TRIAD GUARANTY INC
Form 10-Q
November 14, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2012

OR

£ 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: 0-22342

Triad Guaranty Inc.
(Exact name of registrant as specified in its charter)

Delaware	56-1838519
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
101 South Stratford Road Winston-Salem, North Carolina	27104
(Address of principal executive offices)	(Zip Code)

(336) 723-1282
(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 T No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes T No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer £	Accelerated filer £	Non-accelerated filer £ (Do not check if a smaller reporting company)	Smaller reporting company T

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

Number of shares of common stock, par value $0.01 per share, outstanding as of November 2, 2012 was 15,368,128.

TRIAD GUARANTY INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TRIAD GUARANTY INC.
CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share data)	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Invested assets:		
Securities available-for-sale, at fair value:		
Fixed maturities (amortized cost: $644,863 and $721,168)	$673,254	$746,238
Short-term investments	46,452	30,102
Total invested assets	719,706	776,340
Cash and cash equivalents	32,891	40,590
Accrued investment income	6,346	6,680
Property and equipment	551	1,140
Reinsurance recoverable, net	17,231	22,988
Other assets	43,865	48,489
Total assets	$820,590	$896,227
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Liabilities:		
Losses and loss adjustment expenses	$741,808	$854,188
Unearned premiums	5,874	6,871
Deferred payment obligation, including interest	764,972	629,700
Accrued expenses and other liabilities	110,725	109,042
Total liabilities	1,623,379	1,599,801
Contingencies - Note 4		
Stockholders' deficit:		
Preferred stock, par value $0.01 per share --- authorized 1,000,000 shares; no shares issued and outstanding	-	-
Common stock, par value $0.01 per share --- authorized 32,000,000 shares; issued and outstanding 15,368,128 and 15,328,128 shares	154	153
Additional paid-in capital	114,118	114,111
Accumulated other comprehensive income, net of income tax liability of $16,575	12,118	8,977
Accumulated deficit	(929,179)	(826,815)
Deficit in assets	(802,789)	(703,574)
Total liabilities and stockholders' deficit	$820,590	$896,227

See accompanying notes.

TRIAD GUARANTY INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands, except per share data)	2012	2011	2012	2011
Revenue:				
Premiums written:				
Direct	$26,653	$50,271	$100,750	$125,608
Ceded	(1,165)	(1,579)	(3,719)	(4,796)
Net premiums written	25,488	48,692	97,031	120,812
Change in unearned premiums	1,239	1,027	993	1,429
Earned premiums	26,727	49,719	98,024	122,241
Net investment income	5,455	7,364	17,438	23,981
Net realized investment gains	103	1,349	1,083	3,913
Other income	4	10	2,520	66
	32,289	58,442	119,065	150,201
Losses and expenses:				
Net losses and loss adjustment expenses	54,026	87,842	190,192	170,847
Interest expense on the deferred payment obligation	5,147	4,813	15,066	13,260
Other operating expenses	6,451	4,450	16,171	14,065
	65,624	97,105	221,429	198,172
Loss before income taxes	(33,335)	(38,663)	(102,364)	(47,971)
Income tax benefit	-	(1,134)	-	(1,134)
Net loss	$(33,335)	$(37,529)	$(102,364)	$(46,837)
Other comprehensive income (loss), net of tax:				
Change in unrealized gains on investments	$1,943	$(55)	$3,141	$2,106
Comprehensive loss	$(31,392)	$(37,584)	$(99,223)	$(44,731)
Loss per common and common equivalent share:				
Diluted loss per share	$(2.17)	$(2.46)	$(6.68)	$(3.07)
Shares used in computing loss per common and common equivalent share:				
Diluted	15,328,128	15,258,128	15,319,794	15,247,102

See accompanying notes.

TRIAD GUARANTY INC.
CONSOLIDATED STATEMENTS OF CASH FLOW
(unaudited)

(dollars in thousands)	Nine Months Ended September 30, 2012	2011
Operating activities		
Net loss	$(102,364)	$(46,837)
Adjustments to reconcile net loss to net cash used in operating activities:		
Losses, loss adjustment expenses and unearned premium reserves	(113,377)	(197,408)
Accrued expenses and other liabilities	1,683	8,384
Deferred payment obligation, including accrued interest	135,272	160,853
Income taxes recoverable	-	11,707
Reinsurance, net	5,757	17,087
Accrued investment income	334	672
Net realized investment gains	(1,083)	(3,913)
Provision for depreciation	588	770
Discount accretion on investments	2,973	1,790
Deferred income taxes	-	(1,134)
Other assets	4,427	(9,813)
Other operating activities	7	22
Net cash used in operating activities	(65,783)	(57,820)
Investing activities		
Securities available-for-sale:		
Purchases – fixed maturities	(47,296)	(92,206)
Sales – fixed maturities	19,969	83,296
Maturities – fixed maturities	101,429	88,240
Sales – equities	7	-
Other investment activity	327	(1,309)
Short-term investments	(16,353)	6,087
Property and equipment	1	1
Net cash provided by investing activities	58,084	84,109
Net change in cash and cash equivalents	(7,699)	26,289
Cash and cash equivalents at beginning of period	40,590	38,762
Cash and cash equivalents at end of period	$32,891	$65,051
Supplemental schedule of cash flow information		
Cash received during the period for:		
Income taxes	$-	$(11,707)

See accompanying notes.

TRIAD GUARANTY INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2012
(Unaudited)

1. The Company

Triad Guaranty Inc. ("TGI") is a holding company which, through its wholly-owned subsidiary, Triad Guaranty Insurance Corporation ("TGIC"), is a nationwide mortgage guaranty insurer pursuing a run-off of its existing in-force book of business. Mortgage insurance allows buyers to achieve home ownership with a reduced down payment, facilitates the sale of mortgage loans in the secondary market, and protects lenders from credit default-related expenses. The term "run-off" as used in these financial statements means continuing to service existing mortgage guaranty insurance policies but not writing any new policies.

Unless the context requires otherwise, references to "Triad" in this Quarterly Report on Form 10-Q refer to the operations of TGIC and its wholly-owned subsidiary, Triad Guaranty Assurance Corporation ("TGAC"). References to the "Company" refer collectively to the operations of TGI and Triad.

TGIC is an Illinois-domiciled mortgage guaranty insurance company and TGAC is an Illinois-domiciled mortgage guaranty reinsurance company. The Illinois Department of Insurance (the "Insurance Department") is the primary regulator of both TGIC and TGAC. The Illinois Insurance Code grants broad powers to the Insurance Department and its director (collectively, the "Department") to enforce rules or exercise discretion over almost all significant aspects of Triad's insurance business.

Triad ceased issuing new commitments for mortgage guaranty insurance coverage in 2008 and is operating its business in run-off under two Corrective Orders issued by the Department, as discussed in "Corrective Orders and Regulation" below. The first Corrective Order was issued in 2008. The second Corrective Order was issued in 2009. Servicing existing policies during run-off includes:

- billing and collecting premiums on policies that remain in force;
- working with borrowers in default to remedy the default and/or mitigate losses;
- reviewing policies for the existence of misrepresentation, fraud or non-compliance with stated programs; and
- settling all legitimate filed claims per the provisions of the policies and the two Corrective Orders issued by the Department.

The term "settled," as used in these financial statements in the context of the payment of a claim, refers to the satisfaction of Triad's obligations following the submission of valid claims by its policyholders. As required by the second Corrective Order, effective on and after June 1, 2009, valid claims are settled by a combination of 60% in cash and 40% in the form of a deferred payment obligation ("DPO"). The Corrective Orders, among other things, allow management to continue to operate Triad under the close supervision of the Department, include restrictions on the distribution of dividends or interest on notes payable to TGI by Triad, and include certain requirements on the payment of claims. Failure to comply with the provisions of the Corrective Orders, or other factors, could result in the imposition of fines or penalties or subject Triad to further legal proceedings, including receivership proceedings for the conservation, rehabilitation, or liquidation of Triad. During the third quarter of 2012, Triad reported that it was not in compliance with a provision in the second Corrective Order, and Triad is currently awaiting recommendations of the Department regarding modifications to the Corrective Order. See the discussion below under "Pending Regulatory Matters" for more information.

Pending Regulatory Matters

The second Corrective Order requires Triad to set aside invested assets in an escrow account in an amount equal to the combined DPO and accrued interest thereon. The second Corrective Order also requires Triad to accrue interest on the DPO at a rate equal to Triad's investment portfolio yield as defined in the second Corrective Order. At September 30, 2012, the recorded DPO, including accrued interest of $45.7 million, amounted to $765.0 million, which exceeded the cash and invested assets of Triad at that date. Triad previously reported to the Department that as of August 31, 2012, the aggregate amount of the DPO liability exceeded the cash and invested assets of Triad that were available for segregation in a separate account. Accordingly, Triad was not in compliance with this provision of the second Corrective Order as of August 31, 2012. Triad has asked the Department to amend, modify or otherwise waive compliance with this provision of the second Corrective Order. In addition, Triad has requested that the calculation of the interest on the DPO prescribed in the second Corrective Order be amended to limit the amount to a maximum equal to the actual aggregate net investment income that Triad earns rather than an amount based on the effective rate earned by Triad on its investments.

In response to Triad's requests for these modifications to the second Corrective Order, the Department held a public hearing on September 10, 2012, and invited Triad and its policyholders to provide testimony regarding these proposed amendments. In addition, the Department invited Triad and its policyholders to provide testimony as to whether Triad should be permitted to continue to run off its existing book of insurance business or whether the Department should implement a different regulatory approach, including receivership proceedings for the conservation, rehabilitation or liquidation of Triad. The Department extended the period for comments and written testimony on these matters until November 30, 2012.

Triad's failure to comply with the provisions of the second Corrective Order or any other violation of the Illinois Insurance Code may result in the imposition of fines or penalties or subject Triad to further legal proceedings, including the institution by the Department of receivership proceedings for the conservation, rehabilitation or liquidation of Triad. Moreover, if the Department determines that Triad is insolvent under applicable law, it would be required to institute a receivership proceeding over Triad. In addition, the Department retains the inherent authority to institute such proceedings against Triad for any reason and Triad has previously agreed not to contest the taking of any such actions. As of the date of this Form 10-Q, the Department has not issued any final decision or order as a result of the public hearing and Triad's request to amend the second Corrective Order. Because the subject matter of the hearing specifically included an assessment of whether the Department should implement a different regulatory approach with respect to Triad, including institution of receivership proceedings for the conservation, rehabilitation or liquidation of Triad, the Company believes institution of such a proceeding could be imminent. If this should occur, among other things, TGI could lose control of Triad and could be forced to deconsolidate its financial statements. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or take other steps to wind up its business and liquidate. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

Impact of Expense Reimbursements on TGI's Liquidity

TGI is the public company whose stock is traded on the OTC Markets Group's OTCQB tier ("Pink Sheets") under the symbol "TGIC". TGI owns Triad, which is its only operating subsidiary. Aside from its ownership of Triad, TGI's assets at September 30, 2012 total approximately $1.0 million, which consist primarily of cash holdings. The remainder of the $820.6 million of assets reported on the September 30, 2012 Consolidated Balance Sheets presented in this Form 10-Q are the assets of Triad. TGI currently has no outstanding debt or other known material liabilities other than potential liabilities and costs of defense associated with the pending securities law class action litigation described under Note 4, Litigation and Contingencies.

TGI has explored strategies to acquire complementary profitable businesses and utilize the net operating loss carryforwards ("NOLs") that were generated on a consolidated basis with Triad in order to increase its future value for the benefit of its stockholders as well as provide a limited benefit for Triad policyholders. Tax laws related to the use of NOLs effectively preclude TGI from raising material amounts of equity capital because such a transaction would likely materially impair the value of the NOLs. To date, TGI has been unsuccessful in identifying a viable acquisition candidate. Given the limited amount of cash remaining at TGI and its inability to raise additional funds, no assurance can be given that TGI will ever be successful in implementing such a strategy.

Given its current financial condition, it is unlikely that TGI would be able to successfully access the capital markets to obtain long-term or short-term debt or equity financing. TGI's primary source of revenue is the reimbursement of expenses from Triad. Investment income from TGI's cash holdings is immaterial. Triad is prohibited from paying dividends or distributing assets to TGI without the approval of the Department. The Company believes that, absent significant positive changes in the economy and the residential real estate market, Triad's existing assets combined with its future premiums will not be sufficient to meet Triad's current and future policyholder obligations. Therefore, none of Triad's assets would be available to TGI and its stockholders other than to reimburse certain TGI expenses incurred on behalf of Triad, but only if approved by the Department. Accordingly, the ultimate value of TGI could be considered its cash holdings, which will decline over time to the extent its future expenses are not reimbursed by Triad. Since September 30, 2012, TGI's cash holdings have declined further from $1.0 million to approximately $750,000 as of the date of this Form 10-Q.

TGI's expenses primarily consist of legal fees, fees paid to our Board of Directors, audit fees paid to our registered public accounting firm, and annual premiums for directors' and officers' liability insurance. These expenses have ranged from approximately $100,000 to approximately $500,000 per quarter and, historically, substantially all of these expenses have been reimbursed by Triad on a routine basis. In May 2012, TGI submitted a reimbursement request to the Department for approximately $164,000, which represented TGI's expenses that were incurred in the first quarter of 2012 that were eligible for reimbursement under historical practices. The Department has not yet responded to that request and has not advised TGI when to expect a response. TGI also incurred expenses during the second and third quarters of 2012 totaling approximately $323,000 and a reimbursement request to the Department for those expenses was submitted in October of 2012, which also is pending Department approval. The Department has broad discretion in determining whether to approve TGI's expense reimbursement requests and the Company is unsure how much, if any, of these expenses will ultimately be approved for reimbursement by the Department. Even if some or all of the pending expense reimbursement requests are approved by the Department, the Company expects that future expense reimbursements from Triad, if any, would be reduced from historical levels. Absent expense reimbursements from Triad, the remaining assets of TGI will continue to be depleted each month and unless TGI's expenses are substantially reduced, the Company expects that TGI will have depleted all of its remaining cash by mid-2013, or earlier depending on the timing of any costs of defense associated with the pending securities law class action litigation described under Note 4, Litigation and Contingencies.

This will ultimately cause TGI to commence winding up its business and liquidating through a Chapter 11 bankruptcy proceeding or through other liquidation proceedings. A final decision by the Department to cease allowing Triad to reimburse TGI's expenses will likely leave TGI with no alternative other than to commence such a proceeding. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

Accounting Principles

The Company prepares its financial statements presented in this Quarterly Report on Form 10-Q in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The financial statements for Triad that are provided to the Department are prepared in accordance with Statutory Accounting Principles ("SAP") as set forth in the Illinois Insurance Code or prescribed by the Department. The primary difference between GAAP and SAP for Triad at September 30, 2012 and December 31, 2011 was the reporting requirements relating to the DPOs stipulated in the second Corrective Order.

A deficit in assets occurs when recorded liabilities exceed recorded assets in financial statements prepared under GAAP. A deficiency in policyholders' surplus occurs when recorded liabilities exceed recorded assets in financial statements prepared under SAP. A deficit in assets at any particular point in time under GAAP is not necessarily a measure of insolvency. However, the Company believes that if Triad were to report a deficiency in policyholders' surplus under SAP for an extended period of time, Illinois law may require the Department to seek receivership of Triad, which could compel TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or otherwise consider dissolution of the Company. The second Corrective Order was designed in part to help Triad maintain its positive policyholders' surplus.

2. Going Concern

The Company has prepared its financial statements on a going concern basis under GAAP, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. However, there is substantial doubt as to the Company's ability to continue as a going concern. This uncertainty is based on, among other things, Triad's current non-compliance with a provision of the second Corrective Order, the possible failure of Triad to comply with other provisions of the Corrective Orders, and the Company's ability to generate enough income over the term of the remaining run-off to overcome its $802.8 million deficit in assets at September 30, 2012.

The positive impact on statutory surplus resulting from the second Corrective Order has resulted in Triad reporting a policyholders' surplus in its SAP financial statements of $224.1 million at September 30, 2012, as opposed to a deficiency in policyholders' surplus of $834.5 million on the same date had the second Corrective Order not been implemented. While the implementation of the second Corrective Order has deferred the institution of an involuntary receivership proceeding, no assurance can be given that the Department will not seek receivership of Triad in the future and there continues to be substantial doubt about the Company's ability to continue as a going concern.

The Department may seek receivership of Triad based on Triad's current non-compliance with a provision of the second Corrective Order or for any other violation of the Illinois Insurance Code. Moreover, if the Department determines that Triad is insolvent under applicable law, it would be required to institute a receivership proceeding over Triad. In addition, the Department retains the inherent authority to institute such proceedings against Triad for any reason and Triad has previously agreed not to contest the taking of any such actions.

As of the date of this Form 10-Q, the Department has not issued any final decision or order as a result of the public hearing and Triad's request to amend the second Corrective Order. Because the subject matter of the hearing specifically included an assessment of whether the Department should implement a different regulatory approach with respect to Triad, including institution of receivership proceedings for the conservation, rehabilitation or liquidation of Triad, the Company believes institution of such a proceeding could be imminent. If this should occur, among other things, TGI could lose control of Triad and could be forced to deconsolidate its financial statements. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or take other steps to wind up its business and liquidate. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information. The consolidated financial statements that are presented in this report do not include any accounting adjustments that reflect the financial risks of Triad entering receivership proceedings or otherwise not continuing as a going concern.

3. Accounting Policies and Basis of Presentation

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with GAAP for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three months and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012 or subsequent periods. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Consolidation

The consolidated financial statements include the accounts of TGI and its wholly owned subsidiary, TGIC, including TGIC's wholly-owned subsidiary, TGAC. All significant intercompany accounts and transactions have been eliminated.

Corrective Orders and Regulation

Triad has entered into two Corrective Orders with the Department as detailed below and in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Among other things, the Corrective Orders:

- Require the oversight of the Department on substantially all operating matters;
- Prohibit stockholder dividends from Triad to TGI without the prior approval of the Department;
- Prohibit the accrual of interest and the payment of interest and principal on Triad's surplus note to TGI without the prior approval of the Department;
- Restrict Triad from making any payments or entering into any transaction that involves the transfer of assets to, or liabilities from, any affiliated parties without the prior approval of the Department;
- Require Triad to obtain prior written approval from the Department before entering into certain transactions with unaffiliated parties;
- Require that all valid claims under Triad's mortgage guaranty insurance policies are settled 60% in cash and 40% by recording a DPO;
- Require the accrual of simple interest on the DPO at the same average net rate earned by Triad's investment portfolio; and
- Require that loss reserves in financial statements prepared in accordance with SAP be established to reflect the cash portion of the estimated claim settlement but not the DPO.

The DPO is an interest-bearing subordinated obligation of Triad with no stated repayment terms. The second Corrective Order requires that Triad hold assets to support the DPO liability in a separate account pursuant to a custodial arrangement. As mentioned in Note 1, Triad is currently not in compliance with this provision of the second Corrective Order. See "Pending Regulatory Matters" above for more information.

The recording of a DPO does not impact reported settled losses as the Company continues to report the entire amount of a claim in its statements of comprehensive loss. The accounting treatment for the recording of DPOs on Triad's balance sheet on a SAP basis is similar to a surplus note that is reported as a component of statutory surplus which serves to increase reported statutory surplus. However, in the Company's financial statements prepared in accordance with GAAP included in this report, the DPOs and related accrued interest are reported as a liability. At September 30, 2012, the cumulative effect of the DPO requirement on statutory policyholders' surplus, including the impact of establishing loss reserves at anticipated cash payment rather than the estimated full claim amount, was to increase statutory policyholders' surplus by $1.1 billion over the amount that would have been reported absent the second Corrective Order. The cumulative increase to statutory policyholders' surplus as a result of the DPO requirement was $967.5 million at December 31, 2011. There was no such impact to loss reserves or stockholders' deficit calculated on a GAAP basis, which is the primary reason for the reported deficit in assets. Any repayment of the DPO or the associated accrued interest is dependent on the financial condition and future prospects of Triad and is subject to the approval of the Department.

The second Corrective Order provides financial thresholds, specifically regarding the statutory risk-to-capital ratio and the level of statutory policyholders' surplus that, if met, may indicate that the Department should reduce the DPO percentage and/or require distributions to DPO holders. In January 2012, the Department notified Triad that as of December 31, 2011, based upon Triad's surplus position, risk-to-capital ratio and the continued economic uncertainty, the Department determined that no change to the DPO percentage was in order nor would it be appropriate for Triad to make a distribution to the DPO holders.

Failure to comply with the provisions of the Corrective Orders or any other violation of the Illinois Insurance Code may result in the imposition of fines or penalties or subject Triad to further legal proceedings, including the institution by the Department of receivership proceedings for the conservation, rehabilitation or liquidation of Triad. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws or otherwise consider dissolution of the Company.

Triad is also subject to comprehensive regulation by the insurance departments of the various other states in which it is licensed to transact business. The insurance departments of the other states have been working with the Department in the administration and oversight of the Corrective Orders.

Insurance regulations generally limit the writing of mortgage guaranty insurance to an aggregate amount of insured risk no greater than twenty-five times the total of statutory capital, which is defined as the statutory surplus plus the statutory contingency reserve. The Corrective Orders under which Triad is currently operating specifically prohibit the writing of new insurance by Triad. While the risk-to-capital ratio of Triad has benefitted from the DPO requirements of the Corrective Orders, it remains greater than the 25-to-1 regulatory guideline. Even if Triad's risk-to-capital ratio were to be reduced to 25-to-1 or lower as a result of the second Corrective Order, Triad would continue to be prohibited by the Department as well as other states from issuing new commitments for insurance.

Reinsurance

Prior to entering into run-off, the Company entered into various captive reinsurance agreements that were designed to allow lenders to share in the risks of mortgage insurance. All of the captive reinsurance agreements include, among other things, minimum capital requirements and require a trust be established to partially support the reinsurer's obligations under the agreement. Reinsurance agreements do not relieve the Company from its obligations to policyholders. Failure of the reinsurer to honor its obligation in excess of the minimum capital level required by the reinsurance agreement could result in losses to the Company; consequently, allowances are established for amounts deemed uncollectible from the captive reinsurance company. At September 30, 2012, reinsurance recoverable on loss reserves from captive reinsurers was approximately $15.9 million and captive reinsurance trust balances were $35.0 million. At September 30, 2012, approximately $1.8 million of reinsurance recoverable on loss reserves exceeded the available trust balance for which no benefit was recognized in these financial statements.

Loss Reserves

The Company establishes loss reserves to provide for the estimated costs of settling claims on loans reported in default and estimates on loans in default that are in the process of being reported to the Company as of the date of the financial statements. Consistent with industry accounting practices, the Company does not establish loss reserves for future claims on insured loans that are not currently in default. Loss reserves are established by management using historical experience and by making various assumptions and judgments about claim rates (frequency) and claim amounts (severity) to estimate ultimate losses to be paid on loans in default. The Company's reserving methodology gives effect to current economic conditions and profiles delinquencies by such factors as, among others, default status, policy year, and the number of mortgage payments missed, as well as the combined loan-to-value ("LTV") ratio. The Company also incorporates in the calculation of loss reserves the probability that a defaulted policy may be rescinded for underwriting violations.

A number of factors can impact the actual frequency and severity realized during the year compared to those utilized in the reserve assumptions including: changes in home prices at a faster rate than anticipated; the unanticipated impact of loan modification programs on cure rates; the impact of a higher or lower unemployment rate than anticipated; an unanticipated slowdown or acceleration of the overall economy; or social and cultural changes that are more accepting of mortgage defaults even when the borrower has the ability to pay. Changes in the actual rescission rate compared to the rescission rate utilized in the reserve assumptions can also impact the frequency factor.

Rescissions are a key component in determining the level of estimated loss reserves and ultimately the level of paid claims. During the three months and nine months ended September 30, 2012, the Company rescinded coverage on policies with risk in force of $95.3 million and $245.4 million, respectively, compared with $64.6 million and $321.7 million in the comparable prior year periods. The rescission factor utilized in the calculation of loss reserves resulted in a reduction to gross reserves of $104.5 million at September 30, 2012 compared to $205.7 million at December 31, 2011. Any change to the actual rescission rate compared to those utilized in the reserve methodology can have a material impact on the Company's financial condition. Such changes may come about for a number of reasons including legal determinations and agreements regarding Triad's ability to rescind coverage.

The assumptions utilized in the calculation of the loss reserve estimate are continually reviewed and adjusted as necessary. Such adjustments are reflected in the financial statements in the periods in which the adjustments are made.

The estimation of loss reserves requires assumptions as to future events, and there are inherent risks and uncertainties involved in making these assumptions. Economic conditions that have affected the development of loss reserves in the past may not necessarily affect development patterns in the future in either a similar manner or degree.

Recent Accounting Pronouncements

Changes to GAAP are established by the Financial Accounting Standards Board ("FASB") in the form of an Accounting Standards Update ("ASU") to the FASB's Accounting Standards Codification ("ASC"). The Company considers the applicability and impact of all ASUs. ASUs not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on the Company's financial statements.

In May 2011, the FASB, together with the International Accounting Standards Board ("IASB"), jointly issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS ("ASU 2011-04"). The adoption of ASU 2011-04 gives fair value the same meaning between GAAP and International Financial Reporting Standards ("IFRS"), and improves consistency of disclosures relating to fair value. The Company adopted the provisions of ASU 2011-04 effective January 1, 2012 and included the required disclosures in these financial statements. The adoption of this statement did not have a material impact on the financial statements.

In December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 ("ASU 2011-12"), which defers the effective date required to comply with reclassification adjustments out of accumulated other comprehensive income found in ASU 2011-05. The delay will allow the Board time to re-deliberate whether to require the presentation, on the face of the financial statements, of the effects of reclassifications out of accumulated other comprehensive income. All other requirements in ASU 2011-05 are not affected by ASU 2011-12. The Company does not expect the adoption of ASU 2011-12 to have a material impact on its financial statements.

4. Litigation and Contingencies

The Company is involved in litigation and other legal proceedings in the ordinary course of business as well as the matters identified below. No reserves have been established in the financial statements regarding current litigation as the potential liabilities, if any, are not probable or cannot be reasonably estimated.

On February 6, 2009, James L. Phillips served a complaint alleging violations of federal securities laws against TGI and two of its officers in the United States District Court, Middle District of North Carolina on behalf of a purported class of persons who acquired the common stock of the Company between October 26, 2006 and April 1, 2008. TGI filed its motion to dismiss the amended complaint on August 21, 2009 and on January 27, 2012 the Magistrate Judge recommended that TGI's motion to dismiss be granted. The plaintiff filed an amended complaint on March 30, 2012, TGI filed its motion to dismiss on May 15, 2012, the plaintiff filed its opposition to Triad's motion to dismiss on July 6, 2012, and TGI filed its reply brief on August 6, 2012. TGI intends to vigorously defend this matter.

On September 4, 2009, Triad filed a complaint against American Home Mortgage ("AHM") in the United States Bankruptcy Court for the District of Delaware seeking rescission of multiple master mortgage guaranty insurance policies ("master policies") and declaratory relief. The complaint seeks relief from AHM as well as all owners of loans insured under the master policies by way of a defendant class action. Triad alleged that AHM failed to follow the delegated insurance underwriting guidelines approved by Triad, that this failure breached the master policies as well as the implied covenants of good faith and fair dealing, and that these breaches were so substantial and fundamental that the intent of the master policies could not be fulfilled and Triad should be excused from its obligations under the master policies. Three groups of current owners and/or servicers of AHM-originated loans filed motions to intervene in the lawsuit, which were granted by the Court on May 10 and October 29, 2010. On March 4, 2011, Triad amended its complaint to add a count alleging fraud in the inducement. On March 25, 2011, each of the interveners filed a motion to dismiss. Triad filed its answer and answering brief in opposition to the motions to dismiss on May 27, 2011 and the interveners filed their reply briefs on July 13, 2011. The total amount of risk originated under the AHM master policies, accounting for any applicable stop-loss limits associated with Modified Pool contracts and less risk originated on policies that have been subsequently rescinded, was $1.2 billion, of which $0.5 billion remained in force at September 30, 2012. Triad continues to accept premiums and process claims under the master policies, with the earned premiums and settled losses reflected in the Consolidated Statements of Comprehensive Loss. However, as a result of the litigation, Triad ceased remitting claim payments to companies servicing loans originated by AHM and the liability for losses settled but not paid is included in "Accrued expenses and other liabilities" on the Consolidated Balance Sheets. Triad has not recognized any benefit in its financial statements pending the outcome of the litigation. On August 27, 2012, the Bankruptcy Court issued an order dismissing the lawsuit on jurisdictional grounds. Triad is evaluating whether to refile in jurisdictions where the current master policyholder is located.

On March 5, 2010, Countrywide Home Loans, Inc. filed a lawsuit in the Los Angeles County Superior Court of the State of California alleging breach of contract and seeking a declaratory judgment that bulk rescissions of flow loans is improper and that Triad is improperly rescinding loans under the terms of its master policies. On May 10, 2010 the case was designated as complex and transferred to the Court's Complex Litigation Program. Non-binding mediation occurred on July 22, 2011 with a follow-up mediation session on October 13, 2011. The parties have agreed to a proposed settlement which is subject to regulatory approval. In the event that the settlement is not approved, Triad intends to vigorously defend this matter.

On December 19, 2011, January 17, 2012, and April 12, 2012, complaints were served against TGIC in the United States District Court, Central District of California, United States District Court, Eastern District of Pennsylvania, and United States District Court, Eastern District of Pennsylvania, respectively. The plaintiffs purport to represent a class of persons whose loans were insured by a mortgage guaranty insurance policy and reinsured through a captive reinsurer. The complaints allege that such reinsurance is in violation of the Real Estate Settlement Procedures Act. In each case, the lender, captive reinsurer, and various mortgage guaranty insurers were sued. Triad did not provide mortgage guaranty insurance on the named plaintiffs' loans in any of these lawsuits. Triad intends to vigorously defend these matters.

The Consumer Financial Protection Bureau (the "CFPB") issued a letter to TGI on January 3, 2012, advising TGI that the CFPB was investigating premium ceding practices by mortgage insurers, lenders, and their captive reinsurers and requested certain information from Triad. The CFPB formally requested additional information on June 20, 2012. Triad is cooperating with the CFPB in its investigation.

Triad reported to the Department that as of August 31, 2012, Triad was not in compliance with the second Corrective Order because the aggregate amount of the DPO liability exceeded the cash and invested assets of Triad that were available for segregation in a separate account. Triad has asked the Department to amend, modify or otherwise waive compliance with this provision of the second Corrective Order. In addition, Triad also has requested that the calculation of the carrying charge on the DPO prescribed in the second Corrective Order be amended to limit the amount to a maximum equal to the actual aggregate net investment income that Triad earns rather than an amount based on the effective rate earned by Triad on its investments. In response to Triad's requests for these modifications to the second Corrective Order, the Department held a public hearing on September 10, 2012, and invited Triad and its policyholders to provide testimony regarding these proposed amendments. In addition, the Department invited Triad and its policyholders to provide testimony as to whether Triad should be permitted to continue to runoff its existing book of insurance business or whether the Department should implement a different regulatory approach. The Department extended the period for comments and written testimony until November 30, 2012. Triad's failure to comply with the provisions of the second Corrective Order or any other violation of the Illinois Insurance Code may result in the imposition of fines or penalties or subject Triad to further legal proceedings, including the institution by the Department of receivership proceedings for the conservation, rehabilitation or liquidation of Triad. Moreover, if the Department determines that Triad is insolvent under applicable law, it would be required to institute a receivership proceeding over Triad. In addition, the Department retains the inherent authority to institute such proceedings against Triad for any reason and Triad has previously agreed not to contest the taking of any such actions. As of the date of this Form 10-Q, the Department has not issued any final decision or order as a result of the public hearing and Triad's request to amend the second Corrective Order. Because the subject matter of the hearing specifically included an assessment of whether the Department should implement a different regulatory approach with respect to Triad, including institution of receivership proceedings for the conservation, rehabilitation or liquidation of Triad, the Company believes institution of such a proceeding could be imminent. If this should occur, among other things, TGI could lose control of Triad and could be forced to deconsolidate its financial statements. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or take other steps to wind up its business and liquidate. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

5. Investments

All fixed maturity securities are classified as "available-for-sale" and are carried at fair value. Unrealized gains on available-for-sale securities, net of tax, are reported as a separate component of accumulated other comprehensive income in shareholders' equity. Due to Triad's operating in run-off under the supervision by the Department and the uncertainty surrounding the Company's ability to continue as a going concern, the Company may be unable to retain a security that is in an unrealized loss position, even on a temporary basis, until it potentially recovers value. Accordingly, the Company recognizes an other-than-temporary impairment loss on all securities for which the fair value is less than the amortized cost at the balance sheet date. Impairment losses are recognized as realized investment losses in the Consolidated Statements of Comprehensive Loss. If the Company believes that the recorded impairment was due to reasons other than credit related, the difference between the impaired value and principal amount will be amortized as a component of interest income through the anticipated maturity date. The amortized cost, gross unrealized gains and losses and fair value of available-for-sale securities as of September 30, 2012 and December 31, 2011 were as follows:

	As of September 30, 2012			
(dollars in thousands)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed maturity securities:				
U. S. government and agency securities	$8,825	$ 168	$-	$8,993
Foreign government securities	9,588	549	-	10,137
Corporate debt	475,907	20,860	-	496,767
Residential mortgage-backed	13,495	1,298	-	14,793
Commercial mortgage-backed	28,003	735	-	28,738
Asset-backed	64,499	290	-	64,789
State and municipal bonds	44,546	4,491	-	49,037
Total fixed maturities	644,863	28,391	-	673,254
Short-term investments	46,452	-	-	46,452
Total securities	$691,315	$ 28,391	$-	$719,706

	As of December 31, 2011			
(dollars in thousands)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed maturity securities:				
U. S. government and agency securities	$13,662	$ 341	$-	$14,003
Foreign government securities	9,585	439	-	10,024
Corporate debt	498,919	16,708	-	515,627
Residential mortgage-backed	28,036	1,280	-	29,316
Commercial mortgage-backed	31,184	374	-	31,558
Asset-backed	76,006	730	-	76,736
State and municipal bonds	63,776	5,198	-	68,974
Total fixed maturities	721,168	25,070	-	746,238
Short-term investments	30,099	3	-	30,102
Total securities	$751,267	$ 25,073	$-	$776,340

Unrealized gains do not necessarily represent future gains that the Company will realize. The value of the Company's investment portfolio will vary depending on overall market interest rates, credit spreads, and changing conditions related to specific securities, as well as other factors. Volatility may increase in periods of uncertain market or economic conditions. Unrealized gains at both September 30, 2012 and December 31, 2011 were due primarily to a decline in interest rates from those at the time of initial purchase, although the recovery in value of previously impaired fixed maturity securities also contributed to the level of unrealized gains.

The amortized cost and estimated fair value of fixed maturity available-for-sale securities at September 30, 2012 are summarized by stated maturity below. Asset-backed, commercial mortgage-backed, and residential mortgage-backed securities are presented separately below because they generally provide for periodic payments of principal.

	Available-for-Sale	
(dollars in thousands)	Amortized Cost	Fair Value
Maturity:		
One year or less	$172,226	$174,302
After one year through five years	330,996	349,097
After five years through ten years	19,382	22,052
After ten years	16,262	19,483
	538,866	564,934
Securities with periodic principal payments:		
Asset-backed	64,499	64,789
Commercial mortgage-backed	28,003	28,738
Residential mortgage-backed	13,495	14,793
Total	$644,863	$673,254

Actual and expected maturity for certain securities may differ from stated maturity due to call and prepayment provisions.

Realized Gains (Losses) Related to Investments

The details of net realized investment gains (losses) for the three months and nine months are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2012	2011	2012	2011
Securities available-for-sale:				
Fixed maturity securities:				
Gross realized gains	$103	$2,780	$1,133	$6,423
Gross realized losses	(2)	(1,429)	(57)	(2,509)
Equity securities:				
Gross realized gains	2	-	7	1
Other investment losses	-	(2)	-	(2)
Net realized gains (losses)	$103	$1,349	$1,083	$3,913

Gross realized losses for the three months and nine months ended September 30, 2012 and 2011 were primarily attributable to the other-than-temporary write downs of securities whose market value was less than the respective cost basis.

6. Fair Value Measurement

Fair Value of Financial Instruments

The carrying values and fair values of financial instruments as of September 30, 2012 and December 31, 2011 are summarized below:

	September 30, 2012		December 31, 2011	
(dollars in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets				
Fixed maturity securities available-for-sale	$673,254	$673,254	$746,238	$746,238
Short-term investments	46,452	46,452	30,102	30,102

Valuation Methodologies and Associated Inputs

The Company utilizes the provisions of ASC 820 as amended by ASU 2010-06 in its estimation and disclosures about fair value of financial assets. There are no liabilities as of September 30, 2012 or December 31, 2011 that meet the criteria of a financial instrument. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are as follows:

Level 1:	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets.
Level 2:	Quoted prices for similar assets in active markets or for identical or similar assets in inactive markets. Alternatively, quoted prices may be based on models where the significant inputs are observable or can be supported by observable market data.
Level 3:	Prices or valuation techniques where one or more of the significant inputs are unobservable (i.e., supported with little or no market activity). This includes broker quotes which are non-binding.

An asset's or a liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. An asset's or a liability's level within the fair value hierarchy as well as transfers in and out of Level 3 are determined at the end of the reporting period. At September 30, 2012, none of the Company's invested assets were Level 3 securities.

The Company utilizes independent pricing services in the valuation of its invested assets. The independent pricing services primarily use generic models which use standard inputs including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, market bids/offers, and other reference data. Market indicators as well as industry and economic events are also monitored.

The Company utilizes its investment advisor to assist in determining if the pricing methodologies of the independent pricing services comply with ASC 820-10. Working under the Company's supervision, the investment advisor reviews the pricing techniques of the independent pricing services and has controls in place to ensure quality including, but not limited to:

- reviewing price tolerance reports for month-over-month price changes that exceed certain thresholds;
- reviewing evaluation dates for stale prices;
- comparing with alternative pricing sources;
- comparing with trade activity; and
- comparing to a benchmarked price.

Based upon this review, prices submitted by the independent pricing services may be challenged and replaced if appropriate.

The investment advisor will obtain a price for any individual security not priced by the independent pricing services or for any individual security whose price is replaced as a result of the quality control review. The investment advisor seeks pricing from a variety of sources including external brokers, index pricing, internal sources of the investment advisor, and spread matrixes, among others. For broker-quoted only securities, quotes from market makers or broker-dealers are obtained from sources recognized to be market participants. For those securities trading in less liquid or illiquid markets with limited or no pricing information, unobservable inputs are used in order to measure the fair value of these securities. In cases where this information is not available, such as for privately placed securities, fair value is estimated using an internal pricing matrix. This matrix relies on judgment concerning the discount rate used in calculating expected future cash flows, credit quality, industry sector performance, and expected maturity. The following is a description of the valuation methodologies used in determining the fair value of the Company's assets.

Fixed maturities

U.S. Government and agency securities – U.S. Government and agency securities include U.S. Treasury securities, agency/government sponsored entity ("GSE") issues, and corporate government-backed obligations issued under the Temporary Liquidity Guarantee Program. The fair value for U.S. Treasury securities is based on regularly updated quotes from active market makers and brokers. The fair value for agency and other government-backed obligations is based on regularly updated dealer quotes, secondary trading levels, and the new issue market. U.S. Government and agency securities are categorized as Level 2.

Foreign Government securities – The fair value of Foreign Government securities is based on discounted cash flow models incorporating observable option-adjusted spread features where necessary. Foreign Government securities are categorized as Level 2.

Corporate debt – The fair value for corporate debt is based on regularly updated dealer quotes, secondary trading, and the new issue market incorporating observable option-adjusted spread features where necessary. Corporate debt is categorized as Level 2.

Residential mortgage-backed securities – Residential mortgage-backed securities include securities issued by the GSEs and the Government National Mortgage Association (GNMA), as well as private-label securities. The fair value of residential mortgage-backed securities is based on prices of similar securities and discounted cash flow analysis incorporating prepayment and default assumptions. Residential mortgage-backed securities are categorized as Level 2.

Commercial mortgage-backed securities – The fair value of commercial mortgage-backed securities is based on prices of similar securities and discounted cash flow analysis incorporating prepayment and default assumptions. Commercial mortgage-backed securities are categorized as Level 2.

Asset-backed securities – The fair value of asset-backed securities is based on prices of similar securities and discounted cash flow analysis incorporating prepayment and default assumptions. Asset-backed securities are generally categorized as Level 2. For certain securities, if cash flow or other security structure or market information is not available, the fair value may be based on broker quotes or benchmarked to an index. In such instances, these asset-backed securities are generally categorized as Level 3.

State and municipal bonds – The fair value for state and municipal bonds is based on regularly updated trades, bid-wanted lists, and offerings from active market makers and brokers. Evaluations incorporate current market conditions, trading spreads, spread relationships and the slope of the yield curve, among others. Information is applied to bond sectors and individual bond evaluations are extrapolated. Evaluation for distressed or non-performing bonds may be based on liquidation value or restructuring value. State and municipal bonds are categorized as Level 2.

Short-term investments

Money market instruments – The fair value is based on unadjusted quoted prices that are readily and regularly available in active markets. Money market instruments are categorized as Level 1.

Other short-term instruments – Other short-term instruments primarily include discounted and coupon bearing commercial paper as well as corporate securities purchased with maturity less than twelve months at time of purchase. Short term investments are carried at amortized cost which approximates fair market value or at fair market value utilizing regularly updated dealer or secondary trading quotes. Other short-term instruments are categorized as Level 2.

Fair Value of Investments

The Company did not have any material assets measured at fair value on a non-recurring basis as of September 30, 2012 or at December 31, 2011. The following table summarizes the assets measured at fair value on a recurring basis and the source of the inputs in the determination of fair value as of September 30, 2012 and December 31, 2011:

		Fair Value at Reporting Date Using		
(dollars in thousands)	September 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available-for-sale:				
Fixed maturities:				
U. S. government and agency securities	$ 8,993	$ -	$ 8,993	$ -
Foreign government securities	10,137	-	10,137	-
Corporate debt	496,767	-	496,767	-
Residential mortgage-backed	14,793	-	14,793	-
Commercial mortgage-backed	28,738	-	28,738	-
Asset-backed	64,789	-	64,789	-
State and municipal bonds	49,037	-	49,037	-
Total fixed maturities	673,254	-	673,254	-
Short-term investments:				
Money market instruments	32,367	32,367	-	-
Other	14,085	-	14,085	-
Total	$ 719,706	$ 32,367	$ 687,339	$ -

		Fair Value at Reporting Date Using		
(dollars in thousands)	December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available-for-sale:				
Fixed maturities:				
U. S. government and agency securities	$ 14,003	$ -	$ 14,003	$ -

Foreign government securities	10,024	-	10,024	-
Corporate debt	515,627	-	515,627	-
Residential mortgage-backed	29,316	-	29,316	-
Commercial mortgage-backed	31,558	-	31,558	-
Asset-backed	76,736	-	75,736	1,000
State and municipal bonds	68,974	-	68,974	-
Total fixed maturities	746,238	-	745,238	1,000
Short-term investments:				
Money market instruments	4,575	4,575	-	-
Other	25,527	-	25,527	-
Total	$ 776,340	$ 4,575	$ 770,765	$ 1,000

The Company did not have any securities priced using significant unobservable inputs (Level 3) as of September 30, 2012. One security totaling $0.6 million was transferred from Level 3 to Level 2 during the third quarter of 2012 as quoted prices can now be supported by observable market data. Quantitative information about the significant unobservable inputs used in the fair value measurement of Level 3 securities at September 30, 2012 and sensitivity to changes in unobservable inputs have not been disclosed in this Form 10-Q due to the immateriality of Level 3 securities. The following table provides a reconciliation of the beginning and ending balances of these Level 3 bonds and the related gains and losses related to these assets during the three months and nine months ended September 30, 2012 and 2011, respectively.

Fair Value Measurement Using Significant Unobservable Inputs (Level 3)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2012	2011	2012	2011
Securities available-for-sale:				
Asset-backed bonds:				
Beginning balance	$600	$1,064	$1,000	$1,591
Transfers into Level 3	-	-	-	-
Transfers out of Level 3	(601)	-	(601)	-
Total gains and losses (realized and unrealized):				
Included in operations	-	3	480	55
Included in other comprehensive income	1	(20)	(437)	65
Purchases, issuances, sales, and settlements:				
Purchases	-	-	695	55
Issuances	-	-	-	-
Sales	-	-	(1,137)	(719)
Settlements	-	-	-	-
Ending balance	$-	$1,047	$-	$1,047
The amount of total gains and losses for the period included in operations attributable to realized gains and losses and the change in unrealized gains and losses relating to assets still held at the reporting date.	$1	$(17)	$43	$120

7. Loss Per Share ("EPS")

Basic and diluted EPS are based on the weighted-average daily number of shares outstanding. In computing diluted EPS, only potential common shares that are dilutive – those that reduce EPS or increase loss per share – are included. Exercises of options and unvested restricted stock are not assumed if the result would be antidilutive, such as when a loss from operations is reported. For the three months and nine months ended September 30, 2012 and 2011, the Company reported a loss from operations and therefore had no dilutive effect of stock options and unvested restricted stock on the weighted-average shares outstanding. The numerator used in both the basic EPS and diluted EPS calculation is the actual loss reported for the period represented. For the three months and nine months ended September 30, 2012, options to purchase approximately 3,200 and 4,200 shares, respectively, of the Company's common stock were excluded from the calculation of EPS because they were antidilutive. For the three months and nine months ended September 30, 2011, options to purchase approximately 8,000 and 8,500 shares, respectively, of the Company's common stock were excluded from the calculation of EPS because they were antidilutive.

8. Comprehensive Loss

Comprehensive loss consists of the net loss and other comprehensive income (loss). For the Company, other comprehensive income (loss) is normally composed of the change in unrealized gains on available-for-sale securities, net of deferred income taxes. Given the Company's previous substantial losses from operations, regulatory oversight of its operations, and the significant doubt regarding its ability to continue as a going concern, the Company may be unable to hold impaired assets for a sufficient time to recover their value. Thus, any security with a fair value less than the book value at the balance sheet date is considered to be other-than-temporarily impaired and the loss is recognized as a realized loss in the Consolidated Statements of Comprehensive Loss. For the three months and nine months ended September 30, 2012, the Company reported other comprehensive income of $1.9 million and $3.1 million, respectively. For the same three month and nine month periods of 2012, the Company had a comprehensive loss of $31.4 million and $99.2 million, respectively. For the three month and nine month periods ended September 30, 2011, the Company reported other comprehensive loss of $0.1 million and comprehensive income of $2.1 million, respectively. The Company had comprehensive loss of $37.6 million and $44.7 million, respectively, for the three month and nine month periods ended September 30, 2011.

At September 30, 2012, the Company's accumulated other comprehensive income of $12.1 million was comprised of unrealized gains on investments of $28.7 million, offset by income tax liability of $10.1 million and a valuation allowance against deferred tax assets of $6.5 million. At December 31, 2011, the Company's accumulated other comprehensive income of $9.0 million was comprised of unrealized gains on investments of $25.6 million, offset by income tax liability of $9.0 million and a valuation allowance against deferred tax assets of $7.6 million.

9. Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and deferred tax liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Federal tax law permits mortgage guaranty insurance companies to deduct from taxable income, subject to certain limitations, the amounts added to contingency loss reserves required under SAP. Generally, the amounts so deducted must be included in taxable income in the tenth subsequent year. However, due to the large amount of losses generated through September 30, 2012, the Company has extensive NOLs that will not allow it to take advantage of these special tax deductions until such time as future profits exceed the amounts on the NOLs.

The Company uses the provisions of ASC 740, Income Taxes ("ASC 740") to account for and report tax positions taken or expected to be taken in its tax return that directly or indirectly affect amounts reported in its financial statements, including the accounting and disclosure for uncertainty in tax positions.

The Company's policy for recording interest and penalties, if any, associated with audits is to record such items as a component of income before taxes. Penalties would be recorded in "other operating expenses" and interest paid or received would be recorded as interest expense or interest income, respectively, in the consolidated statements of comprehensive loss.

The Company cannot determine that any of its deferred tax assets will result in future tax benefits with any degree of certainty; therefore, a valuation allowance was established for the portion of these assets that are not currently expected to be realized. At September 30, 2012, the Company established a valuation allowance of approximately $380.7 million against a $391.3 million deferred tax asset. Based upon a review of the Company's anticipated future taxable income, and also including all other available evidence, both positive and negative, the Company concluded that it is more likely than not that the $391.3 million of the gross deferred tax assets, net of $10.6 million of deferred tax liabilities, will not be realized.

As of September 30, 2012, the Company had NOLs on a regular tax basis of approximately $779.7 million. Of this amount, if it remains unused, $195.3 million expires in 2028, $85.6 million expires in 2029, $126.6 million expires in 2030, $226.0 million expires in 2031, and $146.2 million will expire in 2032. The amount and timing of realizing the benefit of NOLs depends on future taxable income and limitations imposed by tax laws. The benefit of the NOLs has not been recognized in the consolidated financial statements.

Shareholders have approved a Tax Benefits Preservation Plan ("Plan") and amended the TGI certificate of incorporation to help protect its ability to recognize certain potential tax benefits in future periods from NOLs and tax credits, as well as any net operating losses that may be generated in future periods (the "Tax Benefits"). Section 382 of the Internal Revenue Code limits the ability of a company to take advantage of Tax Benefits when an ownership change occurs. In general, an "ownership change" under Section 382 occurs if there is a cumulative percentage change in the Company's ownership by certain stockholders over a rolling three-year period. The Plan is designed to reduce the likelihood that the Company will experience an ownership change. In connection with the adoption of the Plan in 2010, the Company declared a dividend of one preferred stock purchase right ("Rights"), for each outstanding share of its common stock to holders of record on September 27, 2010. Subject to certain exceptions, the Rights generally are not exercisable until certain stockholders increase their ownership in the Company in excess of certain percentages.

10. Subsequent Events

We are not aware of any significant events that occurred subsequent to the balance sheet date but prior to the filing of this report that would have a material impact on the Company's Consolidated Financial Statements and related disclosures except as previously disclosed.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes our consolidated financial condition, changes in financial position, and results of operations for the three months and nine month periods ended September 30, 2012 and 2011. This discussion supplements Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2011, and should be read in conjunction with the interim financial statements and notes contained herein.

Certain of the statements contained in this Quarterly Report on Form 10-Q are "forward-looking statements" and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements include estimates and assumptions related to economic, competitive, regulatory, operational and legislative developments and typically are identified by use of terms such as "may," "will," "should," "could," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," "continue" and similar words, although some forward-looking statements are expressed differently. These forward-looking statements are subject to change, uncertainty and circumstances that are, in many instances, beyond our control and they have been made based upon our current expectations and beliefs concerning future developments and their potential effect on us. Actual developments and their results could differ materially from those expected by us, depending on the outcome of a number of factors, including: the possibility that the Illinois Department of Insurance may take various actions regarding Triad if we do not operate our business in accordance with the revised financial and operating plan and the Corrective Orders, or for other reasons, including seeking receivership proceedings; our ability to operate our business in run-off and maintain a solvent run-off; our ability to continue as a going concern; the possibility of general economic and business conditions that are different than anticipated; legislative, regulatory, and other similar developments; changes in interest rates, employment rates, the housing market, the mortgage industry and the stock market; legal and other proceedings regarding modifications and refinancing of mortgages and/or foreclosure proceedings; the possibility that there will not be adequate interest in our common stock to ensure efficient pricing; and the relevant factors described in Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011 and in the Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995 section below, as well as in other reports and statements that we file with the Securities and Exchange Commission (the "SEC"). Forward-looking statements are based upon our current expectations and beliefs concerning future events and we undertake no obligation to update or revise any forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements are made, except as required by the federal securities laws. Any forward-looking statements that are made are current only as of the date on which we filed this report.

Overview

Triad Guaranty Inc. ("TGI") is a holding company which, through its wholly-owned subsidiary, Triad Guaranty Insurance Corporation ("TGIC"), is a nationwide mortgage guaranty insurer pursuing a run-off of its existing in-force book of business. The term "run-off" means continuing to service existing mortgage guaranty insurance policies but not writing any new policies. Unless the context requires otherwise, references to "Triad" in this Quarterly Report on Form 10-Q refer to the operations of TGIC and its wholly-owned subsidiary, Triad Guaranty Assurance Corporation ("TGAC"). References to "we," "us," "our," and the "Company" refer collectively to the operations of TGI and Triad.

TGIC is an Illinois-domiciled mortgage guaranty insurance company and TGAC is an Illinois-domiciled mortgage guaranty reinsurance company. The Illinois Department of Insurance (the "Insurance Department") is the primary regulator of both TGIC and TGAC. The Illinois Insurance Code grants broad powers to the Insurance Department and its director (collectively, the "Department") to enforce rules or exercise discretion over almost all significant aspects of our insurance business. We ceased issuing new commitments for mortgage guaranty insurance coverage in 2008 and are operating our business in run-off under two Corrective Orders issued by the Department. As noted above and throughout this report, the term "run-off" means continuing to service existing policies, but writing no new mortgage guaranty insurance policies. Servicing existing policies during run-off includes:

- billing and collecting premiums on policies that remain in force;
- working with borrowers in default to remedy or cure the default and/or mitigate our loss;
- reviewing policies for the existence of misrepresentation, fraud, or non-compliance with stated programs; and
- settling all legitimate filed claims per the provisions of the policies and the two Corrective Orders issued by the Department.

The term "settled," as used in this report in the context of the payment of a claim, refers to the satisfaction of Triad's obligations following the submission of valid claims by our policyholders. As required by the second Corrective Order, effective on and after June 1, 2009, valid claims are settled by a combination of 60% in cash and 40% in the form of a deferred payment obligation ("DPO"). The Corrective Orders, among other things, allow management to continue to operate Triad under the close supervision of the Department, include restrictions on the distribution of dividends or interest on surplus notes payable to TGI by Triad, and include restrictions on the payment of claims.

Recent Developments and Risks

Pending Regulatory Matters

The second Corrective Order requires Triad to set aside invested assets in an escrow account in an amount equal to the combined DPO and accrued interest thereon. The second Corrective Order also requires Triad to accrue interest on the DPO at a rate equal to Triad's investment portfolio yield as defined in the second Corrective Order. At September 30, 2012, the recorded DPO, including accrued interest of $45.7 million, amounted to $765.0 million, which exceeded the cash and invested assets of Triad at that date. We previously reported to the Department that as of August 31, 2012, the aggregate amount of the DPO liability exceeded the cash and invested assets of Triad that were available for segregation in a separate account. Accordingly, Triad was not in compliance with this provision of the second Corrective Order as of August 31, 2012. We have asked the Department to amend, modify or otherwise waive compliance with this provision of the second Corrective Order. In addition, we have requested that the calculation of the interest on the DPO prescribed in the second Corrective Order be amended to limit the amount to a maximum equal to the actual aggregate net investment income that Triad earns rather than an amount based on the effective rate earned by Triad on its investments.

In response to Triad's requests for these modifications to the second Corrective Order, the Department held a public hearing on September 10, 2012, and invited Triad and its policyholders to provide testimony regarding these proposed amendments. In addition, the Department invited Triad and its policyholders to provide testimony as to whether Triad should be permitted to continue to run off its existing book of insurance business or whether the Department should implement a different regulatory approach, including receivership proceedings for the conservation, rehabilitation or liquidation of Triad. The Department extended the period for comments and written testimony on these matters until November 30, 2012.

Triad's failure to comply with the provisions of the second Corrective Order or any other violation of the Illinois Insurance Code may result in the imposition of fines or penalties or subject Triad to further legal proceedings, including the institution by the Department of receivership proceedings for the conservation, rehabilitation or liquidation of Triad. Moreover, if the Department determines that Triad is insolvent under applicable law, it would be required to institute a receivership proceeding over Triad. In addition, the Department retains the inherent authority to institute such proceedings against Triad for any reason and Triad has previously agreed not to contest the taking of any such actions. As of the date of this Form 10-Q, the Department has not issued any final decision or order as a result of the public hearing and Triad's request to amend the second Corrective Order. Because the subject matter of the hearing specifically included an assessment of whether the Department should implement a different regulatory approach with respect to Triad, including institution of receivership proceedings for the conservation, rehabilitation or liquidation of Triad, we believe institution of such a proceeding could be imminent. If this should occur, among other things, TGI could lose control of Triad and we could be forced to deconsolidate our financial statements. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or take other steps to wind up its business and liquidate. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

Impact of Expense Reimbursements on TGI's Liquidity

TGI is the public company whose stock is traded on the OTC Markets Group's OTCQB tier ("Pink Sheets") under the symbol "TGIC". TGI owns Triad, which is its only operating subsidiary. Aside from its ownership of Triad, TGI's assets at September 30, 2012 total approximately $1.0 million, which consisted primarily of cash holdings, compared to $1.3 million at June 30, 2012 and $1.5 million at December 31, 2011. The remainder of the $820.6 million of assets reported on the September 30, 2012 consolidated balance sheet presented in this Form 10-Q are the assets of Triad. TGI currently has no outstanding debt or other known material liabilities other than potential liabilities and costs of defense associated with the pending securities law class action litigation described under "Legal Proceedings" elsewhere in this Form 10-Q.

As previously reported, TGI has explored strategies to acquire complementary profitable businesses and utilize the net operating loss carryforwards ("NOLs") that were generated on a consolidated basis with Triad in order to increase its future value for the benefit of its stockholders as well as provide a limited benefit for Triad policyholders. Tax laws related to the use of NOLs effectively preclude TGI from raising material amounts of equity capital because such a transaction would likely materially impair the value of the NOLs. To date, TGI has been unsuccessful in identifying a viable acquisition candidate. Given the limited amount of cash remaining at TGI and its inability to raise additional funds, no assurance can be given that TGI will ever be successful in implementing such a strategy.

Given its current financial condition, we do not believe TGI would be able to successfully access the capital markets to obtain long-term or short-term debt or equity financing. TGI's primary source of revenue is the reimbursement of expenses from Triad. Investment income from TGI's cash holdings is immaterial. Triad is prohibited from paying dividends or distributing assets to TGI without the approval of the Department. We believe that, absent significant positive changes in the economy and the residential real estate market, Triad's existing assets combined with its future premiums will not be sufficient to meet Triad's current and future policyholder obligations. Therefore, none of Triad's assets would be available to TGI and its stockholders other than to reimburse certain TGI expenses incurred on behalf of Triad, but only if approved by the Department. Accordingly, the ultimate value of TGI could be considered its cash holdings, which will decline over time to the extent its future expenses are not reimbursed by Triad. Since September 30, 2012, TGI's cash holdings have declined further from $1.0 million to approximately $750,000 as of the date of this Form 10-Q.

TGI's expenses primarily consist of legal fees, fees paid to our Board of Directors, audit fees paid to our registered public accounting firm, and annual premiums for directors' and officers' liability insurance. These expenses have ranged from approximately $100,000 to approximately $500,000 per quarter and, historically, substantially all of these expenses have been reimbursed by Triad on a routine basis. In May 2012, we submitted a reimbursement request to the Department for approximately $164,000, which represented TGI's expenses that were incurred in the first quarter of 2012 that were eligible for reimbursement under historical practices. The Department has not yet responded to that request and has not advised TGI when to expect a response. TGI also incurred expenses during the second and third quarters of 2012 totaling approximately $323,000 and we submitted a reimbursement request to the Department for those expenses in October of 2012, which also is pending Department approval. The Department has broad discretion in determining whether to approve TGI's expense reimbursement requests and we are unsure how much, if any, of these expenses will ultimately be approved for reimbursement by the Department. Even if some or all of our pending expense reimbursement requests are approved by the Department, we expect that future expense reimbursements from Triad, if any, would be reduced from historical levels. Absent expense reimbursements from Triad, the remaining assets of TGI will continue to be depleted each month and unless we substantially reduce TGI's expenses, we expect that TGI will have depleted all of its remaining cash by mid-2013, or earlier depending on the timing of any costs of defense associated with the pending securities law class action litigation described under "Legal Proceedings" elsewhere in this Form 10-Q.

This will ultimately cause TGI to commence winding up its business and liquidating through a Chapter 11 bankruptcy proceeding or through other liquidation proceedings. A final decision by the Department to cease allowing Triad to reimburse TGI's expenses will likely leave TGI with no alternative other than to commence such a proceeding. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

Legal Matters

On September 4, 2009, Triad filed a complaint against American Home Mortgage ("AHM") in the United States Bankruptcy Court for the District of Delaware seeking rescission of multiple master mortgage guaranty insurance policies ("master policies") and declaratory relief. The complaint sought relief from AHM as well as all owners of loans insured under the master policies by way of a defendant class action. Triad continued to accept premiums and process claims under the master policies, with the earned premiums and settled losses reflected in the Consolidated Statements of Comprehensive Loss. However, as a result of the litigation, Triad ceased remitting claim payments to companies servicing loans originated by AHM and the liability for losses settled but not paid is included in "Accrued expenses and other liabilities" on the Consolidated Balance Sheets. On August 27, 2012, Triad's complaint was dismissed on jurisdictional grounds. Triad continues to accept premiums and process claims under the master policies and accrue the claim payments. If Triad does not institute new proceedings in state or federal court to rescind coverage under the master policies, Triad will be required to pay the accrued claim payments, which total approximately $83 million, in the fourth quarter of 2012 or the first quarter of 2013. Triad currently has adequate liquidity to fund this payment.

We have been in mediation with Countrywide in an effort to settle its lawsuit filed against us alleging breach of contract. We have agreed to a proposed settlement, which is subject to regulatory approval by the Department. In connection with the proposed settlement, we have voluntarily suspended rescissions of coverage related to loans originated by Countrywide and that would be included in the settlement. We cannot predict whether the Department will approve this settlement or the impact on Triad if the Department fails to approve the settlement and the litigation is restarted. See "Legal Proceedings" elsewhere in this Form 10-Q.

Business Summary

We have historically provided Primary and Modified Pool mortgage guaranty insurance coverage on U.S. residential mortgage loans. We classify a policy as Primary insurance when the policy is not part of a structured bulk transaction that includes an aggregate stop-loss limit applied to the entire group of loans. We classify all other insurance as Modified Pool insurance. Policies insured as part of a Modified Pool transaction have individual coverage but there is an aggregate stop-loss limit applied to the entire group of insured loans.

Our insurance remains effective until one of the following events occurs: the policy is cancelled at the insured's request; we terminate the policy for non-payment of premium; the policy defaults and we satisfy our obligations under the insurance contract; or we rescind or deny coverage under the policy for violations of provisions of a master policy. Additionally, coverage may be cancelled on certain Modified Pool transactions if pre-determined aggregate stop loss limits are met, or if coverage is reduced to a de minimus amount of the initial amount insured or, for some contracts, ten years from the date of the contract.

Persistency, which measures the percentage of insurance in force remaining from one-year prior, is an important metric in understanding our future premium revenue. The longer a policy remains on our books, or "persists", the greater the amount of total premium revenue we will earn from the policy.

In run-off, our revenues principally consist of earned renewal premiums, which are reported net of reinsurance premiums ceded to captive reinsurers and premium refunds paid or accrued related primarily to rescissions, and investment income. We also realize investment gains and investment losses on the sale and impairment of securities, with the net gain or loss reported as a component of revenue.

In run-off, our expenses consist primarily of: settled claims (including loss adjustment expenses) net of any losses ceded to captive reinsurers; changes in reserves for estimated future claim payments on loans that are currently in default (including new defaults that are reported during the period) net of any reserves ceded to captive reinsurers; general and administrative costs of servicing existing policies; other general business expenses; and interest expense on the DPO.

As we are operating in run-off and are issuing no new insurance commitments, our future results of operations largely depend on the amount of future premium that we earn less the amount of losses that we incur each period on the new defaults reported to us. In addition, our results may be significantly impacted by the favorable or adverse development of our loss reserves. Our results from operations will benefit if we are able to settle our loss reserves at a lesser amount than that reported on our balance sheet through loss mitigation, litigation and settlements with servicers. Conversely, our results from operations will be negatively impacted if the settled losses are greater than the loss reserves provided. Our results of operations also depend on a number of other factors, many of which are not under our control. These factors include:

- the conditions of the housing, mortgage and capital markets that have a direct impact on default rates, loss mitigation efforts, cure rates, and ultimately, the amount of claims settled;
- the overall general state of the economy and job market;
- persistency levels on our remaining insurance in force; and
- operating efficiencies.

Our results of operations in run-off could also be impacted by Federal government and private initiatives to limit foreclosures through loan modifications, refinancing mortgages at lower interest rates, or debt forgiveness. See the discussion below for further details on these initiatives. Lastly, our results of operations in run-off could be materially affected by our ability to recognize benefits from our NOL carryforwards.

Accounting Principles

To better comprehend our financial position and results of operations, it is important to understand the difference between accounting principles generally accepted in the United States of America ("GAAP") and statutory accounting principles ("SAP") applicable to insurance companies and how we use these accounting principles.

As an insurance company, Triad is required to file financial statements prepared in accordance with SAP with the Department as well as the insurance departments of the states in which it conducts business. The financial statements for Triad that are provided to the Department and that form the basis for our corrective plan required by the Corrective Orders are prepared in accordance with SAP as set forth in the Illinois Insurance Code or prescribed by the Department. However, the Company prepares its financial statements presented in this Quarterly Report on Form 10-Q and in our other SEC filings in conformity with GAAP. The primary difference between GAAP and SAP for Triad at September 30, 2012 was the reporting requirements relating to the establishment of the DPO stipulated in the second Corrective Order, which is described below.

A deficit in assets occurs when recorded liabilities exceed recorded assets in financial statements prepared under GAAP. A deficiency in policyholders' surplus occurs when recorded liabilities exceed recorded assets in financial statements prepared under SAP. A deficit in assets at any particular point in time under GAAP is not necessarily a measure of insolvency. However, we believe that if Triad were to report a deficiency in policyholders' surplus under SAP for an extended period of time, Illinois law may require the Department to seek receivership of Triad, which could compel TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or otherwise consider dissolution of the Company. The second Corrective Order was designed in part to help Triad maintain its policyholders' surplus.

Corrective Orders

Triad has entered into two Corrective Orders with the Department as detailed below and in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Among other things, the Corrective Orders:

- Require oversight by the Department on substantially all operating matters;
- Prohibit stockholder dividends from Triad to TGI without the prior approval of the Department;
- Prohibit the accrual of interest and the payment of interest and principal on Triad's surplus note to TGI without the prior approval of the Department;
- Restrict Triad from making any payments or entering into any transaction that involves the transfer of assets to, or liabilities from, any affiliated parties without the prior approval of the Department;
- Require Triad to obtain prior written approval from the Department before entering into certain transactions with unaffiliated parties;
- Require that all valid claims under Triad's mortgage guaranty insurance policies are settled 60% in cash and 40% by recording a DPO;
- Require the accrual of simple interest on the DPO at the same average net rate earned by Triad's investment portfolio; and
- Require that loss reserves in financial statements prepared in accordance with SAP be established to reflect the cash portion of the estimated claim settlement but not the DPO.

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The DPO is an interest-bearing subordinated obligation of Triad with no stated repayment terms. The second Corrective Order requires that Triad hold assets to support the DPO liability in a separate account pursuant to a custodial arrangement. As previously mentioned, Triad is currently not in compliance with this provision of the second Corrective Order. See "Pending Regulatory Matters" above for more information.

The recording of a DPO does not impact reported settled losses as we continue to report the entire amount of a claim in our statements of comprehensive loss under both bases of accounting. The accounting treatment for the recording of DPOs on our balance sheet on a SAP basis is similar to a surplus note that is reported as a component of statutory surplus, which serves to increase reported statutory surplus. However, in our financial statements prepared in accordance with GAAP included in this report, the DPOs and related accrued interest are reported as a liability. At September 30, 2012, the cumulative effect of the DPO requirement on statutory policyholders' surplus, including the impact of establishing loss reserves at anticipated cash payment rather than the estimated full claim amount, was to increase statutory policyholders' surplus by $1.1 billion over the amount that would have been reported absent the second Corrective Order. The cumulative increase to statutory policyholders' surplus of the DPO requirement was $967.5 million at December 31, 2011. There was no such impact to loss reserves or stockholders' deficit calculated on a GAAP basis which is the primary reason for the reported deficit in assets. Any repayment of the DPO or the associated accrued interest is dependent on the financial condition and future prospects of Triad and is subject to the approval of the Department.

The second Corrective Order provides financial thresholds, specifically regarding the statutory risk-to-capital ratio and the level of statutory policyholders' surplus that, if met, may indicate that the Department should reduce the DPO percentage and/or require distributions to DPO holders. In January 2012, the Department notified Triad that as of December 31, 2011, based upon Triad's surplus position, risk-to-capital ratio and the continued economic uncertainty, the Department determined that no change to the DPO percentage was in order nor would it be appropriate for Triad to make a distribution to the DPO holders.

Failure to comply with the provisions of the Corrective Orders or any other violation of the Illinois Insurance Code may result in the imposition of fines or penalties or subject Triad to further legal proceedings, including the institution by the Department of receivership proceedings for the conservation, rehabilitation, or liquidation of Triad. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or otherwise consider dissolution of the Company. See Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

Triad is also subject to comprehensive regulation by the insurance departments of the various other states in which it is licensed to transact business. Currently, the insurance departments of the other states have been working with the Department in the administration and oversight of the Corrective Orders.

Going Concern

We have prepared our financial statements on a going concern basis under GAAP, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. However, there is substantial doubt as to our ability to continue as a going concern. This uncertainty is based on, among other things, Triad's current non-compliance with a provision of the Corrective Orders, the possible failure of Triad to comply with other provisions of the second Corrective Order, and our ability to generate enough income over the term of the remaining run-off to overcome our $802.8 million deficit in assets at September 30, 2012.

The positive impact on statutory surplus resulting from the second Corrective Order has resulted in Triad reporting a policyholders' surplus in its SAP financial statements of $224.1 million at September 30, 2012, as opposed to a deficiency in policyholders' surplus of $834.5 million on the same date had the second Corrective Order not been implemented. While the implementation of the second Corrective Order has deferred the institution of an involuntary receivership proceeding, no assurance can be given that the Department will not seek receivership of Triad in the future and there continues to be substantial doubt about our ability to continue as a going concern.

The Department may seek receivership of Triad based on Triad's current non-compliance with a provision of the second Corrective Order or for any other violation of the Illinois Insurance Code. Moreover, if the Department determines that Triad is insolvent under applicable law, it would be required to institute a receivership proceeding over Triad. In addition, the Department retains the inherent authority to institute such proceedings against Triad for any reason and Triad has previously agreed not to contest the taking of any such actions.

As of the date of this Form 10-Q, the Department has not issued any final decision or order as a result of the public hearing and Triad's request to amend the second Corrective Order. Because the subject matter of the hearing specifically included an assessment of whether the Department should implement a different regulatory approach with respect to Triad, including institution of receivership proceedings for the conservation, rehabilitation or liquidation of Triad, we believe institution of such a proceeding could be imminent. If this should occur, among other things, TGI could lose control of Triad and we could be forced to deconsolidate our financial statements. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or take other steps to wind up its business and liquidate. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information. The consolidated financial statements that are presented in this report do not include any accounting adjustments that reflect the financial risks of Triad entering receivership proceedings or otherwise not continuing as a going concern.

Foreclosure Prevention Initiatives and Moratoriums

Several programs have been initiated by the federal government, the GSEs, and certain lenders that are, in general, designed to prevent foreclosures and provide relief to homeowners. These programs may involve modifications to the original terms of existing mortgages or their complete refinancing. These programs seek to provide borrowers a more affordable mortgage by modifying the interest rate, extending the term of the mortgage or, in limited cases, reducing the principal amount of the mortgage. We are active participants in many of these programs, including government-initiated programs such as the Home Affordable Modification Program ("HAMP") and the Home Affordable Refinance Program ("HARP").

HAMP provides incentives to borrowers, servicers, and lenders to modify loans that are currently in default. HAMP and other such programs have been responsible for a large percentage of our cures since 2009. The number of policies cured under these programs declined in 2011 from levels experienced in 2010; however, recent changes to these programs have proven beneficial. HAMP was scheduled to expire at the end of 2012, but the U.S. government has extended the program until December 2013.

A number of the borrowers that have completed the trial modification period have subsequently re-defaulted and we believe the number of borrowers that re-default will increase in the future, especially if the economic recovery stalls or moves slowly. This could be exacerbated by additional deterioration in the housing market or economy in general. The ultimate impact of HAMP and other modification programs is dependent on the number of borrowers that successfully modify their loans and do not re-default. Currently, we are unable to estimate with any degree of precision the number of policies that will ultimately cure and not re-default and are, therefore, unable to estimate the ultimate impact of these programs on our results of operations and financial condition. If HAMP or similar programs prove to be effective in preventing ultimate foreclosure, future settled claim activity could be reduced.

If a loan is modified as part of one of these programs, the previously reported default would be cured, but we would maintain insurance on the loan and would be subject to the same ongoing risk if the policy were to re-default. Policies that re-default under these programs may ultimately result in losses that are greater than the loss that would have occurred if the policy were never modified. However, we do not provide loss reserves to account for the potential for re-default. These programs could adversely affect us to the degree that borrowers who otherwise could make their mortgage payment choose to default in an attempt to become eligible for modification.

HARP was launched in 2009 and revised in the third quarter of 2011. This program is designed to provide a borrower who is current on all mortgage payments with the opportunity to take advantage of existing lower interest rates through a refinancing that would make the loan more affordable. We do not expect the revised HARP program will have a significant impact on our short-term results because: (i) these loans must not be in default to qualify; and (ii) we would continue to provide mortgage insurance on the refinanced loan.

Foreclosure moratoriums typically serve to temporarily reduce our claims settled because the completion of a valid foreclosure is a requirement for the filing of a claim for loss. However, such programs may lead to greater ultimate claim costs due to the accrual of interest and other expenses. While moratoriums have delayed our claims settled in recent years and increased the time a policy remains in our default inventory and may continue to do so, we do not expect a significant direct impact on our results of operations or financial condition from foreclosure moratoriums.

In February 2012, the federal government and state attorneys general reached a $25 billion settlement agreement with five of the nation's largest banks regarding claims that alleged, among other things, improper foreclosure practices. The funds generally will be used for principal reductions, refinancing underwater mortgages, forbearance and short sales, and foreclosure prevention programs. The banks have three years to implement the settlement agreement. A great deal of uncertainty currently remains over how the program will be implemented as well as borrower eligibility, but currently we do not believe the settlement will have a meaningful impact on our future results of operations or financial condition.

See Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011 for more information on the risks and uncertainties associated with foreclosure moratoriums.

Consolidated Results of Operations

Following is selected financial information for the three months and nine months ended September 30, 2012 and 2011:

(dollars in thousands, except per share data)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	% Change	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011	% Change
Earned premiums	$26,727	$49,719	(46)	$98,024	$122,241	(20)
Net losses and loss adjustment expenses	54,026	87,842	(38)	190,192	170,847	11
Net loss	(33,335)	(37,529)	11	(102,364)	(46,837)	(119)
Diluted loss per share	(2.17)	(2.46)	12	(6.68)	(3.07)	(118)

The financial results for the three months and nine months ended September 30, 2012 as compared to the same period of 2011 were affected by the following:

- A significant decline in earned premium during the third quarter of 2012 compared to the respective period of 2011 due to a 22% decline in average insurance in force coupled with a substantial negative impact of premium refunds in the 2012 third quarter. Additionally, earned premium in the 2011 third quarter benefitted from a $9.3 million accrual for the net present value of the future premiums for Modified Pool transactions where contractual aggregate stop-loss limits in specific contracts were reached on a settled basis compared to only a $0.8 million accrual in the 2012 third quarter for such contracts.
- A decline in investment income for both comparable periods due to declines in average invested assets and lower realized yields.
- A significant decrease in net losses and loss adjustment expenses ("LAE") during the 2012 third quarter compared to the third quarter of 2011, primarily due to a smaller impact from new default activity. The increase in net losses and LAE for the first nine months of 2012 compared to the one year prior period was primarily due to reserve factor changes.
- An increase in other operating expenses in the third quarter of 2012 and first nine months of 2012 primarily due to increases in the reserve for expected contract underwriting remedies.

We describe our results of operations in greater detail in the discussion that follows. The information is presented in four sub-headings: Production; Insurance and Risk in Force; Revenues; and Losses and Expenses.

Production

On July 15, 2008, we ceased issuing commitments for mortgage insurance, only issuing coverage to borrowers for which we had made a commitment as of that date. We have had no material production since 2008.

Insurance and Risk in Force

The term "Insurance in force" is described as the total principal balance of our insured loans. Net risk in force is computed by applying the various percentage settlement options to the insurance in force amounts, adjusted by risk ceded under reinsurance agreements on Primary coverage and applicable stop-loss limits and deductibles on Modified Pool coverage, but before accounting for carried loss reserves. The following table provides detail on our direct insurance in force at September 30, 2012 and 2011:

(dollars in thousands)	September 30, 2012	2011	% Change
Primary insurance	$20,826,479	$25,362,615	(18)
Modified Pool insurance	4,430,601	7,090,306	(38)
Total insurance	$25,257,080	$32,452,921	(22)

The decline in Primary insurance in force over the twelve month period ended September 30, 2012 is due to cancellation of insurance coverage, which includes cancellations resulting from claim settlement and rescission activity. The decline in Modified Pool insurance in force for the same period was also affected by the termination of a number of Modified Pool transactions where pre-determined aggregate stop loss limits in the contracts were met on a settled basis.

Primary insurance persistency was 82.1% at September 30, 2012 compared to 82.3% at September 30, 2011. Modified Pool insurance persistency decreased to 62.5% at September 30, 2012 compared to 67.0% at September 30, 2011. Modified Pool persistency is subject to significant changes between periods due primarily to the timing and size of Modified Pool transactions reaching their pre-determined aggregate stop loss limits on a settled basis. We believe our persistency has benefited from the temporary delays in foreclosures as well as the inability of many borrowers on loans that we have insured to sell or refinance existing homes due to the decline in home prices and stricter underwriting standards.

A portion of our Modified Pool contracts contain provisions that terminate both the coverage and the contract when cumulative settled losses reach the stop loss limit. No future premium is received following the termination of these Modified Pool contracts. During the first nine months of 2012, approximately $152 million of Modified Pool insurance in force under this type of contract was terminated compared to approximately $390 million during the same period of 2011.

The majority of our Modified Pool contracts do not terminate when settled losses reach the stop loss limit and premiums will continue to be collected until such time that the remaining insurance in force is reduced to a de minimus amount or, in some cases, ten years from the date of the contract. For these types of contracts, we recognize the net present value of the estimated future premium in the period during which our settled losses reach the stop loss limit. During the first nine months of 2012, approximately $612 million of Modified Pool insurance in force under this type of contract was terminated compared to approximately $1.5 billion during the same period of 2011. For both types of Modified Pool contracts, affected policies are excluded from in force statistics once the contractual stop loss limit is met on a settled basis. We expect that other Modified Pool transactions will reach their contractual stop loss limits on a settled basis which will further accelerate the decline of our Modified Pool insurance in force.

Approximately 61% of our Modified Pool insurance in force was originated from 2005 through 2007. Given the adverse development of our Modified Pool insurance originated in these years, the majority of these transactions have already reached the stop loss limit on an incurred basis. As the following table indicates, under our Modified Pool contracts, we have limited loss exposure for future defaults, or changes in loss reserves on existing defaults, from contracts originated from 2005 through 2007. The majority of our exposure on Modified Pool insurance is with transactions originated in 2004 and prior years and, given the performance to date for these policy years, we expect losses from Modified Pool insurance to have significantly less bearing on our future results compared to our Primary business.

	September 30,	
(dollars in thousands)	2012	2011
Modified Pool Summary		
Net risk in force (1)	$296,681	$375,124
Carried reserves on net risk in force	99,163	125,769
Remaining aggregate loss exposure on Modified Pool contracts	$197,518	$249,355
Remaining Aggregate Loss Exposure by Policy Year		
2003 and Prior	$101,628	$112,126
2004	55,800	60,454
2005	4,053	5,457
2006	34,693	64,179
2007	1,344	7,139
	$197,518	$249,355

(1) Net risk in force for Modified Pool business reflects the remaining stop loss limits for Modified Pool transaction less any remaining deductible amount.

Total net risk in force was $5.7 billion at September 30, 2012 compared to $6.9 billion at September 30, 2011. Primary insurance accounted for approximately 95% of our net risk in force at September 30, 2012 compared to 94% at September 30, 2011. The following table provides detail on our Primary risk in force, net of risk ceded to captives.

	September 30,		%
(dollars in thousands)	2012	2011	Change
Gross Primary risk in force	$5,489,499	$6,644,811	(17)
Less: Ceded risk in force	(74,575)	(99,987)	25
Net Primary risk in force	$5,414,924	$6,544,824	(17)

The percentage of our Primary insurance in force subject to captive reinsurance arrangements was 9.9% at September 30, 2012 and assets held in trusts supporting the reinsured risk was $36.3 million. Certain remaining captive reinsurance agreements have trust balances below the reserves ceded under the contracts. In those cases, the net reserve credit that we recognize in our financial statements is limited to the trust balance. Given this limitation, as well as the decline in insurance in force subject to captive reinsurance, we expect to only receive limited benefits in future periods from these agreements.

At September 30, 2012, approximately 17% of our gross Primary risk in force was comprised of coverage on loans with the potential for negative amortization ("pay-option ARM") and interest only loans. An inherent risk in these types of loan products is the impact of the scheduled milestone in which the borrower must begin making amortizing payments, which can be substantially greater than the minimum payments required before the milestone is met. An additional risk to a pay-option ARM loan is that the payment being made may be less than the amount of interest accruing, creating negative amortization on the outstanding principal of the loan. The majority of our pay-option ARM loan portfolio has accumulated negative amortization and we believe these pay-option ARM loans have been or will be subject to significant payment shock, which increases our risk of loss.

At September 30, 2012, approximately 15% of our gross Primary risk in force is comprised of coverage on "Alt-A" loans. We define Alt-A loans as loans that have been underwritten with reduced or no documentation verifying the borrower's income, assets, or employment and where the borrower has a FICO score greater than 619. Due in part to depressed conditions in the housing markets, the Alt-A loans, pay-option ARM loans, and interest-only loans have, as a group, performed significantly worse than the remaining prime fixed rate loans.

Business originated in 2005, 2006, and 2007 comprise the majority of our risk in force. In general, policies originated during these years have exhibited higher default rates and claim rates than preceding vintage years. In addition, these policy years have significantly higher amounts of average risk per policy than policies originated prior to 2005. For additional information regarding these vintage years, see "Losses and Expenses," below.

Revenues

A summary of the individual components of our revenue for the third quarter and first nine months of 2012 and 2011 follows:

(dollars in thousands)	Three Months Ended September 30, 2012	2011	% Change	Nine Months Ended September 30, 2012	2011	% Change
Direct premium written before the impact of refunds	$37,160	$58,408	(36)	$122,261	$163,748	(25)
Less:						
Cash refunds primarily related to rescissions	(16,327)	(7,944)	(106)	(40,446)	(36,865)	(10)
Change in refund accruals primarily related to rescissions	5,820	(193)	3,116	18,935	(1,275)	1,585
Direct premium written	26,653	50,271	(47)	100,750	125,608	(20)
Less ceded premium	(1,165)	(1,579)	26	(3,719)	(4,796)	22
Net premium written	25,488	48,692	(48)	97,031	120,812	(20)
Change in unearned premiums	1,239	1,027	21	993	1,429	(31)
Earned premiums	$26,727	$49,719	(46)	$98,024	$122,241	(20)
Net investment income	$5,455	$7,364	(26)	$17,438	$23,981	(27)
Net realized investment gains	$103	$1,349	(92)	$1,083	$3,913	(72)
Total revenues	$32,289	$58,442	(45)	$119,065	$150,201	(21)

The decrease in direct premium written before the impact of refunds was primarily due to the decline in insurance in force over the previous twelve months. Additionally, we accrue the net present value of the estimated premium stream for certain Modified Pool transactions where we continue to receive premium income once the transaction reaches its stop loss on a settled basis. As a result of such Modified Pool transactions reaching their respective stop loss limit on a paid basis and the establishment of the accrual, reported earned premium during the third quarter of 2011 increased by $9.3 million compared to an increase of only $0.8 million during the third quarter of 2012.

Premium refunds, primarily related to rescission activity, include cash premiums refunded as well as the change in the accrual for expected premium refunds. Cash premiums refunded is dependent on the number of policies rescinded and the amount previously collected while the accrual for expected premium refunds is dependent on our future expectations for these items. Rescission activity was significant in the third quarter of 2012 and resulted in a large amount of premium refunds. Rescission activity in the third quarter of 2012 was concentrated with a specific originator whose policies in general have higher average loan balances and premium rates, which contributed to this increase. The accrual we have established for expected premium refunds, which is reported in "Accrued expenses and other liabilities" on our Consolidated Balance Sheets, was $13.7 million at September 30, 2012, down from $19.5 million at June 30, 2012 and $30.9 million at September 30, 2011. The impact of premium refunds on our financial statements going forward will be determined primarily by our expectations for future cash premium refunds and the number of policies for which we retain the right to rescind coverage. We expect rescissions and cash premium refunds to continue to be strong in the fourth quarter of 2012 and then decline significantly during 2013.

Ceded premium written is comprised of premiums written under excess of loss reinsurance treaties with captive reinsurers. Ceded premium continues to decline as the amount of insurance in force subject to captive reinsurance declines. Ceded premium in the third quarter of 2012 declined by 26% when compared to the one year-prior period and 6% on a sequential basis.

Net investment income declined in the third quarter and first nine months of 2012 compared to the respective periods in 2011 primarily due to a decline in invested assets as well as a decline in investment yield. We expect invested assets to continue to decline for the foreseeable future as we anticipate funding our deficit in operating cash flow with the proceeds from the maturity and sale of these assets. Settlements of certain liabilities could result in large one-time payments which would hasten the decline in invested assets. For further discussion, see "Investment Portfolio."

Losses and Expenses

A summary of the significant individual components of losses and expenses for the three month and nine month periods ended September 30, 2012 and 2011 follows:

	Three Months Ended September 30,		%	Nine Months Ended September 30,		%
(dollars in thousands)	2012	2011	Change	2012	2011	Change
Net losses and loss adjustment expenses:						
Net settled claims	$87,858	$132,545	(34)	$293,123	$351,037	(16)
Net change in loss reserves	(34,905)	(44,192)	21	(106,460)	(181,638)	41
Loss adjustment expenses	1,073	(511)	310	3,529	1,448	144
Total	54,026	87,842	(38)	190,192	170,847	11
Other operating expenses	6,451	4,450	45	16,171	14,065	15
Interest expense, including interest on the deferred payment obligation	5,147	4,813	7	15,066	13,260	14
Total losses and expenses	$65,624	$97,105	(32)	$221,429	$198,172	12
Loss ratio	202.1 %	176.7 %		194.0 %	139.8 %	
Expense ratio	25.3 %	9.1 %		16.7 %	11.6 %	
Combined ratio	227.5 %	185.8 %		210.7 %	151.4 %	

Net losses and LAE are comprised of settled claims, LAE, and the change in the loss and LAE reserve during the period. The decrease in net losses and LAE during the third quarter of 2012 compared to the respective period of 2011 was due to a lower amount of new risk in default. The increase in net losses and LAE in the first nine months of 2012 compared to the respective period of 2011 was primarily due to reserve factor changes made based on loss development trends and future expectations, offset somewhat by lower amounts of new risk in default during the first nine months of 2012 compared to the respective period of 2011. For the first nine months of 2011, incurred losses were reduced by approximately $30.5 million due to reserve factor changes, whereas for the same period of 2012, changes to reserve factors increased incurred losses by approximately $11.6 million. The increase in incurred losses in the first nine months of 2012 due to reserve factor changes primarily resulted from a decrease in the expected rescission factor for policies being investigated for possible underwriting violations.

The following table presents a roll-forward of our Primary risk in default for the three month and nine month periods ended September 30, 2012 and 2011. Risk in default includes the risk in force for all reported delinquencies that are in excess of two payments in arrears at the reporting date and the risk in force for all reported delinquencies that were previously in excess of two payments in arrears that have not been brought current. For the three month and nine month periods ended September 30, 2012, Primary new risk in default has declined considerably compared to the comparable prior-year periods.

(dollars in thousands)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	% Change	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011	% Change
Beginning risk in default	$1,017,534	$1,314,262	(23)	$1,195,911	$1,555,499	(23)
Plus: New risk in default	131,784	187,518	(30)	412,323	577,555	(29)
Less: Paid risk in default	(74,586)	(93,637)	20	(239,794)	(262,719)	9
Rescinded/Denied risk in default (1)	(72,773)	(61,807)	(18)	(193,291)	(274,214)	30
Cured risk in default	(78,408)	(92,745)	15	(251,598)	(342,530)	27
Ending risk in default	$923,551	$1,253,591	(26)	$923,551	$1,253,591	(26)

(1) The majority of amounts included in "Rescinded/Denied risk in default" is comprised of risk on policies that were rescinded.

The cure rate (cured risk in default as a percentage of beginning risk in default) for Primary risk in default increased to 7.7% for the third quarter of 2012 compared to 7.1% in both the second quarter of 2012 and in the third quarter of 2011. Cures result when a delinquent borrower makes all past due mortgage payments. Cures are most likely to occur while the default is in its early stage and the borrower has missed only a few payments. In general, our expectation for a cure decreases as the underlying mortgage becomes further delinquent. The average age of the total default inventory has increased over the past year due in part to continued delays in foreclosure activity and other factors slowing settled claim activity. At September 30, 2012, the weighted average number of payments missed on loans in default was 19.6 compared to 16.7 payments missed at September 30, 2011.

The following table presents the distribution of Primary risk in default at September 30, 2012 and 2011 by the number of payments for which the borrower is in default. The most significant increase has been with policies that have missed more than 30 payments.

	September 30, 2012	2011
Primary Business		
0 - 3 payments	9.5 %	9.4 %
4 - 6 payments	13.3	14.0
7 - 9 payments	10.4	10.9
10 - 12 payments	9.5	10.0
13 - 15 payments	8.1	9.4
16 - 18 payments	6.2	8.4
19 - 21 payments	5.1	7.1
22 - 30 payments	12.0	15.2
More than 30 payments	25.9	15.6
	100.0%	100.0%

HAMP and other lender loan modification programs have contributed to cure activity, including cures on policies that have been in default for more than 12 months. However, the benefit we have received from these programs has generally declined as the number of policies eligible for the programs has declined.

Rescission activity continues to mitigate our level of loss reserves and settled losses. During the third quarter of 2012, we rescinded coverage on Primary policies with $65.8 million of risk in force compared to $51.4 million of risk in force during the second quarter of 2012 and $52.3 million in the third quarter of 2011. The rescission rate during the third quarter of 2012 was consistent with our expectations, although the level of activity increased during the quarter, which resulted in the larger amount of risk being rescinded. We expect rescission activity and the resulting impact on our level of incurred losses to continue in the fourth quarter of 2012 and decline significantly in 2013 as we complete the current investigations. Additionally, some of the recent rescission activity has come from Modified Pool deals where the stop loss is expected to be reached over the next year. We believe the majority of the rescinded risk in default would have ultimately resulted in settled claims. See Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011 for risks and uncertainties associated with rescission activity.

The following table details the amount of Primary risk in default and the Primary reserve balance as a percentage of risk in default at September 30, 2012 and 2011. Primarily due to the increase in the average age of the default inventory and a lower percentage of risk in default that is projected to be rescinded in the future, the gross case reserves, net of expected rescissions, expressed as a percentage of gross risk in default has increased to 66% at September 30, 2012 compared to 57% one-year prior. The table also provides the impact of the rescission factor, which is a component of the frequency factor utilized in the reserve model, on gross case reserves at the respective period end, and illustrates the expected decline in rescission activity compared to previous levels.

(dollars in thousands)	September 30, 2012	September 30, 2011
Primary Business		
Gross risk on loans in default	$923,551	$1,253,591
Risk expected to be rescinded on loans in default	(104,704)	(224,138)
Risk in default net of expected rescissions	$818,847	$1,029,453
Gross case reserve (1)	$685,076	$879,825
Gross case reserves on loans expected to be rescinded	(72,186)	(166,314)
Gross case reserves net of expected rescissions	$612,891	$713,512
Gross case reserves net of expected rescissions as a percentage of gross risk in default	66.4 %	56.9 %
Gross case reserves net of expected rescissions as a percentage of gross risk in default, net of expected rescissions	74.8 %	69.3 %
Percentage decrease in gross case reserves from rescission factor	10.5 %	18.9 %

(1) Reflects gross case reserves, which excludes IBNR and ceded reserves.

The following table provides details on both the dollar amount and average settled claim amount of both Primary and Modified Pool insurance for the periods ended September 30, 2012 and 2011:

(dollars in thousands)	Three Months Ended September 30, 2012	2011	% Change	Nine Months Ended September 30, 2012	2011	% Change
Net settled claims:						
Primary insurance	$80,484	$101,290	(21)	$260,976	$283,511	(8)
Modified Pool insurance	9,760	34,777	(72)	39,476	85,127	(54)
Total direct settled claims	90,244	136,067	(34)	300,452	368,637	(18)
Ceded paid losses	(2,386)	(3,522)	32	(7,329)	(17,600)	58
Total net settled claims	$87,858	$132,545	(34)	$293,123	$351,038	(16)
Average settled claim:						
Primary insurance	$51.6	$56.5	(9)	$53.6	$54.9	(2)
Modified Pool insurance	$50.2	$66.7	(25)	$55.6	$63.2	(12)

We believe that settled claim activity in all periods presented has been slowed due to delays in foreclosure proceedings resulting from, among other factors, the required judicial process in many states. Settled claim activity has also been affected by other factors including our investigation of policies for underwriting violations. Settled claim activity for Modified Pool insurance has been significantly affected by the number of Modified Pool transactions reaching their respective stop loss level on a settled basis.

As shown in the table below, the average risk in default per policy has declined over the past year, which has led to the decline in the average settled claim amount.

(dollars in thousands)	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011
Average risk in default:					
Primary insurance	$ 49.9	$51.1	$51.5	$ 51.9	$ 52.2
Modified Pool insurance	$ 52.3	$53.6	$54.7	$ 55.1	$ 55.7

Based on the decline in average risk in default, we expect the average settled claim for both Primary and Modified Pool insurance to trend downwards in the future, although average severity can fluctuate quarter to quarter depending on a number of factors including policy year, geography, and average coverage of the settled claim inventory. Modified Pool average severity is subject to greater volatility given the relatively small number of settled claims.

Another factor affecting average severity on settled claims is our ability to mitigate claims. Historically, the sale of properties by the borrower either before or during the foreclosure process was effective in reducing average severity. However, the decline in home prices since 2007 across almost all markets combined with reduced mortgage credit availability has continued to negatively impact our ability to mitigate losses from sales of properties. Policies originated in 2006 and 2007 have been particularly impacted by the decline in home prices because the properties were acquired by the borrowers at the peak of the market. We expect our ability to mitigate losses will continue to be adversely affected by these factors.

In 2007, we identified Arizona, California, Florida, and Nevada as distressed states given the dramatic increase in default rates we witnessed during that year for those states. In addition, as these states had previously experienced some of the largest home price appreciation prior to 2007, home prices began to fall dramatically for these states in 2007. These states have also accounted for a large percentage of our claims settled since 2007, in part due to the higher average loan amount of policies originated in these states. However, home price depreciation has been experienced in almost all states since 2007 and the recessionary employment environment combined with the general lack of mortgage credit has subsequently adversely impacted a number of states for which we have a high concentration of risk in force. The table below presents the dispersion of our Primary risk in force for our top ten states and the associated Primary default rate. Performance in states and within states can vary significantly depending on, among other factors, local economic conditions, house price levels, credit availability, and bankruptcy and foreclosure laws.

	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011
Percent of Primary Risk in Force:					
Florida	9.3 %	9.4 %	9.6 %	9.7 %	9.7 %
Texas	8.6	8.7	8.7	8.7	8.7
California	7.0	7.1	7.2	7.4	7.5
North Carolina	5.4	5.4	5.4	5.4	5.3
Illinois	4.8	4.8	4.7	4.7	4.6
Georgia	4.5	4.4	4.4	4.4	4.4
New Jersey	3.9	3.8	3.8	3.7	3.6
Virginia	3.6	3.6	3.5	3.5	3.5
Pennsylvania	3.5	3.4	3.4	3.4	3.4
Arizona	3.2	3.2	3.3	3.3	3.4
All Other	46.2	46.2	46.0	45.8	45.9
Total Risk in Force	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %
Primary Default Rate:					
Florida	29.1 %	29.9 %	31.2 %	31.9 %	31.8 %
Texas	6.1	6.4	6.5	6.8	6.7
California	17.4	19.5	21.3	22.5	23.4
North Carolina	10.6	10.5	11.3	11.8	11.7
Illinois	22.3	22.6	22.9	23.1	22.4
Georgia	10.7	11.1	11.4	12.0	12.7
New Jersey	25.4	24.7	25.1	24.3	22.7
Virginia	9.4	9.4	9.4	10.1	9.9
Pennsylvania	14.1	13.5	13.4	13.3	12.7
Arizona	13.7	15.7	17.4	18.8	19.6
All Other	12.7	12.8	13.0	13.4	13.3
Total Default Rate	14.1	14.4	14.9	15.2	15.2

The table below presents the dispersion of Primary risk in force by policy year and the associated Primary default rate. The 2005 – 2007 policy years comprise the majority of our risk in force and also have the highest defaults rate. However, policies originated prior to 2005 have also exhibited elevated default rates when compared to historical norms and are subject to many of the same conditions that have affected the performance of the 2005 – 2007 policy years. The recent lower default rate trends in the 2005 – 2007 policy years is primarily due to settled claim and rescission activity rather than actual improvements though cures or other sources.

	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011
Percent of Primary Risk in Force:					
2003 and prior	11.0 %	11.3 %	11.7 %	12.0 %	12.5 %
2004	8.6	8.7	8.8	8.8	8.8
2005	13.9	13.9	13.8	13.8	13.8
2006	19.8	19.8	19.8	19.8	19.8
2007	39.5	39.2	39.0	38.7	38.3
2008	7.2	7.1	6.9	6.9	6.8
Total Risk in Force	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %
Primary Default Rate:					
2003 and prior	9.8 %	9.6 %	9.4 %	9.5 %	9.4 %
2004	12.8	12.4	12.7	12.7	12.6
2005	16.7	16.6	17.1	17.4	17.0
2006	16.3	17.3	18.2	19.0	19.5
2007	15.5	16.2	17.0	17.7	17.7
2008	9.9	10.0	10.1	10.1	10.1
Total Default Rate	14.1	14.4	14.9	15.2	15.2

The table below provides a trend analysis of the gross cumulative incurred loss incidence rate by book year for our Primary business (calculated as cumulative gross losses settled plus loss reserves, excluding the impact of captive structures, divided by policy risk originated, in each case for a particular book year) as it has developed during each of the last five quarters.

	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011
Book Year:					
2003 and prior	2.06 %	2.03 %	2.01 %	2.00 %	1.97 %
2004	7.26	7.17	6.97	6.86	6.65
2005	17.48	17.14	16.60	16.22	15.57
2006	18.13	17.89	17.46	16.88	16.49
2007	17.33	17.06	16.48	15.83	15.07
2008	8.50	8.09	7.78	7.23	6.55
Total	8.30	8.17	7.94	7.71	7.43

In addition to depressed economic conditions since 2007 and the general lack of credit in the mortgage market, we believe the adverse performance of our insured portfolio has been due, in part, to non-sustainable levels of home price appreciation in the years prior to 2007 and the subsequent unprecedented depreciation in home prices, combined with less restrictive underwriting standards when the loans were originated. The 2005 – 2007 policy years are also comprised of a large amount of pay-option ARM loans and Alt-A loans that have exhibited significant adverse performance.

Prior to 2007, the policies that we insured defaulted for a variety of reasons, but primarily due to loss of employment, divorce, or illness of a mortgage holder. However, because of the decline in home prices, many borrowers are now in the position where they owe more on the mortgage than the home is worth, causing some borrowers to strategically default, or stop paying the mortgage even though they are financially able to do so. Prior to 2007, strategic defaults were believed to be a minimal cause of reported defaults.

Expenses and Taxes

Other operating expenses increased in the third quarter of 2012 and first nine months of 2012 when compared to the respective periods of 2011 due to significant increases in our contract underwriting expenses. We recognized $2.8 million of expense related to our legacy contract underwriting activities during the third quarter of 2012 which was comprised of paid remedies of $0.8 million and an increase in the reserve for future contract underwriting remedies of $2.0 million, reflecting an increase in submission of indemnification requests from lenders. Contract underwriting expenses were $0.3 million in the third quarter of 2011.

Contract underwriting expenses were $5.4 million in the first nine months of 2012 which included an increase in the reserve for contract underwriting remedies of $2.9 million. The reserve increase was primarily due to an increase in anticipated remedy payments as we have received a large number of indemnification requests during 2012. These expenses totaled $2.0 million in the same period of 2011. The reserve for expected contract underwriting remedies was $10.0 million at September 30, 2012, compared to $6.0 million at September 30, 2011. The reserve for contract underwriting remedies may increase in the fourth quarter of 2012 and in 2013 as the limited period under which an indemnification request may be submitted by certain lenders is approaching an end.

Personnel related costs in the third quarter of 2012 declined by 2% compared to the third quarter of 2011. For the nine months ended September 30, 2012, personnel related costs declined by 12% compared to the comparable prior year period. The decline was primarily due to a reduction in personnel over the period and the related salary and benefit costs. Severance costs were immaterial in both the third quarter and first nine months of 2012 and 2011.

We lease office space with lease commitments through November 2012. Following the termination of our current lease in November 2012, we have entered into a new two-year sublease agreement at the same location for a substantially reduced amount of square footage.

Interest expense increased in the 2012 third quarter compared to the 2011 third quarter as the balance of the DPO liability continues to grow. Under the second Corrective Order, the interest rate utilized in the accrual of interest expense is equal to the investment yield from the investment portfolio. As previously mentioned, the Department is considering changes in the way that interest is calculated and we are awaiting their decision on this matter that could possibly impact this expense going forward. Interest accrued on the DPO liability was the only component of interest expense in both periods. The payment of the accrued interest related to the DPOs is dependent on attaining certain risk to capital and other operating ratios and is subject to approval by the Department. No amounts have been paid on the DPO since they were established in June 2009.

Because the Company has NOLs as of September 30, 2012, we are unable to obtain an immediate benefit from an operating loss. Therefore, we did not recognize an income tax benefit in the Consolidated Statements of Comprehensive Loss for the first nine months of 2012. The NOLs are calculated using the amounts reported on our income tax returns, which approximates amounts we reported under SAP as opposed to GAAP. At September 30, 2012, our NOLs totaled $779.7 million compared to $627.0 million at December 31, 2011.

Financial Position

Total assets were $820.6 million at September 30, 2012, a decrease of 8% from December 31, 2011. Total cash and invested assets decreased to $752.6 million at September 30, 2012 compared to $816.9 million at December 31, 2011.

Total liabilities were $1.6 billion at both September 30, 2012 and December 31, 2011 as a decrease in the reserve for losses and LAE was offset by an increase in the DPO liability. The reserve for losses and LAE declined to $741.8 million at September 30, 2012 from $854.2 million at December 31, 2011 while the DPO and related accrued interest increased to $765.0 million at September 30, 2012 from $629.7 million at 2011 year-end. At September 30, 2012, the aggregate amount of the DPO liability exceeded the cash and invested assets that were available for segregation in a separate account as required by the second Corrective Order. Accordingly, we were not in compliance with the second Corrective Order as of September 30, 2012 and remain in noncompliance. We expect the DPO liability to continue to increase. See 'Recent Developments and Risks' for more information on our noncompliance with the second Corrective Order and the potential implications for Triad.

If the Department determines that the DPO percentage should be reduced and/or distributions should be made to DPO holders, it would most likely result in a large cash payment by Triad, which would be funded from our invested assets. If the maturity of investments fails to provide sufficient cash flow to fund any such possible payments to DPO holders, we could be forced to liquidate securities prior to maturity, which may result in unanticipated realized investment losses. See Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

Investment Portfolio

The majority of our assets are included in our investment portfolio. Our goals for managing our investment portfolio are to preserve capital, provide liquidity as necessary for the payment of claims, and adhere to regulatory requirements, while optimizing investment returns within these constraints. We have established a formal investment policy that describes our overall quality and diversification objectives and limits, although this policy is subject to change depending on market conditions, the economic and regulatory environment, as well as our financial condition. We classify our entire investment portfolio as available-for-sale. All investments are carried on our balance sheet at fair value.

We utilize a third-party investment manager that specializes in the management of fixed income portfolios for insurance companies for investment advice, portfolio management, and investment accounting and reporting services. We utilize independent pricing services in determining the fair value of the majority of our investments and the investment manager assists in verifying the accuracy of these values. For more information on the pricing of our securities, see Note 6 to the Consolidated Financial Statements included in this document.

Our portfolio is primarily composed of taxable publicly-traded fixed income securities as well as tax-preferred state and municipal securities. Our taxable publicly-traded fixed income securities primarily include corporate debt obligations, residential mortgage-backed securities, asset-backed securities, and obligations of the U.S. Government and its agencies.

The following table reflects the composition of our investment portfolio at September 30, 2012 and December 31, 2011:

(dollars in thousands)	September 30, 2012 Fair Value	Percent	December 31, 2011 Fair Value	Percent
Fixed maturity securities:				
U. S. government and agency securities	$8,993	1.2	$14,003	1.8
Foreign government securities	10,137	1.4	10,024	1.3
Corporate debt	496,767	69.0	515,627	66.4
Residential mortgage-backed	14,793	2.1	29,316	3.8
Commercial mortgage-backed	28,738	4.0	31,558	4.1
Asset-backed	64,789	9.0	76,736	9.9
State and municipal bonds	49,037	6.8	68,974	8.9
Total fixed maturities	673,254	93.5	746,238	96.2
Short-term investments	46,452	6.5	30,102	3.8
Total securities	$719,706	100.0	$776,340	100.0

Total invested assets decreased by $56.6 million from December 31, 2011. The decrease was due to the use of cash proceeds from the sale or maturity of invested assets to fund our negative cash flow from operations although we partially funded our negative cash flow from operations from our 2011 year-end cash holdings. We anticipate negative cash flow from operations in the foreseeable future and we expect the proceeds from the maturity and sale of securities will be used to fund these anticipated shortfalls. We have attempted to structure maturities in our investment portfolio in anticipation of these funding needs. The effective duration of our fixed maturity portfolio declined to 1.7 years at September 30, 2012 from 2.2 years at December 31, 2011.

Unrealized Gains and Losses

The following table summarizes by category our unrealized gains and losses in our securities portfolio at September 30, 2012:

(dollars in thousands)	As of September 30, 2012 Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed maturity securities:				
U. S. government and agency securities	$8,825	$ 168	$-	$8,993
Foreign government securities	9,588	549	-	10,137
Corporate debt	475,907	20,860	-	496,767
Residential mortgage-backed	13,495	1,298	-	14,793
Commercial mortgage-backed	28,003	735	-	28,738
Asset-backed	64,499	290	-	64,789
State and municipal bonds	44,546	4,491	-	49,037
Total fixed maturities	644,863	28,391	-	673,254
Short-term investments	46,452	-	-	46,452
Total securities	$691,315	$ 28,391	$-	$719,706

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Given our previous substantial losses from operations, regulatory oversight of our operations, and the significant doubt regarding our ability to continue as a going concern, we may be unable to hold impaired assets for a sufficient time to recover their value. As a result, we recognized impairment losses on all securities whose amortized cost was greater than the fair value at September 30, 2012. If we believe that the recorded impairment was due to reasons other than credit related, we will amortize the difference between the impaired value and principal amount into interest income based upon the anticipated maturity date. Impairment losses during the first nine months of 2012 were immaterial compared to $2.5 million in the first nine months of 2011.

The unrealized gains are partly due to the recovery in value of previously impaired fixed income securities. These unrealized gains do not necessarily represent future gains that we will realize.

The value of our investment portfolio is in part determined by interest rates. In general, the value of our investment portfolio will move inversely to the change in interest rates. An increase in interest rates would most likely result in further impairment losses. Furthermore, if interest rates increase from the current level, we may be required to fund a negative cash flow from operations by selling securities for less than par value, which would be detrimental to our financial position. Changing conditions related to specific securities, overall market interest rates, and credit spreads, as well as our decisions concerning the timing of a sale, may also impact the values we ultimately realize.

Credit Risk

Credit risk is inherent in an investment portfolio. One way we attempt to limit the inherent credit risk in our portfolio is to maintain investments with relatively high ratings. The following table shows our investment portfolio by credit ratings.

	September 30, 2012		December 31, 2011	
(dollars in thousands)	Fair Value	Percent	Fair Value	Percent
Fixed maturity securities:				
U.S. treasury and agency bonds	$8,993	1.3	$14,003	1.9
AAA	74,643	11.1	90,936	12.2
AA	170,374	25.3	201,621	27.0
A	367,638	54.6	371,267	49.8
BBB	40,393	6.0	56,355	7.6
BB	1,954	0.3	1,759	0.2
B	204	-	283	-
CCC	1,668	0.2	1,844	0.2
CC and lower	1,433	0.2	1,762	0.2
Not rated	5,954	1.0	6,408	0.9
Total fixed maturities	$673,254	100.0	$746,238	100.0

At September 30, 2012, our fixed income portfolio included limited direct exposure to foreign governments and no direct exposure to the governments of Greece, Ireland, Italy, Portugal, or Spain, whose obligations have deteriorated in value due to sovereign debt concerns including ratings downgrades and potential debt restructuring. However, further deterioration of governments in the European Union, including potential default and ratings downgrades, could have adverse effects on the value of our fixed income portfolio, particularly the financial sector where several individual companies may have a direct interest in European Union sovereign debt.

We evaluate the credit risk of a security by analyzing the underlying credit qualities of the security. For corporate securities, we attempt to mitigate credit risk by managing exposure to different market sectors as well as individual issuers. We also seek value in enhancements provided by financial guaranty insurers to our tax-preferred state and municipal fixed income securities which may benefit the credit rating. Taxable securities generally do not have such credit enhancements and the credit rating reflects only the securities' underlying credit qualities.

Liquidity and Capital Resources

The second Corrective Order requires Triad to set aside invested assets in an escrow account in an amount equal to the combined DPO and accrued interest thereon. The second Corrective Order also requires Triad to accrue interest on the DPO at a rate equal to Triad's investment portfolio yield as defined in the second Corrective Order. At September 30, 2012, the recorded DPO, including accrued interest of $45.7 million, amounted to $765.0 million, which exceeded the cash and invested assets of Triad at that date. We previously reported to the Department that as of August 31, 2012, the aggregate amount of the DPO liability exceeded the cash and invested assets of Triad that were available for segregation in a separate account. Accordingly, Triad was not in compliance with this provision of the second Corrective Order as of August 31, 2012. We have asked the Department to amend, modify or otherwise waive compliance with this provision of the second Corrective Order. In addition, we have requested that the calculation of the interest on the DPO prescribed in the second Corrective Order be amended to limit the amount to a maximum equal to the actual aggregate net investment income that Triad earns rather than an amount based on the effective rate earned by Triad on its investments.

In response to Triad's requests for these modifications to the second Corrective Order, the Department held a public hearing on September 10, 2012, and invited Triad and its policyholders to provide testimony regarding these proposed amendments. In addition, the Department invited Triad and its policyholders to provide testimony as to whether Triad should be permitted to continue to run off its existing book of insurance business or whether the Department should implement a different regulatory approach, including receivership proceedings for the conservation, rehabilitation or liquidation of Triad. The Department extended the period for comments and written testimony on these matters until November 30, 2012.

Triad's failure to comply with the provisions of the second Corrective Order or any other violation of the Illinois Insurance Code may result in the imposition of fines or penalties or subject Triad to further legal proceedings, including the institution by the Department of receivership proceedings for the conservation, rehabilitation or liquidation of Triad. Moreover, if the Department determines that Triad is insolvent under applicable law, it would be required to institute a receivership proceeding over Triad. In addition, the Department retains the inherent authority to institute such proceedings against Triad for any reason and Triad has previously agreed not to contest the taking of any such actions. As of the date of this Form 10-Q, the Department has not issued any final decision or order as a result of the public hearing and Triad's request to amend the second Corrective Order. Because the subject matter of the hearing specifically included an assessment of whether the Department should implement a different regulatory approach with respect to Triad, including institution of receivership proceedings for the conservation, rehabilitation or liquidation of Triad, we believe institution of such a proceeding could be imminent. If this should occur, among other things, TGI could lose control of Triad and we could be forced to deconsolidate our financial statements. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or take other steps to wind up its business and liquidate. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

TGI is the public company whose stock is traded on the OTC Markets Group's OTCQB tier ("Pink Sheets") under the symbol "TGIC". TGI owns Triad, which is its only operating subsidiary. Aside from its ownership of Triad, TGI's assets at September 30, 2012 total approximately $1.0 million, which consisted primarily of cash holdings, compared to $1.3 million at June 30, 2012 and $1.5 million at December 31, 2011. The remainder of the $820.6 million of assets reported on the September 30, 2012 consolidated balance sheet presented in this Form 10-Q are the assets of Triad. TGI currently has no outstanding debt or other known material liabilities other than potential liabilities and costs of defense associated with the pending securities law class action litigation described under "Legal Proceedings" elsewhere in this Form 10-Q.

As previously reported, TGI has explored strategies to acquire complementary profitable businesses and utilize the net operating loss carryforwards ("NOLs") that were generated on a consolidated basis with Triad in order to increase its future value for the benefit of its stockholders as well as provide a limited benefit for Triad policyholders. Tax laws related to the use of NOLs effectively preclude TGI from raising material amounts of equity capital because such a transaction would likely materially impair the value of the NOLs. To date, TGI has been unsuccessful in identifying a viable acquisition candidate. Given the limited amount of cash remaining at TGI and its inability to raise additional funds, no assurance can be given that TGI will ever be successful in implementing such a strategy.

Given its current financial condition, we do not believe TGI would be able to successfully access the capital markets to obtain long-term or short-term debt or equity financing. TGI's primary source of revenue is the reimbursement of expenses from Triad. Investment income from TGI's cash holdings is immaterial. Triad is prohibited from paying dividends or distributing assets to TGI without the approval of the Department. We believe that, absent significant positive changes in the economy and the residential real estate market, Triad's existing assets combined with its future premiums will not be sufficient to meet Triad's current and future policyholder obligations. Therefore, none of Triad's assets would be available to TGI and its stockholders other than to reimburse certain TGI expenses incurred on behalf of Triad, but only if approved by the Department. Accordingly, the ultimate value of TGI could be considered its cash holdings, which will decline over time to the extent its future expenses are not reimbursed by Triad. Since September 30, 2012, TGI's cash holdings have declined further from $1.0 million to approximately $750,000 as of the date of this Form 10-Q.

TGI's expenses primarily consist of legal fees, fees paid to our Board of Directors, audit fees paid to our registered public accounting firm, and annual premiums for directors' and officers' liability insurance. These expenses have ranged from approximately $100,000 to approximately $500,000 per quarter and, historically, substantially all of these expenses have been reimbursed by Triad on a routine basis. In May 2012, we submitted a reimbursement request to the Department for approximately $164,000, which represented TGI's expenses that were incurred in the first quarter of 2012 that were eligible for reimbursement under historical practices. The Department has not yet responded to that request and has not advised TGI when to expect a response. TGI also incurred expenses during the second and third quarters of 2012 totaling approximately $323,000 and we submitted a reimbursement request to the Department for those expenses in October of 2012, which also is pending Department approval. The Department has broad discretion in determining whether to approve TGI's expense reimbursement requests and we are unsure how much, if any, of these expenses will ultimately be approved for reimbursement by the Department. Even if some or all of our pending expense reimbursement requests are approved by the Department, we expect that future expense reimbursements from Triad, if any, would be reduced from historical levels. Absent expense reimbursements from Triad, the remaining assets of TGI will continue to be depleted each month and unless we substantially reduce TGI's expenses, we expect that TGI will have depleted all of its remaining cash by mid-2013, or earlier depending on the timing of any costs of defense associated with the pending securities law class action litigation described under "Legal Proceedings" elsewhere in this Form 10-Q.

This will ultimately cause TGI to commence winding up its business and liquidating through a Chapter 11 bankruptcy proceeding or through other liquidation proceedings. A final decision by the Department to cease allowing Triad to reimburse TGI's expenses will likely leave TGI with no alternative other than to commence such a proceeding. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

The specific terms of the Corrective Order requiring the DPO have and will continue to positively impact our operating cash flows until such time, if any, that we are required to distribute payments on the DPO. However, because we remain obligated to pay the DPO and will accrue interest on the DPO, we do not expect to realize any ultimate financial benefit or expense from recording a DPO. The ultimate payment of both the DPO and the interest are subject to Triad's future financial performance and requires the approval of the Department.

On September 4, 2009, Triad filed a complaint against American Home Mortgage ("AHM") in the United States Bankruptcy Court for the District of Delaware seeking rescission of multiple master mortgage guaranty insurance policies ("master policies") and declaratory relief. The complaint sought relief from AHM as well as all owners of loans insured under the master policies by way of a defendant class action. Triad continued to accept premiums and process claims under the master policies, with the earned premiums and settled losses reflected in the Consolidated Statements of Comprehensive Loss. However, as a result of the litigation, Triad ceased remitting claim payments to companies servicing loans originated by AHM and the liability for losses settled but not paid is included in "Accrued expenses and other liabilities" on the Consolidated Balance Sheets. On August 27, 2012, Triad's complaint was dismissed on jurisdictional grounds. Triad continues to accept premiums and process claims under the master policies and accrue the claim payments. If Triad does not institute new proceedings in state or federal court to rescind coverage under the master policies, Triad will be required to pay the accrued claim payments, which total approximately $83 million, in the fourth quarter of 2012 or the first quarter of 2013. Triad currently has adequate liquidity to fund this payment.

We sold our information technology and operating platform to Essent in the fourth quarter of 2009 in exchange for fixed payments of $15 million and contingent payments of up to $15 million. We have collected the original $15 million fixed portion of the agreement and $2.5 million of the contingent purchase price was received in the second quarter of 2012. The remaining $12.5 million contingent payment price is payable in five equal payments, beginning December 2012, and is subject to Essent writing a certain minimum amount of insurance in each of the five consecutive six-month periods. The majority of the payments are remitted to Triad while a small amount is remitted to TGI. Under a services agreement, Essent is providing ongoing information systems maintenance and services, customer service and policy administration support to Triad. Payment for these services is a variable expense based on the number of policies in force with a minimum payment of $150,000 per month for the initial five-year term of the agreement.

Our sources of operating funds generally consist of premiums received and investment income which are applied to the payment of claims and expenses. We reported a deficit in operating cash flow of $65.8 million in the first nine months of 2012 compared to a $57.8 million deficit in the respective period of 2011, which benefitted from a one-time tax refund of $11.7 million. The operating cash flows in both periods have benefited from the DPO requirements of the second Corrective Order. Operating cash flow shortfalls were funded primarily through available cash holdings as well as sales and maturities of short-term investments.

Net cash received from premiums decreased to $83.4 million in the nine-month period ended September 30, 2012 compared to $111.9 million in the respective period of 2011. This decrease was due to the overall decline in insurance in force and an increase in premium refunds. During the first nine months of 2012, premium refunds were $40.4 million compared to $36.9 million in the first nine months of 2011. We expect the rate of premium refunds related to rescissions to continue at an accelerated rate in the fourth quarter of 2012 and then decline significantly during 2013.

Cash outflows on settled claims decreased to $176.4 million in the first nine months of 2012 compared to $201.7 million in the first nine months of 2011. The DPO requirement resulted in a reduction to cash outflow on settled claims of $135.3 million and $160.9 million in the first nine months of 2012 and 2011, respectively.

We expect to report negative quarterly cash flows from operations in the foreseeable future as we continue to believe that claims and expenses will exceed our net premium and investment income. We currently do not anticipate any other significant cash receipts in future periods from captive commutations, income tax refunds, or from other sources. We anticipate that the funds necessary to meet the operating shortfall will come from the scheduled maturities of invested assets and, if needed, sales of other assets in our investment portfolio.

Our deficit in assets increased to $802.8 million at September 30, 2012 from $703.6 million at December 31, 2011. We expect to continue to report a deficit in assets for the foreseeable future.

Update on Critical Accounting Policies and Estimates

In our Annual Report on Form 10-K for the year ended December 31, 2011, we identified the establishment of the reserves for losses and LAE as well as the valuations on our investments as the two areas that require a significant amount of judgment and estimates. We provided a sensitivity analysis surrounding the reserve for losses and LAE and the two most sensitive areas of judgment, specifically the frequency and severity factors used in the establishment of reserves. We continue to believe that a 20% change, plus or minus, in the frequency factor (which includes our estimate of future rescissions in the existing defaults) is possible given the uncertainty surrounding home prices and the economy. Additionally, we believe a 5% increase or decrease in the severity factor remains a viable range. In the nine months ended September 30, 2012, we made slight changes to both the frequency and severity factors, none of which had a material impact on the financial statements.

Economic conditions that could give rise to an increase in the frequency rate include a sudden increase in unemployment rates, further deterioration in home prices, especially in geographical areas that had previously been less susceptible to such downward trends, a lessened ability to rescind coverage as a result of misrepresentations at closing than what we estimated in the reserve methodology, or increased cultural or social acceptance of strategic defaults. Conversely, an improved housing market, a sustained period of economic and job growth or the inability of servicers to foreclose on delinquent borrowers due to documentation issues could potentially decrease the frequency rate. Any factor that would affect the ability to sell a home of a borrower in default prior to foreclosure could affect our severity. The most prominent of these would be the value of the underlying home. Government and private industry programs designed to stem the volume of foreclosures could also impact frequency and severity and the impact of these programs would most likely have a positive effect on our severity and frequency factors.

While rescission activity has been significant over recent years, our recent level of rescission activity is not necessarily indicative of future trends. Our ability to rescind a policy may be adversely impacted by legal challenges from policyholders and the inability to validate rescindable events as the length of time between loan origination and investigation grows. The increased level of rescission and claims denial activity by mortgage insurers has caused certain policyholders and loan servicers to institute legal actions to challenge the validity of rescissions and claim denials, and we are currently a defendant in such a proceeding. See Part II, Item 1, "Legal Proceedings" for further information. We believe it is likely that other lenders and mortgage servicers will challenge the ability of mortgage insurers to rescind and deny coverage, including the filing of additional lawsuits. An adverse court decision against us or another mortgage insurer could set a precedent that has the effect of significantly restricting or limiting our ability to rescind policies or deny coverage of claims and require a corresponding decrease in our rescission factor.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

We had no material off-balance sheet arrangements at September 30, 2012.

We lease office facilities and office equipment under operating leases with minimum lease commitments that range from several months to two years. We currently sublease space on three of the five floors of our office facility to Essent. The office lease is set to expire on November 30, 2012 and we have executed a sublease with Essent for substantially less square footage. We had no capitalized leases or material purchase commitments at September 30, 2012.

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

Management's Discussion and Analysis of Financial Condition and Results of Operations and other portions of this report contain forward-looking statements relating to future plans, expectations and performance, which involve various risks and uncertainties, including, but not limited to, the following:

- the decision by the Department as to Triad's violation of the second Corrective Order requiring Triad to escrow assets to support the DPO;
- the decision by the Department as to whether Triad should be permitted to continue to run-off its existing book of insurance business or whether the Department should implement a different regulatory approach;
- our existing assets and future premium will not be sufficient to meet our current and future policyholder obligations absent significant positive changes in the economy and the residential real estate market;
- adverse economic conditions in the United States, a continued decline or the lack of significant recovery in home prices, and/or high unemployment levels could increase defaults and limit opportunities for borrowers to cure defaults or for us to mitigate losses, which could have an adverse material impact on our business or results of operations;
- the possibility that the Department may take various actions regarding Triad if we do not operate our business in accordance with the Corrective Orders, or for other reasons, including instituting receivership proceedings, which would likely eliminate all remaining stockholder value;
- our ability to operate our business during run-off and maintain a solvent run-off;
- our ability to continue as a going concern;
- if Triad is not permitted or is otherwise unable to provide funds to TGI, the available resources of TGI will be insufficient to satisfy future operating expenses;
- our ability to rescind coverage or deny claims could be restricted or limited by legal challenges from policyholders and loan servicers;
- our loss reserve estimates are subject to uncertainties and are based on assumptions that remain volatile in the housing and mortgage markets and, therefore, settled claims may be substantially different from our loss reserves;

- we do not expect to realize benefits from rescissions at the levels that we have recently experienced;
- if home prices remain depressed or continue to fall, additional borrowers may default and claims could be higher than anticipated;
- if unemployment rates remain at elevated levels or begin to increase, especially in those areas that have already experienced significant declines in home prices, defaults and claims could be higher than anticipated;
- further economic downturns in regions where we have larger concentrations of risk and in markets already distressed could have a particularly adverse effect on our financial condition and loss development;
- the impact of programs, legislation, and legal proceedings regarding modifications and refinancings of mortgages and/or foreclosure proceedings, which could materially affect our financial performance in run-off;
- the impact of pending and future litigation and regulatory proceedings, which may result in unexpected financial losses or gains;
- our financial condition and performance in run-off could be affected by legislation adopted in the future impacting the mortgage industry, the GSEs specifically, or the financial services industry in general;
- if the GSEs or our lender customers choose to cancel the insurance on policies that we insure, our financial performance in run-off could be adversely affected;
- if we have failed to properly underwrite mortgage loans under contract underwriting service agreements, we may be required to reimburse lenders for the losses incurred on those loans that we underwrote or provide other remedies;
- the possibility that there will not be adequate interest in our common stock to ensure efficient pricing on the over the counter markets; and
- our ability to lower operating expenses to the most efficient level while still mitigating losses effectively during run-off, which will directly impact our financial performance in run-off.

Accordingly, actual results may differ from those set forth in these forward-looking statements. Attention also is directed to other risks and uncertainties set forth in documents that we file from time to time with the SEC.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The information required by this Item 3 is not required to be provided by issuers, such as us, that satisfy the definition of "smaller reporting company" under SEC rules.

Item 4. Controls and Procedures

a) We carried out an evaluation, under the supervision and with the participation of our management, including our Principal Executive Officer ("PEO") and Principal Financial Officer ("PFO"), of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, our management, including our PEO and PFO, concluded, as of the end of the period covered by this report, that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (a) accumulated and communicated to our management, including our PEO and PFO, as appropriate to allow timely decisions regarding required disclosure, and (b) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. In designing and evaluating disclosure controls and procedures, we recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do.

b) There were no changes to our internal control over financial reporting during the period ended September 30, 2012 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in litigation and other legal proceedings in the ordinary course of business as well as the matters identified below. No reserves have been established in the financial statements regarding current litigation as the potential liabilities, if any, are not probable or cannot be reasonably estimated.

On February 6, 2009, James L. Phillips served a complaint alleging violations of federal securities laws against TGI and two of its officers in the United States District Court, Middle District of North Carolina on behalf of a purported class of persons who acquired the common stock of the Company between October 26, 2006 and April 1, 2008. TGI filed its motion to dismiss the amended complaint on August 21, 2009 and on January 27, 2012 the Magistrate Judge recommended that TGI's motion to dismiss be granted. The plaintiff filed an amended complaint on March 30, 2012, TGI filed its motion to dismiss on May 15, 2012, the plaintiff filed its opposition to Triad's motion to dismiss on July 6, 2012, and TGI filed its reply brief on August 6, 2012. TGI intends to vigorously defend this matter.

On September 4, 2009, Triad filed a complaint against American Home Mortgage ("AHM") in the United States Bankruptcy Court for the District of Delaware seeking rescission of multiple master mortgage guaranty insurance policies ("master policies") and declaratory relief. The complaint seeks relief from AHM as well as all owners of loans insured under the master policies by way of a defendant class action. Triad alleged that AHM failed to follow the delegated insurance underwriting guidelines approved by Triad, that this failure breached the master policies as well as the implied covenants of good faith and fair dealing, and that these breaches were so substantial and fundamental that the intent of the master policies could not be fulfilled and Triad should be excused from its obligations under the master policies. Three groups of current owners and/or servicers of AHM-originated loans filed motions to intervene in the lawsuit, which were granted by the Court on May 10 and October 29, 2010. On March 4, 2011, Triad amended its complaint to add a count alleging fraud in the inducement. On March 25, 2011, each of the interveners filed a motion to dismiss. Triad filed its answer and answering brief in opposition to the motions to dismiss on May 27, 2011 and the interveners filed their reply briefs on July 13, 2011. The total amount of risk originated under the AHM master policies, accounting for any applicable stop-loss limits associated with Modified Pool contracts and less risk originated on policies that have been subsequently rescinded, was $1.2 billion, of which $0.5 billion remained in force at September 30, 2012. Triad continues to accept premiums and process claims under the master policies, with the earned premiums and settled losses reflected in the Consolidated Statements of Comprehensive Loss. However, as a result of the litigation, Triad ceased remitting claim payments to companies servicing loans originated by AHM and the liability for losses settled but not paid is included in "Accrued expenses and other liabilities" on the Consolidated Balance Sheets. Triad has not recognized any benefit in its financial statements pending the outcome of the litigation. On August 27, 2012, the Bankruptcy Court issued an order dismissing the lawsuit on jurisdictional grounds. Triad is currently evaluating whether to refile similar actions in jurisdictions where the current master policyholders are located.

On March 5, 2010, Countrywide Home Loans, Inc. filed a lawsuit in the Los Angeles County Superior Court of the State of California alleging breach of contract and seeking a declaratory judgment that bulk rescissions of flow loans is improper and that Triad is improperly rescinding loans under the terms of its master policies. On May 10, 2010 the case was designated as complex and transferred to the Court's Complex Litigation Program. Non-binding mediation occurred on July 22, 2011 with a follow-up mediation session on October 13, 2011. The parties have agreed to a proposed settlement which is subject to regulatory approval. In the event that the settlement is not approved, Triad intends to vigorously defend this matter.

On December 19, 2011, January 17, 2012, and April 12, 2012, complaints were served against TGIC in the United States District Court, Central District of California, United States District Court, Eastern District of Pennsylvania, and United States District Court, Eastern District of Pennsylvania, respectively. The plaintiffs purport to represent a class of persons whose loans were insured by a mortgage guaranty insurance policy and reinsured through a captive reinsurer. The complaints allege that such reinsurance is in violation of the Real Estate Settlement Procedures Act. In each case, the lender, captive reinsurer, and various mortgage guaranty insurers were sued. Triad did not provide mortgage guaranty insurance on the named plaintiffs' loans in any of these lawsuits. Triad intends to vigorously defend these matters.

The Consumer Financial Protection Bureau (the "CFPB") issued a letter to TGI on January 3, 2012, advising TGI that the CFPB was investigating premium ceding practices by mortgage insurers, lenders, and their captive reinsurers and requested certain information from Triad. The CFPB formally requested additional information on June 20, 2012. Triad is cooperating with the CFPB in its investigation.

Triad reported to the Department that as of August 31, 2012, Triad was not in compliance with the second Corrective Order because the aggregate amount of the DPO liability exceeded the cash and invested assets of Triad that were available for segregation in a separate account. Triad has asked the Department to amend, modify or otherwise waive compliance with this provision of the second Corrective Order. In addition, Triad also has requested that the calculation of the carrying charge on the DPO prescribed in the second Corrective Order be amended to limit the amount to a maximum equal to the actual aggregate net investment income that Triad earns rather than an amount based on the effective rate earned by Triad on its investments. In response to Triad's requests for these modifications to the second Corrective Order, the Department held a public hearing on September 10, 2012, and invited Triad and its policyholders to provide testimony regarding these proposed amendments. In addition, the Department invited Triad and its policyholders to provide testimony as to whether Triad should be permitted to continue to runoff its existing book of insurance business or whether the Department should implement a different regulatory approach. The Department extended the period for comments and written testimony until November 30, 2012. Triad's failure to comply with the provisions of the second Corrective Order or any other violation of the Illinois Insurance Code may result in the imposition of fines or penalties or subject Triad to further legal proceedings, including the institution by the Department of receivership proceedings for the conservation, rehabilitation or liquidation of Triad. Moreover, if the Department determines that Triad is insolvent under applicable law, it would be required to institute a receivership proceeding over Triad. In addition, the Department retains the inherent authority to institute such proceedings against Triad for any reason and Triad has previously agreed not to contest the taking of any such actions. As of the date of this Form 10-Q, the Department has not issued any final decision or order as a result of the public hearing and Triad's request to amend the second Corrective Order. Because the subject matter of the hearing specifically included an assessment of whether the Department should implement a different regulatory approach with respect to Triad, including institution of receivership proceedings for the conservation, rehabilitation or liquidation of Triad, the Company believes institution of such a proceeding could be imminent. If this should occur, among other things, TGI could lose control of Triad and could be forced to deconsolidate its financial statements. Any such actions would likely lead TGI to institute a proceeding seeking relief from creditors under U.S. bankruptcy laws, or take other steps to wind up its business and liquidate. See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for more information.

Item 6. Exhibits

The exhibits filed with this Quarterly Report on Form 10-Q are set forth in the Exhibit Index on page 57 and are incorporated herein by reference.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	Triad Guaranty Inc.
November 14, 2012	/s/ Kenneth S. Dwyer Kenneth S. Dwyer Senior Vice President and Chief Accounting Officer (Duly Authorized Officer and Principal Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description
31.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from the Company's Quarterly Report on Form 10-Q, filed on November 14, 2012, for the quarter ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011; (ii) the Consolidated Statements of Comprehensive Loss for the three months and nine months ended September 30, 2012 and 2011; (iii) the Consolidated Statements of Cash Flow for the nine months ended September 30, 2012 and 2011; and (iv) the Notes to Consolidated Financial Statements.*

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.