NMI Holdings, Inc.
Form 424B3
December 17, 2013
Filed pursuant to Rule 424(b)(3)
Registration Number 333-189507

Prospectus Supplement No. 2
(To the Prospectus dated December 6, 2013)

51,101,434 Shares

NMI Holdings, Inc.
Class A Common Stock

This Prospectus Supplement supplements the prospectus dated December 6, 2013, as previously supplemented (the "Prospectus"), relating to the offering of up to 51,101,434 shares of Class A common stock of NMI Holdings, Inc. by the selling stockholders identified in the Prospectus. This Prospectus Supplement should be read in conjunction with the Prospectus which is to be delivered with this Prospectus Supplement. If there is any inconsistency between the information in the Prospectus and this Prospectus Supplement, you should rely on the information in this Prospectus Supplement.

INVESTING IN OUR COMMON STOCK INVOLVES RISK. SEE "RISK FACTORS" BEGINNING ON PAGE 15 OF THE PROSPECTUS.

This Prospectus Supplement is filed for the purpose of including in the Prospectus the information contained in the attached quarterly report on Form 10-Q for the quarter ended September 30, 2013, which was filed with the Securities and Exchange Commission on December 17, 2013.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the adequacy or accuracy of this Prospectus Supplement (or the Prospectus, including any supplements or amendments thereto). Any representation to the contrary is a criminal offense.

The date of this Prospectus Supplement is December 17, 2013.

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 September 30, 2013
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 333-191635
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 o NO x

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, 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. (Check one):
Large accelerated filer o Accelerated filer o Non-accelerated filer x Smaller reporting company o
(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

CLASS OF STOCK	PAR VALUE	DATE	NUMBER OF SHARES
Common stock	$0.01	December 1, 2013	58,052,480

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements. 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,” “believes,” “can,” “could,” “may,” “predicts,” “potential,” “should,” “will,” “estimate,” “plans,” “projects,” “continuing,” “ongoing,” “expects,” “ similar words or phrases. Accordingly, these statements are only predictions and involve estimates, known and unknown risks, assumptions and uncertainties that could cause actual results to differ materially from those expressed in them. Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors more fully described under the caption “Risk Factors”, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report, including the exhibits hereto.

Any or all of our forward-looking statements in this report may turn out to be inaccurate. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future plans, estimates or expectations contemplated by us will be achieved. We have based these forward-looking statements largely 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, statements regarding:

- our status as a recently organized corporation and lack of operating history;
- receipt of certificate of authority to act as a mortgage insurer in Wyoming and, of the 49 states where NMIC has received certificates of authority, approvals of our insurance rates in Washington and policy forms in Florida, Alaska and Maryland;
- retention of our existing certificates of authority in states where we have obtained them and our ability to remain a mortgage insurer in good standing in those states;
- changes in the business practices of the GSEs, including modifications to their mortgage insurer eligibility requirements or decisions to decrease or discontinue the use of MI;
- our ability to remain a qualified mortgage insurer under the requirements imposed by the GSEs;
- actions of existing competitors and potential market entry by new competitors;
- changes to laws and regulations, including changes to the GSEs' role in the secondary mortgage market or other changes that could affect the residential mortgage industry generally or MI in particular;
- 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 MI;
- changes in the regulatory environment;
- our ability to implement our business strategy, including our ability to attract customers, 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;
- failure of risk management or investment strategy;
- claims exceeding our reserves or amounts we had expected to experience;
- failure to achieve the results shown in the financial projections;
- failure to develop, maintain and improve necessary information technology systems or the failure of technology providers to perform;
- ability to recruit, train and retain key personnel; and
- emergence of claim and coverage issues.

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. In particular, you should consider the numerous risks described in the Company's Prospectus filed with the Securities and Exchange Commission ("SEC") on December 9, 2013 as part of the Company's Registration Statement on Form S-1 (File No. 333-189507) (the "Prospectus") under the caption "Risk Factors" and under Item 1A of Part II of this report and in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of 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. You should, however, review the risk factors we describe in the reports we will file from time to time with the SEC after the date of this report.

PART I — FINANCIAL INFORMATION
Item 1. Financial Statements

NMI HOLDINGS, INC. (A Development Stage Company)
CONSOLIDATED BALANCE SHEETS

	September 30, 2013 (Unaudited)	December 31, 2012 (Audited)
Assets		
Investments, available-for-sale, at fair value:		
Fixed maturities (amortized cost of $419,021,671 and $0 as of September 30, 2013 and December 31, 2012, respectively)	$411,983,016	$—
Short-term investments	—	4,864,206
Total investment portfolio	411,983,016	4,864,206
Cash and cash equivalents	34,097,356	485,855,418
Accrued investment income	1,834,079	—
Prepaid expenses	1,053,057	416,861
Restricted cash	—	40,338,155
Deferred policy acquisition costs, net	4,226	—
Goodwill and other intangible assets	3,634,197	3,634,197
Software and equipment, net	9,053,995	7,550,095
Other assets	59,050	108,802
Total Assets	$461,718,976	$542,767,734
Liabilities		
Accounts payable and accrued expenses	$9,275,843	$8,707,573
Placement fee payable	—	38,305,405
Purchase consideration payable	—	2,032,750
Warrant liability	5,452,428	4,841,765
Deferred tax liability	132,600	132,600
Total Liabilities	14,860,871	54,020,093
Commitments and Contingencies		
Shareholders' Equity		
Common stock - Class A shares, $0.01 par value, 55,637,480 and 55,250,100 shares issued and outstanding as of September 30, 2013 and December 31, 2012, respectively (250,000,000 shares authorized)	556,375	552,501
Common stock - Class B shares, $0.01 par value, 0 and 250,000 shares issued and outstanding as of September 30, 2013 and December 31, 2012, respectively (250,000 authorized)	—	2,500
Additional paid-in capital	524,280,385	517,032,619
Accumulated other comprehensive (loss) income	(7,038,655)	559
Deficit accumulated during the development phase	(70,940,000)	(28,840,538)
Total Shareholders' Equity	446,858,105	488,747,641
Total Liabilities and Shareholders' Equity	$461,718,976	$542,767,734

See accompanying notes to consolidated financial statements.

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NMI HOLDINGS, INC. (A Development Stage Company)
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

	Three Months Ended September 30,		Nine months ended September 30,		For the Period from May 19, 2011 (inception) to September 30
	2013	2012	2013	2012	2013
Revenues					
Direct premiums written	$481,529	$—	$482,566	$—	$482,566
Increase (decrease) in unearned premiums	—	—	—	—	—
Net premiums earned	481,529	—	482,566	—	482,566
Net investment income	1,519,361	874	3,336,150	874	3,341,975
Net realized investment gains (losses)	(308,418)	—	172,291	—	172,291
Gain (Loss) from change in fair value of warrant liability	468,848	—	(610,663)	—	(332,859)
Total Revenues	2,161,320	874	3,380,344	874	3,663,973
Expenses					
Payroll and related	7,090,357	4,085,597	20,896,375	5,914,924	32,455,289
Share-based compensation	1,967,980	2,045,215	8,827,053	3,091,096	14,942,413
Depreciation and amortization	2,045,306	—	3,892,054	—	3,894,971
Professional fees	2,348,771	1,143,135	5,576,684	2,470,368	11,079,486
Information technology	1,328,268	281,364	3,455,087	281,364	4,327,540
Travel and related costs	262,701	227,634	965,569	424,502	1,691,033
Rent and office expenses	212,040	97,852	524,849	124,690	757,841
Financial fees and interest expense	—	—	—	1,628,635	1,632,364
Loss on impairment	—	—	—	—	1,200,000
Other	778,571	232,750	1,342,135	760,118	2,623,036
Total Expenses	16,033,994	8,113,547	45,479,806	14,695,697	74,603,973
Net Loss	$(13,872,674)	$(8,112,673)	$(42,099,462)	$(14,694,823)	$(70,940,000)
Share Data					
Basic and Diluted loss per share	$(0.25)	$(0.15)	$(0.76)	$(0.46)	$(2.11)
Weighted average common shares	55,637,480	55,500,100	55,589,674	32,003,750	33,585,018
Other Comprehensive Income (Loss) (net of tax)					
Net unrealized holding gains (losses) for the period included in accumulated other comprehensive income (loss)	2,283,106	—	(7,039,214)	—	(7,038,655)
Other Comprehensive Income (Loss) (net of tax)	2,283,106	—	(7,039,214)	—	(7,038,655)
Total Comprehensive Loss	$(11,589,568)	$(8,112,673)	$(49,138,676)	$(14,694,823)	$(77,978,655)

See accompanying notes to consolidated financial statements.

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NMI HOLDINGS, INC. (A Development Stage Company)
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(UNAUDITED)

	Common stock Class A		Class B		Additional Paid-in capital	Accumulated other comprehensive income (loss)	Deficit Accumulated During the Development Phase	Total
	Shares	Amount	Shares	Amount				
Period from year-ended December 31, 2011								
Balance, December 31, 2011	100	$1	—	$—	$—	$—	$(1,348,825)	$(1,348,824)
Issuance of Class A shares of common stock	55,000,000	550,000	—	—	508,419,759	—	—	508,969,759
Issuance of Class B shares of common stock	—	—	250,000	2,500	—	—	—	2,500
Issuance of common stock related to acquisition of subsidiaries	250,000	2,500	—	—	2,497,500	—	—	2,500,000
Share-based compensation expense	—	—	—	—	6,115,360	—	—	6,115,360
Change in unrealized investment gains	—	—	—	—	—	559	—	559
Net loss	—	—	—	—	—	—	(27,491,713)	(27,491,713)
Balance, December 31, 2012	55,250,100	$552,501	250,000	$2,500	$517,032,619	$559	$(28,840,538)	$488,747,641
Period from May 19, 2011 (inception) to September 30, 2013								
Balance, May 19, 2011	—	$—	—	$—	$—	$—	$—	$—
Issuance of Class A shares of common stock	55,137,480	551,375	—	—	506,840,472	—	—	507,391,847
Issuance of Class B shares of common stock	—	—	250,000	2,500	—	—	—	2,500
Conversion of Class B shares of common stock into Class A shares of common stock	250,000	2,500	(250,000)	(2,500)	—	—	—	—
Issuance of common stock	250,000	2,500	—	—	2,497,500	—	—	2,500,000

related to acquisition of subsidiaries								
Share-based compensation expense	—	—	—	—	14,942,413	—	—	14,942,413
Change in unrealized investment gains/losses	—	—	—	—	—	(7,038,655)	—	(7,038,655)
Net loss	—	—	—	—	—	—	(70,940,000)	(70,940,000)
Balance, September 30, 2013	55,637,480	$556,375	—	$—	$524,280,385	$(7,038,655)	$(70,940,000)	$446,858,105
Nine months ended September 30, 2013								
Balance, December 31, 2012	55,250,100	$552,501	250,000	$2,500	$517,032,619	$559	$(28,840,538)	$488,747,641
Issuance of Class A shares of common stock	137,380	1,374	—	—	(1,579,287)	—	—	(1,577,913)
Conversion of Class B shares of common stock into Class A shares of common stock	250,000	2,500	(250,000)	(2,500)	—	—	—	—
Share-based compensation expense	—	—	—	—	8,827,053	—	—	8,827,053
Change in unrealized investment gains/losses	—	—	—	—	—	(7,039,214)	—	(7,039,214)
Net loss	—	—	—	—	—	—	(42,099,462)	(42,099,462)
Balance, September 30, 2013	55,637,480	$556,375	—	$—	$524,280,385	$(7,038,655)	$(70,940,000)	$446,858,105

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC. (A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine months ended September 30, 2013	For the Nine months ended September 30, 2012	For the Period from May 19, 2011 (inception) to September 30, 2013
Cash Flows from Operating Activities			
Net loss	$(42,099,462)	$(14,694,823)	$(70,940,000)
Adjustments to reconcile net loss to net cash used in operating activities:			
Share-based compensation expense	8,827,053	3,091,096	14,942,413
Warrants issued in connection with line of credit	—	1,619,569	1,619,569
Loss from change in fair value of warrant liability	610,663	—	332,859
Net realized investment gains	(172,291)	—	(172,291)
Loss on impairment	—	—	1,200,000
Depreciation and other amortization	5,409,867	—	5,412,784
Accrued investment income	(1,834,079)	—	(1,839,904)
Changes in operating assets and liabilities:			
Prepaid expense	(636,196)	(200,211)	(1,053,057)
Deferred policy acquisition costs, net	(4,226)	—	(4,226)
Other assets	49,752	(47,716)	(55,244)
Accounts payable and accrued expenses	568,270	1,368,314	6,474,873
Net Cash Used in Operating Activities	(29,280,649)	(8,863,771)	(44,082,224)
Cash Flows from Investing Activities			
Purchase of short-term investments	(509,964)	(3,457,717)	(5,371,592)
Purchase of fixed maturities, available-for-sale	(559,752,153)	—	(559,752,153)
Proceeds from maturity of short-term investments	5,375,000	—	5,375,000
Proceeds from sale of fixed maturities, available-for-sale	139,383,571	—	139,383,571
Purchase of software and equipment	(5,395,954)	(654,597)	(7,842,458)
Acquisition of subsidiaries	—	(2,500,000)	(2,500,000)
Net Cash Used in Investing Activities	(420,899,500)	(6,612,314)	(430,707,632)
Cash Flows from Financing Activities			
Payments on line of credit	—	(205,318)	—
Taxes paid related to net share settlement of equity awards	(1,577,913)	—	(1,577,913)
Issuance of common stock	—	510,465,124	510,465,125
Net Cash (Used in) Provided by Financing Activities	(1,577,913)	510,259,806	508,887,212
Net (Decrease) Increase in Cash and Cash Equivalents	(451,758,062)	494,783,721	34,097,356
Cash and Cash Equivalents, beginning of period	485,855,418	1	—
Cash and Cash Equivalents, end of period	$34,097,356	$494,783,722	$34,097,356
Supplemental Disclosures of Cash Flow Information			
Restricted Cash	$—	$20,830,488	$40,338,155
Noncash Financing Activities			
Conversion of Class B shares of common stock into Class A shares of common stock	2,500	—	2,500
Acquisition of subsidiaries			
Warrants issued in connection with acquisition of subsidiaries	—	3,500,000	3,500,000

Common stock issued in connection with acquisition of subsidiaries	—	2,500,000	2,500,000

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC. (A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Organization and Basis of Presentation

NMI Holdings, Inc. (A Development Stage Company) ("the Company"), a Delaware corporation, was formed in May 2011 with the intention of providing private mortgage guaranty insurance through a wholly owned insurance subsidiary. From May 2011 through March 2013, the Company's activities were limited to raising capital, seeking to acquire the assets and approvals necessary to become a private mortgage guaranty insurance provider and hiring personnel. The accompanying consolidated financial statements include the accounts of NMI Holdings, Inc. and its wholly owned subsidiaries, MAC Financial Holding Corporation, National Mortgage Insurance Corporation ("NMIC"), previously named Mortgage Assurance Corporation, National Mortgage Reinsurance Inc One ("NMI Re One"), previously named Mortgage Assurance Reinsurance Inc One, and National Mortgage Reinsurance Inc Two ("NMI Re Two"), previously named Mortgage Assurance Reinsurance Inc Two. In April 2013, the Company, through its primary insurance subsidiary, began writing its first mortgage guaranty insurance policies. On September 30, 2013, the Company merged NMI Re Two into NMIC with NMIC surviving the merger and MAC Financial Holding Corporation merged into NMI Holdings, Inc., with NMI Holdings, Inc. surviving the merger.

On November 30, 2011, the Company entered into an agreement with MAC Financial Ltd. to acquire MAC Financial Holding Corporation and its subsidiaries, Mortgage Assurance Corporation, Mortgage Assurance Reinsurance Inc One and Mortgage Assurance Reinsurance Inc Two, for approximately $8.5 million in cash, common stock and warrants plus the assumption of approximately $1.3 million in liabilities ("MAC Acquisition"). In addition, the Company incurred $0.1 million in tax liabilities as a result of the acquisition of certain indefinite-lived intangibles. The acquisition was completed in April 2012.

In April 2012, the Company offered and sold 55.0 million shares of common stock at an issue price of $10.00 per share. Gross proceeds from the offering were $550.0 million. Net proceeds from the offering, after an approximate 7% underwriting fee and other offering expenses, were approximately $510 million. The fee was escrowed for the benefit of FBR Capital Markets and Co. ("FBR") and was released to FBR upon the Company's receipt of approval from Federal National Home Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac") ("GSE Approval"). An additional $1.5 million in offering expenses were paid by the Company upon GSE Approval in January 2013.

Under the terms of the offering, the Company had until January 17, 2013 to obtain GSE Approval ("GSE Approval Deadline"). The Company was approved as an eligible mortgage guaranty insurer by Freddie Mac and Fannie Mae, on January 15, 2013 and January 16, 2013, respectively, which approvals are conditioned upon the Company maintaining certain conditions.

Basis of Presentation

The accompanying consolidated financial statements include the results of the Company and its wholly owned subsidiaries. All intercompany transactions have been eliminated. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). The accounts of the Company and its subsidiaries are maintained in US dollars. The preparation of financial statements in accordance with generally accepted accounting principles 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.

Basic net loss per share is based on the weighted-average number of common shares outstanding, while diluted net loss per share is based on the weighted-average number of common shares outstanding and common stock equivalents that would be issuable upon the exercise of stock options, other stock-based compensation arrangements, and the dilutive effect of outstanding warrants. As a result of the Company's net loss for the three and nine months ended September 30, 2013, 5,304,693 shares of the Company's common stock equivalents issued under stock-based compensation arrangements and warrants were not included in the calculation of diluted net loss per share as of such

dates because they were anti-dilutive. As a result of the Company's net loss for the three and nine months ended September 30, 2012, 4,414,165 shares of the Company's common stock equivalents issued under stock-based compensation arrangements and warrants were not included in the calculation of diluted net loss per share as of such dates because they were anti-dilutive.

2. Summary of Accounting Principles

Cash and Cash Equivalents

The Company considers items such as certificates of deposit and money market funds with original maturities of 90 days or less to be cash equivalents.

NMI HOLDINGS, INC. (A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The Company had restricted cash as of December 31, 2012. The restricted cash balance was comprised of two escrow accounts that were initially funded on April 24, 2012 with an agreement that the funds would be released upon GSE Approval. The restricted cash was payable to FBR and MAC Financial Ltd. and was released from escrow on January 23, 2013. There was no restricted cash as of September 30, 2013.

Investments

The Company has designated its investment portfolio as available-for-sale and is reported at fair value. The related unrealized gains and losses are, after considering the related tax expense or benefit, recognized as a component of accumulated other comprehensive income (loss) in shareholders' equity. Net realized investment gains and losses are reported in income based upon specific identification of securities sold.

Purchases and sales of investments are recorded on a trade date basis. Net investment income is recognized when earned and includes interest and dividend income together with amortization of market premiums and discounts using the effective yield method and is net of investment management fees and other investment related expenses. For asset-backed securities and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any adjustments required due to the change in effective yields and maturities are recognized on a prospective basis through yield adjustments.

Each quarter the Company evaluates the investments in order to determine whether declines in fair value below amortized cost were considered other-than-temporary in accordance with applicable guidance. In evaluating whether a decline in fair value is other-than-temporary, the Company considers several factors including, but not limited to:

- the Company's intent to sell the security or whether it is more likely than not that the Company will be required to sell the security before recovery;
- severity and duration of the decline in fair value;
- the financial condition of the issuer;
- failure of the issuer to make scheduled interest or principal payments;
- recent credit downgrades of the applicable security or the issuer below investment grade; and
- adverse conditions specifically related to the security, an industry, or a geographic area.

Under the current guidance, a debt security impairment is deemed other than temporary if (1) the Company either intends to sell the security, or it is more likely than not that the Company will be required to sell the security before recovery or (2) the Company does not expect to collect cash flows sufficient to recover the amortized cost basis of the security. In the event of the decline in fair value of a debt security, a holder of that security that does not intend to sell the debt security and for whom it is more likely than not that such holder will be required to sell the debt security before recovery of its amortized cost basis is required to separate the decline in fair value into (a) the amount representing the credit loss and (b) the amount related to other factors. The amount of total decline in fair value related to the credit loss shall be recognized in earnings as other-than-temporary impairment ("OTTI") with the amount related to other factors recognized in accumulated other comprehensive income or loss, net of tax. In periods after recognition of an OTTI on debt securities, the Company accounts for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI were recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted into net investment income. The determination of OTTI is a subjective process, and different judgments and assumptions could affect the timing of the loss realization.

Revenue Recognition

In the mortgage guaranty insurance industry, a “book” is a group of loans that an MI ("Mortgage Insurance") company insures in a particular period, normally a calendar year. The Company sets premiums at the time a policy is issued based on the Company's expectations regarding likely performance over the term of coverage. The policies the Company writes are guaranteed renewable contracts at the policyholder's option on a single, annual or monthly premium basis. The Company generally has no ability to reunderwrite or reprice these contracts. Premiums written on a single premium basis and an annual premium basis are initially deferred as unearned premium reserve and earned

over the policy term. Premiums written on policies covering more than one year are amortized over the policy life in accordance with the expiration of risk which is the anticipated claim payment pattern based on industry experience. Premiums written on annual policies are earned on a monthly pro rata basis. Premiums written on monthly policies are earned as coverage is provided. Premiums written on pool transactions are earned over the period that coverage is provided. Upon cancellation of a policy, all premium that is non-refundable is immediately earned. Any refundable premium is returned to the policyholder. The actual return of premium for all periods affects premiums written and earned in those periods.

NMI HOLDINGS, INC. (A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Deferred Policy Acquisition Costs

Costs directly associated with the successful acquisition of mortgage guaranty insurance business, consisting of certain employee compensation and other policy issuance and underwriting expenses, are initially deferred and reported as deferred policy acquisition costs ("DAC"). For each book year of business, these costs are amortized to income in proportion to estimated gross profits over the estimated life of the policies.

Business Combinations, Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the estimated fair value of net assets acquired from a business combination. In accordance with Accounting Standards Codification ("ASC") 350, Intangibles - Goodwill and Other, the Company will test goodwill for impairment during the third quarter each year or more frequently if the Company believes indicators of impairment exist. The Company has not identified any impairments of goodwill through September 30, 2013.

The Company's intangible assets consist of state licenses and GSE applications which have indefinite lives. The Company tests indefinite-lived intangible assets for impairment during the fourth quarter of each year or more frequently if the Company believes indicators of impairment exist. The Company does not believe that the indefinite-lived intangible assets were impaired as of September 30, 2013.

Software and Equipment

Software and equipment are stated at cost, less accumulated amortization and depreciation. Amortization and depreciation are calculated using the straight-line method over the estimated useful lives of the respective assets ranging typically from 3 to 7 years, unless factors indicate a shorter useful life. During the second quarter of 2013, the Company conducted an analysis on the existing Insurance Management System ("IMS"), which was acquired in connection with the MAC Acquisition, and evaluated development efforts in pursuit of designing a system that would meet the Company's business requirements. Based on that analysis, the Company made the business decision during the second quarter of 2013 to pursue the development of new modules to support policy servicing, billing and delinquency and claims management business functions. As a result of the change in approach, the Company reduced the useful life of the modules of IMS that support these business functions and shortened the amortization period of the modules to 7 and 18 months. Amortization of software and depreciation of equipment commences at the beginning of the month following the placement of the assets into use by the Company.

Warrants

The Company accounts for warrants to purchase common shares of the Company that were issued to FBR and MAC Financial Ltd. in conjunction with the line of credit and stock purchase agreement, respectively, in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 470-20 Debt with Conversion and Other Options and ASC 815-40 Derivatives and Hedging - Contracts in Entity's Own Equity. These warrants may be settled by the Company using the physical settlement method or through cashless exercises in which shares subject to the warrants are reduced in lieu of cash payment of the exercise price. The exercise price and the number of warrants are subject to anti-dilution provisions whereby the existing exercise price is adjusted downward and the number of warrants increased for events that may not be dilutive and the adjustment may be in excess of any dilution suffered. As a result, the warrants are classified as a liability. The Company revalues the warrants at the end of each reporting period and any change in fair value is reported in the statements of operations in the period in which the change occurred. The fair value of the warrants is calculated using a Black-Scholes option-pricing model in combination with a binomial model and a Monte Carlo simulation model used to value the pricing protection features within the warrant.

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Stock-Based Compensation

The Company adopted ASC 718, Compensation - Stock Compensation ("ASC 718"). ASC 718 addresses accounting for share-based awards and recognition of compensation expense, measured using grant date fair value, over the requisite service or performance period of the award. Share-based payments include restricted stock units and stock option grants under the 2012 Stock Incentive Plan. The fair value of stock option grants issued are determined based on an option pricing model which takes into account various assumptions that are subjective. Key assumptions used in the stock option valuation include the expected term of the equity award taking into account the contractual term of the award, the effects of expected exercise and post-vesting termination behavior, expected volatility, expected dividends and the risk-free interest rate for the expected term of the award. Restricted stock unit grants to employees contain a market condition and/or service condition. The fair value of restricted stock unit grants to employees with a market condition is determined based on a Monte Carlo simulation model at the date of grant. Restricted stock unit grants to employees with a service condition and restricted stock unit grants to non-employee directors are valued at the Company's stock price on the date of grant less the present value of anticipated dividends.

Offering and Incorporation Expenses

Offering expenses incurred in connection with the capitalization of the Company were recorded as a reduction of paid-in-capital at closing. These costs include certain investment banking fees, legal fees, printer fees and audit fees. Any incorporation and organizational expenses not related to the raising of capital are expensed as incurred and are included in the statement of operations.

Income Taxes

The Company accounts for income taxes using the liability method in accordance with FASB ASC Topic 740 - Income Taxes. The liability method measures the expected future tax effects of temporary differences at the enacted tax rates applicable for the period in which the deferred asset or liability is expected to be realized or settled. Temporary differences are differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements that will result in future increases or decreases in taxes owed on a cash basis compared to amounts already recognized as tax expense in the consolidated statement of operations.

The Company evaluates the need for a valuation allowance against its deferred tax assets on a quarterly basis. In the course of its review, the Company assesses all available evidence, both positive and negative, including future sources of income, tax planning strategies, future contractual cash flows and reversing temporary differences. Additional valuation allowance benefits or charges could be recognized in the future due to changes in management's expectations regarding the realization of tax benefits. Uncertain tax positions taken or expected to be taken in a tax return by the Company are recognized in the financial statements when it is more likely than not that the position would be sustained upon examination by tax authorities. There are no tax uncertainties that are expected to result in significant increases or decreases to unrecognized tax benefits within the next twelve month period.

In assessing the valuation of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

Recent Accounting Developments Not Adopted

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued an Accounting Standards Update addressing the reporting of reclassifications out of accumulated other comprehensive income. The Update requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the statement of operations if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. For public entities, the amendments are effective for reporting periods beginning after December 15, 2012. For nonpublic entities, the amendments are effective for reporting periods

beginning after December 15, 2013. Early adoption is permitted. The Company expects this guidance to affect financial statement disclosures but not to have an impact on the Company's results of operations, financial position or liquidity.

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Recent Accounting Standards Updates Adopted
Nonpublic Entity Disclosures about Financial Instruments
In February 2013, the FASB issued an Accounting Standards Update clarifying the intended scope of the disclosures required by Update 2011-04, Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments clarify that the requirement to disclose "the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3)" does not apply to nonpublic entities for items that are not measured at fair value in the statement of financial position but for which fair value is disclosed. The amendments were effective upon issuance. The adoption of this guidance in February 2013 did not have any effect on the Company's results of operations, financial position or liquidity.
Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities
In January 2013, the FASB issued an Accounting Standards Update clarifying that the scope of Update 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities, applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The amendments are effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance in January 2013 did not have any effect on the Company's results of operations, financial position or liquidity.
Reclassifications
Certain items in the financial statements as of December 31, 2012 and for the periods ending September 30, 2012 and for the period from May 19, 2011 (inception) to September 30, 2013 have been reclassified to conform to the current period's presentation. There was no effect on net income or shareholders' equity previously reported.
3. Common Stock Offering
The Company entered into a purchase/placement agreement with FBR on April 17, 2012 and offered and sold an aggregate of 55,000,000 of its class A common shares resulting in net proceeds of approximately $510 million. In accordance with the terms of the Offering, the Company placed approximately 93% (or $476 million) of the Company's net proceeds from this offering into investment accounts established for the purpose of preserving such proceeds on a short-term basis, prior to approval from at least one of the GSEs as an eligible mortgage guaranty insurance provider to the GSE. As provided in the Company's Certificate of Incorporation, this amount was not to be disbursed (used for operating activities) until the earlier of (i) receipt by the Company of GSE Approval or (ii) the liquidation of the Company. Approximately $35 million of the net proceeds were available for paying the cash portion of the MAC Acquisition and to pay off the FBR loan. The remaining balance of approximately $32 million was placed in an operating account for the purpose of funding the Company's operations through the time of GSE Approval.
The initial purchaser's discount and placement fee of $38.3 million was comprised of $19.5 million in common stock and $18.8 million in cash. On October 24, 2012, FBR sold the aforementioned common stock and proceeds of $19.5 million were retained in an escrow account until the Company received GSE Approval.
In January 2013, following GSE Approval, the escrow funds were released and distributed to FBR (its initial purchasers' discount and placement fees from the escrow account) and to MAC (its cash portion of the MAC Acquisition), respectively.
4. Acquisition of MAC
On November 30, 2011, the Company entered into a definitive stock purchase agreement with MAC Financial Ltd. to acquire MAC Financial Holdings Corporation and its wholly owned subsidiaries (collectively "MAC"). The transaction closed shortly after the closing of the common stock offering described above. Under the agreement, the total initial consideration paid for MAC was $8.5 million consisting of $2.5 million in cash, $2.5 million in the Company's common stock, and warrants to acquire the Company's common stock valued at $3.5 million. The consideration (net of expenses paid on MAC's behalf) was held in an escrow account until the Company received GSE

Approval, upon which time it was released to MAC Financial Ltd. The total purchase consideration was allocated to the acquired assets and liabilities as follows:

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April 24, 2012	
Current assets	$52,159
Intangibles	1,590,000
Capitalized software	5,000,000
Goodwill	3,244,197
Subtotal	9,886,356
Current liabilities and deferred tax liabilities	(1,386,356)
Estimated fair value of net assets acquired	$8,500,000

Pursuant to the terms of the stock purchase agreement, the Company assumed approximately $1.3 million of MAC's existing liabilities, which related to outstanding payment obligations under its vendor contracts with CDW, LLC, Milliman, Inc., and Intellect/SEEC, Inc. and incurred $0.1 million in tax liabilities as a result of the acquisition of certain indefinite-lived intangibles. All other liabilities which existed at closing are the sole obligation of MAC Financial Ltd. As of September 30, 2013 and December 31, 2012, the total amount of cash held in escrow (net of expenses paid on MAC's behalf) was $0 and $2.0 million, respectively.

Included in the acquired intangibles of $1.6 million are operational manuals valued at $1.2 million which at the time of acquisition, were a key deliverable in the Company's GSE application and were expected to be placed in service following GSE approval. Subsequently, the processes and procedures underlying the operational manuals were reengineered to be substantially different as defined by the Company's current management. Therefore, at December 31, 2012 the Company determined the carrying value of operational manuals would not be recovered and the manuals could not be sold and would be disposed of, and as a result, the Company assessed the fair value at zero and recognized a loss on impairment of $1.2 million in the fourth quarter of 2012.

5. Investments

As of September 30, 2013, there were approximately $7 million of cash and investments in the form of U.S. Treasury securities on deposit with various state insurance departments to satisfy regulatory requirements.

Fair Values and Gross Unrealized Gains and Losses on Investments

	Amortized Cost	Gross Unrealized Gains	(Losses)	Fair Value
As of September 30, 2013				
U.S. Treasury securities and obligations of U.S. government agencies	$108,067,508	$—	$(1,178,688)	$106,888,820
Municipal bonds	12,019,214	—	(103,372)	11,915,842
Corporate debt securities	224,245,377	150,482	(4,818,660)	219,577,199
Asset-backed securities	74,689,572	81,955	(1,170,372)	73,601,155
Total Investments	$419,021,671	$232,437	$(7,271,092)	$411,983,016

	Amortized Cost	Gross Unrealized Gains	(Losses)	Fair Value
As of December 31, 2012				
Short-term investments	$4,863,647	$559	$—	$4,864,206
Total Investments	$4,863,647	$559	$—	$4,864,206

Scheduled Maturities as of September 30, 2013

The amortized cost and fair values of available for sale securities at September 30, 2013, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Because most asset-backed securities provide for periodic payments throughout their lives, they are listed below in separate categories.

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	Amortized Cost	Fair Value
Due in one year or less	$—	$—
Due after one through five years	253,500,682	250,727,716
Due after five through ten years	75,369,556	72,704,193
Due after ten years	15,461,861	14,949,952
Asset-backed securities	74,689,572	73,601,155
Total Investments	$419,021,671	$411,983,016

All investments held at December 31, 2012 had a scheduled maturity of one year or less.

Net Realized Investment (Losses) Gains on Investments

	Three Months Ended September 30, 2013	Nine months ended September 30, 2013	For the Period from May 19, 2011 (inception) to September 30, 2013
Corporate Bond	$(206,875)	$309,234	$309,234
U.S. Treasury securities and obligations of U.S. government agencies	(71,700)	(87,359)	(87,359)
Mortgage-backed security	(29,843)	(49,584)	(49,584)
Total Net Realized Investment (Losses) Gains	$(308,418)	$172,291	$172,291

There were no realized investment gains or losses for the three and nine months ended September 30, 2012.

Aging of Unrealized Losses

At September 30, 2013, the investment portfolio had gross unrealized losses of approximately $7 million. For those securities in an unrealized loss position, the length of time the securities were in such a position, as measured by their month-end fair values, is as follows:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
As of September 30, 2013						
U.S. Treasury Securities and Obligations of U.S. government agencies	$106,888,820	$(1,178,688)	$—	$—	$106,888,820	$(1,178,688)
Municipal bonds	11,915,842	(103,372)	—	—	11,915,842	(103,372)
Corporate debt securities	197,641,652	(4,818,660)	—	—	197,641,652	(4,818,660)
Assets-backed securities	66,012,200	(1,170,372)	—	—	66,012,200	(1,170,372)
Total Investments	$382,458,514	$(7,271,092)	$—	$—	$382,458,514	$(7,271,092)

At December 31, 2012, the investment portfolio had no unrealized losses.

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Net investment income is comprised of the following:

	Nine months ended September 30, 2013	For the Nine months ended September 30, 2012	For the Year Ended December 31, 2012	For the Period From May 19, 2011 (inception) to September 30, 2013
Fixed maturities	$3,663,254	$874	$2,019	$3,665,273
Cash equivalents	—	—	3,806	3,806
Other	1,517	—	—	1,517
Investment income	3,664,771	874	5,825	3,670,596
Investment expenses	(328,621)	—	—	(328,621)
Net Investment Income	$3,336,150	$874	$5,825	$3,341,975

6. Fair Value of Financial Instruments

The following describes the valuation techniques used by the Company to determine the fair value of financial instruments held at September 30, 2013 and December 31, 2012:

The Company 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 - Unadjusted quoted prices for identical assets or liabilities in active markets that are accessible at the measurement date for identical assets or liabilities;

Level 2 - Prices or valuations based on observable inputs other than quoted prices in active markets for identical assets and liabilities; and

Level 3 - Unobservable inputs that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The level of market activity used to determine the fair value hierarchy is based on the availability of observable inputs market participants would use to price an asset or a liability, including market value price observations.

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. The Company has not made any adjustments to the prices obtained from the independent pricing sources.

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Liabilities classified as Level 3
The warrants held by FBR and MAC Financial Ltd. and are valued using a Black-Scholes option-pricing model in combination with a binomial model and Monte Carlo simulation used to value the pricing protection features within the warrant. Variables in the model include the risk-free rate of return, dividend yield, expected life and expected volatility of the Company's stock price. Any potential value associated with pricing protection features are assessed using internal models and management estimation.
ASC 825, "Disclosures about Fair Value of Financial Instruments", requires all entities to disclose the fair value of their financial instruments, both assets and liabilities recognized and not recognized in the balance sheet, for which it is practicable to estimate fair value.
The following is a list of those assets and liabilities that are measured at fair value by hierarchy level as of September 30, 2013 and December 31, 2012:

	Fair Value Measurements Using			
Assets and Liabilities at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
As of September 30, 2013				
U.S. Treasury securities and obligations of U.S. government agencies	$106,888,820	$—	$—	$106,888,820
Municipal bonds	—	11,915,842	—	11,915,842
Corporate debt securities	—	219,577,199	—	219,577,199
Asset-backed securities	—	73,601,155	—	73,601,155
Cash and cash equivalents	34,097,356	—	—	34,097,356
Total Assets	$140,986,176	$305,094,196	$—	$446,080,372
Warrant liability	—	—	$5,452,428	$5,452,428
Total Liabilities	$—	$—	$5,452,428	$5,452,428

	Fair Value Measurements Using			
Assets and Liabilities at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
As of December 31, 2012				
U.S. Treasury securities and obligations of U.S. government agencies	$4,864,206	$—	$—	$4,864,206
Cash and cash equivalents	526,193,573	—	—	526,193,573
Total Assets	$531,057,779	$—	$—	$531,057,779
Warrant liability	—	—	$4,841,765	$4,841,765
Total Liabilities	$—	$—	$4,841,765	$4,841,765

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The following is a roll-forward of Level 3 liabilities measured at fair value for the nine months ended September 30, 2013:

Nine months ended September 30, 2013 Level 3 Instruments Only	Total Fair Value Measurements Warrant Liability
Balance, January 1, 2013	$4,841,765
Change in fair value of warrant liability included in earnings	610,663
Balance, September 30, 2013	$5,452,428

Period from May 19, 2011 (inception) to September 30, 2013 Level 3 Instruments Only	Total Fair Value Measurements Warrant Liability
Balance, May 19, 2011	$—
Initial fair value of warrant liability	5,119,569
Change in fair value of warrant liability included in earnings	332,859
Balance, September 30, 2013	$5,452,428

The fair value of the warrants issued to FBR and MAC Financial Ltd. was estimated on the date of grant using the Black-Scholes option-pricing model, including consideration of any potential additional value associated with pricing protection features. The volatility assumption used, 39.0%, was derived from the historical volatility of the share price of a range of publicly-traded companies with similar types of business to that of the Company. No allowance was made for any potential illiquidity associated with the private trading of the Company's shares. The Company revalues the warrant liability quarterly using a Black-Scholes option-pricing model in combination with a binomial model and a Monte-Carlo simulation model used to value the pricing protection features within the warrant. As of September 30, 2013 the assumptions used in the option pricing model were as follows: a common stock price as of September 30, 2013 of $11.40, risk free interest rate of 2.03%, expected life of 7.06 years and a dividend yield of 0%.

The carrying value of other selected assets on our consolidated balance sheet approximates fair value.

7. Software and Equipment

Software and equipment consist largely of capitalized software purchased in connection with the MAC Acquisition which had a fair value of $5.0 million at the date of acquisition. Software and equipment, net of accumulated amortization and depreciation, as of September 30, 2013 and December 31, 2012, consist of the following:

As of September 30, 2013		
Software	$12,526,481	
Equipment	387,446	
Leasehold Improvements	35,039	
Less accumulated amortization and depreciation	(3,894,971	)
Software and equipment, net	$9,053,995	
As of December 31, 2012		
Software	$7,268,439	
Equipment	284,573	
Less accumulated amortization and depreciation	(2,917	)
Software and equipment, net	$7,550,095	

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Amortization and depreciation expense for the three and nine months ended September 30, 2013 was $2.0 million and $3.9 million, respectively. During the second quarter of 2013, the Company conducted an analysis on the existing Insurance Management System ("IMS") which was acquired in connection with the MAC Acquisition. Based on that analysis, the Company made the business decision during the second quarter of 2013 to pursue the development of new modules to support policy servicing, billing and delinquency and claims management business functions. As a result of the change in approach, during the second quarter the Company reduced the useful life of the modules of IMS that support these business functions and shortened the amortization period to a range of 7 and 18 months. There was no amortization and depreciation expense for the three and nine months ended September 30, 2012.

8. Intangible Assets

Intangible assets consist of identifiable intangible assets purchased in connection with the MAC Acquisition.
Intangible assets, net, as of September 30, 2013 and December 31, 2012, consist of the following:

As of September 30, 2013 and December 31, 2012		Expected Lives
State licenses	$260,000	Indefinite
GSE Approvals	130,000	Indefinite
Total Intangible Assets	$390,000	

The Company tests goodwill and intangibles for impairment in the third and fourth quarter, respectively, of every year, or more frequently if the Company believes indicators of impairment exist. At the time of the MAC Acquisition, the Company, as part of the acquisition, acquired operational manuals that were a key deliverable in the Company's GSE application and were expected to be placed in service following GSE Approval. Subsequently, the processes and procedures underlying the operational manuals were reengineered to be substantially different as defined by the Company's current management. Therefore, at December 31, 2012 the Company determined the carrying value of operational manuals would not be recovered and the manuals could not be sold and would be disposed, and as a result, assessed the fair value at zero and recognized a loss on impairment of $1.2 million. No impairments of indefinite-lived intangibles were identified as of September 30, 2013.

9. Commitments and Contingencies

GSE Approvals

Fannie Mae and Freddie Mac have imposed certain capitalization, operational and reporting conditions in connection with their approvals of NMIC as a qualified mortgage guaranty insurer. Some of these conditions remain in effect for a three (3) year period from the date of GSE Approval while others do not expressly expire. These conditions require, among other things, that NMIC:

- be initially capitalized in the amount of $200 million and that its affiliate reinsurance companies, NMI Re One and NMI Re Two, be initially capitalized in the amount of $10 million each (as of September 30, 2013, NMI Re Two was merged into NMIC, with NMIC surviving the merger. See Note 1. Organization);
- maintain minimum capital of $150 million;
- operate at a risk-to-capital ratio not to exceed 15:1 for its first three (3) years and then pursuant to the GSE Eligibility Requirements then in effect;
- not declare or pay dividends to affiliates or to the Company for its first three (3) years, then pursuant to the Eligibility Requirements;
- not enter into capital support agreements or guarantees for the benefit of, or purchase or otherwise invest in the debt of, affiliates without the prior written approval of the GSEs for its first three (3) years, then pursuant to the Eligibility Requirements;
- not enter into reinsurance or other risk share arrangements without the GSEs' prior written approval for its first three (3) years, then pursuant to the Eligibility Requirements; and
- at the direction of one or both of the GSEs, re-domicile from Wisconsin to another state.

The conditional approvals also include certain additional conditions, limitations and reporting requirements that the Company anticipates will be included in the GSEs' final Eligibility Requirements, such as limits on costs allocated to NMIC under affiliate expense sharing arrangements, risk concentration, rates of return, requirements to obtain a

financial strength rating, provision of

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ancillary services (i.e., non-insurance) to customers, transfers of underwriting to affiliates, notification requirements regarding change of ownership and new five percent (5%) shareholders, provisions regarding underwriting policies and claims processing as well as certain other obligations.

During the third quarter of 2013, NMIC entered into an agreement with Fannie Mae, pursuant to which NMIC insures a pool of approximately 22,000 loans with an aggregate unpaid principal balance of approximately $5.2 billion. The effective date of the agreement and the coverage is September 1, 2013, and in September 2013, NMIC received the first premium payment from Fannie Mae. The agreement has an expected term of 10 years from the coverage effective date.

The initial pool risk-in-force to NMIC, as of September 1, 2013 was approximately $93.1 million which represents the amount between a deductible payable by Fannie Mae on initial losses and a stop loss, above which, losses are borne by Fannie Mae. The pool agreement obligates NMIC to maintain the greater of (1) the risk-to-capital requirements outlined in the January 2013 approval letter, or (2) a risk-to-capital ratio of 18:1 on primary business plus statutory capital equal to the amount of net risk-in-force of the pool. As of September 30, 2013, the pool risk-in-force was $93.1 million.

In addition to the conditions noted above, the Company's insurance subsidiary, NMIC entered into risk-to-capital agreements with certain state insurance regulators. See Note 14. Statutory Financial Information.

Office Lease

The Company entered into an office facility lease effective July 1, 2012 for a term of two years.

Management expects that, in the normal course of business, as of September 30, 2013, future minimum lease payments under this lease will be as follows:

Years ending December 31,	
2013	$205,884
2014	416,176
Totals	$622,060

The Company incurred rent expense, related to this lease, of approximately $0.2 million, and $0.4 million for the three and nine months ended September 30, 2013, respectively. Rent expense for the three and nine months ended September 30, 2012 was approximately $0.1 million.

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10. Income Taxes
Following is a reconciliation of the Company's net deferred income tax asset as of September 30, 2013 and December 31, 2012:

	September 30, 2013	
	Gross	Tax Effected
Deferred tax asset:		
Capitalized start-up costs	$40,318,967	$13,708,449
Stock compensation	13,159,292	4,474,159
Unrealized loss on investments	7,038,655	2,393,143
Net operating loss carry forwards	14,825,590	5,040,701
Other	5,647,019	1,919,986
Total gross deferred tax assets	80,989,523	27,536,438
Less: valuation allowance	78,544,235	26,705,040
Total deferred tax assets	2,445,288	831,398
Deferred tax liability:		
Capitalized Software	(2,439,542)	(829,444)
Intangible Assets	(390,000)	(132,600)
Other	(5,746)	(1,954)
Total deferred tax liabilities	(2,835,288)	(963,998)
Net deferred income tax liability	$(390,000)	$(132,600)

	December 31, 2012	
	Gross	Tax Effected
Deferred tax asset:		
Capitalized start-up costs	$21,796,012	$7,410,644
Net operating loss carry forwards	7,307,344	2,484,497
Total gross deferred tax assets	29,103,356	9,895,141
Less: valuation allowance	24,103,356	8,195,141
Total deferred tax assets	5,000,000	1,700,000
Deferred tax liability:		
Capitalized Software	(5,000,000)	(1,700,000)
Intangible Assets	(390,000)	(132,600)
Total deferred tax liabilities	(5,390,000)	(1,832,600)
Net deferred income tax liability	$(390,000)	$(132,600)

The Company has a net deferred tax liability of approximately$0.1 million as a result of the acquisition of indefinite-lived intangibles in the MAC Acquisition for which a benefit has been reflected in the acquired net operating loss carry forwards. The tax liability incurred at the acquisition is recorded as an increase in Goodwill. Excluded from deferred tax assets is $1.5 million of excess stock compensation for which any benefit realized will be recorded to stockholders' equity. Additionally, Section 382 imposes annual limitations on a corporation's ability to utilize its net operating loss carry forwards ("NOLs") if it experiences an "ownership change." As a result of the MAC Acquisition, $7.3 million of NOLs are subject to annual limitations of approximately $0.8 million through 2016, then $0.3 million. The NOLs will expire in years 2029 through 2033.
As the Company has just recently begun insurance operations and has no history to provide a basis for reliable future net income projections, a valuation allowance of $26.7 million and $8.2 million was recorded at September 30, 2013 and December 31, 2012, respectively, to reflect the amount of the deferred tax asset that may not be realized.

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11. Stock Compensation
The 2012 Stock Incentive Plan (the "Plan") was approved by the Board of Directors (the "Board") on April 16, 2012, and authorized 5.5 million shares be reserved for issuance under the Plan with 3.85 million shares available for stock options and 1.65 million shares available for restricted stock unit grants ("RSUs"). Options granted under the Plan are Non-Qualified Stock Options and may be granted to employees, directors and other key persons of the Company. The exercise price per share for the common stock covered by this Plan shall be determined by the Board at the time of grant, but shall not be less than the fair market value on the date of the grant. The term of the stock option grants will be established by the Board, but no stock option shall be exercisable more than 10 years after the date the stock option is granted. The vesting period of the stock option grants will also be established by the Board at the time of grant and generally is for a three year period.
A summary of option activity in the plan during the period ending September 30, 2013 is as follows:

	Shares	Weighted Average Grant Date Fair Value per Share
Options balance at December 31, 2012	2,546,750	$3.86
Options granted	531,829	4.57
Less: Options forfeited	(14,701)	3.84
Options balance outstanding at September 30, 2013	3,063,878	$3.98

As of September 30, 2013 there were no exercises and 659,723 options were exercisable.
The remaining weighted average contractual life of options outstanding as of September 30, 2013 was 8.8 years. As of September 30, 2013, there was approximately $4.6 million of total unrecognized compensation cost related to non-vested stock options. The weighted-average period over which total compensation related to non-vested stock options will be recognized is 0.96 years.
The Company accounts for stock options under ASC No. 718, Compensation - Stock Compensation ("ASC 718"), which requires all share-based payments to be recognized in the financial statements at their fair values. To measure the fair value of stock options granted, the Company utilizes the Black-Scholes options pricing model. Expense is recognized over the required service period, which is generally the three-year vesting period of the options (vesting in one-third increments per year).
The estimated grant date fair values of the stock options granted during 2013 were calculated using the Black-Scholes valuation model based on the following assumptions:

Expected life	6.00 years	
Risk free interest rate	0.85%	
Dividend yield	0.00	%
Expected stock price volatility	39.00	%
Projected forfeiture rates	1.00	%

Expected Price Volatility - is a measure of the amount by which a price has fluctuated or is expected to fluctuate. At the time of grant, the Company's common shares trading history was less than six months which was not sufficient to calculate an expected volatility representative of the volatility over the expected lives of the options. As a substitute for such estimate, the Company used historical volatilities of a set of comparable companies in the industry in which the Company operates.
Risk-Free Interest Rate - is the U.S. Treasury rate for the date of the grant having a term approximating the expected life of the option.
Expected Lives - is the period of time over which the options granted are expected to remain outstanding giving consideration to vesting schedules, historical exercise and forfeiture patterns. The Company uses the simplified method outlined in SEC Staff Accounting Bulletin No. 107 to estimate expected lives for options granted during the period as historical exercise data is not available and the options meet the requirements set out in the Bulletin. Options

granted have a maximum term of ten years.
Forfeiture Rate - is the estimated percentage of options granted that are expected to be forfeited or canceled before becoming fully vested. An increase in the forfeiture rate will decrease compensation expense.

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Dividend Yield - is calculated by dividing the expected annual dividend by the stock price of the Company at the valuation date.

A summary of restricted stock unit activity in the plan during the period ending September 30, 2013 is as follows:

	Shares	Weighted Average Grant Date Fair Value per Share
Restricted Stock Units balance at December 31, 2012	1,429,260	$7.35
Restricted Stock Units Granted	82,000	11.75
Less: Restricted Stock Units Vested	(262,610)	6.79
Less: Restricted Stock Units Forfeited	—	—
Restricted Stock Units balance outstanding at September 30, 2013	1,248,650	$7.76

In February 2013, the Board of Directors approved a modification to the vesting terms of approximately 400,000 outstanding and unvested restricted stock units held by employees of the Company. The modification to the vesting terms removed the market condition leaving the restricted stock units subject to a service condition only. The modification resulted in a change in the period over which compensation costs are recognized and prospective recognition of incremental compensation cost, measured as the excess of the fair value of the modified award over the fair value of the original award immediately before its terms are modified, measured based on the share price and relevant valuation inputs at the modification date.

At September 30, 2013, the 1.2 million shares of restricted stock units outstanding consisted of 0.5 million shares that are subject to both a market and service condition and 0.7 million shares that are subject only to service conditions. The restricted stock units subject to both a market and service condition vest in one-third increments upon the achievement of certain market price goals and continued service. Restricted stock units subject only to a service condition vest over a service period ranging from 1 to 3 years. The fair value of restricted stock units subject to market and service conditions is determined based on a Monte Carlo simulation model at the date of grant. The fair value of restricted stock units subject only to service conditions are valued at the Company's stock price on the date of grant less the present value of anticipated dividends.

The estimated grant date fair values of the restricted stock units granted in 2012 that are subject to both a market and service condition were calculated using a Monte Carlo simulation model based on the average outcome of 150,000 simulations using the following assumption:

Expected life	5.00 years	
Risk free interest rate	0.86	%
Dividend yield	0.00	%
Expected stock price volatility	39.00	%
Projected forfeiture rates	1.00	%

The remaining weighted average contractual life of RSUs outstanding as of September 30, 2013 was 4.3 years. As of September 30, 2013, there was approximately $4.8 million of total unrecognized compensation cost related to non-vested restricted stock units. The weighted-average period over which total compensation related to non-vested RSUs will be recognized is 0.93 years.

On April 5, 2013 approximately 263,000 restricted stock units containing a market condition vested resulting in an acceleration of compensation expense of approximately $1.1 million in the second quarter of 2013.

12. Line of Credit and Related Warrants

As of December 31, 2011, in connection with the funding of the Company and prior to the offering, FBR granted an uncommitted line of credit up to an aggregate principal amount of $1.5 million to support legal, accounting and others costs associated with the formation and the capitalization of the Company.

As part of the consideration for granting the line of credit, upon successful completion of the common stock offering on April 24, 2012, the Company issued warrants to FBR having an aggregate value equal to three times the amount of

the outstanding line of credit balance. Each warrant gave the holder thereof the right to purchase one share of common stock at an exercise price equal to $10.00. Accordingly, FBR was issued approximately 314,000 warrants with an aggregate fair value of approximately $1.6

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million. These warrants were measured at fair value and recorded as a finance fee with an offsetting charge to liabilities. As the line of credit was paid off on April 24, 2012, the debt discount was fully amortized as of April 24, 2012.

Upon exercise of these warrants, the amounts will be reclassified from warrant liability to additional paid-in capital. The Company is required to revalue the warrants at the end of each reporting period and any change in fair value is reported in the statements of operations as "Gain (Loss) from change in fair value of warrant liability" in the period in which the change occurred. The fair value of the warrants is calculated using a Black-Scholes option-pricing model in combination with a binomial model and a Monte-Carlo simulation model used to value the pricing protection features within the warrant. The loss from the change in fair value for the nine months ended September 30, 2013 was $0.6 million.

13. Litigation

On August 8, 2012, Germaine Marks, as Receiver, and Truitte Todd, as Special Deputy Receiver, of PMI Mortgage Insurance Co. (“PMI”), an Arizona insurance company in receivership, filed a complaint (the “PMI Complaint”) against the Company, NMIC and certain named individuals, in California Superior Court, Alameda County. The PMI Complaint, as amended, alleges breach of fiduciary duty, breach of loyalty, aiding and abetting breach of fiduciary duty and loyalty, misappropriation of trade secrets, conversion, breach of proprietary information agreement, breach of separation agreement and intentional interference with contractual relations and unfair competition. The lawsuit seeks injunctive relief as well as unspecified monetary damages. The litigation is at an early stage of review and evaluation and the Company has filed an answer to PMI's complaint denying all allegations and believes the claims are without merit.

The parties are now engaged in discovery and the court has set a trial date for May 27, 2014. Because the litigation and related discovery are still at an early stage, the Company does not have sufficient information to determine or predict the ultimate outcome or estimate the range of possible losses, if any. Accordingly, no provision for litigation losses has been included in the financial statements.

14. Statutory Information

The Company's insurance subsidiaries, NMIC, NMI Re One and NMI Re Two, file financial statements in conformity with statutory basis accounting principles ("SAP") prescribed or permitted by the Wisconsin Office of the Commission of Insurance ("WOCI"). Prescribed SAP includes state laws, regulations and general administrative rules, as well as a variety of publications of the National Association of Insurance Commissioners ("NAIC"). The WOCI recognizes only statutory accounting practices prescribed or permitted by the state of Wisconsin for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under Wisconsin insurance laws. As of September 30, 2013, NMI Re Two was merged into NMIC, with NMIC surviving the merger. See Note 1. Organization.

Prescribed and permitted practices generally vary in some respects from accounting principles generally accepted in the United States of America ("GAAP"). The principal differences between these accounting practices and GAAP are as follows: (1) acquisition expenses incurred in connection with acquiring new business are charged to expense under SAP but under GAAP are deferred and amortized as the related premiums are earned; (2) under SAP there are limitations on the net deferred tax assets created by the tax effects of temporary differences; (3) under SAP unpaid losses and loss adjustment expense ceded to reinsurers are reported as a deduction of the related reserve rather than as an asset as would be required under GAAP; (4) under SAP, fixed maturity investments are generally valued at amortized cost while under GAAP, those investments are considered to be available-for-sale and are recorded at fair value, with the unrealized gain or loss recognized, net of tax, as an increase or decrease to shareholders' equity.

NMIC's principal regulator is the Wisconsin OCI. Under applicable Wisconsin law, as well as that of 15 other states, a mortgage guaranty insurer must maintain a minimum amount of statutory capital relative to the risk-in-force (Risk to Capital ratio or “RTC ratio”) in order for the mortgage guaranty insurer to continue to write new business. The Company refers to these requirements as the “RTC requirement.” While formulations of minimum capital may vary in each jurisdiction that has such a requirement, the most common measure applied allows for a maximum permitted

RTC ratio of 25 to 1. Wisconsin and certain other states, including California and Illinois, apply a substantially similar requirement referred to as minimum policyholders position. The Company's operation plan filed with the WOCI and other state insurance departments in connection with NMIC's applications for licensure includes the expectation that the Company will downstream additional capital if needed so that NMIC does not exceed an 18 to 1 risk-to-capital ratio. NMIC may in the future seek state insurance department approvals, as needed, of an amendment to the Company's business plan to increase this ratio to the Wisconsin regulatory minimum of 25 to 1.
Additionally, as a condition of GSE Approval, NMIC has agreed with Fannie Mae and Freddie Mac to limit NMIC's RTC ratio to no greater than 15 to 1 and to maintain total statutory capital of at least $150 million for a three year period ending on December 31, 2015. After that date, NMIC agreed to comply with the risk-to-capital ratios that are imposed in the GSEs' then existing

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eligibility requirements. As part of the state licensing process, NMIC entered into risk-to-capital agreements with the California Insurance Department, the Missouri Department of Insurance, the New York State Department of Financial Services, the Ohio Department of Insurance and the Texas Commissioner of Insurance. These agreements require NMIC to maintain a risk-to-capital ratio not to exceed 20 to 1 until January 15, 2016.
Certain states limit the amount of risk a mortgage guaranty insurer may retain on a single loan to 25% of the indebtedness to the insured and as a result the portion of such insurance in excess of 25% must be reinsured. NMIC has entered into a primary excess share reinsurance agreement with NMI Re One effective August 1, 2012. NMIC cedes premiums and losses to NMI Re One on an excess share basis for any primary or pool policy which offers coverage greater than 25%. The Company will use reinsurance provided by NMI Re One solely for purposes of compliance with statutory coverage limits. During April 2013, NMIC began writing its first mortgage insurance policies and began ceding premium and risk to NMI Re One the following month.
As of December 31, 2012, none of the Company's insurance subsidiaries had written any business, had no risk-in-force and therefore had no ratios. As of September 30, 2013 NMIC's RTC ratio is less than 1:1, significantly below the limits established with the GSEs and state insurance departments.
The risk-to-capital calculation for the Company's combined insurance subsidiaries is:

	September 30, 2013
	(In Thousands)
Pool risk-in-force [(1)]	$93,090
Primary risk-in-force	1,196
Total risk-in-force	$94,286
Statutory policyholders' surplus	$198,981
Statutory contingency reserve	2,149
Statutory policyholders' position	$201,130
Risk-to-capital [(2)]	0.5:1

[(1)] Pool risk-in-force as shown in the table above is equal to the aggregate stop loss less a deductible.
[(2)] Represents total risk-in-force divided by statutory policyholders' position which is the metric by which the majority of state insurance regulators will assess our capital adequacy. Additionally, Fannie Mae requires us to maintain the greater of (a) the risk-to-capital requirements outlined in the January 2013 approval letter, or (b) a risk-to-capital ratio of 18:1 on primary business plus statutory capital equal to the amount of net risk-in-force of the pool.
NMI Holdings, Inc. is not subject to any limitations on its ability to pay dividends except those generally applicable to corporations that are incorporated in Delaware, such as NMI Holdings, Inc. Delaware corporation law provides that dividends are only payable out of a corporation's capital surplus or (subject to certain limitations) recent net profits. As of December 31, 2012