

Essent Group Ltd.
Form 10-Q
November 09, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the period ended September 30, 2018

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

For the transition period from _____ to _____

Commission file number 001-36157

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

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

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

(441) 297-9901
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232-405 of this chapter) during the preceding 12 months (or for

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such shorter period that the registrant was required to submit such files.) Yes No

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 Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of the registrant's common shares outstanding as of November 2, 2018 was 98,139,176.

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Essent Group Ltd. and Subsidiaries

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Unless the context otherwise indicates or requires, the terms “we,” “our,” “us,” “Essent,” and the “Company,” as used in this Quarterly Report on Form 10-Q, refer to Essent Group Ltd. and its directly and indirectly owned subsidiaries, including our primary operating 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, 2017 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 on the basis of price, terms and conditions or otherwise, 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 impact of recently enacted U.S. Federal tax reform on us, our shareholders and our operations;

- the definition of “Qualified Mortgage” reducing the size of the mortgage origination market or creating incentives to use government mortgage insurance programs;

the definition of “Qualified Residential Mortgage” reducing the number of low down payment loans or lenders and investors seeking alternatives to private mortgage insurance;

the implementation of the Basel III Capital Accord, which may discourage the use of private mortgage insurance;

management of risk in our investment portfolio;

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

	September 30, 2018	December 31, 2017
(In thousands, except per share amounts)		
Assets		
Investments		
Fixed maturities available for sale, at fair value (amortized cost: 2018 — \$2,527,850; 2017 — \$1,994,200)	\$2,473,840	\$1,992,371
Short-term investments available for sale, at fair value (amortized cost: 2018 — \$191,911; 2017 — \$312,714)	191,912	312,694
Total investments available for sale	2,665,752	2,305,065
Other invested assets	24,865	500
Total investments	2,690,617	2,305,565
Cash	29,797	43,524
Accrued investment income	17,125	12,807
Accounts receivable	35,597	29,752
Deferred policy acquisition costs	16,159	15,354
Property and equipment (at cost, less accumulated depreciation of \$53,005 in 2018 and \$50,466 in 2017)	7,387	6,979
Prepaid federal income tax	185,935	252,157
Other assets	10,806	8,230
Total assets	\$2,993,423	\$2,674,368
Liabilities and Stockholders' Equity		
Liabilities		
Reserve for losses and LAE	\$53,355	\$46,850
Unearned premium reserve	292,331	259,672
Net deferred tax liability	155,349	127,636
Credit facility borrowings (at carrying value, less unamortized deferred costs of \$1,513 in 2018 and \$1,409 in 2017)	223,487	248,591
Securities purchases payable	21,741	14,999
Other accrued liabilities	32,021	36,184
Total liabilities	778,284	733,932
Commitments and contingencies (see Note 7)		
Stockholders' Equity		
Common shares, \$0.015 par value:		
Authorized - 233,333; issued and outstanding - 98,128 shares in 2018 and 98,434 shares in 2017	1,472	1,476
Additional paid-in capital	1,107,206	1,127,137
Accumulated other comprehensive loss	(47,449)	(3,252)
Retained earnings	1,153,910	815,075
Total stockholders' equity	2,215,139	1,940,436

Total liabilities and stockholders' equity	\$2,993,423	\$2,674,368
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See accompanying notes to condensed consolidated financial statements.

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Essent Group Ltd. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(In thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues:				
Net premiums written	\$175,221	\$155,055	\$508,850	\$408,415
Increase in unearned premiums	(8,546)	(17,115)	(32,659)	(26,261)
Net premiums earned	166,675	137,940	476,191	382,154
Net investment income	16,646	10,626	45,494	28,461
Realized investment gains, net	524	564	1,160	1,763
Other income	1,153	1,073	3,384	3,023
Total revenues	184,998	150,203	526,229	415,401
Losses and expenses:				
Provision for losses and LAE	5,452	4,313	12,574	9,776
Other underwriting and operating expenses	36,899	37,035	111,451	109,053
Interest expense	2,500	1,456	7,568	3,361
Total losses and expenses	44,851	42,804	131,593	122,190
Income before income taxes	140,147	107,399	394,636	293,211
Income tax expense	24,136	29,006	55,801	76,102
Net income	\$116,011	\$78,393	\$338,835	\$217,109
Earnings per share:				
Basic	\$1.19	\$0.83	\$3.48	\$2.35
Diluted	1.18	0.82	3.46	2.31
Weighted average shares outstanding:				
Basic	97,438	94,185	97,388	92,285
Diluted	98,013	96,094	97,944	94,104
Net income	\$116,011	\$78,393	\$338,835	\$217,109
Other comprehensive income (loss):				
Change in unrealized (depreciation) appreciation of investments, net of tax (benefit) expense of (\$1,352) and \$752 in the three months ended September 30, 2018 and 2017 and (\$7,963) and \$6,462 in the nine months ended September 30, 2018 and 2017	(8,201)	1,978	(44,197)	15,298
Total other comprehensive (loss) income	(8,201)	1,978	(44,197)	15,298
Comprehensive income	\$107,810	\$80,371	\$294,638	\$232,407

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, 2017	\$ 1,397	\$ 918,296	\$ (12,255)	\$ 436,335	\$ —	\$ 1,343,773
Net income				379,747		379,747
Other comprehensive income			8,068			8,068
Issuance of common shares, net of issuance cost of \$1,802	75	197,623				197,698
Issuance of management incentive shares	8	(8)				—
Stock-based compensation expense		18,688				18,688
Cumulative effect of ASU 2016-09 adoption		111		(72)		39
Treasury stock acquired					(7,577)	(7,577)
Cancellation of treasury stock	(4)	(7,573)			7,577	—
Reclassification of certain income tax effects resulting from tax reform			935	(935)		—
Balance at December 31, 2017	\$ 1,476	\$ 1,127,137	\$ (3,252)	\$ 815,075	\$ —	\$ 1,940,436
Net income				338,835		338,835
Other comprehensive loss			(44,197)			(44,197)
Issuance of management incentive shares	6	(6)				—
Stock-based compensation expense		11,269				11,269
Treasury stock acquired					(31,204)	(31,204)
Cancellation of treasury stock	(10)	(31,194)			31,204	—
Balance at September 30, 2018	\$ 1,472	\$ 1,107,206	\$ (47,449)	\$ 1,153,910	\$ —	\$ 2,215,139

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,	
	2018	2017
Operating Activities		
Net income	\$338,835	\$217,109
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on the sale of investments, net	(1,160	) (1,763
Depreciation and amortization	2,539	2,955
Stock-based compensation expense	11,269	13,980
Amortization of premium on investment securities	10,701	8,752
Deferred income tax provision	35,676	49,032
Change in:		
Accrued investment income	(4,318	) (2,351
Accounts receivable	(5,842	) (7,657
Deferred policy acquisition costs	(805	) (1,431
Prepaid federal income tax	66,222	(52,185
Other assets	(2,439	) 21
Reserve for losses and LAE	6,505	3,437
Unearned premium reserve	32,659	26,261
Other accrued liabilities	(3,888	) (4,139
Net cash provided by operating activities	485,954	252,021
Investing Activities		
Net change in short-term investments	120,782	(164,165
Purchase of investments available for sale	(861,042	) (567,335
Proceeds from maturity of investments available for sale	82,746	51,440
Proceeds from sales of investments available for sale	241,865	197,623
Purchase of other invested assets	(24,751) —
Distributions from other invested assets	386	—
Purchase of property and equipment	(2,947	) (2,661
Net cash used in investing activities	(442,961	) (485,098
Financing Activities		
Issuance of common shares, net of costs	—	198,212
Credit facility borrowings	15,000	125,000
Credit facility repayments	(40,000	) (50,000
Treasury stock acquired	(31,204	) (7,329
Payment of issuance costs for credit facility	(516	) (2,596
Net cash (used in) provided by financing activities	(56,720	) 263,287
Net (decrease) increase in cash	(13,727	) 30,210
Cash at beginning of year	43,524	27,531
Cash at end of period	\$29,797	\$57,741

Supplemental Disclosure of Cash Flow Information

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Income tax payments	\$(18,600)	\$(28,300)
Interest payments	(7,051)	(3,120)
Noncash Transactions		
Repayment of borrowings with term loan proceeds (see Note 6)	\$(100,000)	\$(125,000)

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 Group 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. A significant portion of our premium revenue relates to master policies with certain lending institutions. For the nine months ended September 30, 2018 one lender represented 10% of our total revenue. The loss of this customer could have a significant impact on our revenues and results of operations.

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, 2017, 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, 2018 prior to the issuance of these condensed consolidated financial statements.

Within the Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2017, the financing activities were revised to reflect the repayment of credit facility borrowings with term loan proceeds of \$125 million as a non-cash transaction to be consistent with the December 31, 2017 presentation. The term loan proceeds were directly applied at closing to pay down credit facility borrowings. This revision did not impact net cash provided by financing activities or the net increase in cash or any other financial statements or disclosures for the nine months ended September 30, 2017.

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,

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

and uncertainty of revenue and cash flows arising from contracts with customers. 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. The Company adopted this ASU effective January 1, 2018. The adoption of this ASU did not 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 Company adopted this ASU effective January 1, 2018. The adoption of this ASU did not have a material effect on the Company's consolidated operating results or financial position.

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. We anticipate adopting this standard on January 1, 2019 using the retrospective adoption approach as of the adoption date and electing certain practical expedients allowed under the standard. The adoption of this ASU is not expected to have a material effect on the Company's consolidated operating results or financial position.

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.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this update modify the disclosure requirements for fair value measurements by removing, modifying, or adding certain disclosures. The provisions of this update are effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for the removed disclosures. The Company is evaluating the impact the adoption of this ASU will

have on the consolidated financial statements and related disclosures.

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 3. Investments

Investments available for sale consist of the following:

September 30, 2018 (In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	\$275,423	\$ —	\$(10,190)	\$265,233
U.S. agency securities	33,651	—	(974)	32,677
U.S. agency mortgage-backed securities	588,499	117	(21,990)	566,626
Municipal debt securities(1)	462,546	2,096	(7,136)	457,506
Non-U.S. government securities	44,964	87	(253)	44,798
Corporate debt securities(2)	720,722	295	(14,687)	706,330
Residential and commercial mortgage securities	102,093	547	(991)	101,649
Asset-backed securities	299,952	280	(1,211)	299,021
Money market funds	191,911	1	—	191,912
Total investments available for sale	\$2,719,761	\$ 3,423	\$(57,432)	\$2,665,752
December 31, 2017 (In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	\$231,905	\$ 2	\$(4,102)	\$227,805
U.S. agency securities	33,669	—	(555)	33,114
U.S. agency mortgage-backed securities	462,986	567	(7,516)	456,037
Municipal debt securities(1)	457,418	9,098	(1,261)	465,255
Corporate debt securities(2)	610,516	4,249	(3,037)	611,728
Residential and commercial mortgage securities	78,974	791	(358)	79,407
Asset-backed securities	167,638	467	(183)	167,922
Money market funds	263,808	—	(11)	263,797
Total investments available for sale	\$2,306,914	\$ 15,174	\$(17,023)	\$2,305,065

	September 30, 2018	December 31, 2017		
(1) The following table summarizes municipal debt securities as of :				
Special revenue bonds	66.3	63.6	%	%
General obligation bonds	28.6	30.7		
Certificate of participation bonds	3.7	4.4		
Tax allocation bonds	0.9	0.8		
Special tax bonds	0.5	0.5		
Total	100.0	100.0	%	%
(2) The following table summarizes corporate debt securities as of :				
Financial	37.7	45.9	%	%
Consumer, non-cyclical	21.4	16.2		
Communications	12.4	7.3		
Energy	6.9	7.8		
Consumer, cyclical	5.5	5.3		
Industrial	5.4	6.3		

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Utilities	4.7	5.3
Technology	3.5	3.9
Basic materials	2.5	2.0
Total	100.0 %	100.0 %

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

The amortized cost and fair value of investments available for sale at September 30, 2018, 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	\$1,995	\$1,977
Due after 1 but within 5 years	173,681	170,686
Due after 5 but within 10 years	70,168	65,030
Due after 10 years	29,579	27,540
Subtotal	275,423	265,233
U.S. agency securities:		
Due in 1 year	—	—
Due after 1 but within 5 years	33,651	32,677
Subtotal	33,651	32,677
Municipal debt securities:		
Due in 1 year	27,808	27,768
Due after 1 but within 5 years	91,977	91,050
Due after 5 but within 10 years	174,111	172,250
Due after 10 years	168,650	166,438
Subtotal	462,546	457,506
Non-U.S. government securities:		
Due in 1 year	—	—
Due after 1 but within 5 years	19,770	19,790
Due after 5 but within 10 years	25,194	25,008
Subtotal	44,964	44,798
Corporate debt securities:		
Due in 1 year	76,859	76,455
Due after 1 but within 5 years	375,792	369,276
Due after 5 but within 10 years	259,457	252,293
Due after 10 years	8,614	8,306
Subtotal	720,722	706,330
U.S. agency mortgage-backed securities	588,499	566,626
Residential and commercial mortgage securities	102,093	101,649
Asset-backed securities	299,952	299,021
Money market funds	191,911	191,912
Total investments available for sale	\$2,719,761	\$2,665,752

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)	2018	2017	2018	2017
Realized gross gains	\$574	\$605	\$1,883	\$2,035
Realized gross losses	50	41	723	272

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

September 30, 2018 (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	\$122,842	\$(1,525)	\$142,391	\$(8,665)	\$265,233	\$(10,190)
U.S. agency securities	500	(15)	32,177	(959)	32,677	(974)
U.S. agency mortgage-backed securities	266,952	(5,822)	277,959	(16,168)	544,911	(21,990)
Municipal debt securities	277,700	(5,196)	55,770	(1,940)	333,470	(7,136)
Non-U.S. government securities	23,316	(253)	—	—	23,316	(253)
Corporate debt securities	518,678	(10,146)	139,222	(4,541)	657,900	(14,687)
Residential and commercial mortgage securities	50,881	(473)	10,095	(518)	60,976	(991)
Asset-backed securities	214,400	(1,099)	6,281	(112)	220,681	(1,211)
Total	\$1,475,269	\$(24,529)	\$663,895	\$(32,903)	\$2,139,164	\$(57,432)

December 31, 2017 (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	\$151,119	\$(1,240)	\$69,454	\$(2,862)	\$220,573	\$(4,102)
U.S. agency securities	17,320	(190)	15,794	(365)	33,114	(555)
U.S. agency mortgage-backed securities	180,443	(1,394)	217,944	(6,122)	398,387	(7,516)
Municipal debt securities	124,171	(817)	23,492	(444)	147,663	(1,261)
Corporate debt securities	214,371	(1,213)	94,261	(1,824)	308,632	(3,037)
Residential and commercial mortgage securities	29,842	(179)	5,988	(179)	35,830	(358)
Asset-backed securities	58,798	(133)	5,828	(50)	64,626	(183)
Money market funds	59,489	(11)	—	—	59,489	(11)
Total	\$835,553	\$(5,177)	\$432,761	\$(11,846)	\$1,268,314	\$(17,023)

The gross unrealized losses on these investment securities are principally associated with the changes in market interest rates as well as changes in 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 each of the three and nine months ended September 30, 2018 and 2017.

The Company's other invested assets at September 30, 2018 and December 31, 2017 totaled \$24.9 million and \$0.5 million, respectively. Other invested assets are comprised of limited partnership interests which are accounted for under the equity method of accounting. In applying the equity method, these investments are initially recorded at cost and are subsequently adjusted based on the Company's proportionate share of the net income or loss of the partnership. Due to the timing of receiving financial information from these partnerships, the results are generally reported on a one month or quarter lag.

The fair value of investments deposited with insurance regulatory authorities to meet statutory requirements was \$8.5 million as of September 30, 2018 and \$8.6 million as of December 31, 2017. 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 \$714.4 million at September 30, 2018 and \$615.8 million at December 31, 2017. In connection with an excess-of-loss reinsurance agreement (see Note 4), Essent Guaranty is required to maintain assets on deposit for the benefit of the reinsurer. The fair value of the assets on deposit was \$3.4 million at September 30, 2018. Essent Guaranty is also required to maintain assets on deposit for the benefit of the sponsor of a fixed income investment commitment. The fair value of the assets on deposit was \$6.3 million at September 30, 2018.

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Net investment income consists of:

	Three Months		Nine Months	
	Ended September		Ended September	
	30,		30,	
(In thousands)	2018	2017	2018	2017
Fixed maturities	\$16,476	\$10,982	\$44,615	\$29,964
Short-term investments	910	330	2,959	463
Gross investment income	17,386	11,312	47,574	30,427
Investment expenses	(740)	(686)	(2,080)	(1,966)
Net investment income	\$16,646	\$10,626	\$45,494	\$28,461

Note 4. Reinsurance

In the ordinary course of business, our insurance subsidiaries may use reinsurance to provide protection against adverse loss experience and to expand our capital sources. Reinsurance recoverables are recorded as assets, predicated on a reinsurer's ability to meet their obligations under the reinsurance agreements. If the reinsurers are unable to satisfy their obligations under the agreements, our insurance subsidiaries would be liable for such defaulted amounts.

On March 22, 2018, Essent Guaranty entered into a fully collateralized reinsurance agreement with Radnor Re 2018-1 Ltd. ("Radnor Re"), an unaffiliated special purpose insurer domiciled in Bermuda, that provides for up to \$424.4 million of aggregate excess-of-loss reinsurance coverage at inception for new defaults on a portfolio of mortgage insurance policies issued between January 1, 2017 and December 31, 2017. For the reinsurance coverage period, Essent Guaranty and its affiliates will retain the first layer of \$224.7 million of aggregate losses, and Radnor Re will then provide second layer coverage up to the outstanding reinsurance coverage amount. Essent Guaranty and its affiliates retain losses in excess of the outstanding reinsurance coverage amount. The reinsurance premium due to Radnor Re is calculated by multiplying the outstanding reinsurance coverage amount at the beginning of a period by a coupon rate, which is the sum of one-month LIBOR plus a risk margin, and then subtracting actual investment income collected on the assets in the reinsurance trust during that period. The aggregate excess of loss reinsurance coverage decreases over a ten-year period as the underlying covered mortgages amortize. Essent Guaranty has rights to terminate the reinsurance agreement, which includes an option to terminate after five years from issuance. If the reinsurance agreement is not terminated after five years from issuance, the risk margin component of the reinsurance premium payable to Radnor Re increases by 50%. Radnor Re financed the coverage by issuing mortgage insurance-linked notes in an aggregate amount of \$424.4 million to unaffiliated investors. The notes have ten-year legal maturities and are non-recourse to any assets of Essent Guaranty or its affiliates. The proceeds of the notes were deposited into a reinsurance trust for the benefit of Essent Guaranty that will be the source of reinsurance claim payments to Essent Guaranty and principal repayments on the mortgage insurance-linked notes.

The effect of reinsurance on net premiums written and earned is as follows:

	Three Months		Nine Months Ended	
	Ended		September 30,	
	September 30,			
(In thousands)	2018	2017	2018	2017
Net premiums written:				

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Direct	\$178,379	\$155,055	\$515,887	\$408,415
Ceded	(3,158)	—	(7,037)	—
Net premiums written	\$175,221	\$155,055	\$508,850	\$408,415

Net premiums earned:

Direct	\$169,833	\$137,940	\$483,228	\$382,154
Ceded	(3,158)	—	(7,037)	—
Net premiums earned	\$166,675	\$137,940	\$476,191	\$382,154

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The amount of monthly reinsurance premium ceded will fluctuate due to changes in one-month LIBOR and changes in money market rates that affect investment income collected on the assets in the reinsurance trust. As the reinsurance premium will vary based on changes in these rates, we concluded that the reinsurance agreement contains an embedded derivative that will be accounted for separately like a freestanding derivative. The fair value of this derivative at September 30, 2018 and the change in its fair value from inception of the reinsurance agreement to September 30, 2018 was not material.

In connection with entering the reinsurance agreement with Radnor Re, we concluded that the risk transfer requirements for reinsurance accounting were met as Radnor Re is assuming significant insurance risk and a reasonable possibility of a significant loss. In addition, we assessed whether Radnor Re was a variable interest entity ("VIE") and the appropriate accounting for Radnor Re if it was a VIE. A VIE is a legal entity that does not have sufficient equity at risk to finance its activities without additional subordinated financial support or is structured such that equity investors lack the ability to make significant decisions relating to the entity's operations through voting rights or do not substantively participate in the gains and losses of the entity. A VIE is consolidated by its primary beneficiary. The primary beneficiary is the entity that has both (1) the power to direct the activities of the VIE that most significantly affect the entity's economic performance and (2) the obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE. While also considering these factors, the consolidation conclusion depends on the breadth of the decision-making ability and ability to influence activities that significantly affect the economic performance of the VIE. We concluded that Radnor Re is a VIE. However, given that Essent Guaranty (1) does not have the unilateral power to direct the activities that most significantly affect Radnor Re's economic performance and (2) does not have the obligation to absorb losses or the right to receive benefits that could be potentially significant to Radnor Re, Radnor Re is not consolidated in these financial statements.

The following table presents total assets of Radnor Re as well as our maximum exposure to loss associated with Radnor Re, representing the estimated net present value of investment earnings on the assets in the reinsurance trust, each as of September 30, 2018:

	Total	Maximum Exposure to Loss	
(In thousands)	VIE Assets	On Off - Balance Sheet	Total
Radnor Re 2018-1 Ltd.	\$424,412	\$-\$20,958	\$20,958
Total	\$424,412	\$-\$20,958	\$20,958

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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)	2018	2017
Reserve for losses and LAE at beginning of period	\$46,850	\$28,142
Less: Reinsurance recoverables	—	—
Net reserve for losses and LAE at beginning of period	46,850	28,142
Add provision for losses and LAE, net of reinsurance, occurring in:		
Current period	25,199	19,266
Prior years	(12,625)	(9,490)
Net incurred losses and LAE during the current period	12,574	9,776
Deduct payments for losses and LAE, net of reinsurance, occurring in:		
Current period	620	243
Prior years	5,449	6,096
Net loss and LAE payments during the current period	6,069	6,339
Net reserve for losses and LAE at end of period	53,355	31,579
Plus: Reinsurance recoverables	—	—
Reserve for losses and LAE at end of period	\$53,355	\$31,579
Loans in default at end of period	3,538	2,153

For the nine months ended September 30, 2018, \$5.4 million was paid for incurred claims and claim adjustment expenses attributable to insured events of prior years. There has been a \$12.6 million favorable prior year development during the nine months ended September 30, 2018. Reserves remaining as of September 30, 2018 for prior years are \$28.8 million as a result of re-estimation of unpaid losses and loss adjustment expenses. For the nine months ended September 30, 2017, \$6.1 million was paid for incurred claims and claim adjustment expenses attributable to insured events of prior years. There was a \$9.5 million favorable prior year development during the nine months ended September 30, 2017. Reserves remaining as of September 30, 2017 for prior years were \$12.6 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.

During the third quarter of 2017, certain regions of the U.S. experienced hurricanes which have impacted our insured portfolio's performance. Specifically, on August 26, 2017, Hurricane Harvey made landfall in southeastern Texas and on September 10, 2017, Hurricane Irma made landfall in southern Florida and caused property damage in certain counties. Loans in default identified as hurricane-related defaults totaled 2,288 as of December 31, 2017. The number of hurricane-related defaults declined to 301 as of September 30, 2018 primarily due to hurricane-related loans in default that cured. Based on prior industry experience, we expect the ultimate number of hurricane-related defaults that result in claims will be less than the default-to-claim experience of non-hurricane-related defaults. In addition, under our master policy, our exposure may be limited on hurricane-related claims. For example, we are permitted to exclude a claim entirely where damage to the property underlying a mortgage was the proximate cause of the default and adjust a claim where the property underlying a mortgage in default is subject to unrestored physical damage. The

reserve for losses and LAE on hurricane-related defaults was \$11.1 million at September 30, 2018 and December 31, 2017. The impact on our reserves in future periods will be dependent upon the performance of the hurricane-related defaults and our expectations for the amount of ultimate losses on these delinquencies.

Note 6. Debt Obligations

Credit Facility

Essent Group and its subsidiaries, Essent Irish Intermediate Holdings Limited and Essent US Holdings, Inc. (collectively, the "Borrowers"), are parties to a secured credit facility (the "Credit Facility") which provides for a revolving

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credit facility, term loans and an 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 12). The borrowings under the Credit Facility 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.

On May 2, 2018, the Credit Facility was amended to increase the committed capacity by \$125 million to \$500 million and to increase the uncommitted line by \$25 million to \$100 million. The revolving component of the Credit Facility was increased from \$250 million to \$275 million, and the Borrowers issued \$100 million of additional term loans, resulting in \$225 million of term loans outstanding. The proceeds of \$100 million of additional term loans were used to pay down borrowings outstanding under the revolving component of the Credit Facility. The interest rate, contractual maturity and other terms of the Credit Facility are otherwise unchanged from those described above. As of September 30, 2018, the Company was in compliance with the covenants and \$225 million had been borrowed under the Credit Facility with a weighted average interest rate of 4.15%. As of December 31, 2017, \$250 million had been borrowed with a weighted average interest rate of 3.49%.

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 \$0.1 million related to remedies for each of the nine months ended September 30, 2018 and 2017. As of September 30, 2018, management believes any potential claims for indemnification related to contract underwriting services through September 30, 2018 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 September 30, 2018, 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.

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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, 2018:

(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 Units	Weighted Average Grant Date Fair Value
Outstanding at beginning of year	1,595	\$ 17.03	410	\$ 21.12	536	\$ 29.13
Granted	113	45.02	73	45.02	161	42.19
Vested	(1,226)	14.71	(276)	18.67	(222)	28.27
Forfeited	—	N/A	—	N/A	(7)	31.31
Outstanding at September 30, 2018	482	\$ 29.49	207	\$ 32.82	468	\$ 34.00

In February 2018, 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 2018 vest in three equal installments on March 1, 2019, 2020 and 2021. The performance-based share awards granted in February 2018 vest based upon our compounded annual book value per share growth percentage during a three-year performance period that commenced on January 1, 2018 and vest on March 1, 2021. 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	
	<15	%	0	%
Threshold	15	%	25	%
	16	%	50	%
	17	%	75	%
Maximum	≥18	%	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 2017, in February 2018, time-based share awards and share units were issued to certain employees that vest in three equal installments on March 1, 2019, 2020 and 2021. In May 2018, 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 \$75.2 million and \$21.6 million for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, there was \$22.0 million of total unrecognized compensation expense related to nonvested shares or share units outstanding at September 30, 2018 and we expect to recognize the expense over a weighted average period of 2.0 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 713,932 in the nine months ended September 30, 2018. The tendered shares were recorded at cost and included in treasury stock. All treasury stock has been cancelled as of September 30, 2018.

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

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
(In thousands)	2018	2017	2018	2017
Compensation expense	\$3,837	\$4,692	\$11,269	\$13,980
Income tax benefit	713	1,513	2,098	4,498

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		Nine Months	
	Ended September 30,		Ended September 30,	
(In thousands, except per share amounts)	2018	2017	2018	2017
Net income	\$116,011	\$78,393	\$338,835	\$217,109
Less: dividends declared	—	—	—	—
Net income available to common shareholders	\$116,011	\$78,393	\$338,835	\$217,109
Basic earnings per share	\$1.19	\$0.83	\$3.48	\$2.35
Diluted earnings per share	\$1.18	\$0.82	\$3.46	\$2.31
Basic weighted average shares outstanding	97,438	94,185	97,388	92,285
Dilutive effect of nonvested shares	575	1,909	556	1,819
Diluted weighted average shares outstanding	98,013	96,094	97,944	94,104

There were 11,445 and 956 antidilutive shares for the three months ended September 30, 2018 and 2017, respectively and 164,874 and 59,534 antidilutive shares for the nine months ended September 30, 2018 and 2017, 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, 2018 and 2017, 100% of the dilutive performance-based share awards would be issuable under the terms of the arrangements at each date if September 30 was the end of the contingency period.

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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, 2018 and 2017:

(In thousands)	Three Months Ended September 30, 2018		
	Before Tax	Tax Effect	Net of Tax
Balance at beginning of period	\$(44,456)	\$ 5,208	\$(39,248)
Other comprehensive income (loss):			
Unrealized holding gains (losses) on investments:			
Unrealized holding losses arising during the period	(9,029)	) 1,241	(7,788)
Less: Reclassification adjustment for gains included in net income (1)	(524)	) 111	(413)
Net unrealized losses on investments	(9,553)	) 1,352	(8,201)
Other comprehensive loss	(9,553)	) 1,352	(8,201)
Balance at end of period	\$(54,009)	\$ 6,560	\$(47,449)

(In thousands)	Nine Months Ended September 30, 2018		
	Before Tax	Tax Effect	Net of Tax
Balance at beginning of year	\$(1,849)	) \$(1,403)	\$(3,252)
Other comprehensive income (loss):			
Unrealized holding gains (losses) on investments:			
Unrealized holding losses arising during the period	(51,000)	) 7,686	(43,314)
Less: Reclassification adjustment for gains included in net income (1)	(1,160)	) 277	(883)
Net unrealized losses on investments	(52,160)	) 7,963	(44,197)
Other comprehensive loss	(52,160)) 7,963	(44,197)
Balance at end of period	\$(54,009)	\$ 6,560	\$(47,449)

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	Three Months Ended September 30, 2017		
(In thousands)	Before Tax	Tax Effect	Net of Tax
Balance at beginning of period	\$4,594	\$ (3,529)	\$ 1,065
Other comprehensive income (loss):			
Unrealized holding gains (losses) on investments:			
Unrealized holding gains arising during the period	3,294	(949)	2,345
Less: Reclassification adjustment for gains included in net income (1)	(564)	197	(367)
Net unrealized gains on investments	2,730	(752)	1,978
Other comprehensive income	2,730	(752)	1,978
Balance at end of period	\$7,324	\$ (4,281)	\$ 3,043
	Nine Months Ended September 30, 2017		
(In thousands)	Before Tax	Tax Effect	Net of Tax
Balance at beginning of year	\$(14,436)	\$ 2,181	\$(12,255)
Other comprehensive income (loss):			
Unrealized holding gains (losses) on investments:			
Unrealized holding gains arising during the period	23,523	(7,071)	16,452
Less: Reclassification adjustment for gains included in net income (1)	(1,763)	609	(1,154)
Net unrealized gains on investments	21,760	(6,462)	15,298
Other comprehensive income	21,760	(6,462)	15,298
Balance at end of period	\$7,324	\$ (4,281)	\$ 3,043

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

Note 11. Fair Value of Financial Instruments

We carry certain of our financial instruments at fair value. 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.

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.

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

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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, non-U.S. government securities, corporate debt securities, residential and commercial mortgage 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 debt securities, non-U.S. government securities 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. Residential and commercial mortgage securities 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.

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, 2018 (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	\$ 265,233	\$—	\$	—\$265,233

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U.S. agency securities	—	32,677	—	32,677
U.S. agency mortgage-backed securities	—	566,626	—	566,626
Municipal debt securities	—	457,506	—	457,506
Non-U.S. government securities	—	44,798	—	44,798
Corporate debt securities	—	706,330	—	706,330
Residential and commercial mortgage securities	—	101,649	—	101,649
Asset-backed securities	—	299,021	—	299,021
Money market funds	191,912	—	—	191,912
Total assets at fair value	\$ 457,145	\$2,208,607	\$	—\$2,665,752

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

December 31, 2017 (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	\$ 227,805	\$—	\$	—\$227,805
U.S. agency securities	—	33,114	—	33,114
U.S. agency mortgage-backed securities	—	456,037	—	456,037
Municipal debt securities	—	465,255	—	465,255
Corporate debt securities	—	611,728	—	611,728
Residential and commercial mortgage securities	—	79,407	—	79,407
Asset-backed securities	—	167,922	—	167,922
Money market funds	263,797	—	—	263,797
Total assets at fair value	\$ 491,602	\$1,813,463	\$	—\$2,305,065

Note 12. Statutory Accounting

Our U.S. insurance subsidiaries prepare statutory-basis financial statements in accordance with the accounting practices prescribed or permitted by their respective state's department of insurance, which is a comprehensive basis of accounting other than GAAP. We did not use any prescribed or permitted statutory accounting practices (individually or in the aggregate) that resulted in reported statutory surplus or capital that was significantly different from the statutory surplus or capital that would have been reported had National Association of Insurance Commissioners' statutory accounting practices been followed. The following table presents Essent Guaranty's and Essent PA's statutory net income, statutory surplus and contingency reserve liability as of and for the nine months ended September 30:

(In thousands)	2018	2017
Essent Guaranty		
Statutory net income	\$275,130	\$194,131
Statutory surplus	832,403	684,421
Contingency reserve liability	853,422	623,934
Essent PA		
Statutory net income	\$7,087	\$7,959
Statutory surplus	48,390	45,047
Contingency reserve liability	47,294	41,593

Net income determined in accordance with statutory accounting practices differs from GAAP. In 2018 and 2017, the more significant differences between net income determined under statutory accounting practices and GAAP for Essent Guaranty and Essent PA relate to policy acquisition costs and income taxes. Under statutory accounting practices, policy acquisition costs are expensed as incurred while such costs are capitalized and amortized to expense over the life of the policy under GAAP. We are eligible for a tax deduction, subject to certain limitations for amounts

required by state law or regulation to be set aside in statutory contingency reserves when we purchase non-interest-bearing United States Mortgage Guaranty Tax and Loss Bonds (“T&L Bonds”) issued by the Treasury Department. Under statutory accounting practices, this deduction reduces the tax provision recorded by Essent Guaranty and Essent PA and, as a result, increases statutory net income and surplus as compared to net income and equity determined in accordance with GAAP.

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Essent Group Ltd. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

At September 30, 2018 and 2017, the statutory capital of our U.S. insurance subsidiaries, which is defined as the total of statutory surplus and contingency reserves, was in excess of the statutory capital necessary to satisfy their regulatory requirements.

Effective December 31, 2015, Fannie Mae and Freddie Mac, at the direction of the Federal Housing Finance Agency, implemented new coordinated Private Mortgage Insurer Eligibility Requirements, which we refer to as the "PMIERS." The PMIERS represent the standards by which private mortgage insurers are eligible to provide mortgage insurance on loans owned or guaranteed by Fannie Mae and Freddie Mac. The PMIERS include financial strength requirements incorporating a risk-based framework that require approved insurers to have a sufficient level of liquid assets from which to pay claims. The PMIERS also include enhanced operational performance expectations and define remedial actions that apply should an approved insurer fail to comply with these requirements. As of September 30, 2018 and December 31, 2017, Essent Guaranty, our GSE-approved mortgage insurance company, was in compliance with the PMIERS.

Statement of Statutory Accounting Principles No. 58, Mortgage Guaranty Insurance, requires mortgage insurers to establish a special contingency reserve for statutory accounting purposes included in total liabilities equal to 50% of earned premium for that year. During the nine months ended September 30, 2018, Essent Guaranty increased its contingency reserve by \$174.7 million and Essent PA increased its contingency reserve by \$4.2 million. This reserve is required to be maintained for a period of 120 months to protect against the effects of adverse economic cycles. After 120 months, the reserve is released to unassigned funds. In the event an insurer's loss ratio in any calendar year exceeds 35%, however, the insurer may, after regulatory approval, release from its contingency reserves an amount equal to the excess portion of such losses. Essent Guaranty and Essent PA did not release any amounts from their contingency reserves in the nine months ended September 30, 2018 or 2017.

Under The Insurance Act 1978, as amended, and related regulations of Bermuda (the "Insurance Act"), Essent Re is required to annually prepare statutory financial statements and a statutory financial return in accordance with the financial reporting provisions of the Insurance Act, which is a basis other than GAAP. The Insurance Act also requires that Essent Re maintain minimum share capital of \$1 million and must ensure that the value of its general business assets exceeds the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margins and enhanced capital requirement pertaining to its general business. At December 31, 2017, all such requirements were met.

Essent Re's statutory capital and surplus was \$749.1 million as of September 30, 2018 and \$662.6 million as of December 31, 2017. Essent Re's statutory net income was \$100.6 million and \$70.2 million for the nine months ended September 30, 2018 and 2017, respectively. Statutory capital and surplus as of September 30, 2018 and December 31, 2017 and statutory net income in the nine months ended September 30, 2018 and 2017 determined in accordance with statutory accounting practices were not significantly different than the amounts determined under GAAP.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read together with the "Selected Financial Data" and our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K as of and for the year ended December 31, 2017 as filed with the Securities and Exchange Commission and referred to herein as the "Annual Report," and our condensed consolidated financial statements and related notes as of and for the three and nine months ended September 30, 2018 included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which we refer to as the "Quarterly Report." In addition to historical information, this discussion contains forward-looking statements that involve risks, uncertainties and assumptions that could cause actual results to differ materially from management's expectations. Factors that could cause such differences are discussed in the sections entitled "Special Note Regarding Forward-Looking Statements" in this Quarterly Report and Part I, Item 1A "Risk Factors" in our Annual Report. We are not undertaking any obligation to update any forward-looking statements or other statements we may make in the following discussion or elsewhere in this document even though these statements may be affected by events or circumstances occurring after the forward-looking statements or other statements were made.

Overview

We are an established and growing private mortgage insurance company. We were formed to serve the U.S. housing finance industry at a time when the demands of the financial crisis and a rapidly changing business environment created the need for a new, privately funded mortgage insurance company. We believe that our success in acquiring customers and growing our insurance in force has been driven by the unique opportunity we offer lenders to partner with a well-capitalized mortgage insurer, unencumbered by business originated prior to the financial crisis, that provides fair and transparent claims payment practices, and consistency and speed of service. Essent Guaranty, Inc. ("Essent Guaranty"), our wholly-owned insurance subsidiary, is licensed to write coverage in all 50 states and the District of Columbia. The financial strength of Essent Guaranty is rated Baa1 with a stable outlook by Moody's Investor Services ("Moody's") and BBB+ with a stable outlook by S&P Global Ratings ("S&P"). On September 5, 2018, A.M. Best assigned Financial Strength Ratings of A (Excellent) with a stable outlook to Essent Guaranty.

Our holding company is domiciled in Bermuda and our U.S. insurance business is headquartered in Radnor, Pennsylvania. We operate additional underwriting and service centers in Winston-Salem, North Carolina and Irvine, California. We have a highly experienced, talented team with 394 employees as of September 30, 2018. We generated new insurance written, or NIW, of approximately \$13.9 billion and \$36.1 billion for the three and nine months ended September 30, 2018, respectively, compared to approximately \$13.2 billion and \$32.6 billion for the three and nine months ended September 30, 2017, respectively. As of September 30, 2018, we had approximately \$131.2 billion of insurance in force. Our top ten customers represented approximately 42.8%, 45.8%, 35.1% and 36.6% of NIW on a flow basis for the nine months ended September 30, 2018 and the years ended December 31, 2017, 2016 and 2015, respectively.

We also offer mortgage-related insurance and reinsurance through our wholly-owned Bermuda-based subsidiary, Essent Reinsurance Ltd., which we refer to as "Essent Re." As of September 30, 2018, Essent Re provided insurance or reinsurance relating to GSE risk share and other reinsurance transactions covering approximately \$612.7 million of risk, including in connection with Freddie Mac's Agency Credit Insurance Structure ("ACIS") and Fannie Mae's Credit Insurance Risk Transfer ("CIRT") programs. Essent Re has also reinsured 25% of Essent Guaranty's GSE-eligible mortgage insurance NIW originated since July 1, 2014 under a quota share reinsurance agreement. The insurer financial strength rating of Essent Re is BBB+ with a stable outlook by S&P. On September 5, 2018, A.M. Best assigned Financial Strength Ratings of A (Excellent) with a stable outlook to Essent Re.

Legislative and Regulatory Developments

Our results are significantly impacted by, and our future success may be affected by, legislative and regulatory developments affecting the housing finance industry. See Part I, Item 1 “Business—Regulation” and Part II, Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Legislative and Regulatory Developments” in our Annual Report for a discussion of the laws and regulations to which we are subject as well as legislative and regulatory developments affecting the housing finance industry.

Effective December 31, 2015, Fannie Mae and Freddie Mac, at the direction of the Federal Housing Finance Agency ("FHFA"), implemented new coordinated Private Mortgage Insurer Eligibility Requirements, which we refer to as the "PMIERS." The PMIERS represent the standards by which private mortgage insurers are eligible to provide mortgage insurance on loans owned or guaranteed by Fannie Mae and Freddie Mac. The PMIERS include financial strength requirements incorporating a risk-based framework that require approved insurers to have a sufficient level of liquid assets from which to

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pay claims. The PMIERS also include enhanced operational performance expectations and define remedial actions that apply should an approved insurer fail to comply with these requirements. As of September 30, 2018, Essent Guaranty, our GSE-approved mortgage insurance company, was in compliance with the PMIERS. See additional discussion in “—Liquidity and Capital Resources —Private Mortgage Insurer Eligibility Requirements.”

The GSEs released the revised PMIERS ("PMIERS 2.0") on September 27, 2018 and have indicated that the PMIERS 2.0 framework will take effect on March 31, 2019. Essent expects to remain in full compliance with the existing and revised PMIERS, as applicable, prior to and after March 31, 2019.

Factors Affecting Our Results of Operations

Net Premiums Written and Earned

Premiums associated with our U.S. mortgage insurance business are based on insurance in force ("IIF") during all or a portion of a period. A change in the average IIF during a period causes premiums to increase or decrease as compared to prior periods. Average premium rates in effect during a given period will also cause premiums to differ when compared to earlier periods. IIF at the end of a reporting period is a function of the IIF at the beginning of such reporting period plus NIW less policy cancellations (including claims paid) during the period. As a result, premiums are generally influenced by:

NIW, which is the aggregate principal amount of the new mortgages that are insured during a period. Many factors affect NIW, including, among others, the volume of low down payment home mortgage originations and the competition to provide credit enhancement on those mortgages;

Cancellations of our insurance policies, which are impacted by payments on mortgages, home price appreciation, or refinancings, which in turn are affected by mortgage interest rates. Cancellations are also impacted by the levels of claim payments and rescissions;

Premium rates, which represent the amount of the premium due as a percentage of IIF. Premium rates are based on the risk characteristics of the loans insured, the percentage of coverage on the loans, competition from other mortgage insurers and general industry conditions; and

Premiums ceded or assumed under reinsurance arrangements. Prior to March 2018, we had not ceded any premiums under third-party reinsurance contracts. In March 2018, Essent Guaranty entered into a third-party reinsurance agreement. See Note 4 to our condensed consolidated financial statements.

Premiums are paid either on a monthly installment basis ("monthly premiums"), in a single payment at origination ("single premiums"), or in some cases as an annual premium. For monthly premiums, we receive a monthly premium payment which is recorded as net premiums earned in the month the coverage is provided. Monthly premium payments are based on the original mortgage amount rather than the amortized loan balance. Net premiums written may be in excess of net premiums earned due to single premium policies. For single premiums, we receive a single premium payment at origination, which is recorded as "unearned premium" and earned over the estimated life of the policy, which ranges from 36 to 156 months depending on the term of the underlying mortgage and loan-to-value ratio at date of origination. If single premium policies are cancelled due to repayment of the underlying loan and the premium is non-refundable, the remaining unearned premium balance is immediately recognized as earned premium revenue. Substantially all of our single premium policies in force as of September 30, 2018 were non-refundable. Premiums collected on annual policies are recognized as net premiums earned on a straight-line basis over the year of coverage. For the nine months ended September 30, 2018, monthly and single premium policies comprised 84.1% and 15.9% of our NIW, respectively.

Premiums associated with our GSE and other risk share transactions are based on the level of risk in force.

Persistency and Business Mix

The percentage of IIF that remains on our books after any 12-month period is defined as our persistency rate. Because our insurance premiums are earned over the life of a policy, higher persistency rates can have a significant impact on our profitability. The persistency rate on our portfolio was 84.0% at September 30, 2018. Generally, higher prepayment speeds lead to lower persistency.

Prepayment speeds and the relative mix of business between single premium policies and monthly premium policies also impact our profitability. Our premium rates include certain assumptions regarding repayment or prepayment speeds of the

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mortgages. Because premiums are paid at origination on single premium policies, assuming all other factors remain constant, if loans are prepaid earlier than expected, our profitability on these loans is likely to increase and, if loans are repaid slower than expected, our profitability on these loans is likely to decrease. By contrast, if monthly premium loans are repaid earlier than anticipated, our premium earned with respect to those loans and therefore our profitability declines. Currently, the expected return on single premium policies is less than the expected return on monthly policies.

Net Investment Income

Our investment portfolio was predominantly comprised of investment-grade fixed income securities and money market funds as of September 30, 2018. The principal factors that influence investment income are the size of the investment portfolio and the yield on individual securities. As measured by amortized cost (which excludes changes in fair market value, such as from changes in interest rates), the size of our investment portfolio is mainly a function of increases in capital and cash generated from or used in operations which is impacted by net premiums received, investment earnings, net claim payments and expenses. Realized gains and losses are a function of the difference between the amount received on the sale of a security and the security's amortized cost, as well as any "other-than-temporary" impairments recognized in earnings. The amount received on the sale of fixed income securities is affected by the coupon rate of the security compared to the yield of comparable securities at the time of sale.

Other Income

In connection with the acquisition of our mortgage insurance platform, we entered into a services agreement with Triad Guaranty Inc. and its wholly-owned subsidiary, Triad Guaranty Insurance Corporation, which we refer to collectively as "Triad," to provide certain information technology maintenance and development and customer support-related services. In return for these services, we receive a fee which is recorded in other income. This fee is adjusted monthly based on the number of Triad's mortgage insurance policies in force and, accordingly, will decrease over time as Triad's existing policies are cancelled. The services agreement was automatically extended until November 30, 2019.

Other income also includes revenues associated with contract underwriting services and underwriting services to third-party reinsurers. The level of contract underwriting revenue is dependent upon the number of customers who have engaged us for this service and the number of loans underwritten for these customers. Revenue from underwriting services to third-party reinsurers is dependent upon the number of customers who have engaged us for this service and the number of transactions underwritten for these customers.

Provision for Losses and Loss Adjustment Expenses

The provision for losses and loss adjustment expenses reflects the current expense that is recorded within a particular period to reflect actual and estimated loss payments that we believe will ultimately be made as a result of insured loans that are in default.

Losses incurred are generally affected by:

the overall state of the economy, which broadly affects the likelihood that borrowers may default on their loans and have the ability to cure such defaults;

changes in housing values, which affect our ability to mitigate our losses through the sale of properties with loans in default as well as borrower willingness to continue to make mortgage payments when the value of the home is below or perceived to be below the mortgage balance;

- the product mix of IIF, with loans having higher risk characteristics generally resulting in higher defaults and claims;
- the size of loans insured, with higher average loan amounts tending to increase losses incurred;
- the loan-to-value ratio, with higher average loan-to-value ratios tending to increase losses incurred;
- the percentage of coverage on insured loans, with deeper average coverage tending to increase losses incurred;
- credit quality of borrowers, including higher debt-to-income ratios and lower FICO scores, which tend to increase incurred losses;

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the level and amount of reinsurance coverage maintained with third parties;

the rate at which we rescind policies. Because of tighter underwriting standards generally in the mortgage lending industry and terms set forth in our master policy, we expect that our level of rescission activity will be lower than rescission activity seen in the mortgage insurance industry for vintages originated prior to the financial crisis; and

the distribution of claims over the life of a book. The average age of our insurance portfolio is young with 77% of our IIF as of September 30, 2018 having been originated since January 1, 2016. As a result, based on historical industry performance, we expect the number of defaults and claims we experience, as well as our provision for losses and loss adjustment expenses, to increase as our portfolio seasons. See “— Mortgage Insurance Earnings and Cash Flow Cycle” below.

We establish loss reserves for delinquent loans when we are notified that a borrower has missed at least two consecutive monthly payments (“Case Reserves”), as well as estimated reserves for defaults that may have occurred but not yet been reported to us (“IBNR Reserves”). We also establish reserves for the associated loss adjustment expenses (“LAE”), consisting of the estimated cost of the claims administration process, including legal and other fees. Using both internal and external information, we establish our reserves based on the likelihood that a default will reach claim status and estimated claim severity. See Part II, Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies” included in our Annual Report for further information.

We believe, based upon our experience and industry data, that claims incidence for mortgage insurance is generally highest in the third through sixth years after loan origination. As of September 30, 2018, 77% of our IIF relates to business written since January 1, 2016 and was less than three years old. Although the claims experience on new insurance written by us to date has been favorable, we expect incurred losses and claims to increase as a greater amount of this book of insurance reaches its anticipated period of highest claim frequency. The actual default rate and the average reserve per default that we experience as our portfolio matures is difficult to predict and is dependent on the specific characteristics of our current in-force book (including the credit score of the borrower, the loan-to-value ratio of the mortgage, geographic concentrations, etc.), as well as the profile of new business we write in the future. In addition, the default rate and the average reserve per default will be affected by future macroeconomic factors such as housing prices, interest rates and employment.

During the third quarter of 2017, certain regions of the U.S. experienced hurricanes which have impacted our insured portfolio’s performance. Specifically, on August 26, 2017, Hurricane Harvey made landfall in southeastern Texas and on September 10, 2017, Hurricane Irma made landfall in southern Florida and caused property damage in certain counties. Loans in default identified as hurricane-related defaults totaled 2,288 as of December 31, 2017. The number of hurricane-related defaults declined to 301 as of September 30, 2018 primarily due to hurricane-related loans in default that cured. Based on prior industry experience, we expect the ultimate number of hurricane-related defaults that result in claims will be less than the default-to-claim experience of non-hurricane-related defaults. In addition, under our master policy, our exposure may be limited on hurricane-related claims. For example, we are permitted to exclude a claim entirely where damage to the property underlying a mortgage was the proximate cause of the default and adjust a claim where the property underlying a mortgage in default is subject to unrestored physical damage. The impact on our reserves in future periods will be dependent upon the performance of the hurricane-related defaults and our expectations for the amount of ultimate losses on these delinquencies.

Third-Party Reinsurance

We use third-party reinsurance to provide protection against adverse loss experience and to expand our capital sources. When we enter into a reinsurance agreement, the reinsurer receives a premium and, in exchange, agrees to insure an agreed upon portion of incurred losses. These arrangements have the impact of reducing our earned

premiums, but also reduce our risk in force ("RIF"), which provides capital relief, and may include capital relief under the PMIERS financial strength requirements. Our incurred losses are reduced by any incurred losses ceded in accordance with the reinsurance agreement. For additional information regarding reinsurance, see Note 4 to our condensed consolidated financial statements.

Other Underwriting and Operating Expenses

Our other underwriting and operating expenses include components that are substantially fixed, as well as expenses that generally increase or decrease in line with the level of NIW.

Our most significant expense is compensation and benefits for our employees, which represented 59% and 61% of other underwriting and operating expenses for the three and nine months ended September 30, 2018, respectively, compared to 63% of other underwriting and operating expenses for each of the three and nine months ended September 30, 2017,

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respectively. Compensation and benefits expense includes base and incentive cash compensation, stock compensation expense, benefits and payroll taxes.

Underwriting and other expenses include legal, consulting, other professional fees, premium taxes, travel, entertainment, marketing, licensing, supplies, hardware, software, rent, utilities, depreciation and amortization and other expenses. We anticipate that as we continue to add new customers and increase our IIF, our expenses will also continue to increase. In addition, as a result of the increase in our IIF, we expect that our net premiums earned will grow faster than our underwriting and other expenses resulting in a decline in our expense ratio for the full year 2018 as compared to 2017.

Interest Expense

Interest expense is incurred as a result of borrowings under our secured credit facility (the “Credit Facility”). 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.

Income Taxes

Income taxes are incurred based on the amount of earnings or losses generated in the jurisdictions in which we operate and the applicable tax rates and regulations in those jurisdictions. Our U.S. insurance subsidiaries are generally not subject to income taxes in the states in which we operate; however, our non-insurance subsidiaries are subject to state income taxes. In lieu of state income taxes, our insurance subsidiaries pay premium taxes that are recorded in other underwriting and operating expenses.

Essent Group Ltd. and its wholly-owned subsidiary, Essent Re, are domiciled in Bermuda, which does not have a corporate income tax. Effective July 2014, Essent Re began to reinsure 25% of GSE-eligible new insurance written of Essent Guaranty, an affiliate. Essent Re also provides insurance and reinsurance to Freddie Mac and Fannie Mae.

The amount of income tax expense or benefit recorded in future periods will be dependent on the jurisdictions in which we operate and the tax laws and regulations in effect.

Mortgage Insurance Earnings and Cash Flow Cycle

In general, the majority of any underwriting profit (premium revenue minus losses) that a book generates occurs in the early years of the book, with the largest portion of any underwriting profit realized in the first year. Subsequent years of a book generally result in modest underwriting profit or underwriting losses. This pattern generally occurs because relatively few of the claims that a book will ultimately experience typically occur in the first few years of the book, when premium revenue is highest, while subsequent years are affected by declining premium revenues, as the number of insured loans decreases (primarily due to loan prepayments), and by increasing losses.

Key Performance Indicators

Insurance In Force

As discussed above, premiums we collect and earn are generated based on our IIF, which is a function of our NIW and cancellations. The following table includes a summary of the change in our IIF for the three and nine months ended September 30, 2018 and 2017 for our U.S. mortgage insurance portfolio. In addition, this table includes RIF at the end

of each period.

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
IIF, beginning of period	\$ 122,501,246	\$ 95,494,390	\$ 110,461,950	\$ 83,265,522
NIW	13,913,191	13,221,038	36,099,983	32,623,467
Cancellations	(5,164,480)	(4,779,121)	(15,311,976)	(11,952,682)
IIF, end of period	\$ 131,249,957	\$ 103,936,307	\$ 131,249,957	\$ 103,936,307
Average IIF during the period	\$ 127,052,216	\$ 99,790,653	\$ 119,685,365	\$ 92,353,836
RIF, end of period	\$ 32,361,782	\$ 25,807,358	\$ 32,361,782	\$ 25,807,358

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The following is a summary of our IIF at September 30, 2018 by vintage:

(\$ in thousands)	\$	%	
2018 (through September 30)	\$35,189,027	26.8	%
2017	38,894,605	29.6	
2016	26,510,429	20.2	
2015	14,202,260	10.8	
2014	8,726,281	6.7	
2013 and prior	7,727,355	5.9	
	\$131,249,957	100.0	%

Average Net Premium Rate

Our average net premium rate is dependent on a number of factors, including: (1) the risk characteristics and average coverage on the mortgages we insure; (2) the mix of monthly premiums compared to single premiums in our portfolio; (3) cancellations of non-refundable single premiums during the period; (4) changes to our pricing; and (5) premiums ceded under third-party reinsurance agreements. For the three and nine months ended September 30, 2018, our average net premium rate was 0.50% and 0.51%, respectively, as compared to 0.53% for each of the three and nine months ended September 30, 2017. In June 2018, we announced a reduction in pricing on our published rates effective for future NIW. We anticipate that the pricing reductions will reduce our average net premium rate in future periods.

Persistence Rate

The measure for assessing the impact of policy cancellations on IIF is our persistency rate, defined as the percentage of IIF that remains on our books after any twelve-month period. See additional discussion regarding the impact of the persistency rate on our performance in “— Factors Affecting Our Results of Operations — Persistency and Business Mix.”

Risk-to-Capital

The risk-to-capital ratio has historically been used as a measure of capital adequacy in the U.S. mortgage insurance industry and is calculated as a ratio of net risk in force to statutory capital. Net risk in force represents total risk in force net of reinsurance ceded and net of exposures on policies for which loss reserves have been established. Statutory capital for our U.S. insurance companies is computed based on accounting practices prescribed or permitted by the Pennsylvania Insurance Department. See additional discussion in “— Liquidity and Capital Resources — Insurance Company Capital.”

As of September 30, 2018, our combined net risk in force for our U.S. insurance companies was \$25.1 billion and our combined statutory capital was \$1.8 billion, resulting in a risk-to-capital ratio of 14.1 to 1. The amount of capital required varies in each jurisdiction in which we operate; however, generally, the maximum permitted risk-to-capital ratio is 25.0 to 1. State insurance regulators are currently examining their respective capital rules to determine whether, in light of the financial crisis, changes are needed to more accurately assess mortgage insurers’ ability to withstand stressful economic conditions. As a result, the capital metrics under which they assess and measure capital adequacy may change in the future. Independent of the state regulator and GSE capital requirements, management continually assesses the risk of our insurance portfolio and current market and economic conditions to determine the appropriate levels of capital to support our business.

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Results of Operations

The following table sets forth our results of operations for the periods indicated:

Summary of Operations (In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues:				
Net premiums written	\$ 175,221	\$ 155,055	\$ 508,850	\$ 408,415
Increase in unearned premiums	(8,546)	(17,115)	(32,659)	(26,261)
Net premiums earned	166,675	137,940	476,191	382,154
Net investment income	16,646	10,626	45,494	28,461
Realized investment gains, net	524	564	1,160	1,763
Other income	1,153	1,073	3,384	3,023
Total revenues	184,998	150,203	526,229	415,401
Losses and expenses:				
Provision for losses and LAE	5,452	4,313	12,574	9,776
Other underwriting and operating expenses	36,899	37,035	111,451	109,053
Interest expense	2,500	1,456	7,568	3,361
Total losses and expenses	44,851	42,804	131,593	122,190
Income before income taxes	140,147	107,399	394,636	293,211
Income tax expense	24,136	29,006	55,801	76,102
Net income	\$ 116,011	\$ 78,393	\$ 338,835	\$ 217,109

Three and Nine Months Ended September 30, 2018 Compared to the Three and Nine Months Ended September 30, 2017

For the three months ended September 30, 2018, we reported net income of \$116.0 million, compared to net income of \$78.4 million for the three months ended September 30, 2017. For the nine months ended September 30, 2018, we reported net income of \$338.8 million, compared to net income of \$217.1 million for the nine months ended September 30, 2017. The increase in our operating results in 2018 over the same periods in 2017 was primarily due to the increase in net premiums earned associated with the growth of our IIF, the increase in net investment income and the decrease in income taxes primarily due to the reduction of the U.S. statutory corporate income tax rate, partially offset by increases in the provision for losses and LAE and interest expense.

Net Premiums Written and Earned

Net premiums earned increased in the three months ended September 30, 2018 by 21%, compared to the three months ended September 30, 2017 primarily due to the increase in our average IIF from \$99.8 billion at September 30, 2017 to \$127.1 billion at September 30, 2018, partially offset by a decrease in average net premium rate from 0.53% for the three months ended September 30, 2017 to 0.50% for the