December 20, 2017

Ms. Jill Youtsey
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Ms. Youtsey:

Arch Mortgage Insurance Company, NAIC 40266, is filing a partial amended filing for the Annual Statement for 12/31/2016. The amendment is for Page 014 Note 10 M, All SCA Investments.

The following pages in the Annual Statement are affected by these changes:

Jurat Page
P014 Notes

If additional information is required, please do not hesitate to call.

Sincerely,

Jeffrey Shaw
Assistant Vice President

Enclosures

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# ANNUAL STATEMENT

**For the Year Ended December 31, 2016**

of the Condition and Affairs of the

# ARCH MORTGAGE INSURANCE COMPANY

| | | |
|---|---|---|
| NAIC Group Code.....1279, 1279 (Current Period) (Prior Period) | NAIC Company Code..... 40266 | Employer's ID Number..... 36-3105660 |
| Organized under the Laws of WI | State of Domicile or Port of Entry WI | Country of Domicile US |
| Incorporated/Organized..... December 30, 1980 | Commenced Business..... December 31, 1981 | |

| | | |
|---|---|---|
| Statutory Home Office | 33 East Main Street, Suite 900….. Madison ..... WI ..... US ..... 53703<br>*(Street and Number) (City or Town, State, Country and Zip Code)* | |
| Main Administrative Office | 230 North Elm Street….. Greensboro ..... NC ..... US..... 27401<br>*(Street and Number) (City or Town, State, Country and Zip Code)* | 336-373-0232<br>*(Area Code) (Telephone Number)* |
| Mail Address | Post Office Box 20597….. Greensboro ..... NC ..... US ..... 27420<br>*(Street and Number or P. O. Box) (City or Town, State, Country and Zip Code)* | |
| Primary Location of Books and Records | 230 North Elm Street….. Greensboro ..... NC ..... US ..... 27401<br>*(Street and Number) (City or Town, State, Country and Zip Code)* | 336-373-0232<br>*(Area Code) (Telephone Number)* |
| Internet Web Site Address | www.archmi.com | |
| Statutory Statement Contact | Jeffrey Wayne Shaw<br>*(Name)* | 336-412-0800<br>*(Area Code) (Telephone Number) (Extension)* |
| | statutoryaccountingteam@archmi.com<br>*(E-Mail Address)* | 336-412-0862<br>*(Fax Number)* |

## OFFICERS

| Name | Title | Name | Title |
|---|---|---|---|
| 1. David Evan Gansberg | President & Chief Executive Officer | 2. Sara Fitzgerald Millard # | Executive Vice President, General Counsel & Secretary |
| 3. Thomas Harrison Jeter # | Executive Vice President & Chief Financial Officer | 4. Leslie Renae Marquart # | Senior Vice President & Controller |

## OTHER

| | | | |
|---|---|---|---|
| Christopher Andrew Hovey | Executive Vice President & Chief Operations Officer | Cheryl Ann Feltgen | Executive Vice President & Chief Risk Officer |
| John Edward Gaines # | Executive Vice President, Chief Credit & Pricing Officer | Christopher Martin Clement # | Executive Vice President & Chief Sales Officer |
| David William McLaughry # | Senior Vice President & Chief Actuary | James Heath Taylor # | Vice President & Treasurer |

## DIRECTORS OR TRUSTEES

| | | | |
|---|---|---|---|
| Andrew Thomas Rippert | Dennis Robert Brand | David Evan Gansberg | Mark Donald Lyons |
| Thomas Harrison Jeter | Cheryl Ann Feltgen | John Edward Gaines # | |

The officers of this reporting entity being duly sworn, each depose and say that they are the described officers of said reporting entity, and that on the reporting period stated above, all of the herein described assets were the absolute property of the said reporting entity, free and clear from any liens or claims thereon, except as herein stated, and that this statement, together with related exhibits, schedules and explanations therein contained, annexed or referred to, is a full and true statement of all the assets and liabilities and of the condition and affairs of the said reporting entity as of the reporting period stated above, and of its income and deductions therefrom for the period ended, and have been completed in accordance with the NAIC *Annual Statement Instructions* and *Accounting Practices and Procedures* manual except to the extent that: (1) state law may differ; or, (2) that state rules or regulations require differences in reporting not related to accounting practices and procedures, according to the best of their information, knowledge and belief, respectively. Furthermore, the scope of this attestation by the described officers also includes the related corresponding electronic filing with the NAIC, when required, that is an exact copy (except for formatting differences due to electronic filing) of the enclosed statement. The electronic filing may be requested by various regulators in lieu of or in addition to the enclosed statement.

| | | |
|---|---|---|
| (Signature) | (Signature) | (Signature) |
| David Evan Gansberg | Sara Fitzgerald Millard | Thomas Harrison Jeter |
| 1. (Printed Name) | 2. (Printed Name) | 3. (Printed Name) |
| President & Chief Executive Officer | Executive Vice President, General Counsel & Secretary | Executive Vice President & Chief Financial Officer |
| (Title) | (Title) | (Title) |

*State of North Carolina*
*County of Guilford*

*On* _______________ *before me,* ________________________________________

a. Is this an original filing? Yes [ ] No [ X ]

b. If no:
1. State the amendment number 01
2. Date filed 12/22/17
3. Number of pages attached 02

# NOTES TO FINANCIAL STATEMENTS

## 1. Summary of Significant Accounting Policies and Going Concern

A. Accounting Practices

The accompanying financial statements of Arch Mortgage Insurance Company (the "Company") are presented on the basis of accounting practices prescribed or permitted by the Wisconsin Office of the Commissioner of Insurance (the "Department").

The Department recognizes only statutory accounting practices prescribed or permitted by the state of Wisconsin (the "State") for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under the Wisconsin insurance laws. The National Association of Insurance Commissioners' ("NAIC") Accounting Practices and Procedures manual ("NAIC SAP") has been adopted as a component of prescribed or permitted practices by the State. The State has adopted certain prescribed accounting practices that differ from those found in NAIC SAP. Specifically, changes in contingency reserves for the year are reported in the annual statement as a reduction of or addition to underwriting income. Under Statement of Statutory Accounting Principles ("SSAP") No. 58, *Mortgage Guaranty Insurance* ("SSAP No. 58"), changes in contingency reserves are reported directly to unassigned funds (surplus) and not included in income. This modification adopted by the State does not affect the Company's statutory surplus.

| Description | SSAP # | F/S Page | F/S Line# | 2016 | 2015 |
|---|---|---|---|---|---|
| Net Income (Loss) | | | | | |
| 1. Company state basis (Page 4, Line 20, Columns 1 & 2) | | | | $ (31,796,526) | $ (34,843,210) |
| 2. State Prescribed Practices that increase/(decrease) NAIC SAP | | | | | |
| Change in Contingency Reserve | 58 | 4 | 5 | 36,848,064 | 27,284,047 |
| 3. State Permitted Practices that increase/(decrease) NAIC SAP | | | | - | - |
| 4. NAIC SAP (1-2-3=4) | | | | $ 5,051,538 | $ (7,559,163) |

| Description | SSAP | F/S | F/S | 2016 | 2015 |
|---|---|---|---|---|---|
| Surplus | | | | | |
| 5. Company state basis (Page 3, Line 37, Columns 1 & 2) | | | | $ 155,506,622 | $ 134,484,740 |
| 6. State Prescribed Practices that increase/(decrease) NAIC SAP | | | | - | - |
| 7. State Permitted Practices that increase/(decrease) NAIC SAP | | | | - | - |
| 8. NAIC SAP (5-6-7=8) | | | | $ 155,506,622 | $ 134,484,740 |

B. Use of Estimates in the Preparation of the Financial Statements

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in these financial statements and notes. Actual results could differ materially from these estimates.

C. Accounting Policies

Direct, assumed and ceded premiums are earned over the terms of the related insurance policies and reinsurance contracts. Unearned premium reserves are established to cover the unexpired portion of premiums written. Such reserves are computed by pro rata methods for direct and ceded business. Expenses incurred in connection with acquiring new insurance business, including such acquisition costs associated with underwriting and sales related activities are charged to operations as incurred. Expenses incurred are reduced for ceding allowances received or receivable.

Net investment income earned consists primarily of interest and dividends less investment related expenses. Interest is recognized on an accrual basis and dividends are recognized on an ex-dividend basis. Net realized capital gains (losses) are recognized on a specific identification basis when securities are sold, redeemed or otherwise disposed. Realized capital losses include writedowns for impairments considered to be other than temporary.

In addition, the Company uses the following accounting policies:

(1) Short-term investments are stated at amortized value using the interest method. Non-investment grade short-term investments are stated at the lower of amortized value or fair value.

(2) Investment grade bonds not backed by other loans with NAIC designations 1 or 2 are stated at amortized value using the consistent yield interest method. Non-investment grade bonds not backed by other loans with NAIC designations of 3 through 6 are stated at the lower of amortized value or fair value. See paragraph (6) for loan-backed securities.

(3) Not applicable - the Company has no common stock investments.

(4) Not applicable - the Company has no preferred stock investments.

(5) Not applicable - the Company has no real estate investments.

# NOTES TO FINANCIAL STATEMENTS

(6) Investment grade loan-backed securities are stated at amortized value. The retrospective adjustment method is used to determine amortized value for loan-backed securities. Non-investment grade loan-backed securities with NAIC designations of 3 through 6 are stated at the lower of amortized value or fair value.

Consistent with the NAIC process, the Company establishes the value of residential mortgage-backed securities by determining the NAIC designation and carrying value for the securities. Those securities assigned an NAIC designation of 1 or 2 are stated at amortized value while those with a 3 through 6 designation are stated at the lower of amortized value or fair value. The NAIC designation for the residential mortgage-backed securities held by the Company is reported in Schedule D.

(7) The Company owns 100% of the issued and outstanding shares of common stock of Arch U.S. MI Services Inc. ("Arch MI Services"), a non-insurance subsidiary. See Note 10. (A) regarding the Company's investment in Arch MI Services.

(8) Not applicable - the Company has no investments in joint ventures, partnerships, or limited liability companies.

(9) Not applicable - the Company does not have any derivative instruments or hedging activities.

(10) The Company performs an analysis for premium deficiency using assumptions based on management's best estimate when the assessment is performed. The calculation for premium deficiency reserves ("PDR") requires significant judgment and includes estimates of future expected premiums, expected claims, loss adjustment expenses ("LAE") and maintenance costs as of the date of the analysis. The calculation of future expected premiums uses assumptions for persistency and termination levels on policies currently in force. Assumptions for future expected losses include future expected average claim sizes and claim rates which are based on the current default rate and expected future defaults. The Company considers interest income in connection with its PDR analysis; accordingly, anticipated premium and loss cash flows are discounted. The Company performs premium deficiency analyses quarterly.

(11) The reserve for losses and LAE is the estimated cost of settling claims related to notices of default on insured loans that have been reported to the Company, as well as loan defaults that have occurred but have not been reported. A period of time may elapse between the occurrence of the borrower's default on mortgage payments (the event triggering a potential future claims payment), the reporting of such default to the Company and the eventual payment of the claim related to such default. To recognize the liability for unpaid losses related to the loans in default, the Company, in accordance with industry practice, establishes loss reserves in respect of loans in default based upon the estimated claim rate and estimated average claim amount of loans in default. Included in loss reserves are LAE reserves, and incurred but not reported ("IBNR") reserves. IBNR reserves represent the Company's estimated unpaid losses on loans that are in default but have not yet been reported to the Company as delinquent by its policyholders. Loss reserves are estimates and there can be no assurance that the Company's reserves will prove to be adequate to cover ultimate loss developments on reported defaults. Consistent with industry accounting practices, the Company does not establish loss reserves for estimated potential defaults that have not occurred but that may occur in the future. The Company's reserving process is based upon the assumption that past experience provides a reasonable basis for estimating future events. However, estimation of loss reserves is inherently judgmental. Conditions that have affected the development of the loss reserves in the past may not necessarily affect development patterns in the future, in either a similar manner or degree.

(12) The Company has a written capitalization policy for prepaid expenses and purchases of items such as electronic data processing equipment, software, furniture, other equipment and leasehold improvements. The predefined capitalization thresholds under this policy have not changed from those of the prior year.

(13) Not applicable - the Company does not write any medical insurance.

D. Going Concern:

Based upon its evaluation of relevant conditions and events, management does not have substantial doubt about the Company's ability to continue as a going concern.

2. <u>Accounting Changes and Correction of Errors</u>: Not Applicable.

3. <u>Business Combinations and Goodwill</u>

A. Statutory Purchase Method: Not Applicable.

B. Statutory Mergers: Not Applicable.

C. Writedowns for Impairment of Investment in Affiliates: Not Applicable.

4. <u>Discontinued Operations</u>: Not Applicable.

5. <u>Investments</u>

A. Mortgage Loans: Not Applicable.

B. Troubled Debt Restructuring for Creditors: Not Applicable.

C. Reverse Mortgages: Not Applicable.

# NOTES TO FINANCIAL STATEMENTS

D. Loan-Backed and Structured Securities

(1) Prepayment/default projections are based on historical statistics of the underlying collateral and current market data.

(2) The amounts of the other-than-temporary impairment ("OTTI") related to loan backed securities as of December 31, 2016: None.

(3) Information pertaining to each security with a recognized OTTI: None.

(4) Loan-backed securities in unrealized loss positions as of year-end, stratified based on length of time continuously in these unrealized loss positions, are as follows:

| | | | | |
|---|---|---|---|---|
| a. | The aggregate amount of unrealized losses: | 1 | Less than 12 Months | $ (54,230) |
| | | 2 | 12 Months or Longer | (254) |
| b. | The aggregate related fair value of securities with unrealized losses: | 1 | Less than 12 Months | 13,008,798 |
| | | 2 | 12 Months or Longer | 585,234 |

(5) Additional information

In accordance with SSAP No. 43R, *Loan-backed and Structured Securities – Revised*, the Company's loan-backed securities are stated at amortized cost.

In evaluating whether a decline in value is other-than-temporary, the Company considers several factors, including, but not limited to, the following:

- The extent and the duration of the decline in value;
- The reasons for the decline in value (credit event, interest related or market fluctuations);
- The financial position and access to capital of the issuer, including the current and future impact of any specific events;
- Our intent to sell the securities, or whether it is more likely than not that we will be required to sell it before recovery; and
- The financial condition and near term prospects of the issuer.

Impairment due to deterioration in credit that results in a conclusion that the present value of cash flows expected to be collected will not be sufficient to recover the amortized cost basis of the securities is considered other-than-temporary. Other declines in fair value (for example, due to interest rate changes, sector credit rating changes or company-specific rating changes) that result in a conclusion that the present value of cash flows expected to be collected will not be sufficient to recover the amortized cost basis of the security may also result in a conclusion that an OTTI has occurred. To the extent that the Company determines that a security is other-than-temporarily impaired, an impairment loss is recognized in the Statement of Income.

E. Repurchase Agreements and/or Securities Lending Transactions: Not Applicable.

F. Writedowns for Impairment of Real Estate, Real Estate Sales and Retail and Sales Operations and Real Estate with Participating Mortgage Loan Features: Not Applicable.

G. Low income housing tax credits: Not Applicable.

# NOTES TO FINANCIAL STATEMENTS

H. Restricted Assets

(1) Restricted assets (including pledged) summarized by restricted asset category

| | Gross (Admitted & Nonadmitted) Restricted | | | | | | | Current Year | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Current Year | | | | | | | | | Percentage | |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| Restricted Asset Category | Total General Account (G/A) | G/A Supporting Protected Cell Account Activity (a) | Total Protected Cell Account Restricted Assets | Protected Cell Account Assets Supporting G/A Activity (b) | Total (1 plus 3) | Total From Prior Year | Increase/ (Decrease) (5 minus 6) | Total Nonadmitted Restricted | Total Current Year Admitted Restricted | Gross Restricted to total Assets | Admitted Restricted to total Admitted Assets |
| a. Subject to contractual obligation for which liability is not shown | | | | | | | | | | | |
| b. Collateral held under security lending arrangements | | | | | | | | | | | |
| c. Subject to repurchase agreements | | | | | | | | | | | |
| d. Subject to reverse repurchase agreements | | | | | | | | | | | |
| e. Subject to dollar repurchase agreements | | | | | | | | | | | |
| f. Subject to dollar reverse repurchase agreements | | | | | | | | | | | |
| g. Placed under option contracts | | | | | | | | | | | |
| h. Letter stock or securities restricted as to sale - excluding FHLB capital stock | | | | | | | | | | | |
| i. FHLB capital stock | | | | | | | | | | | |
| j. On deposit with states | 4,588,425 | | | | 4,588,425 | 4,532,335 | 56,090 | - | 4,588,425 | 0.75% | 0.84% |
| k. On deposit with other regulatory bodies | | | | | | | | | | | |
| l. Pledged as collateral to FHLB (including assets backing funding agreements) | | | | | | | | | | | |
| m. Pledged as collateral not captured in other categories | | | | | | | | | | | |
| n. Other restricted assets | | | | | | | | | | | |
| o. Total restricted assets | 4,588,425 | - | - | - | 4,588,425 | 4,532,335 | 56,090 | - | 4,588,425 | 0.75% | 0.84% |

(2) Detail of assets pledged as collateral not captured in other categories (reported on line m above): Not Applicable.

(3) Detail of other restricted assets (reported on line n above): Not Applicable.

(4) Collateral received and reflected as assets within the reporting entity's financial statements: Not Applicable

I. Working Capital Finance Investments: Not Applicable.

J. Offsetting and Netting of Assets and Liabilities: Not Applicable.

K. Structured Notes: Not Applicable.

L. 5* Securities: Not Applicable.

6. Joint Ventures, Partnerships and Limited Liability Companies: Not Applicable.

7. Investment Income

A. Accrued Investment Income:

The Company does not admit investment income due and accrued if amounts are over 90 days past due.

B. Amounts Non-admitted: Not Applicable.

8. Derivative Instruments: Not Applicable.

9. Income Taxes

A. Deferred Tax Assets/(Liabilities)

(1) The components of the net deferred tax asset / (liability) at December 31 are as follows:

# NOTES TO FINANCIAL STATEMENTS

| | 2016 | | | 2015 | | | Change | | |
|---|---|---|---|---|---|---|---|---|---|
| | (1) Ordinary | (2) Capital | (3) (Col 1 + 2) Total | (4) Ordinary | (5) Capital | (6) (Col 4 + 5) Total | (7) (Col 1 - 4) Ordinary | (8) (Col 2 - 5) Capital | (9) (Col 7 + 8) Total |
| (a) Gross Deferred Assets | 55,315,194 | 1,395 | 55,316,589 | 43,461,569 | - | 43,461,569 | 11,853,625 | 1,395 | 11,855,020 |
| (b) Statutory Valuation Allowance Adjustment | - | - | - | - | - | - | - | - | - |
| (c) Adjusted Gross Deferred Tax Asset (1a-1b) | 55,315,194 | 1,395 | 55,316,589 | 43,461,569 | - | 43,461,569 | 11,853,625 | 1,395 | 11,855,020 |
| (d) Deferred Tax Assets Nonadmitted | 34,999,079 | - | 34,999,079 | 25,867,827 | - | 25,867,827 | 9,131,252 | - | 9,131,252 |
| (e) Subtotal Net Admitted Deferred Tax Assets (1c-1d) | 20,316,115 | 1,395 | 20,317,510 | 17,593,742 | - | 17,593,742 | 2,722,373 | 1,395 | 2,723,768 |
| (f) Deferred Tax Liabilities | 34,038 | - | 34,038 | - | 52,254 | 52,254 | 34,038 | (52,254) | (18,216) |
| (g) Net Admitted Deferred Tax Assets (1e-1f) | 20,282,077 | 1,395 | 20,283,472 | 17,593,742 | (52,254) | 17,541,488 | 2,688,335 | 53,649 | 2,741,984 |

(2) The admission calculation components at December 31 are as follows:

| | 2016 | | | 2015 | | | Change | | |
|---|---|---|---|---|---|---|---|---|---|
| | (1) Ordinary | (2) Capital | (3) (Col 1 + 2) Total | (4) Ordinary | (5) Capital | (6) (Col 4 + 5) Total | (7) (Col 1 - 4) Ordinary | (8) (Col 2 - 5) Capital | (9) (Col 7 + 8) Total |
| Admission Calculation Components - SSAP No. 101 | | | | | | | | | |
| (a) Paragraph 11.a. | - | | - | - | | - | - | - | - |
| (b) Paragraph 11.b. (the lesser paragraph of 2b(1) and 2b(2) below) | 20,282,077 | 1,395 | 20,283,472 | 17,541,488 | | 17,541,488 | 2,740,589 | 1,395 | 2,741,984 |
| 1. Paragraph 11.b.i. | 52,270,467 | | 52,270,467 | 43,395,757 | | 43,395,757 | 8,874,710 | - | 8,874,710 |
| 2. Paragraph 11.b.ii. | XXX | XXX | 20,283,472 | XXX | XXX | 17,541,488 | XXX | XXX | 2,741,984 |
| (c) Paragraph 11.c. | - | 34,038 | 34,038 | - | 52,254 | 52,254 | - | (18,216) | (18,216) |
| (d) Total (2a + 2b + 2c) | 20,282,077 | 35,433 | 20,317,510 | 17,541,488 | 52,254 | 17,593,742 | 2,740,589 | (16,821) | 2,723,768 |

(3) Other Admissibility Criteria:

| Realization Threshold Limitation<br>Mortgage Guaranty/Non-RBC Reporting Entities | (1)<br>2016 | (2)<br>2015 |
|---|---|---|
| (a) Risk to Capital Ratio percentage used to determine recovery period and threshold limitation amount | 153.44% | 222.80% |
| (b) Amount of adjusted capital and surplus used to determine recovery period and threshold limitation in 2b(2) above. | 135,223,150 | 116,943,253 |

(4) Impact of Tax Planning Strategies: The tax planning strategies do not include the use of reinsurance-related tax planning strategies. There are no temporary differences for which a deferred tax liability (DTL) has not been established.

B. Deferred Tax Liabilities Not Recognized: Not Applicable.

C. Current and deferred income taxes consist of the following major components:

(1) Current Income Tax

| | (1)<br>2016 | (2)<br>2015 | (3)<br>(Col 1-2) Change |
|---|---|---|---|
| (a) Federal | (697,514) | (218,789) | (478,725) |
| (b) Foreign | | | - |
| (c ) Subtotal | (697,514) | (218,789) | (478,725) |
| (d) Federal income tax on net capital gains | 692,535 | 218,789 | 473,747 |
| (e) Utilization of capital loss carry-forwards | | | - |
| (f) Other | | | - |
| (g) Federal and Foreign income taxes incurred | (4,979) | (0.00) | (4,979) |

# NOTES TO FINANCIAL STATEMENTS

(2) Deferred Tax Assets

| | (1) 2016 | (2) 2015 | (3) (Col 1-2) Change |
|---|---|---|---|
| (a) Ordinary | | | |
| (1) Discounting of unpaid losses | 192,895 | 312,620 | (119,725) |
| (2) Unearned premium discount | 2,090,830 | 1,030,515 | 1,060,315 |
| (3) Policyholder reserves | | | - |
| (4) Investments | | | - |
| (5) Ceding Commission | 2,120,288 | - | 2,120,288 |
| (6) Policyholder dividents accrual | | | - |
| (7) Book Abandonment of Fixed assets | 58,030 | 58,030 | - |
| (8) Compensation and benefits accrual | | | - |
| (9) Pension accrual | | | - |
| (10) Capital loss carryforward | - | - | - |
| (11) Amortization | | - | - |
| (12) Tax credit carry-forward | 5,082,650 | 5,082,650 | - |
| (13) Depreciation | - | (21,507) | 21,507 |
| (14) Prepaid assets | 27,080 | 42,242 | (15,162) |
| (15) Contingency reserve adjustment | 45,743,421 | 36,957,019 | 8,786,402 |
| (99) Subtotal | 55,315,194 | 43,461,569 | 11,853,625 |
| | | | |
| (b) Statutory valuation allowance adjustment | | | - |
| (c ) Nonadmitted | 34,999,079 | 25,867,827 | 9,131,252 |
| | | | |
| (d) Admitted ordinary deferred tax assets | 20,316,115 | 17,593,742 | 2,722,373 |
| | | | |
| (e) Capital: | | | |
| (1) Investments | 1,395 | - | 1,395 |
| (2) Net capital loss carry-forward | | | - |
| (3) Real estate | | | - |
| (4) Other (<5% of total capital tax assets) | | | - |
| (99) Subtotal | 1,395 | - | 1,395 |
| | | | |
| (f) Statutory valuation allowance adjustment | | | - |
| (g) Nonadmitted | | | - |
| | | | |
| (h) Admitted capital deferred tax assets | 1,395 | - | 1,395 |
| | | | |
| (i) Admitted deferred tax assets | 20,317,510 | 17,593,742 | 2,723,768 |

(3) Deferred Tax Liabilities:

| | 2016 | 2015 | (Col 1-2) Change |
|---|---|---|---|
| (a) Ordinary | | | |
| (1) Investments | | | - |
| (2) Fixed Assets | 34,038 | - | 34,038 |
| (3) Deferred and uncollected premium | | | - |
| (4) Policyholder reserves | | | - |
| (5) Other (<5% of total ordinary tax assets) | | | - |
| (6) Additional acq costs-installment premiums | | | - |
| (7) Discount of accrued salvage & subrogation | | | - |
| (8) Guaranty funds receivable | | | - |
| (99) Subtotal | 34,038 | - | 34,038 |
| | | | |
| (e) Capital: | | | |
| (1) Investments | - | 52,254 | (52,254) |
| (2) Real estate | | | - |
| (3) Other (<5% of total capital tax assets) | | | - |
| (99) Subtotal | - | 52,254 | (52,254) |
| | | | |
| (i) Deferred tax liabilities | 34,038 | 52,254 | (18,216) |
| | | | |
| 4. Net Deferred Tax Assets/Liabilities (2i-3c) | 20,283,472 | 17,541,488 | 2,741,984 |

D. Reconciliation of Federal Income Tax Rate to Actual Effective Tax Rate

Among the more significant book to tax adjustment were the following:

# NOTES TO FINANCIAL STATEMENTS

| | 2016 | |
|---|---|---|
| | Amount in Thousands | Effective Tax Rate (%) |
| Provision computed at statutory rate | (11,130,527) | 35.0% |
| | | |
| Tax on Realized Gain and losses | | 0.0% |
| Tax exempt income deduction | (785,782) | 2.5% |
| Dividends received deduction | - | 0.0% |
| Deferred non admit | | 0.0% |
| Contingency Reserve Adjustment | | 0.0% |
| Net loss reserve discount | | 0.0% |
| Unearned premium discount | | 0.0% |
| AMT Tax | - | 0.0% |
| Proration of tax exempt investment income | | 0.0% |
| Change in deferred tax assets | 26,828 | -0.1% |
| Disallowed travel and entertainment | - | 0.0% |
| State tax impact | - | 0.0% |
| True-ups | (648) | 0.0% |
| Other | 11,667 | 0.0% |
| Contingency Reserve Reversal | 247 | 0.0% |
| Totals | (11,878,215) | 37.4% |
| | | |
| Federal and foreign income taxes incurred | (697,514) | 2.2% |
| Realized capital gains (losses) tax | 692,535 | -2.2% |
| Change in net deferred income taxes | (11,873,236) | 37.4% |
| Total statutory income taxes | (11,878,215) | 37.4% |

E. Operating Loss and Tax Credit Carryforwards and Protective Tax Deposits

(1) At December 31, 2016, the Company had no unused operating loss carryforwards available to offset against future income.

(2) The following is income tax expense for 2016 and 2015 that is available for recoupment in the event of future net losses.

| Year | Amount |
|---|---|
| 2016 | - |
| 2015 | - |

(3) The Company did not have any protective tax deposits under Section 6603 of the Internal Revenue Code.

F. Consolidated Federal Income Tax Return

(1) The Company's federal income tax return is consolidated with the following entities:

Arch Capital Group (U.S.) Inc. ( Parent of Tax Group)
Arch Excess & Surplus Insurance Company
Arch Insurance Company
Arch Insurance Group Inc.
Arch Indemnity Insurance Co.
Arch Insurance Solutions Inc.
Arch US MI Services Inc.
Arch Mortgage Guaranty Company
Arch Mortgage Reinsurance Company
Arch Reinsurance Company
Arch Re Facultative Underwriters Inc.
Arch Specialty Insurance Agency Inc.
Arch Specialty Insurance Company
First American Service Corporation
Arch US MI Holdings Inc.
Arch Mortgage Insurance Company
Arch Mortgage Assurance Company

The Company is a party to a tax sharing agreement between Arch Capital Group (U.S.) Inc. ("Arch Capital U.S.") and its subsidiaries. Under this agreement, the Company's taxes are computed as if it filed a separate tax return on a stand-alone basis.

(2) The method of allocation of taxes among Arch Capital U.S. and its subsidiaries is subject to the terms of a tax sharing agreement, whereby allocation is made primarily on a separate return basis with credit given to the Company for any net operating losses or other items used in the consolidated tax return filed by Arch Capital U.S. to the extent those losses or items may be utilized by the Company on a separate return basis.

G. Federal or Foreign Federal Income Tax Loss Contingencies

The Company has no tax loss contingencies for which it is reasonably possible that the total liability will significantly increase within twelve months of the reporting date.

# NOTES TO FINANCIAL STATEMENTS

## 10. Information Concerning Parent, Subsidiaries and Affiliates and Other Related Parties

A. Nature of Relationships

The Company provides private mortgage insurance products and services to residential mortgage lenders. On January 30, 2014, Arch U.S. MI Holdings Inc. ("Arch U.S. MI Holdings"), an indirect subsidiary of Arch Capital Group Ltd. ("ACGL"), completed its acquisition of the Company (the "Acquisition").

Arch MI Services, a wholly-owned subsidiary of the Company issued a dividend of $2.0 million to the Company on July 29, 2015. For the years 2015 and 2016, the Company has elected to not obtain an audit of the financial statements of Arch MI Services and, in accordance with SSAP No. 97, *Investments in Subsidiary, Controlled and Affiliated Entities*, has reflected its investment in Arch MI Services as a non-admitted asset.

Arch U.S. MI Holdings completed the acquisition of United Guaranty Corporation ("UGC", which includes ten U.S. insurance companies) on December 31, 2016 (the "UGC Acquisition"). The UGC Acquisition closed following the satisfaction of closing conditions as stipulated in the Stock Purchase Agreement, the receipt of regulatory approval from the North Carolina Department of Insurance, non-objection by the Department, and federal approvals from the Federal Housing Finance Agency on behalf of the Government-Sponsored Entities ("GSEs") including Fannie Mae and Freddie Mac. The UGC Acquisition expanded the scale of ACGL's mortgage insurance business by combining UGC's position as market leader in the U.S. private mortgage insurance industry with ACGL's financial strength, innovative approach and superior technology platform. While the UGC Acquisition further diversified ACGL's business profile and customer base, it did not include any current plan to change the Company's name, state of domicile, or basic insurance operations.

Arch U.S. MI Holdings made a capital contribution in the form of cash to the Company in the amount of $40.0 million on December 22, 2016. In accordance with SSAP No. 72, *Surplus and Quasi-reorganizations*, the Company recorded this cash capital contribution as an increase to surplus paid-in and contributed.

B. Detail of Transactions Greater than ½% of Admitted Assets

See Notes 14.G for information on contingency reserves transactions.

C. Change in Terms of Intercompany Agreements

On December 14, 2015, the Company filed a Form D – Prior Notice of a Transaction with the Department regarding the Quota Share Reinsurance Agreement between the Company and Arch Reinsurance Ltd. ("Arch Re Ltd.") (the "Arch Reinsurance Agreement"). The Company proposed to enter into an Amended and Restated Quota Share Reinsurance Agreement (the "Restated Agreement") that would amend the Arch Reinsurance Agreement primarily to comply with the Private Mortgage Insurer Eligibility Requirements ("PMIERs") established by the GSEs (see Note 13 for information on the PMIERs). Additionally, the Company filed with the Department a First Amendment to the Reinsurance Trust Agreement ("Trust Amendment"), with Arch Re Ltd. and the Bank of New York Mellon ("BNY"), which limits eligible assets in the trust account to cash in U.S. dollars, U.S. Treasuries and U.S. Federal Agency Securities. The purpose of the Trust Amendment is to comply with the PMIERs. On December 30, 2015, the Department declined to disapprove the Restated Agreement and the Trust Amendment. The Restated Agreement and Trust Agreement were executed effective as of December 31, 2015.

The Department, on December 16, 2016, declined to disapprove Addendum No. 1 to the Arch Reinsurance Agreement that included United Guaranty Residential Insurance Company ("UGRIC") and United Guaranty Indemnity Company ("UG Indemnity") as additional cedents. This amendment became effective on January 1, 2017.

After receiving the Department's prior notice of non-disapproval, the Company entered into a "Fourth Amended and Restated Tax Sharing Agreement between ACGL and Subsidiaries" ('Fourth Amendment") effective January 1, 2017. The Fourth Amendment sets forth the terms for the allocation of tax liabilities among Arch Capital U.S. and its subsidiaries, and adds the thirteen United Guaranty companies acquired by Arch U.S. MI Holdings as additional parties to the agreement.

D. Amounts Due to or from Related Parties

As of December 31, 2016, the Company reported $48.5 million as a net amount due to affiliated companies. The majority of this amount is due to the Company's wholly-owned subsidiary, Arch MI Services, for services provided to the Company pursuant to the terms of the Service Agreement (see Note 10.F for a discussion of the Service Agreement). The terms of the intercompany agreements require that payments for amounts billed are remitted appropriately.

E. Guarantees or Undertakings for Related Parties: Not Applicable.

F. Management, Service Contracts, Cost Sharing Arrangements

On January 30, 2014, the Company, Arch Mortgage Guaranty Company ("AMG"), Arch Mortgage Assurance Company ("Arch MA"), and Arch Mortgage Reinsurance Company ("Arch MI Re") entered into a Service Agreement with Arch U.S. MI Holdings and Arch MI Services ("Service Agreement"), under which Arch MI Services provides various services to the Company, Arch MA and Arch MI Re, including, but not limited to, accounting, data processing, information technology, employee administration, and legal services.

On January 20, 2015, the Company filed a prior notification with the Department of an Amended and Restated Investment Manager Agreement (the "Amended Investment Manager Agreement") with Arch Investment Management Ltd. ("Arch Investment") whereby Arch Investment shall provide investment management services to the Company, including, but not limited to, investment advisory and oversight, investment market risk monitoring, investment compliance monitoring, and asset allocation monitoring. In a letter dated February 2, 2015, the Department declined to disapprove the Amended Investment Manager Agreement.

# NOTES TO FINANCIAL STATEMENTS

G. Nature of Relationships that Could Affect Operations

The Company withholds funds in accordance with the Quota Share Reinsurance Agreement between the Company and PMI Insurance Co. ("PIC") (the "PIC Reinsurance Agreement"). As of December 31, 2016 and 2015, the funds withheld account had a balance of $64.6 million and $33.9 million, respectively. On July 18, 2016, the Company reached $25 billion in cumulative new insurance written ("NIW"). As a result, the Company is no longer ceding reinsurance on new policies written after that date under the PIC Reinsurance Agreement.

The Company cedes coverage (net of other reinsurance) of a certain percentage of insured loans to Arch MI Re, a wholly-owned subsidiary of Arch MA.

H. Amount Deducted for Investment in Upstream Company: Not Applicable.

I. Detail of Investments in Affiliates Greater than 10% of Admitted Assets: Not Applicable.

J. Writedowns for Impairment of Investments in Affiliates: Not Applicable.

K. Foreign Subsidiary Valued Using CARVM: Not Applicable.

L. Downstream Holding Company Valued using Look-through Method: Not Applicable.

M. All SCA Investments

(1) Balance Sheet Value (Admitted and Nonadmitted) All SCAs (Except 8bi Entities)

| SCA Entity | Percentage of SCA Ownership | Gross Amount | Admitted Amount | Nonadmitted Amount |
|---|---|---|---|---|
| a. SSAP No. 97 8a Entities | | | | |
| | % | | | |
| Total SSAP No. 97 8a Entities | XXX | $ | $ | $ |
| b. SSAP No. 97 8b(ii) Entities | | | | |
| | % | | | |
| Total SSAP No. 97 8b(ii) Entities | XXX | $ | $ | $ |
| c. SSAP No. 97 8b(iii) Entities | | | | |
| Arch US MI Services Inc | 100.000 % | 26,494,186 | | 26,494,186 |
| Total SSAP No. 97 8b(iii) Entities | XXX | $ 26,494,186 | $ | $ 26,494,186 |
| d. SSAP No. 97 8b(iv) Entities | | | | |
| | % | | | |
| Total SSAP No. 97 8b(iv) Entities | XXX | $ | $ | $ |
| e. Total SSAP No. 97 8b Entities (exception 8b(i) entities) (b + c + d) | XXX | $ 26,494,186 | $ | $ 26,494,186 |
| f. Aggregate Total (a + e) | XXX | $ 26,494,186 | $ | $ 26,494,186 |

(2) NAIC Filing Response Information

| SCA Entity (Should be the same entities as shown in M(1) above) | Type of NAIC Filing* | Date of Filing to the NAIC | NAIC Valuation Amount | NAIC Response Received Y/N | NAIC Disallowed Entities Valuation Method Resubmission Required Y/N | Code** |
|---|---|---|---|---|---|---|
| a. SSAP No. 97 8a Entities | | | | | | |
| | | | | | | |
| Total SSAP No. 97 8a Entities | XXX | XXX | $ | XXX | XXX | XXX |
| b. SSAP No. 97 8b(ii) Entities | | | | | | |
| | | | | | | |
| Total SSAP No. 97 8b(ii) Entities | XXX | XXX | $ | XXX | XXX | XXX |
| c. SSAP No. 97 8b(iii) Entities | | | | | | |
| Arch US MI Services Inc | S1 | 12/15/2017 | 26,494,186 | Y | N | I |
| Total SSAP No. 97 8b(iii) Entities | XXX | XXX | $ 26,494,186 | XXX | XXX | XXX |
| d. SSAP No. 97 8b(iv) Entities | | | | | | |
| | | | | | | |
| Total SSAP No. 97 8b(iv) Entities | XXX | XXX | $ | XXX | XXX | XXX |
| e. Total SSAP No. 97 8b Entities (exception 8b(i) entities) (b + c + d) | XXX | XXX | $ 26,494,186 | XXX | XXX | XXX |
| f. Aggregate Total (a + e) | XXX | XXX | $ 26,494,186 | XXX | XXX | XXX |

* S1 – Sub-1, S2 – Sub-2 or RDF – Resubmission of Disallowed Filing

** I – Immaterial or M – Material

N. Investment in Insurance SCAs: Not Applicable.

11. Debt: Not Applicable.

# NOTES TO FINANCIAL STATEMENTS

## 12. Retirement Plans, Deferred Compensation, Postemployment Benefits and Compensated Absences and Other Postretirement Benefit Plans

A. Defined Benefit Plans: For the year ended December 31, 2016, the Company had no employees.

B. Investment Policies and Strategies: Not Applicable.

C. Fair Value of Plan Assets: Not Applicable.

D. Basis Used to Determine Expected Long-Term Rate-of-Return: Not Applicable.

E. Defined Contribution Plans: For the year ended December 31, 2016, the Company had no employees.

F. Multiemployer Plans: Not Applicable.

G. Consolidated/Holding Company Plans

For the year ended December 31, 2016, the Company had no employees. The Company is currently serviced by employees of Arch MI Services. To the extent Arch MI Services sponsored defined benefit plans for their employees during 2016 and 2015, no expense or obligations of these plans were charged to the Company for the current and prior years.

H. Postemployment Benefits and Compensated Absences: Not Applicable.

I. Impact of Medicare Modernization Act on Postretirement Benefits: Not Applicable.

## 13. Capital and Surplus, Shareholders' Dividends Restrictions and Quasi-Reorganizations

1. Outstanding Shares

The Company has 40,000,000 shares of $1.25 par value common stock authorized, 2,200,000 shares of which are issued and outstanding. There are no other classes of equity stock authorized.

2. Dividend Rate of Preferred Stock: Not Applicable.

3., 4. and 5. Dividend Restrictions and Dividend Payments

On January 24, 2014, the Company received conditional approval for the expansion of the Company's eligibility to write mortgage insurance for all GSEs approved seller/servicers. This GSE approval is subject to, among other things, maintenance of a minimum capital level and risk-to-capital ratio, limitation on entering into reinsurance or other risk share arrangements without prior written approval and a restriction on the payment of dividends to affiliates for three years commencing February 2014.

On April 17, 2015, the GSEs released the final revised version of the PMIERs with an effective date of December 31, 2015. The PMIERs are the set of requirements imposed upon mortgage insurers to be approved by the GSEs. They include new financial, business and quality control requirements for mortgage insurers. The new PMIERs' primary financial requirement is to maintain "Available Assets" in excess of "Minimum Required Assets" as of the end of each calendar quarter. Minimum Required Assets is the greater of: (1) a calculated amount based on the characteristics of the mortgage insurer's insurance portfolio: and (2) a floor of $400 million. As of December 31, 2016, the Company satisfies the PMIERs' financial requirements.

The Company's ability to pay dividends is limited by, among other restrictions, state insurance laws including, but not limited to, the laws of the State of Wisconsin. Wisconsin Administrative Code ("Wis. Admin. Code") Ins. § 600.03 provides that the Company may pay out ordinary dividends without the prior approval of the Wisconsin Commissioner of Insurance (the "Commissioner") in an amount, when added to other shareholder distributions made in the last 12 months, not in excess of the lesser of (a) 10% of the insurer's surplus as regards to policyholders as of the prior December 31 or, (b) if the insurer is not a life insurer, the greater of the following:

(i) net income of the insurer for the calendar year preceding the date of the dividend or distribution, minus realized capital gains for that calendar year; or

(ii) the aggregate of the net income of the insurer for the three calendar years preceding the date of the dividend or distribution, minus realized capital gains for those calendar years and minus dividends paid or credited and distributions made within the first two of the preceding calendar years.

A dividend that exceeds the foregoing threshold is deemed an "extraordinary dividend" and requires the prior approval of the Commissioner. Other states including California and Illinois limit dividends by a mortgage insurer to its undivided profits. State minimum capital requirements also limit the amount of dividends that the Company may pay. The Company made no dividend payments during 2016. The PMIERs include restrictions on payment of dividends by mortgage insurers when "Available Assets" fall below the "Minimum Required Assets." Mortgage insurers with an "Available Assets Shortfall" must not, without prior written approval from the GSEs, pay dividends or transfer assets to any affiliate or investor. Additionally, under the PMIERs, the Company is deemed to be a "newly-approved insurer." As a result of this status, until January 2017, the Company is subject to additional PMIER requirements, including being prohibited from paying dividends to affiliates.

6. Restrictions on Unassigned Funds: Not Applicable.

7. Mutual Surplus Advances: Not Applicable.

8. Company Stock Held for Special Purposes: Not Applicable.

9. Changes in Special Surplus Funds: Not Applicable.

# NOTES TO FINANCIAL STATEMENTS

10. Changes in Unassigned Funds

The portion of unassigned funds (surplus) represented or reduced by each item below is as follows:

| | | |
|---|---|---|
| (1) | Change in net deferred income taxes | $ 11,873,238 |
| (2) | Change in nonadmitted assets | (12,318,813) |
| (3) | Change in paid-in surplus | 43,263,985 |
| (4) | Surplus notes | 10,000,000 |

11. Surplus Notes:

After obtaining the Department's prior notice of non-disapproval, the Company, on March 27, 2015, issued a surplus note in the amount of $7.5 million (the "First Surplus Note") to Arch Capital U.S. with the following terms:

| Date Issued | Interest Rate | Par Value (Face Amount) | Carrying Value at March 31, 2015 | Interest Paid Current Year | Total Interest Paid | Unapproved Interest and/or Principal | Date of Maturity |
|---|---|---|---|---|---|---|---|
| 03/27/2015 | 30 Year Fixed @ 6.5% annually, interest paid in arrears annually on December 15 of each year, commencing on December 15, 2017 | $7,500,000 | $7,500,000 | $0 | $0 | $0 | 03/27/2045 |

On April 17, 2015, the Company, after prior notification and non-disapproval of the Department, issued a surplus note in the amount of $32.0 million (the "Second Surplus Note") to Arch Capital U.S. with the following terms:

| Date Issued | Interest Rate | Par Value (Face Amount) | Carrying Value at April 17, 2015 | Interest Paid Current Year | Total Interest Paid | Unapproved Interest and/or Principal | Date of Maturity |
|---|---|---|---|---|---|---|---|
| 04/17/2015 | 30 Year Fixed @ 6.25% annually, interest paid in arrears annually on December 15 of each year, commencing on December 15, 2017 | $32,000,000 | $32,000,000 | $0 | $0 | $0 | 04/17/2045 |

# NOTES TO FINANCIAL STATEMENTS

On December 22, 2016, the Company after prior notification and non-disapproval of the Department, issued a surplus note in the amount of $10.0 million (the "Third Surplus Note") to Arch Capital Finance (Ireland) Limited with the following terms:

| Date Issued | Interest Rate | Par Value (Face Amount) | Carrying Value at December 22, 2016 | Interest Paid Current Year | Total Interest Paid | Unapproved Interest and/or Principal | Date of Maturity |
|---|---|---|---|---|---|---|---|
| 12/22/2016 | 30 Year Fixed @ 6.80% annually, interest paid in arrears annually on December 15 of each year, commencing on December 15, 2017 | $10,000,000 | $10,000,000 | $0 | $0 | $0 | 12/22/2046 |

Any payment of principal and interest on the First, Second, or Third Surplus Notes shall be made only with the prior written approval of the Department. In accordance with SSAP No. 41, *Surplus Notes*, the First, Second, and Third Surplus Notes are classified as part of the Company's policyholder's surplus.

12. Impact of Quasi-reorganizations: Not Applicable.

13. Date of Quasi-reorganizations: Not Applicable.

## 14. Liabilities, Contingencies and Assessments

A. Contingent Commitments: Not Applicable.

B. Assessments: Not Applicable.

C. Gain Contingencies: Not Applicable.

D. Claims Related Extra Contractual Obligation and Bad Faith Losses Stemming from Lawsuits: Not Applicable.

E. Product Warranties: Not Applicable.

F. Joint and Several Liabilities: Not Applicable.

G. Other Contingencies:

Under State insurance laws, mortgage insurers are required to establish a special contingency reserve from unassigned funds, with annual additions equal to 50% of premiums earned that year. This reserve is required to be maintained for a period of 120 months to protect against the effects of adverse economic cycles ("Ten-Year Trigger"). After 120 months, the reserve is released to unassigned funds. In the event an insurer's loss ratio in any calendar year exceeds 35%, the insurer may withdraw from its contingency reserve an amount equal to the excess portion (i.e., in excess of 35% of earned premiums) of such losses. Mortgage guaranty insurers can request early withdrawals if, and to the extent, its actual policyholder position exceeds minimum policyholder position. The statute allows the Company, upon approval from the Department, to withdraw from the contingency reserve when incurred losses and incurred loss expenses exceed the greater of either 35% of the net earned premium or 70% of the amount that the Company is required to contribute to the contingency reserve in such a year. Early withdrawals from the contingency reserve are treated on a first-in first-out basis. The contingency reserve is reported in the financial statements as a liability, and not as a special surplus fund reserve. Additions to and withdrawals from contingency reserves are included in underwriting income.

For the year 2016 and 2015, the Company had no contingency reserve withdrawals.

At December 31, 2016 and 2015, the Company had gross admitted assets of $10.5 million and $5.4 million, respectively, related to premiums receivable due from policyholders. The Company routinely assesses the collectability of these receivables. Based upon Company experience, any potential uncollectible premiums receivable as of the end of the current year are not expected to exceed the nonadmitted amount, and therefore, no additional provision for uncollectible amounts has been recorded. The potential for any additional loss is not believed to be material to the Company's financial condition.

## 15. Leases

A. Lessee Operating Lease

(1) During 2014, the Company vacated the leased office space located at 595 Market Street, San Francisco, California ("San Francisco Office") and moved its office to 3003 Oak Road, Walnut Creek, California ("Walnut Creek Lease"). On January 30, 2014, the Company entered into a lease agreement for the Walnut Creek office that expires on January 31, 2019. On August 14, 2014, the Company subleased the San Francisco Office with a term that commenced on February 1, 2015 and expires on February 27, 2017, with monthly rent payments from the subtenant commencing on June 1, 2015. Rental expense allocated to the Company was $2.4 million in 2016 and $3.0 million in 2015, which includes expenses for offices used by or for the benefit of the Company.

(2) Future minimum rental payments are as follows (in thousands):

| Year | Amount |
|---|---|
| 2017 | $ 3,296 |
| 2018 | 3,410 |
| 2019 | 565 |
| 2020 | 315 |
| 2021 | 325 |
| Thereafter | 167 |
| | $ 8,078 |

As of December 31, 2016, the total future minimum rental payments to be received by the Company under the sublease agreement for San Francisco Office is $114 thousand.

(3) The Company has not entered into any sale and leaseback arrangement.

B. Lessor Leasing Arrangements: Not Applicable.

16. Information About Financial Instruments with Off-Balance Sheet Risk: Not Applicable.

17. Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities: Not Applicable.

18. Gain or Loss to the Reporting Entity from Uninsured Plans and the Portion of Partially Insured Plans: Not Applicable.

19. Direct Premiums Written/Produced by Managing General Agents/Third Party Administrators: Not Applicable.

20. Fair Value Measurements

A. Inputs Used for Assets and Liabilities Measured and Reported at Fair Value

(1) Fair Value Measurements at Reporting Date

For the purposes of this Annual Statement, the Company provides the following disclosure regarding measurement of certain financial assets at fair value.

The Company's financial assets measured at fair value are based on a hierarchy defined by SSAP No. 100, *Fair Value Measurements*. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable public sources.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

At December 31, 2016 and 2015, the Company had no financial assets recorded at fair value.

At the end of each reporting period, the Company evaluates whether or not any event has occurred or circumstances have changed that would cause an instrument to be transferred between Levels 1 and 2. There were no transfers of assets or liabilities to or from Levels 1 and 2 for the year ended December 31, 2016. This policy also applies to transfers into or out of Level 3 as stated in paragraph 3 below.

(2) Fair Value Measurements in Level 3 of the Fair Value Hierarchy

At December 31, 2016 and 2015, the Company had no assets or liabilities measured at fair value in this category.

(3) Policy on Transfers Into and Out of Level 3

At the end of each reporting period, the Company evaluates whether or not any event has occurred or circumstances have changed that would cause an instrument to be transferred into or out of Level 3. There were no transfers into or out of Level 3 for the year ended December 31, 2016.

(4) Inputs and Techniques Used for Level 2 and Level 3 Fair Values

Bonds carried at fair value categorized as Level 2 were valued using a market approach. These valuations were determined to be Level 2 valuations as quoted market prices for similar instruments in an active market were utilized.

(5) Derivative Fair Values: Not Applicable.

B. Other Fair Value disclosures: Not Applicable.

C. Fair Values for All Financial Instruments by Levels 1, 2 and 3:

D. The table below reflects the fair values and admitted values of all admitted assets and liabilities that are financial instruments excluding those accounted for under the equity method (subsidiaries, joint ventures, and ventures). The fair values are also categorized into the three-level fair value hierarchy as described above in Note 20.A.

| Type of Financial Instrument | Aggregate Fair Value | Admitted Assets | Level 1 | Level 2 | Level 3 | Not Practicable (Carrying Value) |
|---|---|---|---|---|---|---|
| Financial Instruments - assets | | | | | | |
| Bonds | $ 479,458,211 | $ 484,704,949 | $108,591,130 | $ 370,867,081 | $ - | $ - |
| Cash, cash equivalent and short-term investments | 25,777,839 | 25,777,839 | 25,777,839 | - | - | - |
| Total assets | $ 505,236,050 | $ 510,482,788 | $134,368,969 | $ 370,867,081 | $ - | $ - |
| Financial Instruments - liabilities | | | | | | |
| Derivative liabilities | - | - | - | - | - | - |
| Total liabilities | - | - | - | - | - | - |

E. Financial Instruments for which Not Practicable to Estimate Fair Values: Not Applicable.

## 21. Other Items

A. Extraordinary, Unusual or Infrequent Items: Not Applicable.

B. Troubled Debt Restructuring for Debtors: Not Applicable.

C. Other Disclosures

The Company and its affiliates are subject to examination of their financial condition and market conduct by the insurance departments of each of the states in which they are licensed to transact business. The Department periodically conducts a financial examination of insurance companies domiciled in Wisconsin.

On January 4, 2016, the Department sent notification of its plan to conduct a routine financial examination of the Company, AMG, Arch MA, and Arch MI Re for the five year period January 1, 2011 through December 31, 2015. The Department is in the process of completing the examination.

On April 12, 2016, the California Department of Insurance adopted reports of market conduct examination of the Company’s claims handling, rating and underwriting practices during the 2015 calendar year. These reports alleged no findings of violation or other criticism.

D. Business Interruption Insurance Recoveries: Not Applicable.

E. State Transferable and Non-transferable Tax Credits: Not Applicable.

F. Subprime Mortgage Related Risk Exposure

(1) Subprime Mortgage Exposures

The Company is a direct writer of private mortgage guaranty insurance coverage on residential mortgage loans originated in the United States. For purposes of this disclosure, the Company generally defines a “subprime mortgage” as a mortgage loan with a representative credit score less than 620. The Company insures subprime mortgages through its primary products. Additionally, the Company insures or has insured high loan-to-value (“LTV”) loans, adjustable rate mortgages (“ARMs”), and interest-only loans that have riskier characteristics but do not meet the Company’s definition of subprime mortgage exposure. The Company may also have exposure to subprime mortgages through its investments.

The Company utilizes proprietary and other statistical models to measure and predict loan performance based on the historical prepayment and loss experience of loans. The Company analyzes performance based on borrower, loan and property characteristics, along with geographic factors, through historic economic and real estate cycles. The Company uses the outputs from these models and analyses to develop and refine how it prices coverage and in the establishment of underwriting guidelines.

(2) Direct Exposure Through Investments in Subprime Mortgage Loans: Not Applicable.

(3) Direct Exposure Through Other Investments

As of December 31, 2016, the Company’s investments had no mortgage related bonds. As a result, the Company believes it has minimal subprime mortgage exposure in its investment portfolio. The Company has no investments in monoline mortgage companies, however, debt obligations of financial institutions may have some level of subprime exposure. As stated above, the Company defines a subprime mortgage as a loan with a representative credit score of less than 620. Due to the inherent differences in the definition of subprime exposure used by third parties, there could be many more factors, other than credit score, that are used by these third parties to define their own subprime exposure.

(4) Underwriting Risk on Mortgage Guaranty Insurance Policies Issued by the Company

# NOTES TO FINANCIAL STATEMENTS

The Company has direct exposure in providing mortgage insurance coverage on subprime mortgage loans, and it has indirect exposure to the extent its insurance on other mortgage loans is affected by conditions in the housing and mortgage markets that result from the performance of subprime mortgages, whether or not insured under mortgage insurance coverage.

The Company's subprime exposure is managed and mitigated by its underwriting guidelines and by premium rates on its coverage. The Company believes that mortgage credit risk is materially affected by the following underwriting factors:

- the borrower's credit strength, including the borrower's credit history and debt-to-income ratios;
- the borrower's cash reserves; and
- the loan product, which includes the ratio of the original principal balance to the value of the property at origination, the type of loan instrument (including whether the instrument provides for fixed or variable payments and the amortization schedule), the type of property, the purpose of the loan, and the borrower's documentation for the loan.

The components of the default inventory were as follows:

| *($ in thousands)* | | Reserve Balance | Percentage of Total |
|---|---|---|---|
| Prime | $ | 31,139,962 | 85.6% |
| Subprime | | 5,217,839 | 14.4% |
| Total | $ | 36,357,801 | 100.0% |

Losses and reserves were as follows:

| *($ in thousands)* | | Total | | Subprime | Subprime as Percentage of Total |
|---|---|---|---|---|---|
| Losses and LAE Paid | $ | 19,072,665 | $ | 2,259,267 | 11.8% |
| Losses and LAE Incurred | | 2,755,787 | | -573,474 | -20.8% |
| Case Loss and LAE Reserves | | 33,427,132 | | 4,802,355 | 14.4% |
| IBNR Loss and LAE Reserves | | 2,930,669 | | 415,484 | 14.2% |

See Note 1.C.(11) for a discussion of the Company's loss reserving process.

G. Insurance Linked Securities: Not Applicable

## 22. Events Subsequent

Subsequent events have been considered through February 28, 2017 for the statutory statement issued on March 1, 2017.

## 23. Reinsurance

A. Unsecured Reinsurance Recoverables: Not Applicable.

B. Reinsurance Recoverables in Dispute: Not Applicable.

C. Reinsurance Assumed and Ceded and Protected Cells:

(1) The following table summarizes assumed and ceded unearned premiums and the related commission equity at the end of the current year:

| | | Assumed | | Ceded | | Assumed Less Ceded | |
|---|---|---|---|---|---|---|---|
| | | Unearned Premiums | Commission Equity | Unearned Premiums | Commission Equity | Unearned Premiums | Commission Equity |
| a. | Affiliates | $ - | $ - | $ 29,290,429 | $ - | $ (29,290,429) | $ - |
| b. | All other | - | - | 8,406,496 | - | (8,406,496) | - |
| c. | Totals | $ - | $ - | $ 37,696,925 | $ - | $ (37,696,925) | $ - |

d. Direct unearned premium reserve was $66,885,775

(2) The Company has no additional or return commission as a result of existing contractual arrangements.

(3) The Company does not use protected cells as an alternative to traditional reinsurance.

D. Uncollectible Reinsurance: Not Applicable.

E. Commutation of Ceded Reinsurance: Not Applicable.

F. Retroactive Reinsurance: Not Applicable.

G. Reinsurance Accounted for as a Deposit: Not Applicable.

H. Run-off Agreements: Not Applicable.

# NOTES TO FINANCIAL STATEMENTS

I. Certified Reinsurer Downgraded or Status Subject to Revocation: Not Applicable.

J. Reinsurance Agreements Qualifying for Reinsurer Aggregation: Not Applicable.

24. Retrospectively Rated Contracts and Contracts Subject to Redetermination: Not Applicable.

25. Changes in Incurred Losses and Loss Adjustment Expenses

Reserves for losses and LAE as of December 31, 2015 were $52.7 million. As of December 31, 2016, $17.9 million was paid year to date relating to incurred losses and LAE attributable to insured events of prior years. Reserves for losses and LAE for prior years as of December 31, 2016 were $22.8 million and correspond to $11.9 million, or 22.7%, of favorable prior-year development since December 31, 2015. The $11.9 million decrease is based upon the Company's re-estimation of unpaid claims and ongoing analysis of recent loss development trends and economic trends, including real estate market and unemployment rates, and their effect on recent claim rate and claim severity experience.

26. Intercompany Pooling Arrangements: Not Applicable.

27. Structured Settlements: Not Applicable.

28. Health Care Receivables: Not Applicable.

29. Participating Policies: Not Applicable.

30. Premium Deficiency Reserves

In accordance with SSAP No. 58 and SSAP No. 53, *Property Casualty Contracts – Premiums*, the Company recognizes a PDR by recording an additional liability for the deficiency, with a corresponding charge to operations when the anticipated losses, LAE, and maintenance costs exceed the recorded unearned premium reserve and any future installment premiums on existing policies. The Company performed a PDR analysis as of December 31, 2016 and determined that it did not have to record a liability related to PDR. The Company considers interest income in connection with its PDR analysis; accordingly anticipated premium and loss cash flows are discounted using the Company's pre-tax book yield.

31. High Deductibles: Not Applicable.

32. Discounting of Liabilities for Unpaid Losses and Unpaid Loss Adjustment Expenses: Not Applicable.

33. Asbestos and Environmental Reserves: Not Applicable.

34. Subscriber Savings Accounts: Not Applicable.

35. Multiple Peril Crop Insurance: Not Applicable.

36. Financial Guaranty Insurance: Not Applicable.