NMI Holdings, Inc.
Form 10-Q
August 01, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended June 30, 2017

OR

o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from to

Commission file number 001-36174
NMI Holdings, Inc.
(Exact name of registrant as specified in its charter)

DELAWARE	45-4914248
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2100 Powell Street, Emeryville, CA	94608
(Address of principal executive offices)	(Zip Code)

(855) 530-6642
(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 x NO o
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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES x NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.
(Check one):

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

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

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

The number of shares of common stock, $0.01 par value per share, of the registrant outstanding on July 28, 2017 was 59,862,199 shares.

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CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This report contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), Section 21E of the Securities Exchange Act of 1934, as amended (Exchange Act), and the U.S. Private Securities Litigation Reform Act of 1995. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions or future events or performance are not historical facts and may be forward looking. These statements are often, but not always, made through the use of words or phrases such as "anticipate," "believe," "can," "could," "may," "predict," "potential," "should," "will," "estimate," "plan," "project," "continuing," "ongoing," "expect," "intend" or words of similar meaning and include, but are not limited to, statements regarding the outlook for our future business and financial performance. All forward looking statements are necessarily only estimates of future results, and actual results may differ materially from expectations. You are, therefore, cautioned not to place undue reliance on such statements which should be read in conjunction with the other cautionary statements that are included elsewhere in this report. Further, any forward looking statement speaks only as of the date on which it is made and we undertake no obligation to update or revise any forward looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. We have based these forward looking statements on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, operating results, business strategy and financial needs. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward looking statements including, but not limited to:

- changes in the business practices of Fannie Mae and Freddie Mac (collectively, the GSEs), including decisions that have the impact of decreasing or discontinuing the use of mortgage insurance as credit enhancement;
- our ability to remain an eligible mortgage insurer under the private mortgage insurer eligibility requirements (PMIERs) and other requirements imposed by the GSEs, which they may change at any time;
- retention of our existing certificates of authority in each state and the District of Columbia (D.C.) and our ability to remain a mortgage insurer in good standing in each state and D.C.;
- our future profitability, liquidity and capital resources;
- actions of existing competitors, including governmental agencies like the Federal Housing Administration (FHA) and the Veterans Administration (VA), and potential market entry by new competitors or consolidation of existing competitors;
- developments in the world's financial and capital markets and our access to such markets, including reinsurance;
- adoption of new or changes to existing laws and regulations that impact our business or financial condition directly or the mortgage insurance industry generally or their enforcement and implementation by regulators;
- changes to the GSEs' role in the secondary mortgage market or other changes that could affect the residential mortgage industry generally or mortgage insurance in particular;
- potential future lawsuits, investigations or inquiries or resolution of current lawsuits or inquiries;
- changes in general economic, market and political conditions and policies, interest rates, inflation and investment results or other conditions that affect the housing market or the markets for home mortgages or mortgage insurance;
- our ability to successfully execute and implement our capital plans, including our ability to access the reinsurance market and to enter into, and receive approval of, reinsurance arrangements on terms and conditions that are acceptable to us, the GSEs and our regulators;
- our ability to implement our business strategy, including our ability to write mortgage insurance on high quality low down payment residential mortgage loans, implement successfully and on a timely basis, complex infrastructure, systems, procedures, and internal controls to support our business and regulatory and reporting requirements of the insurance industry;
- our ability to attract and retain a diverse customer base, including the largest mortgage originators;
- failure of risk management or pricing or investment strategies;
- emergence of unexpected claim and coverage issues, including claims exceeding our reserves or amounts we had expected to experience;
- the inability of our counter-parties, including third party reinsurers, to meet their obligations to us;

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- our ability to utilize our net operating loss carryforwards, which could be limited or eliminated in various ways, including if we experience an ownership change as defined in Section 382 of the Internal Revenue Code;
- failure to maintain, improve and continue to develop necessary information technology (IT) systems or the failure of technology providers to perform; and
- ability to recruit, train and retain key personnel.

For more information regarding these risks and uncertainties as well as certain additional risks that we face, you should refer to Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report on Form 10-Q, including the exhibits hereto. In addition, for additional discussion of those risks and uncertainties that have the potential to affect our business, financial condition, results of operations, cash flows or prospects in a material and adverse manner, you should review the Risk Factors in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2016 (2016 10-K), as subsequently updated in other reports we file from time to time with the U.S. Securities and Exchange Commission (SEC).
Unless expressly indicated or the context requires otherwise, the terms "we," "our," "us" and "Company" in this document refer to NMI Holdings, Inc., a Delaware corporation, and its wholly owned subsidiaries on a consolidated basis.

PART I

Item 1. Financial Statements

INDEX TO FINANCIAL STATEMENTS

NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30, 2017	December 31, 2016
Assets	(In Thousands, except for share data)	
Fixed maturities, available-for-sale, at fair value (amortized cost of $669,363 and $630,688 as of June 30, 2017 and December 31, 2016, respectively)	$673,695	$628,969
Cash and cash equivalents	20,035	47,746
Premiums receivable	17,795	13,728
Accrued investment income	3,867	3,421
Prepaid expenses	2,072	1,991
Deferred policy acquisition costs, net	34,206	30,109
Software and equipment, net	21,530	20,402
Intangible assets and goodwill	3,634	3,634
Prepaid reinsurance premiums	38,919	37,921
Deferred tax asset, net	45,771	51,434
Other assets	1,471	542
Total assets	$862,995	$839,897
Liabilities		
Term loan	$143,990	$144,353
Unearned premiums	157,152	152,906
Accounts payable and accrued expenses	21,349	25,297
Reserve for insurance claims and claim expenses	5,048	3,001
Reinsurance funds withheld	32,042	30,633
Deferred ceding commission	4,830	4,831
Warrant liability, at fair value	3,544	3,367
Total liabilities	367,955	364,388
Commitments and contingencies		
Shareholders' equity		
Common stock - class A shares, $0.01 par value;		
59,858,418 and 59,145,161 shares issued and outstanding as of June 30, 2017 and December 31, 2016, respectively (250,000,000 shares authorized)	598	591
Additional paid-in capital	580,499	576,927
Accumulated other comprehensive loss, net of tax	(1,354)	(5,287)
Accumulated deficit	(84,703)	(96,722)
Total shareholders' equity	495,040	475,509
Total liabilities and shareholders' equity	$862,995	$839,897

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (UNAUDITED)

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
Revenues	(In Thousands, except for share data)			
Net premiums earned	$37,917	$ 26,041	$71,142	$ 45,848
Net investment income	3,908	3,342	7,715	6,573
Net realized investment gains (losses)	188	61	130	(824)
Other revenues	185	37	265	69
Total revenues	42,198	29,481	79,252	51,666
Expenses				
Insurance claims and claims expenses	1,373	470	2,008	928
Underwriting and operating expenses	28,048	23,234	54,037	45,906
Total expenses	29,421	23,704	56,045	46,834
Other (expense) income				
Gain (loss) from change in fair value of warrant liability	19	(59)	(177)	611
Interest expense	(3,300)	(3,707)	(6,794)	(7,339)
Total other expense	(3,281)	(3,766)	(6,971)	(6,728)
Income (loss) before income taxes	9,496	2,011	16,236	(1,896)
Income tax expense	3,484	—	4,732	—
Net income (loss)	$6,012	$ 2,011	$11,504	$ (1,896)
Earnings (loss) per share				
Basic	$0.10	$ 0.03	$0.19	$ (0.03)
Diluted	$0.10	$ 0.03	$0.18	$ (0.03)
Weighted average common shares outstanding				
Basic	59,823,396	59,105,613	59,576,747	59,005,983
Diluted	63,010,362	59,830,899	62,688,563	59,005,983
Net income (loss)	$6,012	$ 2,011	$11,504	$ (1,896)
Other comprehensive income, net of tax:				
Net unrealized gains in accumulated other comprehensive income, net of tax expense of $1,388 and $0 for the three months ended June 30, 2017 and 2016, respectively, and $2,073 and $0 for the six months ended June 30,2017 and 2016	2,822	8,670	4,017	17,771
Reclassification adjustment for losses (gains) included in net income, net of tax expense of $66 and $0 for the three months ended June 30, 2017 and 2016, respectively, and $45 and $0 for the six months ended June 30,2017 and 2016	(122)	(61)	(84)	824
Other comprehensive income, net of tax	2,700	8,609	3,933	18,595
Comprehensive income	$8,712	$ 10,620	$15,437	$ 16,699

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

	Common Stock - Class A Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
	(In Thousands)					
Balances, January 1, 2016	58,808	$ 588	$ 570,340	$ (7,474)	$ (160,723)	$ 402,731
Common stock: class A shares issued under stock plans, net of shares withheld for employee taxes	337	3	(227)	—	—	(224)
Share-based compensation expense	—	—	6,814	—	—	6,814
Change in unrealized investment gains/losses, net of tax expense of $1,178	—	—	—	2,187	—	2,187
Net income	—	—	—	—	64,001	64,001
Balances, December 31, 2016	59,145	$ 591	$ 576,927	$ (5,287)	$ (96,722)	$ 475,509
Cumulative effect of change in accounting principle	—	—	388	—	515	903
Common stock: class A shares issued under stock plans, net of shares withheld for employee taxes	713	7	(1,035)	—	—	(1,028)
Share-based compensation expense	—	—	4,219	—	—	4,219
Change in unrealized investment gains/losses, net of tax expense of $2,118	—	—	—	3,933	—	3,933
Net income	—	—	—	—	11,504	11,504
Balances, June 30, 2017	59,858	$ 598	$ 580,499	$ (1,354)	$ (84,703)	$ 495,040

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	For the six months ended June 30,	
	2017	2016
Cash flows from operating activities	(In Thousands)	
Net income (loss)	$11,504	$(1,896)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Net realized investment losses	(130)	824
Loss (gain) from change in fair value of warrant liability	177	(611)
Depreciation and amortization	3,119	2,295
Net amortization of premium on investment securities	772	649
Amortization of debt discount and debt issuance costs	757	918
Share-based compensation expense	4,219	3,156
Deferred income taxes	4,449	—
Changes in operating assets and liabilities:		
Accrued investment income	(445)	(195)
Premiums receivable	(4,067)	(3,725)
Prepaid expenses	(81)	(382)
Deferred policy acquisition costs, net	(4,097)	(7,598)
Other assets	(929)	5
Unearned premiums	4,246	41,143
Reserve for insurance claims and claims expenses	2,047	796
Reinsurance balances, net	409	—
Accounts payable and accrued expenses	(7,358)	(7,817)
Net cash provided by operating activities	14,592	27,562
Cash flows from investing activities		
Purchase of short-term investments	(78,564)	(80,674)
Purchase of fixed-maturity investments, available-for-sale	(116,991)	(93,974)
Proceeds from maturity of short-term investments	94,677	56,758
Proceeds from redemptions, maturities and sale of fixed-maturity investments, available-for-sale	65,587	86,930
Additions to software and equipment	(4,863)	(6,182)
Net cash used in by investing activities	(40,154)	(37,142)
Cash flows from financing activities		
Proceeds from issuance of common stock related to employee equity plans	2,614	504
Taxes paid related to net share settlement of equity awards	(3,643)	(664)
Repayments of term loan	(750)	(750)
Payments of debt modification costs	(370)	—
Net cash used in financing activities	(2,149)	(910)
Net decrease in cash and cash equivalents	(27,711)	(10,490)
Cash and cash equivalents, beginning of period	47,746	57,317
Cash and cash equivalents, end of period	$20,035	$46,827
Supplemental disclosures of cash flow information		
Interest paid	$7,292	$6,431
Income taxes paid	585	—

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Organization and Basis of Presentation

NMI Holdings, Inc. (NMIH) is a Delaware corporation, incorporated in May 2011, to provide private mortgage guaranty insurance (which we refer to as mortgage insurance or MI) through its wholly owned insurance subsidiaries, National Mortgage Insurance Corporation (NMIC) and National Mortgage Reinsurance Inc One (Re One). In April 2012, we completed a private placement of our securities, through which we offered and sold an aggregate of 55,000,000 of our Class A common stock resulting in net proceeds of approximately $510 million (the Private Placement), and we completed the acquisition of our insurance subsidiaries for $8.5 million in cash, common stock and warrants, plus the assumption of $1.3 million in liabilities. In November 2013, we completed an initial public offering of 2.4 million shares of our common stock, and our common stock began trading on the NASDAQ exchange on November 8, 2013, under the symbol "NMIH."

In April 2013, NMIC, our primary insurance subsidiary, issued its first mortgage insurance policy. NMIC is licensed to write mortgage insurance in all 50 states and D.C. In August 2015, NMIH capitalized a wholly owned subsidiary, NMI Services, Inc. (NMIS), through which we offer outsourced loan review services on a limited basis to mortgage loan originators.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, which include the results of NMIH and its wholly owned subsidiaries, have been prepared in accordance with the instructions to Form 10-Q as prescribed by the SEC for interim reporting and include other information and disclosures required by accounting principles generally accepted in the U.S. (GAAP). Our accounts are maintained in U.S. dollars. These statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2016, included in our 2016 10-K. All intercompany transactions have been eliminated. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities as of the balance sheet date. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates. The results of operations for the interim period may not be indicative of the results that may be expected for the full year ending December 31, 2017.

Deferred Policy Acquisition Costs

Costs directly associated with the successful acquisition of mortgage insurance policies, consisting of certain selling expenses and other policy issuance and underwriting expenses, are initially deferred and reported as deferred policy acquisition costs (DAC). DAC is reviewed periodically to determine that it does not exceed recoverable amounts and is adjusted as appropriate for policy cancellations to be consistent with our revenue recognition policy. We estimate the rate of amortization to reflect actual experience and any changes to persistency or loss development. For each book year of business, these costs are amortized to expense in proportion to estimated gross profits over the estimated life of the policies. Total amortization of DAC, net of a portion of ceding commission related to the 2016 QSR Transaction (see Note 5, "Reinsurance"), was $1.3 million for each of the three months ended June 30, 2017 and 2016, and $2.3 million and $2.2 million for the six months ended June 30, 2017 and 2016, respectively.

Premium Deficiency Reserves

We consider whether a premium deficiency exists at each fiscal quarter using best estimate assumptions as of the testing date. Per ASC 944, a premium deficiency reserve shall be recognized if the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs and maintenance costs exceeds related unearned premiums and anticipated investment income. We have determined that no premium deficiency reserves were necessary for the three and six months ended June 30, 2017 or 2016.

Reinsurance

We account for premiums, losses and loss expenses that are ceded to reinsurers on bases consistent with those we use to account for the original policies we issue and pursuant to the terms of our reinsurance contracts. We account for premiums ceded or otherwise paid to reinsurers as reductions to premium revenue.

We earn profit and ceding commissions in connection with our 2016 QSR Transaction (see Note 5, "Reinsurance"). Profit commissions represent a percentage of the profits recognized by reinsurers that are returned to us, based on the level of losses we cede. We recognize any profit commissions we earn as increases to premium revenue. Ceding commissions are calculated as a percentage of ceded written premiums, which are intended to cover our costs to acquire and service the direct policies. We earn the ceding commissions in a manner consistent with our recognition of earnings on the underlying insurance policies, over the terms of the policies reinsured. We account for ceding commissions as reductions to underwriting and operating expenses.

NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

We cede a portion of loss reserves, paid losses and loss expenses to our reinsurers, which are accounted for as reinsurance recoverables on the consolidated balance sheets and as reductions to loss expense on the consolidated statements of operations. We remain directly liable for all loss payments in the event we are unable to collect from any reinsurer.

Variable interest entity

In May 2017, NMIC entered into a reinsurance agreement with Oaktown Re Ltd. (Oaktown Re), a Bermuda-domiciled special purpose reinsurer. We have determined that Oaktown Re is a variable interest entity (VIE), as defined under GAAP (ASC 810), because it does not have sufficient equity at risk to finance its activities. We have evaluated the VIE to determine whether NMIC is its primary beneficiary and, if so, whether we would be required to consolidate the assets and liabilities of the VIE. The primary beneficiary of a VIE is an enterprise that (1) has the power to direct the activities of the VIE, which most significantly impact its economic performance and (2) has significant economic exposure to the VIE; i.e., the obligation to absorb losses or receive benefits that could potentially be significant. The determination of whether an entity is the primary beneficiary of a VIE is complex and requires management judgment regarding determinative factors, including the expected results of the VIE and how those results are absorbed by beneficial interest holders, as well as which party has the power to direct activities that most significantly impact the performance of the VIE.

We have concluded that we are not the primary beneficiary of Oaktown Re and that consolidation is not required, as we do not have significant economic exposure in the entity.

See Note 5, "Reinsurance" for further discussion on the reinsurance arrangement.

Premiums Receivable

Premiums receivable consist of premiums due on our mortgage insurance policies. If a mortgage insurance premium is unpaid for more than 120 days, the receivable is written off against earned premium and the related insurance policy is canceled.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606). This update is intended to provide a consistent approach in recognizing revenue. In accordance with the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, ASU 2015-14 deferred the provisions of ASU 2014-09 to be effective for interim and annual periods beginning after December 15, 2017. In addition, this guidance amends the existing requirements for the recognition of a gain or loss on the transfer of non-financial assets that are not in a contract with a customer (ASU 2017-05). The Company is currently evaluating the impact the adoption of this ASU will have, if any, on the consolidated financial statements; however, this update is not expected to impact the recognition of revenue related to insurance premiums or investments, which represent the majority of our total revenues.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This update requires that businesses recognize rights and obligations associated with certain leases as assets and liabilities on the balance sheet.The standard also requires additional disclosures regarding the amount, timing, and uncertainty of cash flows arising from leases. For public business entities, this update is effective for annual periods beginning after December 15, 2018 and interim periods therein. Early adoption is permitted in any period. We expect to adopt this guidance on January 1, 2019. We anticipate this standard will have an impact on our financial position, primarily due to our office space operating lease, as we will be required to recognize lease assets and lease liabilities on our consolidated balance sheet. We will continue to assess the potential impacts of this standard, including the impact the adoption of this guidance will have on our results of operations or cash flows.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326). This update requires companies to measure all expected credit losses for financial assets held at the reporting date. The accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration also is amended in the standard. The standard will take effect for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently evaluating the impact the adoption of this ASU will have, if any, on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230). This update is intended to reduce diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The standard will take effect for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company is currently evaluating the impact the adoption of this ASU will have, if any, on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-16, Income Taxes- Intra-Entity Transfers of Assets Other Than Inventory (Topic 740). This update is intended to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The standard will take effect for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted at the beginning of any annual reporting period. The Company is currently evaluating the impact the adoption of this ASU will have, if any, on the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350). This update is intended to simplify the test for goodwill impairment. The standard will take effect for public business entities for fiscal years, and interim periods within those fiscal years, after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company has determined that the adoption of this ASU will have no impact on the consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20). This update shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. The standard will take effect for public business entities for fiscal years beginning after December 15, 2017. Early adoption is permitted, and if an entity early adopts the guidance in an interim period, any adjustments are reflected as of the beginning of the fiscal year that includes that interim period. The Company is currently evaluating the impact the adoption of this ASU will have, if any, on the consolidated financial statements.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), and Derivatives and Hedging (Topic 815). This update is intended to simplify the accounting for certain financial instruments with down round features. This standard will take effect for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted in any interim or annual period. The Company is currently evaluating the impact the adoption of this ASU will have, if any, on the consolidated financial statements.

Immaterial Correction of Prior Period Amounts

During the first quarter of 2017, after filing its 2016 10-K, including the audited financial statements included therein, the Company discovered that $1.8 million of deferred taxes on vested options associated with employees who had terminated employment in previous years had not been reversed. Because the Company's deferred tax asset (DTA) was subject to a valuation allowance prior to December 31, 2016, no expense would have been recognized by the Company in periods prior to December 31, 2016. However, at December 31, 2016, when the Company released the valuation allowance against its DTA, the DTA was overstated by $1.8 million. The release of the valuation allowance resulted in a $1.8 million overstatement of the Company's 2016 income tax benefit and net income.

In order to provide consistency in the consolidated statements and as permitted by Staff Accounting Bulletin (SAB) 108, revisions for these immaterial amounts to previously reported annual amounts are reflected in the Consolidated Balance Sheet financial information herein and will be reflected in the Consolidated Statement of Operations in future filings containing such financial information as permitted by SAB 108. A comparison of the affected amounts as previously reported and as adjusted are presented below.

NMI HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

As of and for the full year ended December 31, 2016	As previously reported	As adjusted
	(In thousands)	
Income Statement		
Net income	$65,841	$64,001
Income tax (benefit)	(54,389)	(52,550)
Basic EPS	1.11	1.08
Diluted EPS	1.08	1.05
Balance Sheet		
Deferred tax asset, net	$53,274	$51,434
Total assets	841,737	839,897
Accumulated deficit	(94,882)	(96,722)
Total shareholder's equity	477,349	475,509

Change in Accounting Principle

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718), which intends to simplify various aspects of the accounting for and reporting of share-based payments. The new accounting is required to be adopted using a modified retrospective approach, with a cumulative-effect adjustment to opening retained earnings for any outstanding liability awards that qualify for equity classification under the new guidance.

As the guidance is effective for annual and interim reporting periods beginning after December 15, 2016, the Company adopted the new guidance in the first quarter of 2017. This required us to reflect any adjustments as of January 1, 2017, the beginning of the annual period that includes the interim period of adoption. The primary impact of adoption was the recognition of excess tax benefits in our provision for income taxes in the consolidated statements of operations. Additionally, our consolidated statements of cash flows now present excess tax benefits as an operating activity on a prospective basis. Finally, we have elected to account for forfeitures as they occur, rather than estimate expected forfeitures. The net cumulative effect of this change was recognized as a $0.5 million reduction to the accumulated deficit as of January 1, 2017.

2. Investments

We have designated our investment portfolio as available-for-sale and report it at fair value. The related unrealized gains and losses are, after considering the related tax expense or benefit, recognized through comprehensive income and loss, and on an accumulated basis in shareholders' equity. Net realized investment gains and losses are reported in income based upon specific identification of securities sold.

Fair Values and Gross Unrealized Gains and Losses on Investments

	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
As of June 30, 2017	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	$65,679	$31	$(657)	$65,053
Municipal debt securities	79,154	839	(371)	79,622
Corporate debt securities	375,817	4,729	(1,355)	379,191
Asset-backed securities	103,242	1,147	(141)	104,248
Total bonds	623,892	6,746	(2,524)	628,114
Short-term investments	45,471	110	—	45,581
Total investments	$669,363	$6,856	$(2,524)	$673,695

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of December 31, 2016	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	$64,135	$6	$(962)	$63,179
Municipal debt securities	40,801	131	(663)	40,269
Corporate debt securities	349,712	1,722	(2,356)	349,078
Asset-backed securities	114,456	765	(560)	114,661
Total bonds	569,104	2,624	(4,541)	567,187
Short-term investments	61,584	198	—	61,782
Total investments	$630,688	$2,822	$(4,541)	$628,969

As of June 30, 2017 and December 31, 2016, there were approximately $7.0 million of cash and investments in the form of U.S. Treasury securities on deposit with various state insurance departments to satisfy regulatory requirements.

Scheduled Maturities

The amortized cost and fair values of available-for -sale securities as of June 30, 2017 and December 31, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Because most asset-backed securities provide for periodic payments throughout their lives, they are listed below in a separate category.

As of June 30, 2017	Amortized Cost	Fair Value
	(In Thousands)	
Due in one year or less	$124,108	$124,153
Due after one through five years	134,052	135,215
Due after five through ten years	297,453	299,591
Due after ten years	10,508	10,488
Asset-backed securities	103,242	104,248
Total investments	$669,363	$673,695

As of December 31, 2016	Amortized Cost	Fair Value
	(In Thousands)	
Due in one year or less	$94,382	$94,584
Due after one through five years	173,296	173,251
Due after five through ten years	242,005	240,060
Due after ten years	6,549	6,413
Asset-backed securities	114,456	114,661
Total investments	$630,688	$628,969

Aging of Unrealized Losses

As of June 30, 2017, the investment portfolio had gross unrealized losses of $2.5 million, $0.4 million of which has been in an unrealized loss position for a period of 12 months or greater. We did not consider these securities to be other-than-temporarily impaired as of June 30, 2017. We based our conclusion that these investments were not other-than-temporarily impaired as of June 30, 2017 on the following facts: (i) the unrealized losses were primarily caused by interest rate movements since the purchase date; (ii) we do not intend to sell these investments; and (iii) we do not believe that it is more likely than not that we will be required to sell these investments before recovery of our amortized cost basis, which may not occur until maturity. For those securities in an unrealized loss position, the length of time the securities were in such a position is as follows:

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	Less Than 12 Months			12 Months or Greater			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
As of June 30, 2017	(Dollars in Thousands)								
U.S. Treasury securities and obligations of U.S. government agencies	34	$53,299	$(645)	3	$4,738	$(12)	37	$58,037	$(657)
Municipal debt securities	14	26,390	(353)	1	1,732	(18)	15	28,122	(371)
Corporate debt securities	49	105,388	(1,066)	5	7,916	(289)	54	113,304	(1,355)
Asset-backed securities	12	20,319	(108)	4	4,395	(33)	16	24,714	(141)
Total	109	$205,396	$(2,172)	13	$18,781	$(352)	122	$224,177	$(2,524)

	Less Than 12 Months			12 Months or Greater			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
As of December 31, 2016	(Dollars in Thousands)								
U.S. Treasury securities and obligations of U.S. government agencies	33	$51,093	$(962)	—	$—	$—	33	$51,093	$(962)
Municipal debt securities	14	28,659	(617)	1	1,704	(46)	15	30,363	(663)
Corporate debt securities	77	135,115	(1,955)	8	13,873	(401)	85	148,988	(2,356)
Asset-backed securities	30	38,702	(510)	6	2,472	(50)	36	41,174	(560)
Total	154	$253,569	$(4,044)	15	$18,049	$(497)	169	$271,618	$(4,541)

The following table presents the components of net investment income:

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
	(In Thousands)			
Investment income	$4,099	$3,536	$8,092	$6,945
Investment expenses	(191)	(194)	(377)	(372)
Net investment income	$3,908	$3,342	$7,715	$6,573

The following table presents the components of net realized investment gains (losses):

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
	(In Thousands)			
Gross realized investment gains	$188	$61	$467	$617
Gross realized investment losses	—	—	(337)	(1,441)
Net realized investment gains (losses)	$188	$61	$130	$(824)

Investment Securities - Other-than-Temporary Impairment (OTTI)

For the quarter ended June 30, 2017, we held no other-than-temporarily impaired securities. The impaired security disclosed for the quarter ended March 31, 2017 was liquidated as of June 30, 2017.

There were no credit losses recognized in earnings for which a portion of an OTTI loss was recognized in accumulated other comprehensive income (loss).

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3. Fair Value of Financial Instruments

The following describes the valuation techniques used by us to determine the fair value of our financial instruments:
We established a fair value hierarchy by prioritizing the inputs to valuation techniques 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 this standard are described below:

Level 1 - Fair value measurements based on quoted prices in active markets that we have the ability to access for identical assets or liabilities. Market price data generally is obtained from exchange or dealer markets. We do not adjust the quoted price for such instruments.

Level 2 - Fair value measurements based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 - Fair value measurements based on valuation techniques that use significant inputs that are unobservable. Both observable and unobservable inputs may be used to determine the fair values of positions classified in Level 3. The circumstances for using these measurements include those in which there is little, if any, market activity for the asset or liability. Therefore, we must make certain assumptions, which require significant management judgment or estimation about the inputs a hypothetical market participant would use to value that asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Assets classified as Level 1 and Level 2

To determine the fair value of securities available-for-sale in Level 1 and Level 2 of the fair value hierarchy, independent pricing sources have been utilized. One price is provided per security based on observable market data. To ensure securities are appropriately classified in the fair value hierarchy, we review the pricing techniques and methodologies of the independent pricing sources and believe that their policies adequately consider market activity, either based on specific transactions for the issue valued or based on modeling of securities with similar credit quality, duration, yield and structure that were recently traded. A variety of inputs are utilized by the independent pricing sources including benchmark yields, reported trades, non-binding broker/dealer quotes, issuer spreads, two sided markets, benchmark securities, bids, offers and reference data including data published in market research publications. Inputs may be weighted differently for any security, and not all inputs are used for each security evaluation. Market indicators, industry and economic events are also considered. This information is evaluated using a multidimensional pricing model. Quality controls are performed by the independent pricing sources throughout this process, which include reviewing tolerance reports, trading information and data changes, and directional moves compared to market moves. This model combines all inputs to arrive at a value assigned to each security. We have not made any adjustments to the prices obtained from the independent pricing sources. There were no transfers between Level 1 and Level 2 of the fair value hierarchy during the quarter ended June 30, 2017.

Liabilities classified as Level 3

We calculate the fair value of outstanding warrants utilizing level 3 inputs, including a Black-Scholes option-pricing model, in combination with a binomial model, and we value the pricing protection features within the warrants using a Monte-Carlo simulation model. Variables in the model include the risk-free rate of return, dividend yield, expected life and expected volatility of our stock price.

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The following tables present the level within the fair value hierarchy at which the Company’s financial instruments were measured: