

# Analysis

# Moody's U.S. Insurance

July 2007

## Republic Mortgage Insurance Company

Winston-Salem, North Carolina, USA

### Company Profile

Republic Mortgage Insurance Company (RMIC), based in Winston-Salem, North Carolina, is a wholly-owned subsidiary of publicly traded Old Republic International Corporation (NYSE: ORI), a diversified insurance group with property/casualty, mortgage and title insurance operations. RMIC is the main operating entity for Old Republic's mortgage operations and is licensed to write business in all 50 states and the District of Columbia.

RMIC is an important and profitable component of ORI, contributing approximately 35% of ORI's pre-tax operating profits during 2006. ORI's ownership provides RMIC with additional financial flexibility and mitigates the pressure on the mortgage insurance company to diversify its business operations. With over \$17.8 billion of net risk-in-force as of March 31, 2007, RMIC is the fifth largest of the seven U.S. mortgage insurance companies. Moody's rates RMIC Aa3 for insurance financial strength.

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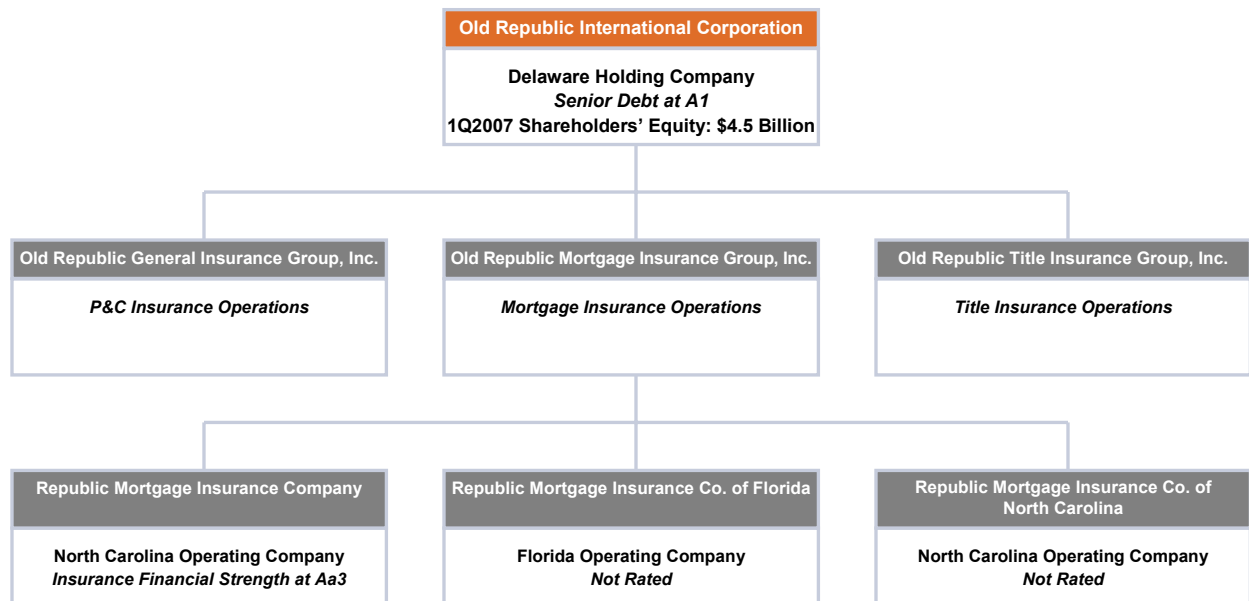
This analysis provides an in-depth discussion of credit rating(s) for Republic Mortgage Insurance Company and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. [Click here to link.](#)



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## Republic Mortgage Insurance Company

### Organizational Chart - Simplified



## Analysis/Key Rating Drivers

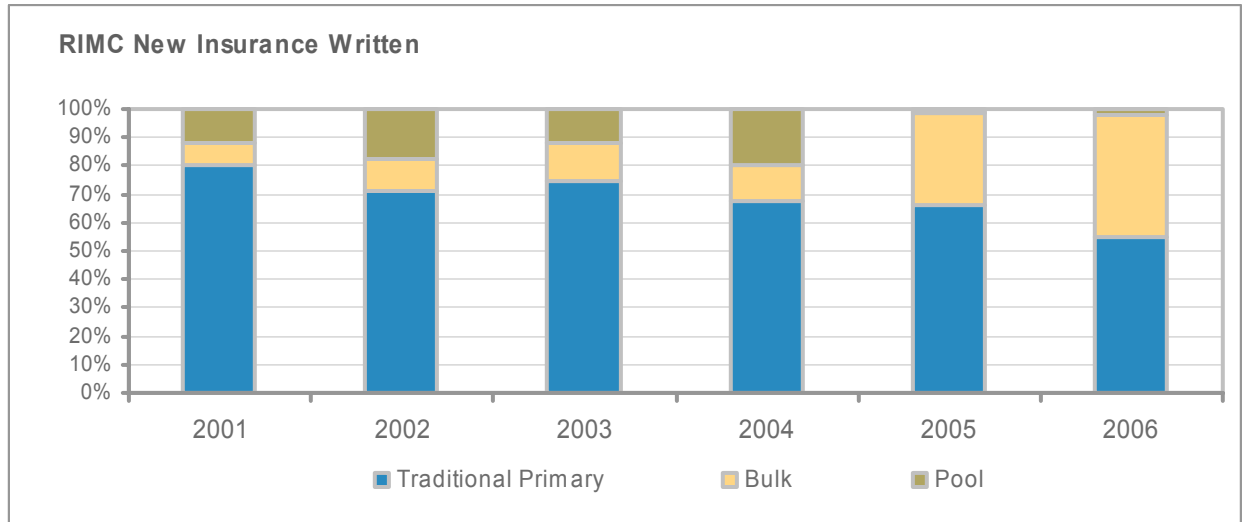
### RMIC's Market Share Holding Steady

In Moody's opinion, market share is a key indicator of franchise value in the mortgage insurance sector. Given the commodity-like nature of the product and the maturity of the U.S. market, market share can only be gained by taking business from others. RMIC has been successful in holding its position among the U.S. mortgage insurers by embracing opportunities presented in the structured bulk channel, which itself is becoming a more significant piece of the overall industry production volume. At year-end 2006, Moody's estimates that RMIC had U.S. market share of approximately 9.8%, based on net premiums earned.

### Flow Business Remains Core Focus; Bulk Channel Becoming More Prominent

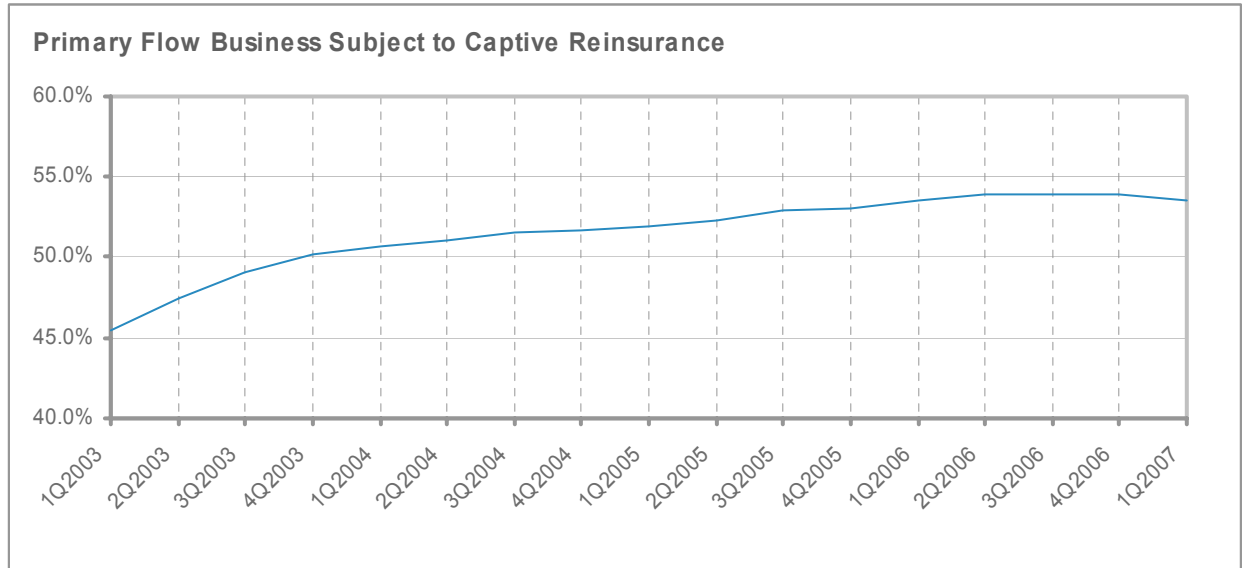
Since 2000, structured bulk transactions have become a more prominent component of RMIC's production volume, accounting for 43.6% of new insurance written during 2006 compared to just 8% of new insurance written in 2001. Importantly, these transactions frequently include deductibles and stop-loss provisions, which limits the company's risk. However, Moody's notes that mortgage defaults typically reach their highest levels in years 2 through 5. Consequently, much of the structured bulk business written by RMIC is now entering this period of peak default rates – a factor that could be further exacerbated by rising interest rates impacting ARMs as payments reset.

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### Captive Reinsurance Aims to Align Incentives with Mortgage Originators

RMIC's participation in captive reinsurance arrangements has continued to grow, reflecting the company's interest in deepening its relationships with large mortgage originators. Under these risk-sharing structures, RMIC cedes a portion of its premiums and certain risk to the originator's captive reinsurer. While these arrangements tend to reduce overall profitability as economics are shifted to lenders, they also align incentives to underwrite quality business. At 1Q2007, approximately 53% of the company's flow business (as measured by insurance in force) is subject to captive reinsurance arrangements.

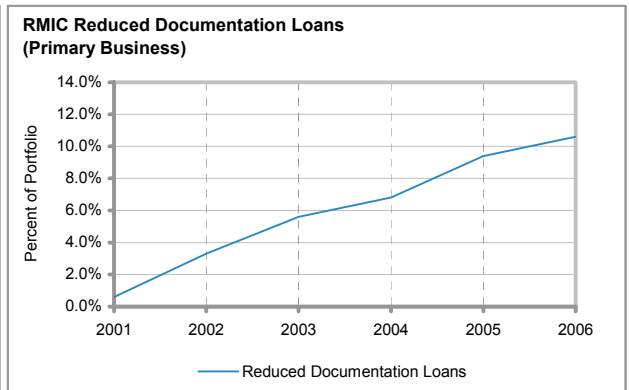
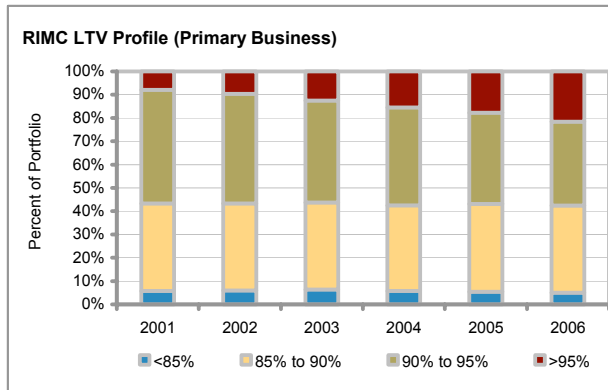
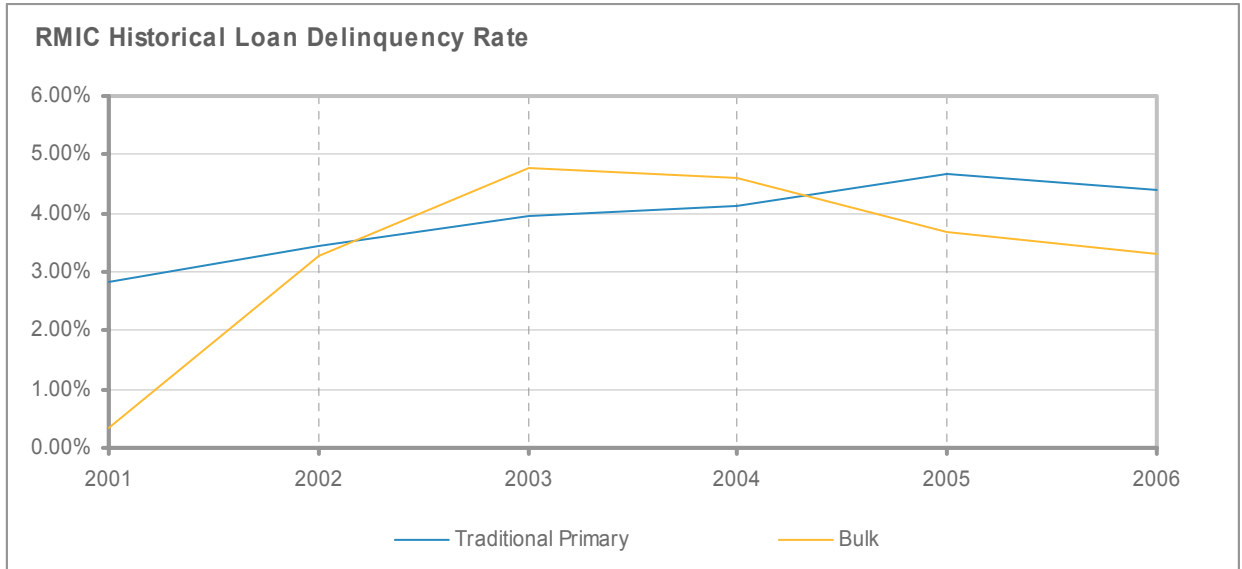


### Delinquency Rates Trends Mirror Shift in Insured Portfolio

While RMIC's delinquency rates have trended lower compared to peaks observed in 2003 (for bulk business) and 2005 (for flow business), they remain significantly higher than rates observed in the early 2000s, largely due to the changing makeup in the insured portfolio, including an increasing percentage of bulk business, a trend toward higher loan-to-value ratio loans and a marked increase in reduced documentation loans, as well as the general change in economic conditions. In Moody's opinion, RMIC's evolution during the past five years has resulted in a portfolio with additional risk – as reflected in increased delinquency rates and loss ratios. However, Moody's also notes that these changes have resulted in higher premiums to offset the

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increased risk. Over the longer term, RMIC's profitability will determine whether this trade-off has resulted in adequate risk-adjusted returns.



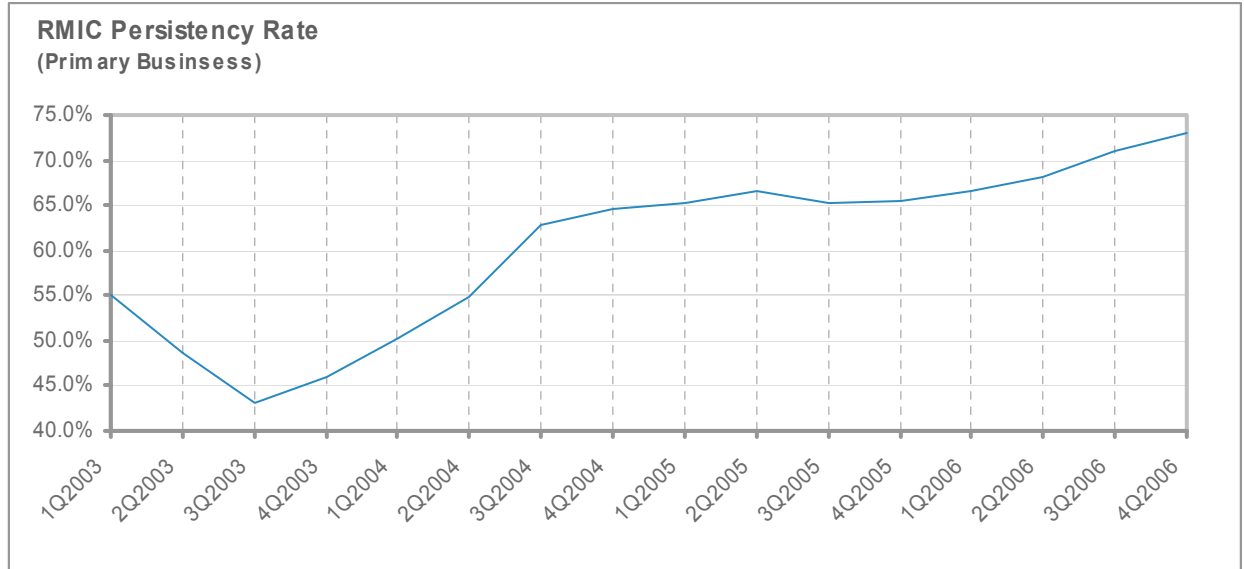
### Subprime Exposure Could Nick Profitability

While the subprime component of RMIC's insured portfolio (e.g. FICO scores less than 620 or FICO unknown) is relatively moderate, Moody's believes that the widely-publicized woes in the subprime loan market could have an impact on the company's overall profitability. Additionally, if poor experience spills over into Alt A, RMIC's profitability could be further impacted. To the extent RMIC's loss ratios rise above 50% for a meaningful period of time, negative ratings pressure could occur.

### Increasing Interest Rates Improve Persistency

As interest rates have risen, there has been a reduction in mortgage refinancing activity, resulting in increased persistency in the portfolio. At year-end 2006, RMIC's annual persistency rate for flow business was 73%, up from a cyclical low of 43% at 3Q2003. Increased persistency typically results in higher levels of insurance in force and lower expenses per policy over time.

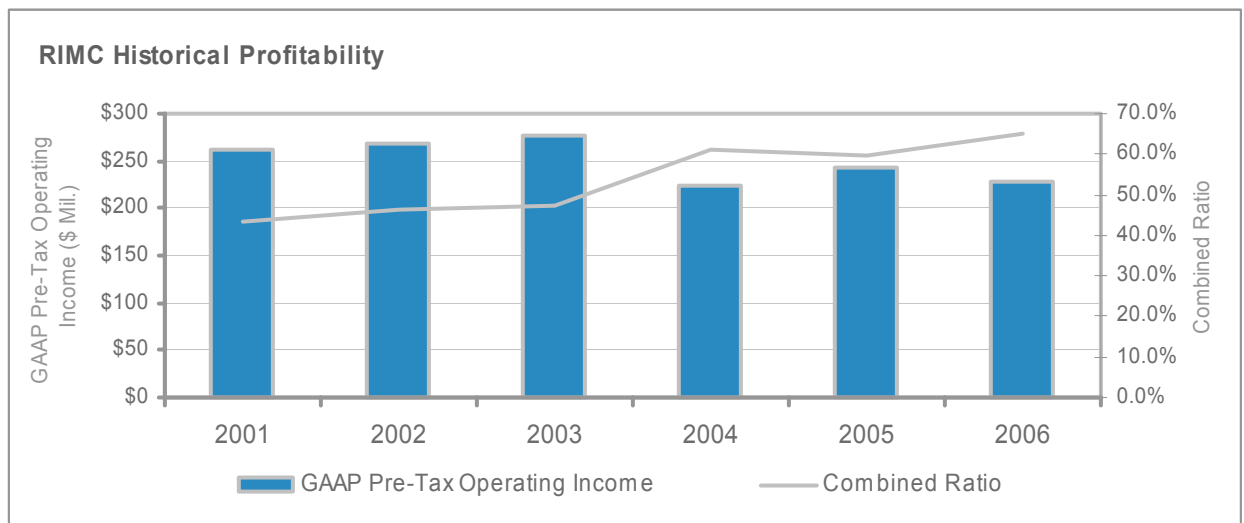
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## Financial Profile

### 2006 Results Down Slightly on Higher Loss Ratio; 2007 Profitability Hinges on Default Trend

On a GAAP basis, RMIC reported 2006 pre-tax operating income of \$228 million, down from \$244 million in 2005, as higher claims rates and severity took an incremental toll on profitability, resulting in a 5.6 point increase in the loss ratio. Looking forward to 2007, Moody's expects RMIC's profitability to be a function of whether the mortgage market will be able to achieve a "soft-landing" or whether delinquencies (and losses) will trend higher, adversely affecting profitability.

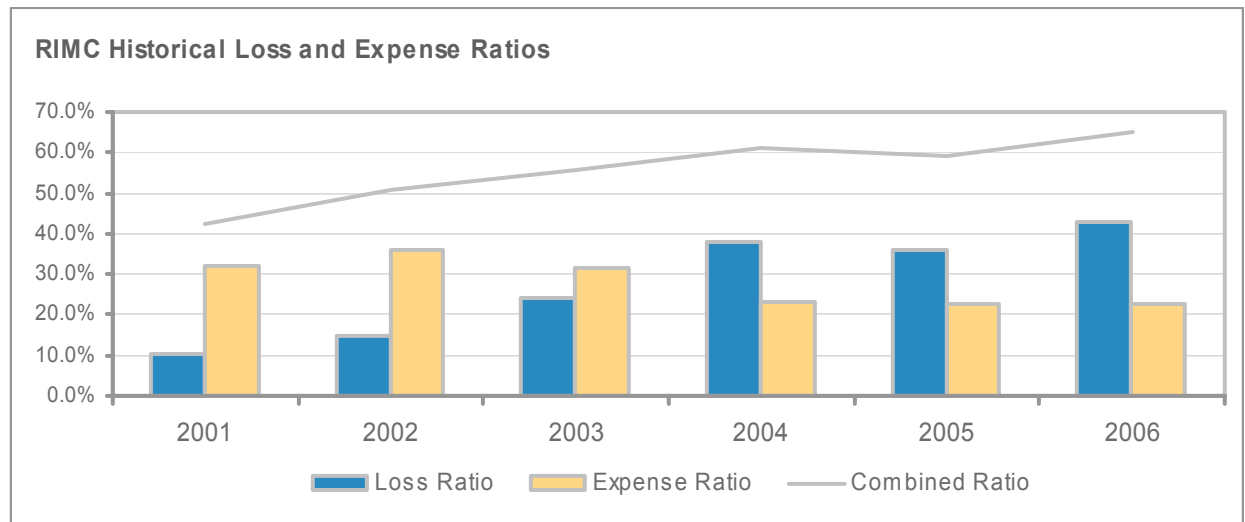


### Expense Ratio Improvements Partially Offset Increasing Loss Ratio

As RMIC's portfolio has grown, the company's expense ratio has declined as underwriting and operating expenses have gained efficiencies of scale. In addition to the company's portfolio growth, RMIC has made significant investments in improving its technology and operational infrastructure, which has also improved efficiencies. The improvement in the expense ratio, from about 32% in 2001 to 22.5% during 2006 has partially offset the increase in the loss ratio, which has trended higher over time largely due to a measured

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increase in the percentage of lower quality mortgages in the insured portfolio, which is reflected in the longer-term increase in delinquency rates mentioned previously.



### High Quality Investment Portfolio

RMIC adheres to a buy and hold investment philosophy focusing on capital preservation and superior risk-adjusted returns. RMIC's investment portfolio is primarily composed of fixed maturity securities, with an equity investment allocation of less than 4% of invested assets. Within the fixed income portfolio, high quality U.S. government and municipal securities form its core, with approximately 83% of the portfolio being rated A3 or higher (NAIC Class 1) at year-end 2006. Below investment grade securities accounted for well under 1% of the fixed income portfolio.

### Statutory Capital Position is Strong

At year-end 2006, RMIC had nearly \$1.8 billion in consolidated group statutory capital, consisting of \$231 million in policyholders' surplus and contingency reserves of approximately \$1.55 billion. RMIC's risk to capital ratio stood at 9.9 times at year-end 2006, down from 10 times at year-end 2005. Moody's notes that this measure, while instructive in getting a sense for trends in capital adequacy, does not measure capital on a risk-adjusted basis. Here, Moody's estimates RMIC's risk-adjusted risk-to-capital ratio at approximately 18.2x at year-end 2006, which is higher than the U.S. peer group average.

### Low Holding Company Financial Leverage Enhances Financial Flexibility

As of December 31, 2006, ORI had an adjusted debt to capital ratio of approximately 9.0% (which includes adjustments for unfunded defined benefit pension obligations and operating leases), which Moody's views as modest relative to its peers – and results in enhanced financial flexibility. Relative to the unrestricted dividend capacity of ORI's general insurance, title insurance and mortgage insurance operations (\$534 million during 2007), the interest expense at the parent company is almost immaterial. As a result, there is not pressure for dividends to be upstreamed from RMIC, which increases RMIC's ability to retain capital when necessary. Moody's notes, however, that ORI has taken \$521 million in dividends from RMIC during the past 5 years as capital generation has exceeded RMIC's ability to effectively deploy it.

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### Key Rating Expectations

- RMIC's ability to increase its U.S. market share would be a credit positive
- Statutory loss ratio above 50% (based on three year average) could precipitate negative ratings pressure
- Severe stress at the parent company (senior unsecured currently at A1) that leads to a multiple notch downgrade would likely result in a downgrade of RMIC's ratings.
- A change in the parent company's commitment to the mortgage insurance business could result in negative ratings pressure.

### Moody's Related Research

#### Financial Reporting Assessment:

- Republic Mortgage Insurance Company, December 2004 (89764)

#### Analysis

- Old Republic General Insurance Group, July 2006 (98195)

#### Rating Methodology:

- Moody's Global Rating Methodology for the Mortgage Insurance Industry, February 2007 (101822)

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.*

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## Company's Annual Statistics

## Republic Mortgage Insurance Company (Consolidated)

	2006	2005	2004	2003	2002
<b>Operating Statistics:</b>					
Net Premium Earned(\$ Mil.)	444	430	403	401	376
Net Income (\$ Mil.)	227	93	208	234	220
Net Income % Average Capital	13.0%	5.3%	12.1%	14.9%	15.4%
<b>Balance Sheet Statistics:</b>					
Loss & LAE Reserve % Net Risk in Force	1.4%	1.2%	1.1%	1.0%	1.0%
Net Risk In Force / Capital (x)	9.9	10.0	9.4	10.0	10.9
Total Assets (\$ Mil.)	2,117	2,125	2,069	1,921	1,772
Loss & LAE Reserves (\$ Mil.)	245	208	194	169	165
<b>Insured Principal and Risk Outstanding (\$ Mil.):</b>					
Gross Primary Insurance in Force	70,001	68,798	69,960	69,941	73,323
Net Primary Insurance in Force	63,060	62,330	64,016	64,824	70,395
Gross Pool Insurance in Force	43,137	36,318	37,232	48,058	42,522
Net Pool Insurance in Force	43,137	36,318	37,232	48,058	42,522
Gross Primary Risk in Force	17,689	17,202	17,057	16,770	16,849
Net Primary Risk in Force	15,948	15,596	15,594	15,520	15,604
Gross Pool Risk in Force	1,685	1,460	1,274	1,105	727
Net Pool Risk in Force	1,685	1,460	1,274	1,105	727
Persistency	73.1%	65.5%	64.5%	46.0%	59.1%
<b>Insured Portfolio Credit Quality:</b>					
Delinquency Rate (Traditional Primary Business)	4.41%	4.67%	4.11%	3.95%	3.43%
Net Losses Incurred	189	155	145	90	56
Net Losses Incurred % Average Risk in Force	1.09%	0.92%	0.87%	0.55%	
Nonprime % of Insurance in Force (incl. Alt-A)	24.1%	24.2%	23.9%	27.1%	
<b>Profitability:</b>					
Expense Ratio (%)	20.5%	21.6%	22.2%	27.1%	32.1%
Loss Ratio (%)	42.6%	36.2%	36.0%	22.4%	14.9%
Combined Ratio (%)	63.1%	57.8%	58.1%	49.6%	47.0%
<b>Investment Distribution (% Total Investments):</b>					
Cash & Short-term Investments (%)	2.2	1.3	2.6	2.4	1.4
Bonds (%)	93.4	95.5	94.5	94.2	94.8
Preferred Stock (%)	-	-	-	-	-
Common Stock (%)	3.8	3.0	2.6	2.9	3.2
Other (%)	0.6	0.1	0.3	0.5	0.6

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	2006	2005	2004	2003	2002
<b>Investment Returns as % of Avg Investment Assets:</b>					
Net investment Yield (%)	3.6%	3.4%	3.5%	3.7%	4.0%
Realized Capital Gain (Loss) (%)	0.0%	0.2%	0.2%	0.1%	-0.1%
Unrealized Capital Gain (Loss) (%)	0.3%	-0.2%	0.0%	0.5%	-0.2%
Total Investment Return (%)	3.8%	3.4%	3.7%	4.3%	3.8%
<b>Capitalization:</b>					
Capital (\$ Mil.)	1,777	1,709	1,785	1,655	1,494
Capital Growth Rate (%)	4.0	(4.3)	7.9	10.8	9.6
Dividend (\$Mil.)	166	111	78	84	83
Dividend % Net Income	73%	118%	37%	36%	38%

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Report Number: 103648

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