

July 29, 2009

Research Update:

**CMG Mortgage Insurance Co.
Ratings Lowered To 'BBB+' From
'A'; Outlook Negative**

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- We have observed an increase in industry-wide prime mortgage defaults, which has affected higher-quality mortgage insurance books like CMG Mortgage Insurance Co.'s.
- CMG Mortgage Insurance Co.'s first-quarter of 2009 operating results were below expectations, resulting in changes to our full-year profitability estimates.
- As a result, we have lowered the ratings on CMG Mortgage Insurance Co. (CMG MI) to 'BBB+' from 'A'.
- The negative outlook reflects our belief that all mortgage insurers continue to face a very challenging operating environment.

Rating Action

On July 29, 2009, Standard & Poor's Ratings Services lowered its counterparty credit and financial strength ratings on CMG Mortgage Insurance Co. (CMG MI) to 'BBB+' from 'A'. The outlook is negative.

Rationale

The ratings on CMG MI are based on its leadership position within its market niche, its effective use of operational support from its parents, and the strong credit quality of credit union customers. CMG MI's operating performance weakened in 2008. Inherent weaknesses, as previously noted, are CMG MI's dependence on its parents for operational support and its narrow focus. In addition, conditions in the credit union segment of the mortgage insurance industry have not bottomed, and competition is heating up. In May 2009, we lowered our ratings on CMG MI to 'A' from 'AA-.'

CMG MI enjoys a strong market niche competitive position. Its effective use of its parents' expertise gives it an advantage in serving its niche segment: credit unions. Consequently, it has a leading position in this segment, with a market share that has averaged roughly 60% since 1988.

The economic environment for mortgage insurers in 2008 was significantly more difficult than in prior years, but a prolonged downturn should continue to have a more moderate impact on CMG MI than on other mortgage insurers. The mortgage and housing markets might be reaching a turning point, but the industry has a long way to go before reaching previous profitable levels. CMG MI's portfolio of insured loans exhibits strong credit quality, and mortgages to credit union customers have had a lower foreclosure rate than mortgages originated by other lending institutions.

CMG MI's internal management performed well through 2008, and its parents provided crucial managerial support. This combination has resulted in a diverse, experienced management team that has been effective in controlling losses and expanding market share.

CMG MI's operating performance deteriorated in the first quarter of 2009

and full-year 2008, but it still performed better than other private mortgage insurers, which sustained large pretax operating losses. CMG MI's primary loans in default increased by 951 units in the first quarter of 2009 from the end of 2008 compared with only 36 units between the first quarter of 2008 and the end of 2007. However, the default rate remains the lowest in the industry at 3.14% in the first quarter of 2009 compared with 1.42% during the same period last year. As a result, the loss ratio for the combined entity more than doubled to 129.1% in the first quarter of 2009 from 57.9% in the same period in 2008.

CMG MI's capitalization is moderately strong. The capital adequacy ratio of 99.6% as of Dec. 31, 2008, is above Standard & Poor's minimum threshold for an 'AA' financial strength rating. The capital adequacy ratio reflects the build-up of retained earnings because of good operating performance, partially offset by past dividend payments to its parents in 2006 and 2007.

Outlook

The negative outlook on CMG MI reflects Standard & Poor's expectations that the economic environment for housing still hasn't hit bottom. The rating is based on the belief that both of CMG MI's owners will continue to view the joint venture as beneficial and devote resources to it. However, the recent downgrade of PMI Mortgage Insurance Co., one of CMG MI's parents, to speculative-grade creditworthiness does question this belief. If either owner were to attempt to sell its stake or stop contributing operational support, Standard & Poor's would likely lower the rating again.

Assuming no changes in parental commitment, CMG MI will likely maintain its U.S. credit union industry-leading competitive position. Revenue should increase in 2009. The company faces the difficult task of turning down business to keep its risk-to-capital ratio in check. At the end of the first quarter of 2009, the combined entity had a risk-to-capital ratio of 16.7 to 1.

The company faces competitors attracted to the growing credit union segment and a possible uptick in mortgage originations because of low interest rates. These two factors are working to CMG MI's advantage. First, persistency, which measures the retention of insured loans, should remain high. (It was 85.4% as of Dec. 31, 2008.) Second, credit unions should continue garnering a larger share of mortgage originations because they use deposits to fund most mortgages instead relying on the securitization process or selling loans. The weakening environment should affect CMG MI's loss ratio less than those of other mortgage insurers because of its good-quality book, but CMG MI's loss ratio will still worsen in 2009. In addition, the company's defaults will increase, but the rate will remain far below the mortgage insurance industry median. Consequently, Standard & Poor's believes CMG MI will perform better than the other private MIs but will be challenged in 2009.

CMG MI has grown premiums about 3x faster than the industry aggregate over the past five years. Standard & Poor's expects CMG MI to continue increasing its market share--but at a slower rate. Loss reserves are dramatically increasing, putting pressure on 2009's loss ratio. If the loss ratio were to exceed 175% and pretax operating losses were to exceed \$84 million in 2009, then Standard & Poor's would likely consider an unfavorable rating action. Claims paid will increase significantly, but at a slower rate

than loss reserves. Standard & Poor's expects that the company's combined ratio and risk-to-capital will continue increasing in 2009. Risk-to-capital could exceed 18.0x at the end of 2009. Standard & Poor's does not anticipate CMG MI breaching the 19.0x risk-to-capital threshold, which would prompt PMI MIC and CUNA Mutual, the two joint venture owners, to contribute capital to bring the ratio back below 19.0x. The environment will be challenging, translating into weak profits, and Standard & Poor's forecasts a pretax operating loss of more than \$45 million in 2009.

A decrease in risk-to-capital, a return to pretax operating profits in 2011, and a loss ratio below 90% could prompt Standard & Poor's to raise the rating.

CMG MI will suspend future dividends to help conserve capital. Even with loan losses in 2009, CMG MI's capitalization should remain moderately strong, with the capital adequacy ratio remaining above the minimum required for an 'AA' financial strength rating.

Ratings List

Downgraded

| | To | From |
|----------------------------|------------------|---------------|
| CMG Mortgage Insurance Co. | | |
| Counterparty Credit Rating | | |
| Local Currency | BBB+/Negative/-- | A/Negative/-- |
| Financial Strength Rating | | |
| Local Currency | BBB+/Negative/-- | A/Negative/-- |

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