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Radian Group Inc. (RDN)

Q2 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for your patience and standing by, and welcome to the Second Quarter 2017 Earnings Call. At this time all of your participant phone lines are in a listen-only mode. And later there will be an opportunity here for questions. [Operator Instructions] And just a brief reminder, today's conference is being recorded.

And I'd now like to turn the call to Senior Vice President of Investor Relations and Corporate Communications, Emily Riley. Please go ahead.

Emily Riley

Senior Vice President-Corporate Communications & Investor Relations, Radian Group Inc.

Thank you, and welcome to Radian's second quarter 2017 conference call. Our press release, which contains Radian's financial results for the quarter was issued earlier this morning and is posted to the Investors section of our website at www.radian.biz. This press release includes certain non-GAAP measures, which will be discussed during today's call, including adjusted pre-tax operating income, adjusted diluted net operating income per share, tangible book value per share, and services adjusted EBITDA. A complete description of these measures and their reconciliation to GAAP may be found in press release Exhibits F and G and on the Investors section of our website.

During today's call, you will hear from Rick Thornberry, Radian's Chief Executive Officer; and Frank Hall, Chief Financial Officer. Also on hand for the Q&A portion of the call are Derek Brummer, Executive Vice President and Chief Risk Officer of Radian Group; and Cathy Jackson, Corporate Controller.

Before we begin, I would like to remind you that comments made during this call will include forward-looking statements. These statements are based on current expectations, estimates, projections, and assumptions that are subject to risks and uncertainties, which may cause actual results to differ materially. For a discussion of these risks, please review the cautionary statements regarding forward-looking statements included in our earnings release and the risk factors included in our 2016 Form 10-K and subsequent reports filed with the SEC. These are also available on our website.

Now, I would like to turn the call over to Rick.

Richard G. Thornberry

Chief Executive Officer & Director, Radian Group Inc.

Thank you, Emily. Good morning. I want to thank each of you for joining us today and for your interest in Radian. Today, I will provide highlights of our second quarter and then turn it over to Frank to review the details of our financial position.

I am pleased to report on a strong quarter for Radian with excellent operating results, continued positive trends in the credit environment, and a growing industry purchase market where Radian captured a meaningful share of new business. As you can see in our press release this morning, we reported a net loss of $27 million or $0.13 per diluted share for the quarter driven by $131 million in after-tax non-cash impairment charges related to our Mortgage and Real Estate Services segment. On an operating basis, adjusted pre-tax operating income was $164 million in the second quarter, an increase of 25% compared to the second quarter of 2016.

Adjusted diluted net operating income per share was $0.48, an increase of 26% compared to the second quarter of 2016. And despite the impact of the impairment charges book value per share grew by 3% year-over-year to $13.54. Over the same period, tangible book value per share grew by 12% to $13.22. Before we discuss our operating results further, I'd like to first address our Services segment and the impairment of goodwill and other intangible assets. While these charges produced a net GAAP loss for our company, this quarter, on a consolidated basis, they do not impact current cash flows, adjusted pre-tax operating income for tangible book value.

So, let me address what drove the Services segment impairment charge and why now. As I mentioned in April during our first quarter call, since joining Radian earlier this year in March, I have been focused on reviewing the strategic opportunities and challenges across all of our businesses. I've been actively meeting with employees, customers, regulators, investors, business partners, and other stakeholders. I've been reviewing our products, services, operations, and technology platforms across all our businesses, evaluating our market and competitive positioning, analyzing the profitability of each business product and service, and working with the team to enhance the strategic roadmap for our mortgage insurance and services businesses.

To-date, this strategic review process has further reinforced by optimism regarding our opportunities going forward to grow this company, deliver value for stockholders. One of the results of this process to-date is that we've identified changes that need to be made to our Services segment to reposition it strategically, and address the segment's recent financial performance, which was not in line with our internal expectations for growth and profitability in the second quarter. Therefore we've decided to discontinue certain business initiatives and focus on our core products and services within our Services segment, which we believe have higher growth potential. These core products and services are expected to produce more predictable and recurring fee-based revenues and better align with customer needs. We believe it is appropriate at this time to take a step back and refocus so that our services business is strategically better positioned to go forward.

As a result of these changes and in light of recent financial performance below our expectations, we determined that an impairment of goodwill and other intangible assets related to the services segment was necessary. This impairment resulted from a decrease in projected future cash flows based on current market trends and changes to the services segment's business strategy going forward. We remain committed to the services business. We are diligently working to finalize our plans and to better position our services business [ph] lines (06:06) for success. Our goal is to refocus our efforts to drive future growth and profitability, and deliver greater value to our customers and shareholders.

As we disclosed this morning in the earnings release based on our strategic review of the services business lines to-date, we have determined to restructure this business and we currently expect to incur charges relating to the changes necessary to reposition the business for sustained profitability. While the restructuring plans are not final, and therefore we cannot provide an estimate of the total expected restructuring charges at this time, we currently expect that these charges would not exceed $25 million on a pre-tax basis and depending on finalization and implementation of the restructuring plans could be materially less. After we complete our strategic review process we will provide an update during the third quarter.

I continue to be excited about the opportunities ahead for Radian. We have a unique opportunity to leverage our market-leading mortgage insurance franchise combined with our core capabilities across the Services segment to deliver high value and relevant products and services. Successfully capturing this opportunity will enable us to further deepen customer relationships, grow sustainable revenues and profitability, and increase stockholder value.

So let me turn to the Mortgage Insurance segment. We wrote 43% more mortgage insurance business in the second quarter than we did in the first quarter of this year, and 11% more compared to the second quarter of last year. In June we broke a record for the highest monthly volume flow business ever written in Radian's 40-year history. The lower refinance activity in the second quarter representing only 9% of NIW combined with our continued success in capturing new business helped drive an 8% increase in our mortgage insurance portfolio year-over-year. Radian has one of the largest high-quality portfolios in our industry, which is the primary driver of future earnings.

Despite reports of low housing inventory, economists continue to anticipate purchase originations for 2017 to be approximately 10% higher than 2016. Since private mortgage insurance can be three to five times more likely to be used than a purchase transaction than in our refinance, we are expecting the mortgage insurance market for 2017 to only be modestly smaller than last year. Based on these market projections and our performance in the first half of the year, we continue to expect to write approximately $50 billion in NIW in 2017, which is comparable to 2016.

Despite supply constraints in many areas, home sales are up from last year with new home sales up 9% and existing home sales up 1%. First time home buyers represented a third of residential sales, which helped create increased demand for private mortgage insurance. Given that those new home buyers are more likely to seek lower down payment options, we are continuing to see a gradual increase in higher LTV loans. Based on our disciplined approach to pricing that is commensurate with the related risk, we are comfortable with the risk attributes we see in the market today. We will remain diligent in measuring and monitoring the risk mix of our portfolio and will continue to focus on generating strong through the cycle returns of our [ph] acquired (09:45) capital.

We continue to benefit from positive credit trends in the second quarter. Frank will discuss the impact on our loss provision in more detail but these trends are reflected in the 20% year-over-year decline in our total number of primary defaults and the continued strong cure rates including on our older defaulted loans. At Radian, our growth strategy includes leveraging our core expertise and credit risk management to expand our presence in the mortgage finance industry, write more business and strengthen our franchise. We continue to participate in the GSE credit risk transfer programs, which were developed by Fannie Mae and Freddie Mac as part of their initiative to increase the role of private capital to mortgage market.

We believe the combination of risk analytics and business intelligence at Radian and Clayton is a unique advantage for us and we feel we are well positioned to assess and price mortgage credit risk for these and future programs. We will continue to carefully evaluate new opportunities in terms of overall risk return and market potential. As part of our strategic review, we are not only considering growth strategies that will strengthen our company for the future, we are also sharpening our focus on improving our operational effectiveness to continually improve our service delivery and increase our operating efficiency. Managing the expenses across the enterprise is strategically important in creating competitive differentiation and to improving profitability and shareholder returns.

Turning to the regulatory and legislative environment, we recently learned from the GSEs that they expect PMIERs 2.0 to become effective in the fourth quarter of 2018. Based on this timing we expect to receive a draft of the recommended changes late this year. And as we experienced in the past, we anticipate a collaborative and interactive process for discussing any changes. The GSE's have committed to provide an improved insurance with an implementation period of at least 180 days after requirements are finalized and prior to the effective date.

More broadly, there continues to be active dialogue at housing finance reform and we are encouraged by the consistent support on Capitol Hill for the important role of private capital.

We remain actively engaged in the discussions and continue to promote through our contacts at Capitol Hill and through industry trade associations including the MBA and USMI the important role of private mortgage insurance as a permanent source of private capital. This concept of permanent private capital is an important point of differentiation for our industry. This industry is the only committed source of permanent private capital that continue to underwrite and support credit risk to the market cycles. As a monoline insurer, this is our core business and as such, we have built the expertise to effectively manage the risk through the cycles. Different than before the financial crisis, this industry is now much stronger for many reasons specifically the lessons learned during the crisis, through the crisis, greater capital strength, and financial flexibility, all combined with expanded regulatory oversight and guardrails.

The MI industry plays a very important role as a committed source of permanent private capital to enable the mortgage market to consistently distribute first-loss credit risk playing a very important role in the primary origination market.

We believe the key players in Congress understand this and, as an industry, we continue to reinforce the importance of our role as part of any housing finance reform proposals. For 40 years, we have helped millions of home buyers achieve their dream of homeownership providing credit in both good as well as challenging times. We believe that we are well positioned to help shape our industry's future and to strengthen our housing finance system.

Now, I would like to turn the call over to Frank for details of our financial position.

J. Franklin Hall

Chief Financial Officer & Executive Vice President, Radian Group Inc.

Thank you, Rick, and good morning, everyone. As Rick mentioned at the top of the call, during the second quarter of 2017, we recorded after-tax impairment charges of $131 million related to pre-tax impairment charges of $184.4 million and $15.8 million of goodwill and other intangible assets respectively. These charges are related to our Services segment and were primarily due to changes in expectations regarding the future growth of certain services product lines, resulting from changes in our business strategy combined with observed market trends that we expect to persist. These charges do not affect our cash flows nor are they part of our adjusted pre-tax operating income per share of $0.48 this quarter.

As a result, as of June 30, 2017, the remaining balances of goodwill and other intangible assets reported in our condensed consolidated balance sheet were $10.9 million and $58.9 million respectively. In performing the quantitative analysis for our goodwill impairment test as of June 30, 2017, we elected to early adopt the updated accounting standard regarding goodwill and other intangibles. This update simplifies the subsequent measurement of goodwill.

I'll now move on to the key operating elements of our performance. I'll start with the key drivers of our revenue. New insurance written was $14.3 billion during the quarter compared to $10.1 billion last quarter, a 43% increase and an 11% increase over the $12.9 billion produced in the second quarter of 2016. The new business we are writing today continues to consist of loans with excellent credit and return characteristics. Our 12-month persistency increased from 77.1% in the first quarter of 2017 to 78.5% in the second quarter of 2017, as noted on Exhibit L.

Our quarterly annualized persistency decreased from 84.4% in the first quarter of 2017 to 82.8% this quarter. Primary insurance in force increased to $191.6 billion at the end of the quarter, an 8% increase over the same period last year, the highest we've seen in recent years. Based on current trends, including an expanded purchase market and increased persistency, we expect insurance in force to grow accordingly, enhancing our strong foundation for future earnings.

Premium yields on our portfolio are dependent on several factors, including the mix of new production and policy cancellations coupled with the composition of the existing portfolio. Our enhanced portfolio yield disclosures on webcast slide 13 show the composition of our net premium yields over the most recent five quarters. Single premium cancellations resulted in $13.3 million of direct earned premiums this quarter, an increase of $2.9 million compared to prior quarter. As a result, both our total direct and total net portfolio yield this quarter increased by approximately 1 basis point compared to last quarter.

As shown on webcast slide 13, our direct yield on policies remaining in force has been relatively stable at 49 basis points over the last three quarters with the majority of the observed volatility in the total direct yield attributable to single premium policy cancellation activity.

While yields increased modestly this quarter, our longer-term expectation is a gradual decrease with the resulting total direct yield of 48 basis points to 50 basis points. This expected future decrease is due to the natural runoff of higher priced vintages with growth in our portfolio driven by new insurance written reflective of current market risk-based pricing. The timing of this gradual decline will depend on several factors, including the pace of cancellations on our higher priced vintages and the mix of new business we write.

In addition, we may continue to see variability among quarters due to single premium policy cancellation activity. Our expectation remains however with the levered returns on current PMIERs capital for our future production, and our portfolio would remain in the mid-teens due to our continued price discipline and effective use of reinsurance.

Net premiums earned for the quarter increased to $229.1 million from $221.8 million last quarter. This increase was partially due to a slight increase in single premium policy cancellations quarter-over-quarter or primarily due to the earned premiums from a larger in force portfolio.

Investment income was relatively flat quarter-over-quarter from $31 million in the first quarter of 2017 to $30.1 million in the second quarter.

Total services revenue for our Mortgage and Real Estate Services segment was approximately $40 million for the second quarter of 2017 as compared to $40 million in the first quarter and $42 million in the second quarter of 2016. Importantly, second quarter revenues were significantly below our previous expectations due primarily to lower volumes.

Moving now to our loss provision and credit quality. As noted on slide 16, during the second quarter 2017, we had positive development of $28.2 million on prior period defaults. This positive development was driven primarily by a reduction in claim rates on existing defaults based on the observed increase in cure rates on these defaults. We remain optimistic about the trends we see in our credit quality. As such, it's important to note that our primary risk in force, including HARP, consists of only 10% legacy business originated before 2009 and that those vintages are contributing positively to earnings, as you can see on slide 14. This portfolio composition is unique, and it can skew overall performance metrics in total where legacy versus non-legacy analysis maybe more informative.

We segregate our new defaults between our legacy and post legacy portfolios on slide 18. It's important to also note that only 20% of total primary defaults are from loans written after 2008 and these productions vintages are producing at very low level of losses as you can see on slide 15. And as our post legacy production vintages reach peak default years, which is typically in years four to six, we are seeing an expected increase in default activity but with very low rates. Our cure rate was 19.4% for the quarter, yet another sign of positive credit experience when compared to our defaults.

Given continued high cure rates on new defaults, we reduced our estimated claim rate on new defaults from 11.5% to 11.0% in the second quarter. As in previous periods, we should note that while there is a longer term expectation of future improvement in our new default to claim rate if current trends continue, the timing of that improvement is difficult to predict. Overall, the performance of our portfolio remains strong with positive trends continuing, further evidence of both the strong credit profile of post-crisis business as well as greater predictability around the legacy portfolio.

Now, turning to expenses. Last quarter, we indicated that our expected future quarterly GAAP other operating expenses would be between $62 million and $66 million with some variability between quarters and inclusive of the known items at that time. In the second quarter of 2017, however, other operating expenses were $68.8 million compared to $68.4 million in the first quarter of 2017 and $63.2 million in the second quarter of last year.

During the second quarter of 2017, we established an immaterial reserve in order to defend and potentially resolve certain outstanding legal matters. Absent this reserve, our quarterly other operating expenses would have been in line with the upper end of our indicated range.

As for future expenses, we would still expect that GAAP other operating expenses, inclusive of known items but excluding restructuring charges, would remain within our previous $62 million to $66 million range. We also continue to expect our mortgage insurance expense ratio to be in the low 20% range over time. Details regarding notable variable items impacting other operating expenses maybe found in Exhibit D.

Moving now to taxes, our overall effective tax rate for the second quarter was 22.9%. This was lower than the 35% statutory rate primarily due to the tax impact associated with discrete items that were recognized during the second quarter and their impact relative to a lower absolute level of earnings than in previous quarters. Our expectation for a 2017 annualized effective tax rate, excluding any potential future discrete items, is approximately the statutory rate of 35%.

And lastly, we have improved our capital structure by removing the convertible notes and distributing our debt maturities more evenly as we continue to move forward on our path to returning to investment grade at the holding company. In the second quarter, we purchased for cash substantially all of the remaining senior convertible notes due 2017. We have given notice that we will settle the remaining outstanding amounts of less than $1 million in cash.

Under the Private Mortgage Insurer Eligibility Requirements, or PMIERs, we had available assets of $4.1 billion, and our minimum required assets were $3.8 billion as of the end of the second quarter 2017. The excess available assets over the minimum required assets of approximately $300 million represents an 8% PMIERs cushion. In addition, holding company liquidity could be utilized to enhance the cushion if needed which, if fully utilized, would bring our cushion up to approximately 18%.

We believe that we will continue to be in compliance with the current PMIERs financial requirements without the need to contribute additional capital to Radian Guaranty from Radian Group. Although subject to fluctuations quarter-to-quarter, it is also expected that Radian Guaranty will continue to build our PMIERs cushion organically over time under the current PMIERs framework.

And now, I'll turn the call back over to Rick.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

Thank you, Frank. Before we open the call to your questions, let me remind you that despite a GAAP loss of $27 million, we had significant year-over-year growth of 26% for adjusted diluted net operating income per share, 3% for book value per share, and 12% for tangible book value per share.

NIW increased 11% year-over-year and MI in force grew 8%, which is the primary driver of future earnings. We remain committed to our Services business. Since joining Radian, it has [ph] become clear to me (26:30) that there is a market need for our diversified set of products, which should position us to increase our relevance keeping our existing relationship [ph] attractive for us (26:40).

Now, operator, we'd like to open the call to questions.

QUESTION AND ANSWER SECTION

Operator: Certainly. Thank you. [Operator Instructions] It looks like first we have the line of Mark DeVries with Barclays. Your line is open.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Yeah, thanks. Rick, I appreciate you indicated you have a lot of optimism around services and see demand there. I was just hoping you could spend some more time discussing why the decision to restructure that business versus sell it. And also, if you could give us some kind of sense as to what kind of improvement in the [ph] profitability and (27:25) returns on that you're looking for filing the restructuring?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Yeah. So, I think, from the Services business today, we remain committed. We see significant opportunity to leverage the core products and services that we offer through that business to enhance current relationships that we have across the MI business. We have really deepened those relationships to broaden really the distribution of those core products and services across the Services segment. So, I think, as we look at the business strategically, it differentiates us from just being a pure monoline business, which I think we've demonstrated great success with in our core MI business as you can see from this quarter.

We have got great momentum. But adding to that our ability to provide products and services to those same customers and new customers from our Services segment is strategically important to us and continues to be strategically important. Part of what we have to do is kind of take a step back and kind of refocus on how we approach that opportunity from a business perspective over the coming years. And I think, part of this restructuring is really just to kind of put us in a position to do that. That's what I'm excited about.

We had several meetings and discussions with our customers. And what's been very clear to me that as we talk to them about a great relationship we have on the MI side, the opportunity for us to have the discussion with them about the other products and services we offer through our services segment is becoming increasingly relevant and important to them. And we become a much more valuable business partner to them in the long-term.

So, certainly, we look at all options as we consider the path forward, and I think we see strategic value and the opportunity to increase value of this business by penetrating the existing relationships and distribution we have through some of our services products. So, I think, it's something that we've tried to be very thoughtful about. And as I come in here, I have the opportunity to look at everything new and I think it's been quite clear to me that the opportunity is there for us to actually do a better job than we've done in the past at penetrating those relationships.

In terms of profitability going forward, as we go through and complete our restructuring plan, I think, we'll have a better view of that kind of going forward. At this point, our objective is to improve profitability and more importantly, or as important, I guess, is to improve the sustainability both of revenue and profitability going forward. So, I think, we're trying to take a step back, refocus the business on the things that we think are core needs of the marketplace, and have more sustainability both in terms of revenue and profitability, and we think we'll see the benefits of those as we go forward. But as we kind of complete our process, Mark, we'll provide more guidance relative to some of the components of that.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay, fair enough. And then, Frank, I was just hoping you would give your thoughts on your plans for cash, the holdco, should we think of that as maybe sitting there while we wait for PMIERs 2.0 in the event that you need some extra cushion there as opposed to finding some other use for it in the near-term?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

Yeah. So thanks for that question. I think, the way that we're thinking about holding company liquidity is actually on a couple different dimensions; one is certainly around just the overall capital planning and our desire to return to investment grade. That is an element that we take into consideration there, just having that flexibility. The other option relates to, as I mentioned in my prepared remarks, the possibility of using it for PMIER support. So, I wouldn't describe it necessarily as being set aside for any particular use, but really just having that flexibility is important to us.

So, we don't know what the upcoming PMIERs may say so, it would certainly be premature to suggest that it's there for that. And we do continue to build the PMIERs cushion organically over time at Radian Guaranty. And then, I think, one other thing that's important to remember as we do our own liquidity planning going forward is that we do have an expense sharing arrangement with Radian Guaranty that provides for expense sharing support and cash flow support for the expenses at Radian Group.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. But for the near-term, we should expect that most of that cash is just going to remain there at this point?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

I would say, the majority of it, yes. That's right.

Mark C. DeVries
Analyst, Barclays Capital, Inc.
Q

Okay. Thank you.

Operator: Next, we have the line of Phil Stefano with Deutsche Bank. Your line is open.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc.
Q

Yeah. Thanks and good morning. Understanding that the market share isn't the goal, it feels at least to us like you picked up a little in the quarter. To what extent is something like the singles quota share helping out there, especially at a time when peers like Arch seem to be pulling back on their singles business?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.
A

Yeah. So, this is Rick. Phil, thank you for the question. I think, it's a little early to know exactly what market share we picked up. We feel like we had a very strong quarter and we continue to feel good about our position relative to market share. Market share is one aspect of kind of a measurement. Obviously we're focused on the quality and value of the business we create. So, it's a little early to also determine kind of how the whole Arch market share redistributes at this point. So, I think, for us, we feel good about holding our own.

The singles mix actually came down to around 23% in our business, and I think net of our reinsurance at about 16%. And so, I think, we see – continue to see across our NIW, [ph] we like (34:01) the economics of the business in total. And as we look at our relationships and the relationship value that we get through the mix of both monthlies and singles, we're happy with where we sit. We continue to monitor that very carefully and look at kind of the mix we see coming through the door. But the good news is, and we're happy to see this that we've seen singles come down as a part of our overall mix. And Phil, I think, from a profitability point of view, we are comfortable with the economics of the business that we're doing today.

I think, the quota share is just, Derek can maybe comment a little bit more on that, but we look at it as part of our overall capital management strategy, and I think it's worked well for us to have that as part of our mix.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc.
Q

Okay, understood. And in the release, there was a note that there was a de minimus number of shares repurchased. Is there anything you can give us around that and as far as particulars and any thoughts around authorization of a new program?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.
A

Sure, Phil; this is Frank. So, yeah, we indicated de minimus number of shares under the previous share repurchase program. If you recall from some of my previous comments about that particular program, the thresholds were value based as far as when we expected to utilize the share repurchase program. And so that's how the thresholds were established, so you can look back over the history of the effective date of that share repurchase program and sort of track to where the value was. When I say de minimus, we're talking about less than 1,000 shares that were purchased. So it was a very, very small amount.

As it relates to future repurchase programs, I would just say that that is certainly a tool that we consider as we look in our capital planning and ways to look at capital returns to shareholders. So, I would say, it was most effective previously when the stock price was at depressed levels. We were able to repurchase some shares, but I would also suggest that last year we were able to take out through not only the share repurchase program but also by the settlement of the convertible notes in cash, roughly 11% of our outstanding shares. So, there are more ways than just the direct share repurchase to manage that diluted share count.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Understood. But presumably as the convertibles have gone away, those options are becoming less.

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

That is correct.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. All right. Thanks. That's all I have.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

And Phil, just back to your singles question, I just want to go back. Part of that singles is just driven by our customer mix. Some of our customers have preferred the single – underpaid singles product. And I think our strong customer relationships that we have in place have helped us increase NIW and grow insurance, of course, which is the primary driver of earnings of course. And the outstanding credit quality of our insurance portfolio illustrates our product mix is excellent. We continue to generate mid-teen levered returns on required capital. So, I think, just going back to how we see the mix from the economics, we're comfortable where we sit today. We continue to monitor it and we monitor the competitive positions as well. So, I think – just wanted to kind of come back and recap for you.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thanks, Rick.

Operator: Next, we have the line of Randy Binner with FBR. Your line is open.

Randy Binner
Analyst, FBR Capital Markets & Co.

Q

Good morning. Thanks. I just [ph] wanted to ask (37:50) on PMIERs 2.0 and just a question of what your expectation is around how significant any rule changes there might be and in what areas they might fall?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

This is Rick. Thank you, Randy, for the question. I think, at this point, we really have no insight other than timing into PMIERs 2.0. So, we await the GSE's kind of communication [indiscernible] (38:19) we expect late this year. And I think, as we get that, then we'll be able to react. But we have, at this point, really no insight into how those rules are being – what changes might come into play or what they're thinking. So, [ph] we have to (38:37) wait and see what we hear late this year.

We do expect that once we hear their initial feedback on that and again late this year, there will be an [ph] interactive (38:49) collaborative process as it was the last time, which I didn't get a chance to experience but I understand it was. So, I think, the expectation is that we'll hear there will be a process back and forth between the industry and the GSEs. And then, once it's finalized, we'll all have 180 days to kind of comply before the effective date. So, I think, we're comfortable with the process and we await kind of their draft.

Randy Binner
Analyst, FBR Capital Markets & Co. **Q**

Sure. So, a couple of follow-ups there. And I guess, the first is, do you have a sense of why the timing got delayed? I think initially we had expected something to come out this spring. And then, with the 180-day notice, is your expectation that you all have 180 days to [indiscernible] (39:40) or it will be an exposure draft that you'll have time to comment on to potentially affect changes?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc. **A**

Yeah. We'll get their comments late this year. There will be a time – a process to go through this kind of interactive and collaborative process to comment and work towards the finalization of PMIERs 2.0. And then, beyond that, we would expect to have 180 days to then comply. So, it's kind of a sequential process. They will communicate to us, we'll go through this kind of back and forth comment period, the rules will get finalized. And then, from that, we'll have 180 days, that's our understanding.

Randy Binner
Analyst, FBR Capital Markets & Co. **Q**

Sure. And just on the timing, any sense of why it kind of got pushed almost a year?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc. **A**

No, I don't think we really have any insight into that. We've all just – as an industry, we've, I think, been kind of waiting to hear back from the GSEs on this. So, I think, at this point, we don't really have any insights on the time why it's taken longer than maybe they expected. But I don't really think there was a firm timeline. It was just something more of an expectation of every couple of years. So, I think, we're fine with the timeline that's in front of us and we feel we'll be in a good position to respond and react as needed.

Randy Binner
Analyst, FBR Capital Markets & Co. **Q**

All right. I'll leave it there. Thank you.

Operator: Next, we have the line of Doug Harter with Credit Suisse. Your line is open.

Douglas Harter
Analyst, Credit Suisse

Q

Thanks. This quarter showed a noticeable improvement in the year-over-year decline in new notices. Was there anything behind that or are you seeing any trends that drove that?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

I think that what we see in terms of trends in the portfolio is what we've seen over the last several years, which is just a gradual decrease in kind of those new defaults, the legacy portfolio is gradually burning out over time, cures are increasing. So, nothing significant, I would say, this quarter, just continuation of the positive trends we've been seeing over the last, I would say, several years really.

Douglas Harter
Analyst, Credit Suisse

Q

So, I guess, looking forward, I mean, I guess what do you think or how do you think about the right ways to kind of forecast how quickly they can continue to burn off or how quickly new notices will come in?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Well, I think, a lot of that's just going to depend upon the distribution. Still, I think about 66% of our new defaults are coming from the pre-2009 vintages. So it's just a question, and that'll probably be still the majority over the next several years. So that's going to, I think, drive significantly that transition. And also, [ph] it's difficult (42:28) to answer in isolation because also you have to look at the amount of business we're putting on and where they are in terms of their relative defaults seasoning peaks.

So, I think, it's difficult to come up with kind of a simple rule of a thumb with respect to that transition. I would say that trends we've been seeing has been pretty consistent. I would expect those to continue over the next couple of years at least.

Douglas Harter
Analyst, Credit Suisse

Q

Thank you.

Operator: Next, we have the line of Mackenzie Aron with Zelman & Associates. Your line is open.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Thanks. Good morning. Rick, just one follow-up question on the Clayton restructuring. The $25 million or less expenses that are expected, is that going to flow-through through the Clayton business or would that be called out as a variable notable item?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Maybe, Frank, you want to take that one?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

Sure. So, Mackenzie, I think – and thanks for the question. I think it's difficult to predict right now because the review is in process, and we're just trying to provide some general sense of magnitude on what the charges could be. They could be materially less than the $25 million as we indicated, but I think the profile from a financial statement standpoint will really depend on the nature of the expenses, and we don't yet know what those will be.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Okay. And just in terms of timing, obviously the review is not complete. We won't have clarity until next quarter. But is this something that we'll see playing out over the next year and a half? Or roughly how long should we be expecting for this to be pretty finalized in Clayton in a position where going forward it will be more stabilized?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

Sure. So, I think for the most part we should be able to identify the charges in this coming quarter. But as far as recognition goes, it really will depend upon the type of expenses that it is. There are some pretty strict accounting rules around recognition of those charges depending on what they are. But I would not expect them to be prolonged. But we'll give you a better sense of timing when we release more details on that plan in the third quarter.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

And Mackenzie, this is Rick, just – that's the answer on the financial side in terms of [indiscernible] (44:44). Certainly from a business strategy and approach to the market, we're positioning to go full speed on that as we speak as part of this whole strategic review process. So, I think part of it is kind of sizing the expense and doing what we need to do there from a restructuring. And the other part is really kind of how we point ourselves into the marketplace and how we align our efforts across different customers. So, a lot of activity will occur over the next month or so to kind of position us for that and that will take place quickly.

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

And Mackenzie, maybe just one clarifying point on your question or actually on my answer to your question. The plans and the restructuring plan that we're talking about is limited in this case to the services business.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Okay, great. And then just one more, Rick. I think last quarter you had mentioned that in terms of replacing Teresa and the MI leadership you would pull from internal resources. Is that still the plan at this point?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Yes, so I think as I mentioned last time and it continues to be true is that, I really wanted to have an opportunity to get very, very close to the business and work with the team and not surprising but certainly a nice benefit is that the team is extremely strong. And been able to really start to think about the organization, leveraging that the team that's here today to go forward. And so as we start to talk more about the strategic path forward, hopefully during this quarter – during the third quarter, our organization will align towards the future as opposed to looking at how we've done things in the past. So, we'll evolve the organization going forward based on our path forward. And so – but the good news is from what the team here is extremely strong and extremely talented and has stepped up to the task across all points and so I couldn't be more happy about that.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Okay, great. Thanks for the color.

Operator: Next we have the line of Jack Micenko with SIG. Your line is open.

Soham Bhonsle
Analyst, Susquehanna Financial Group LLLP

Q

Hey. Good morning, guys. This is actually Soham Bhonsle on for Jack. My first question was on expenses. Frank, can you give us the legal reserves that you established in the quarter in the expense line?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

So, I called it out primarily because we were – our total expenses were above the range that I had provided previously. But given that, that item relates to litigation matters, I'm not going to get into specifics. But I can tell you that we made the decision to set aside an amount to defend what we view as meritless claims. And if possible to resolve them on terms that we're comfortable with. But as I also mentioned, the total amount of the reserve is immaterial.

Soham Bhonsle
Analyst, Susquehanna Financial Group LLLP

Q

Okay. And then I guess on the premium yield, could you maybe help me reconcile the pickup in single premium cancellations versus the increasing persistency sequentially because I would have thought that a pickup in singles would have suggested a pickup in refi but this was not the case in the quarter?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

Yeah. So, I think the increased persistency that you're referencing is the annual persistency whereas if you look at the quarter-over-quarter persistency there actually was a slight down tick.

Soham Bhonsle
Analyst, Susquehanna Financial Group LLLP

Q

Okay. And then just last one I guess on investment income, the yield looks like it came down about four bps sequentially so what's going on there and like what's your expectations going forward?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

Yeah. I wouldn't expect there to be much change going forward and I would suggest that any quarter-over-quarter changes that you see in yield really just has to do with the natural churn in the portfolio. And as securities mature and they get reinvested, we've also calibrated our duration to be slightly shorter. So that that could have some impact as well.

Soham Bhonsle
Analyst, Susquehanna Financial Group LLLP

Q

Okay. Thank you.

Operator: And next we have the line of Geoffrey Dunn with Dowling & Partners. Your line is open.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Thank you. Good morning.

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

Hi Geoff.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Frank, couple of questions to start with you Frank, with respect to the incidence assumption we're down about 100 bps this year so far. Considering seasonality is there more room for that to move this year or [ph] we're (49:12) sticking with kind of the 100 bps expectation on an annual basis?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

Yeah. I think I'll hand that one to Derek.

Derek V. Brummer
Chief Risk Officer & Executive Vice President, Radian Group Inc.

A

Sure. Geoff, I think it's tough to tell kind of what the transition is. I think what we've guided and if you look historically kind of the propensity to roll the claim for kind of those new defaults historically have trended down to kind of the 10% range. So depending upon trends, if they continue this year, we could see an adjustment towards the end of the year. But it's difficult to say exactly how rapid that will be.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. And then within the Services segment between adjusted and GAAP pre-tax we've had that amortization adjustment. Is that now fully gone on a go forward basis or is there still some sort of residual adjustment to make there?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

So, we did not take the other intangibles assets down to zero. There remains about $59 million of remaining intangibles that will continue to be amortized.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

But do you know what that quarterly rate is going forward?

J. Franklin Hall
Chief Financial Officer & Executive Vice President, Radian Group Inc.

A

You know, I don't Geoff. But we can certainly look at the financials and [ph] get back (50:25) to you.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

All right. And then Rick, now you've had a chance to take a look at the Services segment. Obviously, we can look at hindsight and the value that it's brought on is different than what was originally anticipated. As it stands today, is there more value to Radian from what it adds internally than externally?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

So, make sure I understand your question. So, in terms of – just could you just clarify what you mean by internally versus externally?

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Well, I think in hindsight it's clear this was overpaid for but I think that the company has been positively surprised by what it's done in terms of what it's added capability-wise and analytics-wise to the MI business. So, as it stands today, I think the earlier question was why didn't you sell this. I'm curious as to how much value you see to Radian MI from having the service platform relative to the opportunity externally?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Yeah, great question. I just want to make sure I understood where your question was, what you were focused on. So yeah, I think – look I think there's across our services business we have several key products and services that we add that are increasingly relevant across our MI customer base and also new customers. Obviously, we have customers that are purely services based customers. But I think if I just deal with the MI side for one second, as I've gone out and talked to customers, held meetings, brought on not only our MI sales force but our Clayton team, and to talk about products and services it is clear to me that we can become a greater business partner for our customers by providing them some of our core services segment products.

For example, our Red Bell kind of valuation products, our title products and ValuAmerica are highly relevant to the whole origination process connected with the mortgage insurance business. And we've spent a lot of time, I've actually spent a lot of time over the last few months really thinking about how best to approach that working with Jeff and the team and our sales team led by Brian. So it's – we see opportunity to increase the penetration of our customers with a broader set of products that are high value to them and relevant to them and that's been confirmed through these meetings.

So, I think the thing that's unique about it for us is, is that as we think about our business purely as a monoline insurance business, having the Services segment and products allows us to become increasingly relevant to those relationships, a better business partner, and bring greater value to our customers. That benefits us, it benefits them. We're a large scale player in the CFPB days of counterparty management, a company with the net worth we have, the credibility we have. It becomes a very high quality counterparty to do business with across multiple products. Our struggle has been how best to position that through kind of our sales processes, if you will. And I think, you'll hear us talk about that as we go forward as to how we will approach that differently than we have in the past. And I think it'll be more effective but the relevance of those products and services are extremely high and I think that will help us grow the products and services that we have today across the services segment.

Having said that, I think there's also, just refocusing on what's core from a services perspective not only across our MI distribution but across the market. We kind of bringing back our core loan due diligence and loan review business and really focus on recurring the sustainable relationships, leveraging our Red Bell and ValuAmerica products and our Green River REO products. We see organic opportunities in those but really about redefining the products and services on a go forward basis versus kind of looking at our rearview mirror. So that's where the excitement comes from as I think there is a need and a demand. We have to make some changes about how we approach the market to be more – actually more visible in some ways or more effective across our customer base, our existing customer base. And also adjust our products to reflect the market as we see going forward. So those are – the shifts that we'll make are focused about how do we increase the growth and penetration of these products going forward.

Having said that, this is not an easy shift to make. It doesn't happen just because Rick wishes it would happen tomorrow. This would take a significant amount of focus and activity but it's important not just from a services perspective, we think it's an important differentiating factor to us as we look at MI relationships and our customer relationships more broadly. So I think we have some work to do. We're focused on it. We're going to make the moves necessary to do it. But quite frankly, without the core business we have across the MI business, I think the services business would have been less exciting three or four years ago. It would be less exciting today in some ways because the growth potential comes from our ability to really think about this at an enterprise level.

Geoffrey Murray Dunn Q
Analyst, Dowling & Partners Securities LLC

Okay, thank you.

Operator: Next we have the line of Mihir Bhatia of Bank of America.

Mihir Sudhir Bhatia Q
Analyst, Bank of America Merrill Lynch

Hello and thank you for taking my questions. Just a couple of real quick ones here. First is on your NIW expectations for the year. I think last quarter you had said in line with last year, which is around $50 billion, since you're running about 15% above and we're halfway through the year. Any updated views on that?

Richard G. Thornberry A
Chief Executive Officer & Director, Radian Group Inc.

Yeah, I think we continue to maintain the position that we expected to be consistent with last year at the $50 billion market mark. We expect the overall NIW market across the industry to be modestly less I think is what my comments said, relative to last year. So we think the MI share of market, overall market will probably be higher because we see the overall origination market shrinking. But we think we'll hold our own through this kind of decline in the overall origination market and a slight decline in the NIW market. And I think so far our results are playing out that way. But we'll look and see how the third quarter evolves and obviously, as we get closer to the year-end, we'll have a better view of it, but I think that's why we're holding to our guidance.

Mihir Sudhir Bhatia Q
Analyst, Bank of America Merrill Lynch

Okay. And then on your reserves. Just a quick question, your reserves per default has declined fairly sharply. I guess, it's declined over the last two years, it was $27,000 I think back in 2015 and it's down to $23,000 now. Is that a function of just lower claim rate on new defaults and more cures or is there also severity impact going on in there and can you maybe tease that out a little bit?

Derek V. Brummer
Chief Risk Officer & Executive Vice President, Radian Group Inc.

A

Yeah, this is Derek. I mean, it's a combination of things. One is obviously the low rates on new defaults decreasing over time. A lot of that is also driven by the distribution of the defaults and the default inventory. So, generally the reserve per defaults are going to go down to the extent that the distribution is more heavily concentrated in loans that have recently defaulted. And you've seen that shift over time as the backlog inventory has kind of cleared out. That's probably the biggest driver of that over time.

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Got it. Okay, great. Thank you.

Operator: Next we have the line of Bose George with KBW.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hey, guys. Good morning. Just wanted to go back to the insurance in force growth. It's almost 8%, running quite a bit higher than the mid-single-digit number. I think you guys had mentioned probably a couple of quarters ago, just curious your thoughts on how long do you think that level of growth can persist?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

This is Rick, Bose. Thank you for the question. I think that – look our expectation is that insurance in force will continue to grow given the expected increase in persistency though it's kind of difficult to estimate the precise amount of growth because of just the volatility around quarter-to-quarter persistency and refis versus purchase mix. So, I think our $191.6 billion of insurance in force is one of the largest books of high quality. MI business in our industry and the vast majority of our existing book today includes business written after 2008 including those loans that were successfully completed through the HARP program. The 8% growth is on the size of the portfolio. I think we're very pleased with that. The primary driver for growth this year – last year it was NIW and part due to relatively high amount of refinance activity.

Since we expect similar level of NIW in 2017 with increased purchase volume offsetting the reduction and refis, we expect the largest driver of in force growth will be this persistency. So, right now, we're looking at it as a positive trend. We expect it to continue. The exact amount and magnitude is very difficult. As Frank said, the quarter-over-quarter persistency level actually went down from 84.4% to 82.8% and the annualized persistency actually went up. So that just kind of gives you an indication of some of the quarter-to-quarter volatility. But right now we expect to see it grow. How much is very hard to put our hands around.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, fair enough. That makes sense. And then actually just one on the balance sheet, the change in the other comprehensive income relative to 1Q, was that just positive marks on securities?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

That's right.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, great. Thanks.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Thank You.

Operator: And at this point we have no further questions in queue. I would like to turn it back for any closing remarks.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

I want to thank everybody for participating in the call and all the great questions that we received. And I look forward to talking to many of you over the coming months and will certainly have more to report as we complete our restructuring plan around the services business. So appreciate the questions. Look forward to seeing you all soon and have a great day. Thank you.

Operator: And ladies and gentlemen, that does conclude the conference for this morning. We do thank you very much for your participation and using our Executive Teleconference Service. You may now disconnect.