

Research Update:

CMG Mortgage Insurance Co. 'BBB' Rating Affirmed; Outlook Negative

Primary Credit Analyst:

Miles Kaschalk, New York (1) 212-438-9375; miles_kaschalk@standardandpoors.com

Secondary Contact:

Ron Joas, New York (1) 212-438-3131; ron_joas@standardandpoors.com

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Overview

- CMG Mortgage Insurance Co.'s operating performance improved materially in 2011.
- We are affirming our 'BBB' rating on CMG MI.
- Macroeconomic conditions and a transitioning operational support are notable risks to CMG MI in 2012.

Rating Action

On Feb. 2, 2012, Standard & Poor's Rating Services affirmed its 'BBB' rating on CMG Mortgage Insurance Co. (CMG MI). The outlook is negative.

Rationale

The mortgage insurance sector is experiencing high losses amid a struggling economy and very weak job and housing markets. The lack of significant improvement in payroll employment levels helped keep new notices of delinquency (NODs) high.

Relative to its peers, however, CMG MI's operating results have improved at a faster and more stable rate. Compared with the same period in 2010, the third-quarter 2011 pretax statutory operating loss (normalized for changes in the contingency reserve) decreased 47% to \$19 million from \$36 million, and the statutory loss ratio decreased to 118% from 140%. Moreover, unlike many of its peers, CMG MI did not have significant adverse reserve development.

We believe CMG MI's capitalization relative to its operating results compares favorably to that of its peers. With statutory capital of \$230 million and risk-to-capital ratio of 20:1 at the end of third-quarter 2011, CMG MI is better positioned to absorb operating losses expected in 2012. We also do not expect CMG MI to exceed the risk-to-capital or minimum policyholder protection thresholds put in place by certain state regulators. Because of this, CMG MI is at lower risk of facing regulatory action.

The rating contemplates continued losses through 2012 with the expectation of a return to profitability in 2013 because of improving NOD trends.

Outlook

The negative outlook on CMG MI reflects the current trajectory of operating performance and the potential that adverse deviation may strain CMG MI's capital position. Although new NODs continue to decline, they would likely

increase again if the economy enters another recession and payroll employment once again declines. The elevated level of new notices and the volatility in cure activity create uncertainty around expected operating performance improvement in coming quarters.

We expect delinquencies to continue at an elevated but decreasing level throughout 2012, with a full-year default rate approaching 5% and a loss ratio falling to less than 100%. We could lower the ratings if at any time CMG MI's pretax statutory income is not on a trajectory toward profitability in 2013.

The negative outlook also reflects the potential impact of PMI's bankruptcy proceedings on the level of operational support it provides CMG MI. Although we expect PMI to be able to continue providing support in the near-term, CMG MI must begin either building operational capabilities internally or seeking third parties to provide services comparable to those currently provided by PMI. This transition will at a minimum result in incremental expenses, but could also lead to setbacks in CMG MI's operational capabilities, including pricing, underwriting, actuarial services, technology, and other back-office functions. Therefore, we could downgrade CMG MI if there is any hindrance in its ability to write new business and/or to service existing policies.

Conversely, we could affirm the rating if in 2012, CMG MI continues to trend toward a return to profitability in 2013. This would primarily require stability in the macroeconomic environment that translates into a decline in delinquencies and an increase in mortgage originations. Likewise, CMG MI will have to reduce its dependence on PMI and move to a longer-term solution for implementing its operational capabilities.

Related Criteria And Research

- Standard & Poor's Ratings Definitions, Feb. 2, 2012
- Radian Asset Assurance Inc. Rating Unaffected By Downgrade Of Parent, Jan. 30, 2012
- Mortgage Guaranty Insurance Corp. And Parent Company Ratings Lowered On Significant Losses; Outlook Negative, Jan. 30, 2012
- Genworth Mortgage Insurance Corp. Rating Lowered To 'B' From 'BB-'; Outlook Negative, Jan. 30, 2012

Ratings List

Ratings Affirmed

CMG Mortgage Insurance Co.
Counterparty Credit Rating
Local Currency
Financial Strength Rating
Local Currency

BBB/Negative/--

BBB/Negative/--

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