

We wrote much of our pool insurance in the form of structured transactions, including whole loan sales and credit enhancement on loans included in residential mortgage-backed securities (“RMBS”). An insured pool of mortgages may contain mortgages that are already covered by primary mortgage insurance. In these transactions, pool insurance is secondary to any primary mortgage insurance that exists on mortgages within the pool.

Pool insurance made up approximately \$1.8 billion or 5.1% of our total direct first-lien insurance RIF at December 31, 2012, as compared to \$2.1 billion or 6.3% at December 31, 2011.

2. Non-Traditional Risk

In addition to traditional mortgage insurance, we also provided other forms of credit enhancement on residential mortgage assets. We stopped writing this “non-traditional” business in 2007, other than a small amount of international mortgage insurance, which we discontinued writing in 2008. Since 2007, we have been pursuing opportunities to reduce our non-traditional mortgage insurance RIF through a series of commutations, transaction settlements and terminations. Our total amount of non-traditional RIF was \$148.0 million at December 31, 2012, as compared to \$214.0 million at December 31, 2011.

Our non-traditional products have been highly susceptible to the disruption in the housing and subprime mortgage markets and related credit markets that began during 2007. These non-traditional products included:

- *Second-Lien Mortgages (“Second-Lien”).* This product provided insurance on second-liens. This type of insurance is considered more risky than first-lien business as these loans are subordinate to first-liens, and therefore, the borrower’s ability to repay on these loans depends on the borrower’s ability to satisfy both the first-lien and second-lien.
- *Credit Enhancement on Net Interest Margin Securities (“NIMS”) Bonds.* NIMS bonds represent the securitization of a portion of the excess cash flow and prepayment penalties from a mortgage-backed security (“MBS”) comprised mostly of subprime mortgages. We offered credit enhancement that covers any principal and interest shortfalls on the insured NIMS bonds or a portion of the bonds.

In 2008, we stopped writing new international business and have terminated most of our international mortgage insurance risk, with the exception of our insured portfolio in Hong Kong. While we are no longer writing new business in Hong Kong, we continue to insure the existing book of business, which has experienced a low default rate.

3. Premium Rates

We set our premium rates at origination when coverage is established. Premiums for our mortgage insurance products are established based on performance models that consider a broad range of borrower, loan and property characteristics. We set our premium levels commensurate with anticipated policy performance assumptions, including, without limitation, our expectations and assumptions about the following factors: (1) the likelihood of default; (2) how long the policy will remain in place; (3) the costs of establishing the policy; (4) taxes; and (5) the capital that is required to support the insurance. Our performance assumptions for claim frequency and policy life are developed based on internally developed data, as well as data generated from independent, third-party sources. The assumptions used in setting our premiums that relate to policy coverage, expenses and capital, are based on data and models that are developed internally. Premium levels are set to achieve an appropriate, risk-adjusted rate of return on capital given modeled performance expectations.

Premiums on our mortgage insurance products are paid either on a monthly installment basis (monthly premiums), in a single payment at origination (single premiums), as a combination of up-front premium at origination plus a monthly renewal, or in some cases as an annual or multi-year premium. For monthly paid premiums, we receive a monthly premium payment and provide ongoing loan level coverage, as long as the premiums continue to be paid. For single premium insurance, we receive a single premium payment that is paid at origination and provides coverage for the life of the loan subject to certain conditions. In addition, for our split premium products, we receive a single premium payment when the loan is made, plus ongoing monthly renewal premiums. Approximately 65% of our NIW in 2012 was written with monthly premiums or split premiums, and 35% was written with single premiums.

Mortgage insurance premiums can be financed through a number of methods and can either be paid by the borrower or by the lender. Borrower-paid mortgage insurance premiums can be paid either through separate escrowed amounts or financed as a component of the mortgage loan amount. Lender paid mortgage insurance premiums are paid by the lender and are typically passed through to the borrower in the form of additional origination fees or a higher interest rate on the mortgage note.