TRIAD GUARANTY INC
Form 10-Q
May 09, 2007

Table of Contents

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

FORM 10-Q

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

For the quarterly period ended March 31, 2007

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: 0-22342

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

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

(336) 723-1282
(Registrant s telephone number, including area code)

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

Number of shares of Common Stock, par value $0.01 per share, outstanding as of May 4, 2007, was 14,908,523.

TRIAD GUARANTY INC.
INDEX

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

TRIAD GUARANTY INC.
CONSOLIDATED BALANCE SHEETS

	(Unaudited) March 31 2007	December 31 2006
	(In thousands, except share data)	
ASSETS		
Invested assets:		
Securities available-for-sale, at fair value:		
Fixed maturities (amortized cost: $594,228 and $568,992)	**$ 608,945**	$ 586,594
Equity securities (cost: $9,012 and $9,530)	**9,921**	10,417
Other investments	**5,000**	5,000
Short-term investments	**45,294**	5,301
	669,160	607,312
Cash and cash equivalents	**10,429**	38,609
Real estate acquired in claim settlement	**9,764**	10,170
Accrued investment income	**7,875**	8,054
Deferred policy acquisition costs	**35,035**	35,143
Prepaid federal income taxes	**166,693**	166,908
Property and equipment	**8,690**	7,678
Income taxes recoverable		51
Reinsurance recoverable	**211**	841
Other assets	**23,658**	20,865
Total assets	**$ 931,515**	$ 895,631
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Losses and loss adjustment expenses	**$ 98,721**	$ 84,352
Unearned premiums	**15,022**	13,193
Amounts payable to reinsurers	**6,094**	5,909
Deferred income taxes	**180,232**	176,483
Long-term debt	**34,512**	34,510
Accrued interest on debt	**584**	1,275
Current taxes payable	**1,606**	
Accrued expenses and other liabilities	**7,592**	9,685
Total liabilities	**344,363**	325,407
Commitments and contingencies Note 4		
Stockholders equity:		
Preferred stock, par value $0.01 per share authorized 1,000,000 shares; no shares issued and outstanding		

Common stock, par value $0.01 per share authorized 32,000,000 shares; issued and outstanding 14,908,523 shares at March 31, 2007 and 14,856,401 shares at December 31, 2006		**150**		149
Additional paid-in capital		**106,447**		104,981
Accumulated other comprehensive income, net of income tax liability of $5,469 at March 31, 2007 and $6,471 at December 31, 2006		**10,157**		12,018
Retained earnings		**470,398**		453,076
Total stockholders equity		**587,152**		570,224
Total liabilities and stockholders equity	**$**	**931,515**	$	895,631

See accompanying notes.

1

Table of Contents

TRIAD GUARANTY INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended March 31	
	2007	**2006**
	(In thousands, except share data)	
Revenue:		
Premiums written:		
Direct	**$ 78,408**	$ 59,312
Ceded	**(12,701)**	(10,970)
Net premiums written	**65,707**	48,342
Change in unearned premiums	**(1,758)**	(452)
Earned premiums	**63,949**	47,890
Net investment income	**7,349**	6,222
Net realized investment gains	**761**	900
Other income (losses)	**2**	(2)
	72,061	55,010
Losses and expenses:		
Net losses and loss adjustment expenses	**32,581**	16,351
Interest expense on debt	**694**	693
Amortization of deferred policy acquisition costs	**4,624**	3,862
Other operating expenses (net of acquisition costs deferred)	**10,330**	8,513
	48,229	29,419
Income before income taxes	**23,832**	25,591
Income taxes:		
Current	**1,759**	972
Deferred	**4,751**	6,066
	6,510	7,038
Net income	**$ 17,322**	$ 18,553
Earnings per common and common equivalent share:		
Basic	**$ 1.17**	$ 1.26
Diluted	**$ 1.16**	$ 1.25

Shares used in computing earnings per common and common equivalent share:		
Basic	**14,818,900**	14,758,349
Diluted	**14,946,166**	14,862,471

See accompanying notes.

Table of Contents

TRIAD GUARANTY INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31	
	2007	**2006**
	(In thousands)	
Operating activities		
Net income	**$ 17,322**	$ 18,553
Adjustments to reconcile net income to net cash provided by operating activities:		
Losses, loss adjustment expenses and unearned premium reserves	**16,198**	1,990
Accrued expenses and other liabilities	**(2,093)**	(2,865)
Current taxes payable	**1,606**	563
Income taxes recoverable	**51**	181
Amounts due to/from reinsurer	**815**	416
Accrued investment income	**179**	225
Policy acquisition costs deferred	**(4,515)**	(4,082)
Amortization of deferred policy acquisition costs	**4,623**	3,862
Net realized investment gains	**(761)**	(900)
Provision for depreciation	**532**	615
Accretion of discount on investments	**129**	(35)
Deferred income taxes	**4,751**	6,066
Prepaid federal income taxes	**215**	
Real estate acquired in claim settlement, net of write-downs	**406**	(4,477)
Accrued interest on debt	**(691)**	(691)
Other assets	**(2,793)**	(1,122)
Other operating activities	**681**	709
Net cash provided by operating activities	**36,655**	19,008
Investing activities		
Securities available-for-sale:		
Purchases fixed maturities	**(62,304)**	(22,616)
Sales fixed maturities	**35,296**	8,000
Maturities fixed maturities	**2,287**	2,160
Purchases equities	**(38)**	(4,622)
Sales equities	**672**	2,946
Net change in short-term investments	**(39,993)**	(257)
Purchases of property and equipment	**(1,544)**	(401)
Net cash used in investing activities	**(65,624)**	(14,790)
Financing activities		
Excess tax benefits from share-based compensation	**173**	270
Proceeds from exercise of stock options	**616**	321
Net cash provided by financing activities	**789**	591

Net change in cash and cash equivalents	**(28,180)**	4,809
Cash and cash equivalents at beginning of period	**38,609**	8,934
Cash and cash equivalents at end of period	**$ 10,429**	$ 13,743
Supplemental schedule of cash flow information		
Cash paid during the period for:		
Income taxes and United States Mortgage Guaranty Tax and Loss Bonds	**$**	$
Interest	**1,383**	1,383

See accompanying notes.

3

Table of Contents

TRIAD GUARANTY INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2007
(Unaudited)

1. The Company

Triad Guaranty Inc. is a holding company, which through its wholly-owned subsidiary, Triad Guaranty Insurance Corporation (Triad), provides mortgage insurance coverage in the United States. This allows buyers to achieve homeownership with a reduced down payment, facilitates the sale of mortgage loans in the secondary market and protects lenders from credit default-related expenses. Triad Guaranty Inc. and its subsidiaries are collectively referred to as the Company .

2. Accounting Policies And Basis Of Presentation

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Triad Guaranty Inc. annual report on Form 10-K for the year ended December 31, 2006.

Recent Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. The Company is subject to the provisions of FIN 48 as of January 1, 2007, and has analyzed filing positions in its filed income tax returns. The only periods subject to examination for the Company s federal returns are the 2003 through 2006 tax years. In January 2007, the Company received a final notice from the Internal Revenue Service stating that the examination of its 2004 tax return was completed and no changes were made to the Company s reported tax. The Company believes that its income and deduction filing positions in the remaining open tax years would be sustained if subject to audit and does not anticipate any adjustments that will result in a material change in its financial position. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48.

Table of Contents

In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

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

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Company beginning January 1, 2008 and is not expected to have a material impact on the Company s financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. (SFAS 159), which allows companies to choose to measure certain financial assets and liabilities at fair value that are not currently required to be measured at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for the Company beginning January 1, 2008. The Company is currently evaluating the potential impact of adoption of SFAS 159.

Share-Based Compensation

On January 1, 2006, the Company adopted the provisions of SFAS 123(R), Share-Based Payment (SFAS 123(R)). SFAS 123(R) sets accounting requirements for share-based compensation to employees and non-employee directors, including employee stock purchase plans, and requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation.

The Company chose the modified-prospective transition alternative in adopting SFAS 123(R). Under the modified-prospective transition method, compensation cost is recognized in financial statements issued subsequent to the date of adoption for all stock-based payments granted, modified or settled after the date of adoption, as well as for any unvested awards that were granted prior to the date of adoption.

3. Consolidation

The consolidated financial statements include the accounts of Triad Guaranty Inc. and all of its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

4. Commitments and Contingencies

Reinsurance

Certain premiums and losses are ceded to other insurance companies under various reinsurance agreements, the majority of which are captive reinsurance agreements with affiliates of certain customers. Reinsurance contracts do not relieve Triad from its obligations to policyholders. Failure of the reinsurer to honor its obligation could result in losses to Triad; consequently, allowances are established for amounts deemed uncollectible. Triad evaluates the financial condition of its reinsurers and monitors credit risk arising from similar geographic regions, activities, or economic characteristics of its reinsurers to minimize its exposure to significant losses from reinsurer insolvency.

Insurance In Force, Dividend Restrictions, and Statutory Results

Insurance regulations generally limit the writing of mortgage guaranty insurance to an aggregate amount of insured risk no greater than 25 times the total of statutory capital and surplus and the statutory contingency reserve. The amount of net risk for insurance in force at March 31, 2007 and December 31, 2006, as presented below, was computed by applying the various percentage settlement options to the insurance in force amounts, adjusted by risk ceded under reinsurance agreements, any applicable stop-loss limits and deductibles. Triad s ratio is as follows (dollars in thousands):

	March 31, 2007	December 31, 2006
Net risk	**$ 9,757,134**	$ 8,612,912
Statutory capital and surplus	**$ 152,396**	$ 168,439
Statutory contingency reserve	**554,462**	521,836
Total	**$ 706,858**	$ 690,275
Risk-to-capital ratio	**13.8 to 1**	12.5 to 1

Triad and its wholly-owned subsidiaries are each required under their respective domiciliary states insurance code to maintain a minimum level of statutory capital and surplus. Triad, an Illinois domiciled insurer, is required under the Illinois Insurance Code (the Code) to maintain minimum statutory capital and surplus of $5 million. The Code permits dividends to be paid only out of earned surplus and also requires prior approval of extraordinary dividends. An extraordinary dividend is any dividend or distribution of cash or other property, the fair value of which, together with that of other dividends or distributions made within a period of twelve consecutive months, exceeds the greater of (a) ten percent of statutory surplus as regards policyholders, or (b) statutory net income for the calendar year preceding the date of the dividend.

Net income as determined in accordance with statutory accounting practices was $22.6 million and $25.6 million for the three months ended March 31, 2007 and 2006, respectively, and $88.3 million for the year ended December 31, 2006.

At March 31, 2007 and December 31, 2006, the amount of Triad s equity that could be paid out in dividends to stockholders was $68.7 million and $84.7 million, respectively, which was the earned surplus of Triad on a statutory basis on those dates. On April 13, 2007, Triad paid a dividend of $30 million to its parent, Triad Guaranty Inc.

Table of Contents

Loss Reserves

The Company establishes loss reserves to provide for the estimated costs of settling claims on loans reported in default and estimates of loans in default that are in the process of being reported to the Company as of the date of the financial statements. Consistent with industry accounting practices, the Company does not establish loss reserves for future claims on insured loans that are not currently in default. Amounts recoverable from the sale of properties acquired in lieu of foreclosure are considered in the determination of the reserve estimates. Loss reserves are established by management using historical experience and by making various assumptions and judgments about claim rates (frequency) and claim amounts (severity) to estimate ultimate losses to be paid on loans in default. The Company s reserving methodology gives effect to current economic conditions and profiles delinquencies by such factors as default status, policy year, specific lenders, the number of months the policy has been in default, as well as whether the policies in default were underwritten through the flow channel or as part of a structured bulk transaction. The assumptions utilized in the calculation of the loss reserve estimate are continually reviewed, and as adjustments to the reserve become necessary, such adjustments are reflected in the financial statements in the periods in which the adjustments are made.

Litigation

A lawsuit was filed against the Company in January 2004 in the ordinary course of the Company s business alleging violations of the Fair Credit Reporting Act. The Company is vigorously defending the lawsuit. In the opinion of management, the ultimate resolution of this pending litigation will not have a material adverse effect on the financial position or results of operations of the Company.

5. Earnings Per Share

Basic and diluted earnings per share are based on the weighted-average daily number of shares outstanding. For diluted earnings per share, the denominator includes the dilutive effects of stock options and unvested restricted stock on the weighted-average shares outstanding. There are no other reconciling items between the denominators used in basic earnings per share and diluted earnings per share. The numerator used in basic earnings per share and diluted earnings per share is the same for all periods presented.

6. Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. For the Company, other comprehensive income is composed of unrealized gains or losses on available-for-sale securities, net of income tax. For the three months ended March 31, 2007 and 2006, the Company s comprehensive income was $15.5 million and $14.7 million, respectively.

Table of Contents

7. Income Taxes

Income tax expense differs from the amounts computed by applying the Federal statutory income tax rate to income before income taxes primarily due to tax-exempt interest that the Company earns from its investments in municipal bonds.

8. Long-Term Stock Incentive Plan

In May 2006, the Company s shareholders approved the 2006 Long-Term Stock Incentive Plan (the Plan). Under the Plan, certain directors, officers, and key employees are eligible to receive various share-based compensation awards. Stock options, restricted stock and phantom stock rights may be awarded under the Plan for a fixed number of shares with a requirement for stock options granted to have an exercise price equal to or greater than the fair value of the shares at the date of grant. Generally, most awards vest over three years. Options granted under the Plan expire no later than ten years following the date of grant. As of March 31, 2007, 1,597,515 shares were reserved and 978,550 shares were available for issuance under the Plan. Gross compensation expense of approximately $688,000 along with the related tax benefit of approximately $241,000 was recognized in the financial statements for the three months ended March 31, 2007. Gross compensation expense of approximately $800,000 along with the related tax benefit of approximately $280,000 was recognized in the financial statements for the three months ended March 31, 2006. For the three months ended March 31, 2007 and 2006, approximately $71,000 and $125,000, respectively, of share-based compensation was capitalized as part of deferred acquisition costs.

A summary of option activity under the Plan for the three months ended March 31, 2007 is presented below:

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted-Average Remaining Contractual Term
Outstanding, January 1, 2007	564,712	$ 38.36		
Granted	77,190	43.35		
Exercised	22,937	26.87		
Cancelled				
Outstanding, March 31, 2007	618,965	39.41	$ 2,355	5.1 years
Exercisable, March 31, 2007	410,998	37.79	$ 2,323	3.2 years

The fair value of stock options is estimated on the date of grant using a Black-Scholes pricing model. The weighted-average assumptions used for options granted during the three months ended March 31, 2007 and 2006 are noted in the following table. The expected volatilities are based on volatility of the Company s stock over the most recent historical period corresponding to the expected term of the options. The Company also uses historical data to estimate option exercise and employee terminations within the model; separate groups of employees with similar historical exercise and termination histories are considered separately for valuation purposes. The risk-free rates for the periods corresponding to the expected terms of the options are based on U.S. Treasury rates in effect on the dates of grant.

	2007	2006
Expected volatility	31.6%	34.2%
Expected dividend yield	0.0%	0.0%
Expected term	5.0 years	5.0 years
Risk-free rate	4.4%	4.5%

The weighted-average grant-date fair value of options granted during the three months ended March 31, 2007 and 2006 was $15.59 and $15.92, respectively. The total intrinsic value of options exercised during the three months ended March 31, 2007 and 2006 was approximately $470,000 and $738,000, respectively.

A summary of restricted stock activity under the Plan for the three months ended March 31, 2007 is presented below:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested, January 1, 2007	113,941	$46.41
Granted	34,351	44.79
Vested	29,531	49.37
Cancelled	5,166	45.36
Nonvested, March 31, 2007	113,595	45.20

The fair value of restricted stock is determined based on the closing price of the Company s shares on the grant date. The weighted-average grant-date fair value of restricted stock granted during the three months ended March 31, 2007 and 2006 was $44.79 and $42.00, respectively.

As of March 31, 2007, there was $6.4 million of total unrecognized compensation expense related to nonvested stock options and restricted stock granted under the Plan. That expense is expected to be recognized over a weighted-average period of 2.1 years. The total fair value of stock options and restricted stock vested during the three months ended March 31, 2007 and 2006 was $1.5 million and $1.4 million, respectively.

The Company issues new shares upon exercise of stock options.

Table of Contents

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

Management s Discussion and Analysis of Financial Condition and Results of Operations analyzes the consolidated financial condition, changes in financial position, and results of operations for the three months ended March 31, 2007 and 2006, of the Company. This discussion supplements Management s Discussion and Analysis in Form 10-K for the year ended December 31, 2006, and should be read in conjunction with the interim financial statements and notes contained herein.

Certain of the statements contained herein, other than statements of historical fact, are forward-looking statements. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and include estimates and assumptions related to economic, competitive, and legislative developments. These forward-looking statements are subject to change and uncertainty, which are, in many instances, beyond our control and have been made based upon our expectations and beliefs concerning future developments and their potential effect on us. Actual developments and their results could differ materially from those expected by us, depending on the outcome of certain factors, including the possibility of general economic and business conditions that are different than anticipated, legislative developments, changes in interest rates or the stock markets, stronger than anticipated competitive activity, as well as the risk factors described in Item 1A of our Form 10-K for the year ended December 31, 2006 and the Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995 with respect to forward-looking statements contained herein.

Update on Critical Accounting Policies and Estimates

Our Annual Report on Form 10-K for the year ended December 31, 2006 describes the accounting estimates and assumptions that we consider to be the most critical to an understanding of our financial statements because they inherently involve significant judgments and uncertainties. These critical accounting policies relate to the assumptions and judgments utilized in establishing the reserve for losses and loss adjustment expenses, determining if declines in fair values of investments are other than temporary, and establishing appropriate initial amortization schedules for deferred policy acquisition costs (DAC) and subsequent adjustments to that amortization.

We believe that these continue to be the critical accounting policies applicable to the Company and that these policies were applied in a consistent manner during the first three months of 2007. The sensitivity analysis provided in Form 10-K provided the impact on pre-tax income as a result of a 10% increase or decrease in the frequency or severity factors utilized in the reserve model. During the first quarter of 2007 we raised the frequency factor by approximately 5% and made a small upward adjustment to the severity factor as a result of recent conditions in the housing market.

Table of Contents

Overview

Through our subsidiaries, we provide Primary and Modified Pool mortgage guaranty insurance coverage to residential mortgage lenders and investors as a credit-enhancement vehicle. We classify insurance as Primary when we are in the first loss position and the LTV is 80% or greater when the loan is first insured. We classify all other insurance as Modified Pool. The majority of our Primary insurance is delivered through the flow channel, which is defined as loans originated by lenders and submitted to us on a loan-by-loan basis. We also provide mortgage insurance to lenders and investors who seek additional default protection (typically secondary coverage or on loans for which the individual borrower has greater than 20% equity), capital relief, and credit-enhancement on groups of loans that are sold in the secondary market. These transactions are referred to as our structured bulk channel business. Those individual loans in the structured bulk channel in which we are in the first loss position and the LTV ratio is greater than 80% are classified as Primary. All of our Modified Pool insurance is delivered through the structured bulk channel.

Our revenues principally consist of a) initial and renewal earned premiums from flow business (net of reinsurance premiums ceded as part of our risk management strategies), b) initial and renewal earned premiums from structured bulk transactions, and c) investment income on invested assets. We also realize investment gains, net of investment losses, periodically as a source of revenue when the opportunity presents itself within the context of our overall investment strategy.

Our expenses essentially consist of a) amounts paid on claims submitted, b) changes in reserves for estimated future claim payments on loans that are currently in default, c) general and administrative costs of acquiring new business and servicing existing policies, d) other general business expenses, and e) income taxes.

Our profitability depends largely on a) the volume of business insured combined with the adequacy of our product pricing and underwriting discipline relative to the risks insured, b) the conditions of the housing market that have a direct impact on mitigation efforts, cure rates and ultimately the amount of claims paid, c) persistency levels, d) operating efficiencies, and e) the level of investment yield, including realized gains and losses, on our investment portfolio. We define persistency as the percentage of insurance in force remaining from twelve months prior. Cancellations of policies originated during the past twelve months are not considered in our calculation of persistency. This method of calculating persistency may vary from that of other mortgage insurers. We believe that our calculation presents an accurate measure of the percentage of insurance in force remaining from twelve months prior. Cancellations result primarily from the borrower refinancing or selling insured mortgaged residential properties and, to a lesser degree, from the borrower achieving prescribed equity levels at which point the lender no longer requires mortgage guaranty insurance.

For a more detailed description of our industry and operations, refer to the Business section of our Form 10-K.

Table of Contents

Consolidated Results of Operations

Following is selected financial information for the three months ended March 31, 2007 and 2006:

	2007	2006	% Change 2007 vs. 2006
	(In thousands, except percentages and per share information)		
Earned premiums	$ 63,949	$ 47,890	33.5%
Net losses and loss adjustment expenses	32,581	16,351	99.3
Net income	17,322	18,553	(6.6)
Diluted earnings per share	$ 1.16	$ 1.25	(7.2)

Earned premiums for the first quarter of 2007 grew significantly when compared to the first quarter of 2006, but were more than offset by the growth in net losses and loss adjustment expenses, primarily due to a $14 million increase in reserves. Based on information available from the industry association and other public sources, our estimated market share of net new insurance written including flow and bulk channels, using industry definitions, was 10.3% for the first quarter of 2007 compared to 10.1% for the first quarter of 2006.

The growth of our insurance in force, the continued seasoning of our portfolio and an increase in average severity in paid claims ultimately impacting the factors utilized in the reserve methodology were the primary factors causing the significant increase in net losses and loss adjustment expenses in the first three months of 2007 over that of 2006. The actual number of claims paid increased in the first quarter of 2007 as a greater percentage of insurance in force reached the peak claim paying period. Our average severity of paid claims was $30,600 for the first quarter of 2007 compared to $25,100 for the first quarter of 2006 reflecting both an increase in the size of the loans insured during recent years as well as the lack of mitigation opportunities on defaulted loans in the current housing market.

The decrease in diluted earnings per share in the first quarter of 2007 from that of 2006 was consistent with the decrease in net income. Realized investment gains, net of taxes, increased diluted earnings per share in the first quarter of 2007 by $0.03 and $0.04 in the first quarter of 2006. Realized investment gains and losses per diluted share is a non-GAAP measure. We believe this is relevant and useful information to investors because, except for write-downs on other-than-temporarily impaired securities, it shows the effect that our discretionary sales of investments had on earnings. See further discussion of impairment write-downs in the Realized Losses and Impairments section below.

We describe our results in greater detail in the discussions that follow. The information is presented in three categories: Production and In Force, Revenues, and Losses and Expenses.

Production and In Force

A summary of New Insurance Written (NIW) or production for the first quarter of 2007 and 2006 broken out between Primary and Modified Pool follows:

	2007	2006	% Change 2007 vs. 2006
	(In millions, except percentages)		
Primary insurance written:			
Flow	$ 4,372	$ 1,947	124.5%
Structured bulk	1,327	1	1,326.0
Total Primary insurance written	$ 5,699	$ 1,948	192.6
Modified pool insurance written	1,925	4,606	(58.2)
Total insurance written	$ 7,624	$ 6,554	16.3%

According to estimates published by Fannie Mae, the overall mortgage loan origination market declined approximately 12% from the first quarter of 2006. The housing market slowed significantly during 2006 continuing into the first quarter of 2007, as evidenced by reduced sales of new and existing homes. Although the overall loan origination market slowed during the quarter, there was an increase in the market penetration of mortgage insurance products as piggyback loan arrangements such as the 80-10-10 s have lost favor from a lender s perspective as short term interest rates rose and the second lien product has become less marketable in the secondary market. Evidence of this turnaround is the fact that new Primary insurance written using the industry trade association (Mortgage Insurance Companies of America, or MICA) definitions, for the entire industry increased approximately 33% for the first quarter of 2007 as compared to the same period in 2006 based on information received from MICA and other public sources, despite the decline in the overall loan origination market.

The significant increase in Primary NIW in the first quarter of 2007 is partially reflective of the general increase in mortgage insurance penetration in the flow channel noted above. Additionally, we experienced a $2.4 billion increase in NIW in the flow channel as a result of specific lender-paid programs with two lenders that met specific risk characteristics and other parameters that were not in place during the first quarter of 2006. The $1.3 billion of structured bulk transactions noted above met our definition as Primary (LTV greater than 80% and first loss position).

We write Modified Pool insurance only through our structured bulk channel. Structured bulk transactions for the entire industry declined approximately 7% during the first quarter of 2007 according to information available from MICA and other publicly available data. As noted above, approximately $1.3 billion of structured bulk transactions during the first quarter of 2007 were classified as Primary. Modified Pool insurance written is likely to vary significantly from period to period due to: a) the limited number of transactions (but with larger size) occurring in this market, b) the level of competition from other mortgage insurers, c) the relative attractiveness in the marketplace of mortgage insurance versus other forms of credit enhancement, and d) the changing loan composition and underwriting criteria of the market. We

Table of Contents

believe there will continue to be opportunities throughout the remainder of 2007 in the structured bulk transaction market that meet our loan quality and pricing objectives. Approximately 51% of our insurance written attributable to our structured bulk channel during the first three months of 2007 was structured with deductibles that put us in the second loss position compared to 36% for the first three months of 2006.

The following table provides estimates of our national market share of net new insurance written, using industry definitions, through our flow and structured bulk channels based on information available from MICA and other public sources for the three months ended March 31, 2007 and 2006:

	Market Share by Channel Three months ended March 31,	
	2007	**2006**
Flow channel	9.0%	5.3%
Structured bulk channel	13.0%	16.7%
Total	10.3%	10.1%

Total market share increased in the first quarter of 2007 due to the strong production through our flow channel, which included two specific lender-paid programs. One of the lender-paid programs had been originated and reported through the structured bulk channel during the first quarter of 2006. Absent the inclusion of these two lender-paid programs, our first quarter 2007 flow market share would have equaled approximately 6.5%. These lender-paid programs usually extend for periods of three to six months. As mentioned earlier, our structured bulk market share will vary from period to period since this market can have significantly larger transactions and our share of this market is dependent on the availability of transactions that meet our credit quality and pricing benchmarks and on our ability to bid successfully to provide insurance on these transactions.

One of the risk characteristics that we pay particular attention to is credit quality. We have defined Alt-A as individual loans having FICO scores greater than 619 and that have been underwritten with reduced or no documentation. We have defined A Minus loans as those having FICO scores greater than 574, but less than 620. We have defined Sub Prime loans as those with credit scores less than 575. The following table summarizes the credit quality characteristics of our Primary new insurance written during the first quarter of 2007 and 2006:

	Credit Quality of Primary NIW Three months Ended March 31,	
	2007	**2006**
Prime	78.1%	74.9%
Alt-A	14.2	22.8
A Minus	6.1	2.0
Sub Prime	1.6	0.3
Total	100.0%	100.0%

Table of Contents

The increase in the percentage of Prime credit quality in 2007 can be attributed to the credit characteristics of one of the specific lender paid programs as well as an overall tightening of underwriting standards by many lenders. The increase in the percentage of A minus and Sub Prime credit quality in the first quarter of 2007 reflected the structured bulk transactions that were classified as Primary.

Another significant trend in our Primary production was the increase in ARMs, especially those loans subject to potential negative amortization. The following table summarizes the loan type characteristics of our Primary new insurance written during the first quarter of 2007 and 2006 and reflects the growth in ARMs, especially the loans subject to potential negative amortization:

	Loan Type of Primary NIW Three months Ended March 31,	
	2007	**2006**
Fixed	56.5%	67.6%
ARM (positive amortization)	8.2	16.1
ARM (potential negative amortization)	35.3	16.3
Total	100.0%	100.0%

The increase in the potential negative amortization ARMs in the first quarter of 2007 partially reflects a trend in the marketplace. Our production, which represents a greater percentage of potential negative amortization ARMs than exists in the marketplace has been limited to a few lenders where we have a good understanding of both their product and their underwriting guidelines. The large majority of the potential negative amortization ARMs that we have insured are still in the period that the borrower can elect to make minimum payments. An inherent risk in a product such as this is the scheduled milestone in which the borrower must begin making amortizing payments, which can be substantially greater than the minimum payments required. The ability of those borrowers to ultimately make the positive amortizing payments when required or to refinance the original loan adds uncertainty to this product. However, we are aware of the risks of concentration in this or any specific product and we have limits on the amount of potential negative amortization ARMs that we will accept.

Another risk characteristic that we consider in our underwriting guidelines is the LTV of the loan. The following table summarizes the percentage of our Primary production by LTV during the first quarter of 2007 and 2006:

	Loan to Value of Primary NIW Three months Ended March 31,	
	2007	**2006**
LTV ratio:		
Greater than 95%	26.2%	10.1%
90.01% to 95.00%	23.8	25.0
90.00% and below	50.0	64.9
Total	100.0%	100.0%

Table of Contents

The above table indicates an increase in the Primary production of NIW on loans greater than 95% LTV. The majority of this increase resulted from one structured bulk transaction in the amount of $800 million with average LTVs near 100% and is classified as Primary.

The majority of our Modified Pool production has been in the Alt-A marketplace over the last two years. LTVs on policies originated in the structured bulk channel are generally lower than those on policies we receive via the flow channel. Those policies usually have other Primary coverage in front of our risk or are below 80% LTV. The percentages of potential negative amortization ARMs included in our Modified Pool production approximated those included in our Primary production during the first quarter of 2006. However, during the first quarter of 2007, the Modified Pool production of potential negative amortization ARMs was reduced.

Periodically we enter into structured bulk transactions involving loans that have insurance effective dates within the current reporting period but for which detailed loan information regarding the insured loans is not provided by the issuer of the transaction until later. When this situation occurs, we accrue premiums that are due but not yet paid based upon the estimated commitment amount of the transaction in the reporting period with respect to each loan s insurance effective date. However, these policies are not reflected in our insurance in force, new insurance written, or related industry data totals until we verify the loan level detail. At March 31, 2007, we had approximately $1.9 billion of structured transactions with effective dates within the first quarter for which loan level detail had not been received and, therefore, are not included in our own data or industry totals. These amounts will be reported as new production and insurance in force totals in the second quarter of 2007, when the issuer of the transactions provides accurate loan level detail to us. We have included in premium written and premium earned the respective estimated amounts due and earned during the first quarter of 2007 related to this insurance. At March 31, 2006 we had $1.5 billion of structured transactions with effective dates within the first quarter of 2006 for which loan level detail had not been received.

The following table provides detail on our direct insurance in force at March 31, 2007 and 2006:

	2007	2006	% Change 2007 vs. 2006
	(In millions, except percentages)		
Primary insurance	$ 37,982	$ 29,891	27.1%
Modified Pool insurance	23,507	18,309	28.4
Total insurance	$ 61,489	$ 48,200	27.6%

Our Primary insurance in force at March 31, 2007 grew from March 31, 2006 as a result of increased production and improving persistency rates. Primary insurance persistency improved to 77.0% at March 31, 2007 compared to 71.1% at March 31, 2006. We anticipate that persistency rates will continue near current levels or increase moderately throughout the remainder of 2007 due to current housing market weakness and relative flatness of yield curve. However, persistency may be adversely affected if interest rates decline significantly from the levels experienced during the first quarter of 2007. We have experienced a significant amount of growth in both Primary and Modified Pool direct insurance in force. Of the $37.9 billion of Primary insurance in force at March 31, 2007, approximately $2.6 billion is attributable to structured bulk transactions.

Similar to the trend in NIW discussed above, Alt-A continues to grow as a percentage of our Primary insurance in force and continues to comprise the majority of our Modified Pool insurance in force. The following table shows the percentage of our insurance in force that we have classified as Alt-A at March 31, 2007 and 2006:

	2007	2006
Primary insurance in force	19.1%	10.4%
Modified Pool insurance in force	71.1%	68.4%
Total insurance in force	39.0%	32.0%

The following table provides information on risk in force at March 31, 2007 and 2006. Indicators of possible increased risk would include the following:

A decline in the percentage of business with prime credit quality

An increase in the percentage of Alt-A business

An increase in Primary LTV greater than 95%

An increase in potential negative amortization loan types

An increase in condominium property types

A decline in Primary residence occupancy status

A growing percentage of loans in excess of $200,000

Risk in Force[(1)]

	Primary March 31,		Modified Pool March 31,	
	2007	**2006**	**2007**	**2006**
Direct Risk in Force	$9,781	$7,512	$ 769	$ 668
Net Risk in Force	$8,937	$6,779	$ 933	$ 751
Credit quality:				
Prime	76.3%	83.9%	29.9%	32.4%
Alt-A	20.0	11.2	69.2	66.4
A Minus	3.2	4.1	0.8	1.0
Sub Prime	0.5	0.8	0.1	0.2
Total	100.0%	100.0%	100.0%	100.0%

Table of Contents

(Continued)

	Primary March 31,		Modified Pool March 31,	
	2007	**2006**	**2007**	**2006**
LTV:				
95.01% and above	19.4%	14.4%	0.0%	0.0%
90.01% to 95.00%	74.4	79.7	1.0	1.3
90.00% and below	6.2	5.9	99.0	98.7
Total	100.0%	100.0%	100.0%	100.0%
Loan Type:				
Fixed	66.2%	73.8%	28.2%	32.5%
ARM (positive amortization)	19.9	21.3	59.4	65.8
ARM (potential negative amortization)	13.9	4.9	12.4	1.7
Total	100.0%	100.0%	100.0%	100.0%
Mortgage Term:				
15 years and under	2.2%	3.9%	2.0%	2.9%
Over 15 years	97.8	96.1	98.0	97.1
Total	100.0%	100.0%	100.0%	100.0%
Property Type:				
Condominium	10.1%	8.3%	8.9%	6.7%
Other (principally single-family detached)	89.9	91.7	91.1	93.3
Total	100.0%	100.0%	100.0%	100.0%
Occupancy Status:				
Primary residence	88.1%	91.3%	73.8%	74.2%
Secondary home	7.7	5.3	6.1	5.9
Non-owner occupied	4.2	3.4	20.1	19.9
Total	100.0%	100.0%	100.0%	100.0%
Mortgage Amount:				
$200,000 or less	53.9%	66.7%	37.1%	42.9%
Over $200,000	46.1	33.3	62.9	57.1
Total	100.0%	100.0%	100.0%	100.0%

(1) Percentages represent distribution of direct risk in force on a per policy basis and do not account for applicable stop-loss amounts or deductibles on

Modified Pool.

The above table indicates that non-traditional mortgages continue to grow as a percentage of our risk in force. This is somewhat indicative of the move by the overall mortgage industry toward these products. While we have generally stayed away from certain sectors in the marketplace such as Sub Prime and second mortgages, our portfolio contains an increased exposure to Alt A loans as well as ARMs subject to potential negative amortization which carry an increased amount of risk for which we believe we have priced accordingly compared to the more traditional loans.

Due to the recent significant growth in our production and the amount of refinancing that took place in 2002 through 2005 causing much of our earlier books to lapse, our insurance portfolio is relatively unseasoned, having a weighted average life of 2.25 years at March 31, 2007 compared to 2.3 years at December 31, 2006 and 2.4 years at December 31, 2005. The following table shows direct risk in force as of March 31, 2007 by year of loan origination.

	Primary March 31, 2007		Modified Pool * March 31, 2007	
Certificate Year	**Direct Risk in Force**	**Percent**	**Direct Risk in Force**	**Percent**
2001 and before	$ 352.1	3.6%	$ 21.5	2.8%
2002	449.9	4.6	26.1	3.4
2003	1,398.7	14.3	113.0	14.7
2004	1,359.5	13.9	123.0	16.0
2005	1,917.0	19.6	224.5	29.2
2006	2,983.2	30.5	229.9	29.9
2007	1,320.4	13.5	30.8	4.0
Total	$ 9,780.8	100.0%	$ 768.8	100.0%

* For Modified Pool, the Direct Risk in Force is calculated utilizing the particular stop-loss limits and deductibles within each specific structure.

We also offer mortgage insurance structures designed to allow lenders to share in the risks of such insurance. One such structure is our captive reinsurance program under which reinsurance companies that are affiliates of the lenders assume a portion of the risk associated with the lender s insured book of business in exchange for a percentage of the premium. The following table shows the percentage of our Primary flow channel insurance in force as well as the percentage of our total insurance in force that was subject to captive reinsurance arrangements at March 31, 2007 and 2006.

	Percentage Subject to Captive Arrangements	
	2007	**2006**
Primary flow insurance in force	53.9%	59.9%
Total insurance in force	33.3%	36.7%

The decline of the Primary flow insurance in force that was subject to captive reinsurance arrangements at March 31, 2007 over March 31, 2006 was the result of a switch by some of our larger lender partners to lender paid products that do not qualify for captive participation. The decline in the total direct insurance in force subject to captive reinsurance at March 31, 2007 from March 31, 2006 reflects the fact that a greater portion of our insurance in force consists of

Table of Contents

Modified Pool insurance in force, which is written through the structured bulk channel and is not subject to captive reinsurance arrangements.

We believe captive reinsurance arrangements are an effective risk management tool as selected lenders share in the risk under these arrangements. Additionally, captive reinsurance arrangements are structured so that Triad receives credit against the capital required in certain risk-based capital models utilized by rating agencies. We remain committed to structuring captive reinsurance arrangements, including deep ceded arrangements where the net premium cede rate is greater than 25%, on a lender-by-lender basis as we deem it to be prudent. We will continue to be an active participant with our lender partners in captive reinsurance arrangements.

Revenues

A summary of the significant individual components of our revenue for the first quarter of 2007 and 2006 follows:

	2007	2006	% Change 2007 vs. 2006
	(In thousands, except percentages)		
Direct premium written	$ 78,408	$ 59,312	32.2%
Ceded premium written	(12,701)	(10,970)	15.8
Net premium written	65,707	48,342	35.9
Change in unearned premiums	(1,758)	(452)	288.9
Earned premiums	$ 63,949	$ 47,890	33.5
Net investment income	$ 7,349	$ 6,222	18.1
Total revenues	$ 72,061	$ 55,010	31.0

Our direct premium written for the first quarter of 2007 grew substantially over that of 2006 as a result of increased insurance in force over the past year and the strong growth in our new insurance written during the first quarter of 2007 discussed above. Additionally, the average basis points earned on insurance in force has grown due to the change in the risk characteristics of our portfolio as discussed earlier. Total overall annual persistency was 77.5% at March 31, 2007 compared to 70.2% at March 31, 2006.

Ceded premium written is comprised of premiums written under excess of loss reinsurance treaties with captive as well as non-captive reinsurance companies. The growth in ceded premium written in the first quarter of 2007 over the first quarter of 2006 was not as large as the growth in direct premium written as a result of a larger percentage of direct premium written not subject to captive reinsurance arrangements. The following table provides further data on ceded premiums for the three months ended March 31, 2007 and 2006:

	2007	2006
Premium cede rate (ceded premiums written as a percentage of direct premiums written)	16.2%	18.5%
Captive reinsurance premium cede rate (ceded premiums written under captive reinsurance arrangements as a percentage of direct premiums written)	15.5%	17.3%
Average captive premium cede rate (ceded premiums written under captive reinsurance arrangements as a percentage of direct premiums written under captive reinsurance arrangements)	36.3%	37.2%

The table below provides data on insurance written that was subject to captive reinsurance arrangements for the three months ended March 31, 2007 and 2006:

	Percentage Subject to Captive Arrangements	
	2007	2006
Primary insurance written	28.1%	55.1%
Total insurance written	16.1%	16.4%

The percentage of Primary insurance written subject to captive reinsurance arrangements for the first quarter of 2007 decreased from the first quarter of 2006 due primarily to changes by two of our larger lenders to a lender paid product rather than a borrower paid product. Generally, the lender paid product is not captive eligible. None of our Modified Pool insurance written in 2007 and 2006 was subject to captive reinsurance arrangements.

The difference between net written premiums and earned premiums is the change in the unearned premium reserve, which is established primarily on premiums received on annual products. One of the most actively utilized lender paid programs during the first quarter of 2007 included annual premiums, which was responsible for most of the increase in unearned premium during the first quarter of 2007. Our unearned premium liability increased $1.8 million from December 31, 2006 to March 31, 2007 compared to an increase of $0.5 million from December 31, 2005 to March 31, 2006.

Net investment income for the first quarter of 2007 increased over that for the first quarter of 2006 due primarily to growth in invested assets, partially offset by declines in portfolio yields. Average invested assets at cost or amortized cost for the first quarter of 2007 grew by 10.9% over the first quarter of 2006 as a result of the investment of cash flows from operations for the past year. Our investment portfolio tax-equivalent yield was 6.61% at March 31, 2007 compared to 6.74% at March 31, 2006. We anticipate a continuing decline in the overall portfolio tax-equivalent yield as current interest rates are still below our average portfolio rate. See further discussion of the Investment Portfolio section of this document.

Table of Contents

Losses and Expenses

A summary of the individual components of losses and expenses for the three months ended March 31, 2007 and 2006 follows:

	2007	2006	% Change 2007 vs. 2006
	(In thousands, except percentages)		
Net losses and loss adjustment expenses	$32,581	$16,351	99.3%
Amortization of deferred policy acquisition costs	4,624	3,862	19.7
Other operating expenses (net of acquisition costs deferred)	10,330	8,513	21.3
Loss ratio	50.9%	34.1%	
Expense ratio	22.8%	25.6%	
Combined ratio	73.7%	59.7%	

Net losses and loss adjustment expenses (LAE) are comprised of both paid losses and LAE and the change in the loss and LAE reserve during the period. Net losses and LAE for the first quarter of 2007 increased significantly over the first quarter of 2006 primarily due to an increase in reserves. The reserve increase reflected both an increase in the number of loans in default as well as an increase in the size of the loans that are in default at March 31, 2007. The growth in reserves is a result of the continued seasoning of our portfolio and includes an increase in the severity and frequency factors utilized in the reserve calculation. We will focus separately on paid claims and the increase in reserves.

The following table provides detail on paid claims and the average severity for our Primary and Modified Pool insurance for the three months ended March 31, 2007 and 2006:

	2007	2006	% Change 2007 vs. 2006
	(In thousands, except percentages)		
Paid claims:			
Primary insurance	$ 16,447	$ 13,305	23.6%
Modified Pool insurance	1,281	1,078	18.8
Total	$ 17,728	$ 14,383	23.3%
Number of claims paid:			
Primary insurance	526	506	4.0%
Modified Pool insurance	54	67	(19.4)
Total	580	573	1.2%

Table of Contents

Average severity remained relatively flat during the first three quarters of 2006, but increased significantly in the fourth quarter of 2006. The progression continued in the first quarter of 2007, primarily the result of growth in the amount of risk in force on paid claims arising from increased loan size. Additionally, as first noted during the fourth quarter of 2006, we continued to experience a lack of mitigation opportunities existing in the marketplace. The following table shows the average quarterly severity of paid claims during 2006:

	Three Months Ended				
	March 31, 2007	December 31, 2006	September 30, 2006	June 30, 2006	March 31, 2006
			(In thousands)		
Average severity:					
Primary insurance	$31.3	$ 28.1	$ 25.7	$25.8	$26.3
Modified Pool insurance	23.7	26.2	18.8	19.4	16.1
Total	30.6	27.9	25.3	25.3	25.1

The increase in average severity in the first quarter of 2007 was primarily the result of larger loan sizes on the claims paid. Additionally, during the first three quarters of 2006, the average severity remained relatively flat. This was partially the result of the loss mitigation processes implemented during 2005. During the fourth quarter of 2006, we experienced a significant reduction in our ability to reduce claims through our traditional mitigation processes, which we believe was related to weakness in the housing market. In many cases, properties on which loans have defaulted are sold during the foreclosure process, which generally reduces our loss. When the property does not sell prior to foreclosure, or after foreclosure but prior to when the claim is paid, we often pay the full amount of our coverage, which we call a full option settlement. In the fourth quarter of 2006 and continuing into the first quarter of 2007, full option settlements represented a greater percentage of our paid claims than in the prior sequential quarters. The lack of mitigation opportunities contributed to the increase in severity for the fourth quarter and this continues to be problematic in the first quarter of 2007. The percentage paid on claims relative to the covered risk remained relatively constant compared to the fourth quarter of 2006 but had risen substantially from first quarter of 2006. The average severity on Modified Pool claims tends to fluctuate more than the Primary claims due to the smaller volume of paid claims.

As shown in the Production and In Force section above, we are insuring a larger percentage of mortgages in excess of $200,000. Claim payments on defaults of these larger mortgages are greater even if coverage percentages remain constant. Claim payments on these larger mortgages also increased severity in the first quarter of 2007. To illustrate the impact of increasing loan size on the seasoning in both paid claims and the average severity utilized in our loss models, we have provided the following tables that detail the in force by year the loans were insured. As each of the more recent vintage years season and enter the period of peak defaults, the amount of risk per default and, ultimately, the amount of paid claim will continue to rise.

Table of Contents

Average Loan Size of In force Primary

Book Year	March 31, 2007	December 31, 2006	December 31, 2005
2000 and Prior	$ 95,615	$ 95,666	$ 95,536
2001	103,148	103,698	106,503
2002	115,538	116,191	118,458
2003	122,422	123,208	127,619
2004	134,947	136,148	141,293
2005	158,787	159,931	163,793
2006	208,403	206,723	
2007	224,820		
Overall Average	$ 158,702	$ 151,239	$ 136,873

Average Loan Size of In force Modified Pool

Book Year	March 31, 2007	December 31, 2006	December 31, 2005
2000 and Prior	$	$	$
2001	72,442	73,641	76,138
2002	93,265	94,513	97,540
2003	148,565	148,820	154,775
2004	153,736	155,140	161,065
2005	179,953	180,979	184,882
2006	259,913	260,067	
2007	256,881		
Overall Average	$ 204,927	$ 201,852	$ 171,747

We expect that average severity will continue to trend upward as the average loan amounts in our portfolio continue to rise and as the housing market continues to experience a general deterioration, which reduces our loss mitigation opportunities. The increase in severity and the further seasoning of the insurance portfolio indicate that paid losses should continue to trend upward in the remainder of 2007.

Table of Contents

Net losses and loss adjustment expenses also include the change in reserves for losses and loss adjustment expenses. The following table provides further information about our loss reserves at March 31, 2007 and 2006:

	2007	2006	% Change 2007 vs. 2006
	(In thousands, except percentages)		
Primary insurance:			
Reserves for reported defaults	$ 75,395	$ 44,399	69.8%
Reserves for defaults incurred but not reported	6,521	3,686	76.9
Total Primary insurance	81,916	48,085	70.4
Modified Pool insurance:			
Reserves for reported defaults	14,898	3,960	276.2
Reserves for defaults incurred but not reported	753	465	61.9
Total Modified Pool insurance	15,651	4,425	253.7
Reserve for loss adjustment expenses	1,154	104	1,009.6
Total reserves for losses and loss adjustment expenses	$ 98,721	$ 52,614	87.6
Net increase in reserve for losses and loss adjustment expenses	$ 14,369	$ 1,540	833.1

We have increased our reserves significantly over the past year reflecting a growing number of loans in default as well as increased severity and frequency factors utilized in the calculation of the reserves. The increases in severity factors were driven by slowing house price appreciation, and in some markets, actual depreciation. Additionally, during the first quarter of 2007, we noted a decline in our cure rates on reported defaults, which could impact the ultimate number of claims eventually paid on existing defaults. In response to this short-term trend and seeing nothing on the housing market horizon that would alter this view on a longer term basis, we increased the frequency factor utilized in the calculation of the reserves during the first quarter of 2007.

The reserve for losses and loss adjustment expenses increased significantly in the first quarter of 2007 primarily due to refinements in the frequency and severity factors utilized in our reserving methodology based upon the development of claims paid in 2006 and 2007. Reacting to the recent decline in the housing markets and the changing mix in the composition of our defaults, we have increased reserves by 88% from a year ago. To illustrate the impact of the changes in the frequency and severity factors utilized in the reserve model, the following table details the amount of risk in default and the reserve balance as a percentage of risk at March 31, 2007, December 31, 2006 and March 31, 2006.

Table of Contents

	March 31, 2007	December 31, 2006	March 31, 2006
Risk on loans in default excluding loans subject to deductibles (in thousands of dollars)	$292,434	$265,415	$204,934
Reserves as a percentage of risk at default	33.8%	31.8%	25.7%

The number of loans in default includes all reported delinquencies that are in excess of two payments in arrears at the reporting date and all reported delinquencies that were previously in excess of two payments in arrears and have not been brought current.

We continually monitor our reserves and claim development. As new data emerges, we consider its impact on our reserve calculation, and when necessary, refine our estimates. In the fourth quarter of 2006 and continuing in the first quarter of 2007, we experienced a significant increase in our paid loss severity due to the deteriorating developments in the housing market as well as changes in our insured portfolio. We determined that it was prudent to increase the severity and frequency factors utilized in our reserving methodology to reflect trends in the housing markets that will reduce our opportunity for loss mitigation.

Hurricanes Katrina and Rita had a significant impact on reported delinquencies at December 31, 2005. In the FEMA-designated areas affected by these hurricanes, we reported 891 defaults at December 31, 2005 and had established reserves of $4.5 million utilizing our normal reserving methodology. We believe that many borrowers living in these areas did not make scheduled mortgage payments due to forbearance granted by Fannie Mae, Freddie Mac and lenders, even though the individual borrower s financial condition was not significantly impacted. As of March 31, 2007, there remained 194 defaults of the 891 existing at December 31, 2005 with a reserve of $1.5 million. Most of the defaults existing at December 31, 2005, were brought current through payments for the three months for which forbearance had been granted. This significant increase in defaults and the subsequent cures of most of these FEMA-designated had the impact of temporarily inflating the overall cure rate which has since returned to a normalized trend.

The terms of our coverage exclude any cost or expense related to the repair or remedy of any physical damage to the property collateralizing an insured mortgage loan. We have not obtained detailed property assessments for the defaults in the FEMA-designated areas. Our exposure could be limited if such assessments demonstrate that there is significant un-repaired physical damage to properties securing loans for which we have provided mortgage insurance. We will continue to monitor this situation as the longer-term impacts develop.

Table of Contents

The following table shows default statistics as of March 31, 2007 and 2006:

	2007	2006
Total business:		
Number of insured loans in force	354,037	317,670
Number of loans in default	8,998	7,357
With deductibles	2,176	1,384
Without deductibles	6,822	5,973
Percentage of loans in default (default rate)	2.54%	2.32%
Percentage of loans in default excluding deductibles	1.93%	1.88%
Primary insurance:		
Number of insured loans in force	239,326	215,736
Number of loans in default	5,632	5,302
Percentage of loans in default	2.35%	2.46%
Modified Pool insurance:		
Number of insured loans in force	114,711	101,934
Number of loans in default	3,366	2,055
With deductibles	2,176	1,383
Without deductibles	1,190	672
Percentage of loans in default	2.93%	2.51%
Percentage of loans in default excluding deductibles	1.04%	0.88%
Primary Alt-A business:		
Number of insured loans in force	28,774	16,838
Number of loans in default	919	634
Percentage of loans in default	3.19%	3.77%

As shown in the above table, the number of Modified Pool defaults subject to deductibles and those without deductibles increased at March 31, 2007 from March 31, 2006. This is reflective of the strong growth in the Modified Pool insurance portfolio over the past three years. As these specific parts of our portfolio age, we expect to receive the largest number of defaults in years two through four and that is being reflected in these default statistics. At March 31, 2007, no individual structured bulk transaction with deductibles as part of the structure had incurred total losses that were nearing these individual deductible amounts. We do not provide reserves on Modified Pool defaults with deductibles until the incurred losses for that specific structured bulk transaction reach a pre-established threshold and we expect that we will eventually pay claims.

Given the growth of our insurance in force, we anticipate that our number of loans in default for both Primary and Modified Pool insurance will continue to increase as our insurance in force reaches its peak claim paying period. We also expect default rates to increase in the non-traditional business, such as Alt-A loans, higher LTV loans, and potential negative amortization ARMs. We expect the overall default rate to increase as non-traditional business

Table of Contents

becomes a larger percentage of our insurance in force. We expect reserves will increase as our business continues to grow and season.

The housing market continues to be sluggish in most parts of the country as inventories have increased and prices remain flat to declining. The most recent statistics show the supply of homes on the market up 25% from a year ago and home prices, as measured by Case-Schiller, have declined in 17 of the 20 cities comprising the index. These recent events have forced us to make changes to the assumptions utilized in our loss reserve model. Our reserving model incorporates management s judgments and assumptions regarding these factors; however, due to the uncertainty of future economic conditions surrounding the housing market, it is difficult to predict the total impact on future earnings.

Amortization of DAC for the first quarter of 2007 increased moderately over that for the same period in 2006, reflecting growth in the asset balance and, in some part, changes in the assumptions in the DAC amortization models that lowered the expected life of the policy years 2006 and thereon from seven to five years. This was partially offset by improved persistency. A full discussion of the impact of persistency on DAC amortization is included in the Deferred Policy Acquisition Costs section below.

Other operating expenses for the first three months of 2007 increased over the first three months of 2007 due to expenses incurred in connection with the organizational changes and the costs associated with our Canada expansion. Direct expenses relating to the Canadian expansion amounted to approximately $500,000 during the first quarter of 2007 compared to none in the first quarter of 2006. Because the growth in net premiums written was greater than the growth in expenses, the expense ratio (ratio of the amortization of deferred policy acquisition costs and other operating expenses to net premiums written) for the first quarter of 2007 was 22.8% compared to 25.6% for the first quarter of 2006. Given our expectations for premium and expenses growth, we anticipate the expense ratio for the remainder of 2007 will be similar to the first quarter of 2007.

Our effective tax rate was 27.3% for the first three months of 2007 compared to 27.5% for the first three months of 2006. The decline in the effective tax rate was due primarily to an increase in tax-exempt interest resulting from growth of investments in tax-preferred municipal securities. We expect our effective tax rate to remain near current levels or increase slightly as we expect total pre tax earnings to grow faster than tax-preferred income.

Significant Customers

Our objective is controlled, profitable growth in both Primary and Modified Pool business while adhering to our risk management strategies. Our strategy is to continue our focus on national lenders while maintaining the productive relationships that we have built with regional lenders. Competition within the mortgage insurance industry continues to increase as many large mortgage lenders have limited the number of mortgage insurers with whom they do business. At the same time, consolidation among national lenders has increased the share of the mortgage origination market controlled by the largest lenders and that has led to further concentrations of business with a relatively small number of lenders. Many of the national lenders allocate Primary business to several different mortgage insurers. These allocations can

Table of Contents

vary over time. Our ten largest customers were responsible for 84.6% of Primary insurance written during the first quarter of 2007 compared to 78% for the first quarter of 2006. Our two largest customers were responsible for 64.1% of Primary insurance written during the first quarter of 2007 compared to 42% for the first quarter of 2006. Through actively seeking business with other lenders that meet our criteria, we are broadening our customer base in order to limit our concentration with these two largest lenders. The loss of, a considerable reduction in business from, or a decline in the quality of business from one or more of these significant customers without a corresponding increase from other lenders would have an adverse effect on our business.

Financial Position

Total assets increased to $932 million at March 31, 2007, an annualized growth rate of 16% over December 31, 2006, with most of the growth in invested assets. Total liabilities increased moderately to $344 million at March 31, 2007 from $325 million at December 31, 2006, primarily driven by the increase in reserves. This section identifies several items on our balance sheet that are important in the overall understanding of our financial position. These items include deferred policy acquisition costs, prepaid federal income tax and related deferred income taxes. The majority of our assets are in our investment portfolio. A separate Investment Portfolio section follows the Financial Position section and reviews our investment portfolio, key portfolio management strategies, and methodologies by which we manage credit risk.

Deferred Policy Acquisition Costs

Costs expended to acquire new business are capitalized as DAC and recognized as expense over the anticipated premium paying life of the policy in a manner that approximates the estimated gross profits. We employ a dynamic model that calculates amortization of DAC separately for each year of policy origination. The model relies on assumptions that we make based upon historical industry experience and our own unique experience regarding the annual persistency development of each year of policy origination. The base persistency assumption is the most important factor utilized in determining the timing of reported amortization expense reflected in the income statement and the carrying value of DAC on the balance sheet. A change in the assumed base persistency will impact the current and future amortization expense as well as the carrying value on the balance sheet. During 2006, based upon a study performed on the entire mortgage industry and specifically on our own experience, we altered our base persistency assumption on that origination year and all future years going forward to recognize a shorter expected life due to the amount of the refinancing over the past several years. Our model accelerates DAC amortization through a dynamic adjustment when actual persistency for a particular year of policy origination is lower than the estimated base persistency utilized in the model. This dynamic adjustment is capped at the levels assumed in the models, and we do not decrease DAC amortization below the levels assumed in the model when persistency increases above those levels. When actual persistency is lower than that assumed in our models, the dynamic adjustment effectively adjusts the estimated policy life utilized in the model to a policy life based upon the current actual persistency. Due to the increase in actual persistency over the past several quarters, the dynamic adjustment has not been a significant factor in the quarterly DAC amortization as it was during periods of high refinancing and low persistency.

Table of Contents

Our DAC models separate the costs capitalized and the amortization streams between transactions arising from structured bulk and flow delivery channels. Generally, structured bulk transactions have significantly lower acquisition costs associated with the production of the business and they also have a shorter original estimated policy life. We apply the dynamic adjustment to the structured bulk DAC models utilizing the same methodology. At March 31, 2007 and December 31, 2006, net unamortized DAC relating to structured bulk transactions amounted to 7.4% of the total DAC on the balance sheet.

The following table shows the DAC asset for the three months ended March 31, 2007 and 2006 and the effect of persistency on amortization:

	2007	2006
	(In thousands, except percentages)	
Balance beginning of quarter	$ 35,143	$ 33,684
Costs capitalized	4,516	4,082
Amortization normal	(4,496)	(3,849)
Amortization dynamic adjustment	(128)	(13)
Total amortization	(4,624)	(3,862)
Balance end of quarter	$ 35,035	$ 33,904
Annual Persistency	77.5%	70.2%

The growth in the normal DAC amortization is due to the growth in the DAC asset and a decrease in the base assumption of the expected life of the flow and bulk portfolios. Assuming no significant declines in interest rates, we expect persistency to remain at the current rates or improve moderately throughout the remainder of 2007.

Prepaid Federal Income Taxes and Deferred Income Taxes

We purchase ten-year non-interest bearing United States Mortgage Guaranty Tax and Loss Bonds (Tax and Loss Bonds) to take advantage of a special contingency reserve deduction specific to mortgage guaranty companies. We record these bonds on our balance sheet as prepaid federal income taxes. Purchases of Tax and Loss Bonds are essentially a prepayment of federal income taxes that generally will become due in ten years when the contingency reserve is released, and the Tax and Loss Bonds mature. The proceeds from the maturity of the Tax and Loss Bonds are used to fund the income tax payments. Prepaid income taxes were approximately $167 million at March 31, 2007 and December 31, 2006, as no purchases of Tax and Loss Bonds were required in the first quarter of 2007.

Deferred income taxes are provided for the differences in reporting taxable income in the financial statements and on the tax return. The largest cumulative difference is the special contingency reserve deduction for mortgage insurers mentioned above. The remainder of the deferred tax liability has primarily arisen from book and tax reporting differences related to DAC and unrealized investment gains.

Table of Contents

Investment Portfolio

Portfolio Description

Our strategy for managing our investment portfolio is to optimize investment returns while preserving capital and liquidity and adhering to regulatory and rating agency requirements. We invest for the long term, and most of our investments are held until they mature. Our investment portfolio includes primarily fixed income securities, and the majority of these are tax-preferred state and municipal bonds. We have established a formal investment policy that describes our overall quality and diversification objectives and limits. Our investment policy and strategies are subject to change depending upon regulatory, economic, and market conditions as well as our existing financial condition and operating requirements, including our tax position. While we invest for the long term and most of our investments are held until they mature, we classify our entire investment portfolio as available for sale. This classification allows us the flexibility to dispose of securities in order to meet our investment strategies and operating requirements. All investments are carried on our balance sheet at fair value.

The following table shows the growth and diversification of our investment portfolio:

	March 31, 2007		December 31, 2006	
	Amount	Percent	Amount	Percent
	(In thousands, except percentages)			
Fixed maturity securities:				
U. S. government obligations	$ 11,933	1.8%	$ 11,842	2.0%
State and municipal bonds	581,281	86.9	558,131	91.9
Corporate bonds	15,731	2.3	16,572	2.7
Mortgage-backed bonds			49	
Total fixed maturities	608,945	91.0	586,594	96.6
Equity securities	9,921	1.5	10,417	1.7
Total available-for-sale securities	618,866	92.5	597,011	98.3
Other investments	5,000	0.7	5,000	0.8
Short-term investments	45,294	6.8	5,301	0.9
	$ 669,160	100.0%	$ 607,312	100.0%

We seek to provide liquidity in our investment portfolio through cash equivalent investments and through diversification and investment in publicly traded securities. We attempt to maintain a level of liquidity and duration in our investment portfolio consistent with our business outlook and the expected timing, direction, and degree of changes in interest rates. The increase in short-term investments at March 31, 2007 reflected the accumulation of funds by the Company in anticipation of our initial investment in Canada.

Table of Contents

We also manage risk and liquidity by limiting our exposure on individual securities. The following table shows the ten largest exposures to an individual creditor in our investment portfolio as of March 31, 2007:

Name of Creditor	Carrying Value	% of Total Invested Assets
	(In thousands, except percentages)	
City of Atlanta, Georgia Airport	$ 6,677	0.89%
State of Connecticut	6,430	0.85%
Commonwealth of Pennsylvania	6,085	0.81%
Clark County School District	5,455	0.72%
State of Hawaii	5,361	0.71%
Indiana State Finance Authority	5,232	0.69%
Utah Transit Authority	5,069	0.67%
Port of Seattle, Washington	4,498	0.60%
Chicago, Illinois Board of Education	4,354	0.58%
Denver, Colorado Airport	4,075	0.54%

As shown above, no investment in the securities of any single issuer exceeded 1% of our investment portfolio at March 31, 2007.

The following table shows the results of our investment portfolio for the three months ended March 31, 2007 and 2006:

	2007	2006
	(In thousands, except percentages)	
Average investments at cost or amortized cost	$ 596,031	$ 537,631
Pre-tax net investment income	$ 7,349	$ 6,222
Pre-tax yield	4.9%	4.6%
Tax-equivalent yield-to-maturity	6.6%	6.7%
Pre-tax realized investment gains	$ 761	$ 900

The small decline in the tax-equivalent yield-to-maturity shown above reflects the impact of the maturity or call of higher yielding investments and the subsequent investment purchases at new money rates available, which were lower than that of our overall portfolio. We anticipate this trend to continue throughout the remainder of 2007.

Table of Contents

Unrealized Gains and Losses

The following table summarizes by category our unrealized gains and losses in our securities portfolio at March 31, 2007:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In thousands)		
Fixed maturity securities:				
U. S. government obligations	$ 12,125	$ 4	$ (196)	$ 11,933
State and municipal bonds	567,384	14,774	(877)	581,281
Corporate bonds	14,719	1,015	(3)	15,731
Mortgage-backed bonds				
Subtotal, fixed maturities	594,228	15,793	(1,076)	608,945
Equity securities	9,012	998	(89)	9,921
Total securities	$ 603,240	$ 16,791	$ (1,165)	$ 618,866

These unrealized gains and losses do not necessarily represent future gains or losses that we will realize. Changing conditions related to specific securities, overall market interest rates, or credit spreads, as well as our decisions concerning the timing of a sale, may impact values we ultimately realize. We monitor unrealized losses through further analysis according to maturity date, credit quality, individual creditor exposure and the length of time the individual security has continuously been in an unrealized loss position. Of the gross unrealized losses on fixed maturity securities shown above, approximately $600,000 related to bonds with a maturity date in excess of ten years. The largest individual unrealized loss on any one security at March 31, 2007 was approximately $58,000 on a U.S. governmental agency bond with an amortized cost of $5.0 million. Gross unrealized gains and (losses) at March 31, 2006 were $13.9 million and $(2.9 million), respectively.

Table of Contents

Credit Risk

Credit risk is inherent in an investment portfolio. We manage this risk through a structured approach to internal investment quality guidelines and diversification while assessing the effects of the changing economic landscape. One way we attempt to limit the inherent credit risk in the portfolio is to maintain investments with high ratings. The following table shows our investment portfolio by credit ratings:

	March 31, 2007		December 31, 2006	
	Amount	Percent	Amount	Percent
	(In thousands, except percentages)			
Fixed Maturities:				
U.S. treasury and agency bonds	$ 11,933	2.0%	$ 11,842	2.0%
AAA	486,998	80.0	464,042	79.1
AA	73,810	12.1	72,051	12.3
A	23,737	3.9	25,054	4.3
BBB	9,703	1.6	10,782	1.9
BB	50	0.0	50	
CC and lower	96	0.0	279	
Not rated	2,618	0.4	2,494	0.4
Total fixed maturities	$ 608,945	100.0%	$ 586,594	100.0%
Equities:				
Preferred stocks:				
AA	$ 1,235	12.4%	$ 1,708	16.4%
A	2,015	20.3	2,035	19.5
BBB	1,147	11.6	1,132	10.9
	4,397	44.3	4,875	46.8
Common stocks	5,524	55.7	5,542	53.2
Total equities	$ 9,921	100.0%	$ 10,417	100.0%

We regularly review our investment portfolio to identify securities that may have suffered impairments in value that will not be recovered, termed potentially distressed securities. In identifying potentially distressed securities, we screen all securities held with a particular emphasis on those that have a fair value to cost or amortized cost ratio of less than 80%. Additionally, as part of this identification process, we utilize the following information:

§ Length of time the fair value was below amortized cost

§ Industry factors or conditions related to a geographic area negatively affecting the security

§ Downgrades by a rating agency

§ Past due interest or principal payments or other violation of covenants

§ Deterioration of the overall financial condition of the specific issuer

Table of Contents

In analyzing our potentially distressed securities list for other-than-temporary impairments, we pay special attention to securities that have been on the list continually for a period greater than six months. Our ability and intent to retain the investment for a sufficient time to recover its value is also considered. We assume that, absent reliable contradictory evidence, a security that is potentially distressed for a continuous period greater than nine months has incurred an other-than-temporary impairment. Such reliable contradictory evidence might include, among other factors, a liquidation analysis performed by our investment advisors or outside consultants, improving financial performance of the issuer, or valuation of underlying assets specifically pledged to support the credit.

When we conclude that a decline is other-than-temporary, the security is written down to fair value through a charge to realized investment gains and losses. We adjust the amortized cost for securities that have experienced other-than-temporary impairments to reflect fair value at the time of the impairment. We consider factors that lead to an other-than-temporary impairment of a particular security in order to determine whether these conditions have impacted other similar securities.

Of the $1.2 million of gross unrealized losses at March 31, 2007, 51 securities had a fair value to cost or amortized cost ratio of less than 90% and had a combined unrealized loss of approximately $53,000.

Information about unrealized gains and losses is subject to changing conditions. Securities with unrealized gains and losses will fluctuate, as will those securities that we identify as potentially distressed. Our current evaluation of other-than-temporary impairments reflects our intent to hold securities for a reasonable period of time sufficient for a forecasted recovery of fair value. However, our intent to hold certain of these securities may change in future periods as a result of facts and circumstances impacting a specific security. If our intent to hold a security with an unrealized loss changes, and we do not expect the security to fully recover prior to the expected time of disposition, we will write down the security to its fair value in the period that our intent to hold the security changes.

Realized Gains (Losses) and Impairments

Realized gains (losses) include both write-downs of securities with other-than-temporary impairments and gains (losses) from the sales of securities. During the first quarter of 2007, we elected to take gains on certain securities as we liquidated selected debt securities in anticipation of our investment in Canada. In the first quarter of 2006, in an effort to spread the risk related to equity securities, we liquidated our then existing equity portfolio of approximately twenty-five individual securities and reinvested in a portfolio that mirrored the S&P 500. During the first quarter of 2007, we wrote down four securities by a total of approximately $104,000. The most significant impairment of approximately $100,000 was a write-down on an asset-backed security. The Company does not expect any principal recovery, as there is insufficient collateral to cover the Class A3 notes of the security held. Based upon this fact, we determined that the impairment was other-than-temporary. The circumstances surrounding this impairment did not impact any other securities in our portfolio.

We did not write-down any securities during the first quarter of 2006.

Table of Contents

Liquidity and Capital Resources

Our sources of operating funds consist primarily of premiums written and investment income. Operating cash flow is applied primarily to the payment of claims, interest, expenses, and prepaid federal income taxes in the form of Tax and Loss Bonds.

We generated positive cash flow from operating activities of $36.7 million in the first quarter of 2007 compared to $19.0 million for the first quarter of 2006 reflecting the strong growth in premiums collected and a substantial increase in non-cash expenses, primarily the reserve for losses. During the first quarter of 2006, purchases of properties, net of sales, as part of our loss mitigation strategy resulted in a cash outflow of $4.5 million compared to a cash inflow of $400,000 in the first quarter of 2007. The amount of cash outflow from the purchase of properties during the first quarter of 2006 is reflective of the limited past use of the program, as the purchases outnumbered the sales during that quarter.

Positive cash flows are invested pending future payments of claims and expenses. Our business does not routinely require significant capital expenditures other than for enhancements to our computer systems and technological capabilities. Cash flow shortfalls, if any, could be funded through sales of short-term investments and other investment portfolio securities. We have no existing lines of credit due to the sufficiency of the operating funds from the sources described above.

The insurance laws of the State of Illinois impose certain restrictions on dividends that an insurance subsidiary can pay the parent company. These restrictions, based on statutory accounting practices, require that dividends be paid only out of statutory earned surplus and limit the amount of dividends that may be paid without prior approval of the Illinois Insurance Department. Subsequent to March 31, 2007, Triad paid a dividend of $30 million to its parent, Triad Guaranty Inc. that reduced statutory earned surplus to approximately $120 million. There are no other regulatorially imposed restrictions or requirements for capital support arrangements between the parent company and Triad or its subsidiaries.

We cede business to captive reinsurance affiliates of certain mortgage lenders (captives), primarily under excess of loss reinsurance agreements. Generally, reinsurance recoverables on loss reserves and unearned premiums ceded to these captives are backed by trust funds or letters of credit.

Total stockholders equity increased to $587.2 million at March 31, 2007 from $570.2 million at December 31, 2006. This increase resulted primarily from net income for the first quarter of 2007 of $17.3 million and additional paid-in-capital of $1.5 million resulting from share-based compensation to employees and the associated tax benefit, partially offset by a decrease in net unrealized gains on investments of $1.8 million.

Table of Contents

Statutory capital, for the purpose of computing the net risk in force to statutory capital ratio, includes both policyholders surplus and the contingency reserve. The following table provides information regarding our statutory capital position at March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
Statutory policyholders surplus	$ 152.4	$ 168.5
Statutory contingency reserve	554.5	521.8
Total	$ 706.9	$ 690.3

The primary difference between statutory policyholders surplus and equity computed under generally accepted accounting principles is the statutory contingency reserve. As noted earlier, subsequent to March 31, a $30 million dividend was paid out of statutory policyholders surplus. Mortgage insurance companies are required to add to the contingency reserve an amount equal to 50% of calendar year earned premiums and retain the reserve for 10 years, even if the insurance is no longer in force. Therefore, a growing company such as Triad normally has an increase in its contingency reserve rather than in its statutory surplus.

Triad s ability to write insurance depends on the maintenance of its financial strength ratings and the adequacy of its capital in relation to risk in force. A significant reduction of capital or a significant increase in risk may impair Triad s ability to write additional insurance. A number of states also generally limit Triad s risk-to-capital ratio to 25-to-1. As of March 31, 2007, Triad s risk-to-capital ratio was 13.8-to-1 as compared to 12.5-to-1 at December 31, 2006. Taking into consideration the $30 million dividend Triad paid to TGI subsequent to March 31, 2007, the risk-to-capital ratio would have been 14.3-to-1. The risk-to-capital ratio is calculated using net risk in force as the numerator and statutory capital as the denominator. Net risk in force accounts for risk ceded under reinsurance arrangements, including captive risk-sharing arrangements as well as any applicable stop-loss limits and deductible amounts.

Triad is rated AA by both Standard & Poor s Ratings Services and Fitch Ratings and Aa3 by Moody s Investor Service. S&P has not changed its Stable rating outlook for the U.S. private mortgage insurance industry that was issued in February of 2005. In December 2006, Fitch maintained its Negative rating outlook for the U.S. private mortgage insurance industry. Currently, Fitch, S&P, and Moody s all report a Stable ratings outlook for Triad. A reduction in Triad s rating or outlook could adversely affect our operations.

Fannie Mae has revised its approval requirements for mortgage insurers. The new rules require prior approval by Fannie Mae for many of Triad s activities and new products, allow for other approved types of mortgage insurers rated less than AA, and give Fannie Mae increased rights to revise the eligibility standards of mortgage insurers. We do not see any material impact on our current or future operations as a result of the new rules, although a material impact could still occur if Fannie Mae were to begin to utilize mortgage insurers rated below AA or revise eligibility standards of mortgage insurers in a way that would be adverse to Triad.

The Office of Federal Housing Enterprise Oversight (OFHEO) issued its risk-based capital rules for Fannie Mae and Freddie Mac in the first quarter of 2002. The regulation provides capital guidelines for Fannie Mae and Freddie Mac in connection with their use of various types of credit protection counterparties including a more preferential capital credit for insurance from a AAA rated private mortgage insurer than for insurance from a AA rated private mortgage insurer. The phase-in period for OFHEO s risk-based capital rules is ten years. We do not believe the new risk-based capital rules had an adverse impact on our financial condition or operations through the first quarter of 2007 or that these rules will have a significant adverse impact on our financial condition or operations in the future. However, if the risk-based capital rules result in future changes to the preferences of Fannie Mae and Freddie Mac regarding their use of the various types of credit enhancements or their choice of mortgage insurers based on their credit rating, our operations and financial condition could be significantly impacted.

Off Balance Sheet Arrangements and Aggregate Contractual Obligations

We have no material off-balance sheet arrangements at March 31, 2007.

We lease office facilities, automobiles, and office equipment under operating leases with minimum lease commitments that range from one to six years. We have no capitalized leases or material purchase commitments.

Our long-term debt has a single maturity date of 2028. There have been no material changes to the aggregate contractual obligations shown in our Form 10-K.

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

Management s Discussion and Analysis and this Report contain forward-looking statements relating to future plans, expectations, and performance, which involve various risks and uncertainties, including, but not limited to, the following:

§ interest rates may increase or decrease from their current levels;

§ housing prices may increase or decrease from their current levels;

§ housing transactions requiring mortgage insurance may decrease for many reasons including changes in interest rates or economic conditions or alternative credit enhancement products;

§ our market share may change as a result of changes in underwriting criteria or competitive products or rates;

§ the amount of insurance written could be adversely affected by changes in federal housing legislation, including changes in the Federal Housing Administration loan limits and coverage requirements of Freddie Mac and Fannie Mae (Government Sponsored Enterprises);

§ our financial condition and competitive position could be affected by legislation or regulation impacting the mortgage guaranty industry or the Government Sponsored Entities, specifically, and the financial services industry in general;

§ rating agencies may revise methodologies for determining our financial strength ratings and may revise or withdraw the assigned ratings at any time;

§ decreases in persistency, which are affected by loan refinancings in periods of low interest rates, may have an adverse effect on earnings;

Table of Contents

- § the amount of insurance written and the growth in insurance in force or risk in force as well as our performance may be adversely impacted by the competitive environment in the private mortgage insurance industry, including the type, structure, mix and pricing of our products and services and our competitors;

- § if we fail to properly underwrite mortgage loans under contract underwriting service agreements, we may be required to assume the costs of repurchasing those loans;

- § with consolidation occurring among mortgage lenders and our concentration of insurance in force generated through relationships with significant lender customers, our margins may be compressed and the loss of a significant customer or a change in their business practices affecting mortgage insurance may have an adverse effect on our earnings;

- § our performance may be impacted by changes in the performance of the financial markets and general economic conditions;

- § economic downturns in regions where our risk is more concentrated could have a particularly adverse effect on our financial condition and loss development;

- § revisions in risk-based capital rules by the Office of Federal Housing Enterprise Oversight for Fannie Mae and Freddie Mac could severely limit our ability to compete against various types of credit protection counterparties, including AAA rated private mortgage insurers;

- § changes in the eligibility guidelines of Fannie Mae or Freddie Mac could have an adverse effect on the Company;

- § proposed regulation by the Department of Housing and Urban Development to exclude packages of real estate settlement services, which may include any required mortgage insurance premium paid at closing, from the anti-referral provisions of the Real Estate Settlement Procedures Act could adversely affect our earnings;

- § our financial and competitive position could be affected by regulatory activity requiring changes to mortgage industry business practices, such as captive reinsurance.

Accordingly, actual results may differ from those set forth in the forward-looking statements. Attention also is directed to other risk factors set forth in documents filed by the Company with the Securities and Exchange Commission.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company s market risk exposures at March 31, 2007 have not materially changed from those identified in the Form 10-K for the year ended December 31, 2006.

Item 4. Controls and Procedures

a) We carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures pursuant to Securities Exchange Act of 1934 (Act) Rule 13a-15. Based on that evaluation, our management, including our CEO and CFO, concluded, as of the end of the period covered by this report, that our disclosure controls and procedures were effective. Disclosure controls and procedures include controls and procedures designed to ensure that management, including our CEO and CFO, is alerted to material information required to be disclosed in our filings under the Act so as to allow timely decisions regarding our disclosures. In designing and evaluating disclosure controls and procedures, we recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do.

b) There have been no changes in internal controls over financial reporting during the first quarter of 2007 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings None

Item 1A. Risk Factors

There have been no material changes with respect to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds None

Item 3. Defaults Upon Senior Securities None

Item 4. Submission of Matters to a Vote of Security Holders None

Item 5. Other Information None

Item 6. Exhibits See exhibit index on page 42.

Table of Contents

SIGNATURE

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

TRIAD GUARANTY INC.

Date: May 9, 2007

/s/ Kenneth W. Jones
Kenneth W. Jones
Senior Vice President and Chief Financial Officer

41

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.