. agency securities	11,362	(178)	—	—	11,362	(178)
U.S. agency mortgage-backed securities	101,465	(915)	3,683	(138)	105,148	(1,053)
Municipal debt securities	47,850	(255)	1,254	(7)	49,104	(262)
Corporate debt securities	252,792	(3,447)	9,404	(405)	262,196	(3,852)
Mortgage-backed securities	23,360	(458)	26,075	(663)	49,435	(1,121)
Asset-backed securities	86,431	(871)	26,364	(448)	112,795	(1,319)
Total	$633,959	$ (7,212)	$66,780	$ (1,661)	$700,739	$ (8,873)

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. We recorded other-than-temporary impairments of $73 thousand and $80 thousand in the three and nine months ended September 30, 2016, respectively, on securities in an unrealized loss position. The impairments resulted from our intent to sell these securities subsequent to the reporting date. There were no other-than-temporary impairments of investments in the nine months ended September 30, 2015.

The fair value of investments deposited with insurance regulatory authorities to meet statutory requirements was $8.6 million as of September 30, 2016 and $8.5 million as of December 31, 2015. 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 required to be on deposit in these trusts was $304.0 million at September 30, 2016 and $171.5 million at December 31, 2015.

Net investment income consists of:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Fixed maturities	$7,296	$5,774	$21,148	$15,542
Short-term investments	39	19	102	48
Gross investment income	7,335	5,793	21,250	15,590
Investment expenses	(554)	(471)	(1,585)	(1,268)
Net investment income	$6,781	$5,322	$19,665	$14,322

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Note 4. Accounts Receivable

Accounts receivable consists of the following:

(In thousands)	September 30, 2016	December 31, 2015
Premiums receivable	$ 19,634	$ 16,034
Other receivables	619	603
Total accounts receivable	20,253	16,637
Less: Allowance for doubtful accounts	—	—
Accounts receivable, net	$ 20,253	$ 16,637

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 5. 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)	2016	2015
Reserve for losses and LAE at beginning of period	$17,760	$8,427
Less: Reinsurance recoverables	—	—
Net reserve for losses and LAE at beginning of period	17,760	8,427
Add provision for losses and LAE, net of reinsurance, occurring in:		
Current period	16,387	10,356
Prior years	(4,727)	(2,650)
Net incurred losses during the current period	11,660	7,706
Deduct payments for losses and LAE, net of reinsurance, occurring in:		
Current period	467	262
Prior years	3,222	1,323
Net loss and LAE payments during the current period	3,689	1,585
Net reserve for losses and LAE at end of period	25,731	14,548
Plus: Reinsurance recoverables	—	—
Reserve for losses and LAE at end of period	$25,731	$14,548
Loans in default at end of period	1,453	814

For the nine months ended September 30, 2016, $3.2 million was paid for incurred claims and claim adjustment expenses attributable to insured events of prior years. There has been a $4.7 million favorable prior year development during the nine months ended September 30, 2016. Reserves remaining as of September 30, 2016 for prior years are $9.8 million as a result of re-estimation of unpaid losses and loss adjustment expenses. 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 had 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 were $4.5 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.

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Note 6. Debt Obligations

Revolving Credit Facility

On April 19, 2016, Essent Group and its subsidiaries, Essent Irish Intermediate Holdings Limited and Essent US Holdings, Inc. (collectively, the "Borrowers"), entered into a three-year, secured revolving credit facility with a committed capacity of $200 million (the “Facility”). Borrowings under the Facility may be used for working capital and general corporate purposes, including, without limitation, capital contributions to Essent’s insurance and reinsurance subsidiaries. Borrowings will 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 Facility are secured by certain assets of the Borrowers, excluding the stock and assets of its insurance and reinsurance subsidiaries. The 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. This description is not intended to be complete in all respects and is qualified in its entirety by the terms of the Facility, including its covenants. As of September 30, 2016, the Company was in compliance with the covenants and $50 million had been borrowed under the Facility with an interest rate of 2.52%.

Note 7. 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 $93,008 and $16,903 related to remedies for the nine months ended September 30, 2016 and 2015. As of September 30, 2016, management believes any potential claims for indemnification related to contract underwriting services through September 30, 2016 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, 2016, 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 8. Stock-Based Compensation

The following table summarizes nonvested common share and nonvested common share unit activity for the nine months ended September 30, 2016:

(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	1,294	$ 15.15	890	$ 12.31	544	$ 19.84
Granted	209	17.01	181	17.01	205	17.78
Vested	—	N/A	(441)	9.46	(250)	19.62
Forfeited	—	N/A	(5)	0.23	(11)	18.12
Outstanding at September 30, 2016	1,503	$ 15.41	625	$ 15.79	488	$ 19.13

In February 2016, 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 2016 vest in three equal installments on March 1, 2017, 2018 and 2019. The performance-based share awards granted in February 2016 vest based upon our compounded annual book value per share growth percentage during a three-year performance period that commenced on January 1, 2016 and vest on March 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	
	<13	%	0	%
Threshold	13	%	25	%
	14	%	50	%
	15	%	75	%
Maximum	≥16	%	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 2015, in February 2016, time-based share awards and share units were issued to certain employees that vest in three equal installments on March 1, 2017, 2018 and 2019. In May 2016, time-based share units were granted to non-employee directors that vest one year from the date of grant.

The total fair value on the vesting date of nonvested shares or share units that vested was $14.8 million and $21.5 million for the nine months ended September 30, 2016 and 2015, respectively. As of September 30, 2016, there was $19.3 million of total unrecognized compensation expense related to nonvested shares or share units outstanding at September 30, 2016 and we expect to recognize the expense over a weighted average period of 1.7 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 182,286 in the nine months ended September 30, 2016. The tendered shares were recorded at cost, included in treasury stock and have been cancelled as of September 30, 2016.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Compensation expense	$3,953	$3,363	$11,902	$9,959
Income tax benefit	1,270	1,072	3,828	3,197

Note 9. 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)	2016	2015	2016	2015
Net income	$59,711	$40,821	$159,920	$112,852
Less: dividends declared	—	—	—	—
Net income available to common shareholders	$59,711	$40,821	$159,920	$112,852
Basic earnings per share	$0.66	$0.45	$1.76	$1.25
Diluted earnings per share	$0.65	$0.44	$1.74	$1.23
Basic weighted average shares outstanding	90,961	90,418	90,886	90,317
Dilutive effect of nonvested shares	1,438	1,423	1,247	1,361
Diluted weighted average shares outstanding	92,399	91,841	92,133	91,678

There were 1,574 and 905 antidilutive shares for the three months ended September 30, 2016 and 2015, respectively and 128,569 and 100,232 antidilutive shares for the nine months ended September 30, 2016 and 2015, 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, 2016, 100% of the performance-based share awards would be issuable under the terms of the arrangements if September 30, 2016 was the end of the performance period. Based on the compounded annual book value per share growth as of September 30, 2015, 100% of the performance-based share awards would have been issuable under the terms of the arrangements if September 30, 2015 was the end of the performance period.

Note 10. 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, 2016 and 2015:

Three Months Ended September 30, 2016

(In thousands)	Before Tax	Tax Effect	Net of Tax
Balance at beginning of period	$ 35,485	$ (11,523)	$ 23,962
Other comprehensive income (loss):			
Unrealized holding losses arising during the period	(2,470)	752	(1,718)
Less: Reclassification adjustment for gains included in net income (1)	(435)	145	(290)
Net unrealized losses on investments	(2,905)	897	(2,008)
Other comprehensive loss	(2,905)	897	(2,008)
Balance at end of period	$ 32,580	$ (10,626)	$ 21,954

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	Nine Months Ended September 30, 2016		
(In thousands)	Before Tax	Tax Effect	Net of Tax
Balance at beginning of period	$661	$(760)	$(99)
Other comprehensive income (loss):			
Unrealized holding gains arising during the period	33,415	(10,278)	23,137
Less: Reclassification adjustment for gains included in net income (1)	(1,496)	412	(1,084)
Net unrealized gains on investments	31,919	(9,866)	22,053
Other comprehensive income	31,919	(9,866)	22,053
Balance at end of period	$32,580	$(10,626)	$21,954

	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	6,273	(2,013)	4,260
Balance at end of period	$7,213	$(2,166)	$5,047

	Nine Months Ended September 30, 2015		
(In thousands)	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	501	(121)	380
Balance at end of period	$7,213	$(2,166)	$5,047

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

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Note 11. Fair Value of Financial Instruments

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

September 30, 2016 (In thousands)	Carrying Amount	Fair Value
Financial Assets:		
U.S. Treasury securities	$192,769	$192,769
U.S. agency securities	17,385	17,385
U.S. agency mortgage-backed securities	284,610	284,610
Municipal debt securities	332,063	332,063
Corporate debt securities	443,882	443,882
Mortgage-backed securities	48,465	48,465
Asset-backed securities	127,498	127,498
Money market funds	135,484	135,484
Total investments	$1,582,156	$1,582,156
Financial Liabilities:		
Derivative liabilities	$—	$—

December 31, 2015 (In thousands)	Carrying Amount	Fair Value
Financial Assets:		
U.S. Treasury securities	$177,607	$177,607
U.S. agency securities	13,782	13,782
U.S. agency mortgage-backed securities	159,602	159,602
Municipal debt securities	279,828	279,828
Corporate debt securities	396,732	396,732
Mortgage-backed securities	55,356	55,356
Asset-backed securities	126,629	126,629
Money market funds	67,098	67,098
Total investments	$1,276,634	$1,276,634
Financial Liabilities:		
Derivative liabilities	$1,232	$1,232

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.
-

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.

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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 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. U.S. agency securities, U.S. agency mortgage-backed securities, municipal debt securities, corporate debt securities, 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. U.S. agency securities, U.S. agency mortgage-backed securities, municipal and corporate debt securities are valued by our primary vendor using recently executed transactions and proprietary models based on observable inputs, such as interest rate spreads, yield curves and credit risk. Mortgage-backed and asset-backed securities are valued by our primary vendor using proprietary models based on observable inputs, such as interest rate spreads, prepayment speeds and credit risk. As part of our evaluation of investment prices provided by our primary pricing service, we obtained and reviewed their pricing methodologies which include a description of how each security type is evaluated and priced. 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. Through June 30, 2016, certain of our Freddie Mac Agency Credit Insurance Structure ("ACIS") contracts were accounted for as derivatives. In determining an exit market, we considered the fact that there is not a principal market for these contracts. In the absence of a principal market, we valued these ACIS contracts in a hypothetical market where market participants, and potential counterparties, included other mortgage guaranty insurers or reinsurers with similar credit quality to us. We believed 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 were classified as Level 3 of the fair value hierarchy. During the quarter ended September 30, 2016, these contracts were amended and are now accounted for as insurance contracts rather than derivatives.

Through June 30, 2016, we determined the fair value of our derivative instruments primarily using internally-generated models. We utilized market observable inputs, such as the performance of the underlying pool of mortgages, mortgage prepayment speeds and pricing spreads on the reference STACR notes issued by Freddie Mac, whenever they were available. There was a high degree of uncertainty about our fair value estimates since our contracts were not traded or exchanged, which made external validation and corroboration of our estimates difficult. Considerable judgment was required to interpret market data to develop the estimates of fair value. Accordingly, the estimates may not have been indicative of amounts we could have realized in a market exchange or negotiated termination. The use of different market assumptions or estimation methodologies may have had a material effect on the estimated fair value amounts.

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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, 2016 (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	$ 192,769	$—	$ —	$192,769
U.S. agency securities	—	17,385	—	17,385
U.S. agency mortgage-backed securities	—	284,610	—	284,610
Municipal debt securities	—	332,063	—	332,063
Corporate debt securities	—	443,882	—	443,882
Mortgage-backed securities	—	48,465	—	48,465
Asset-backed securities	—	127,498	—	127,498
Money market funds	135,484	—	—	135,484
Total assets at fair value	$ 328,253	$1,253,903	$ —	$1,582,156
Financial Liabilities:				
Derivative liabilities	$ —	$—	$ —	$—
Total liabilities at fair value	$ —			