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RDN - Radian Group Inc at Barclays Global Financial Services Conference

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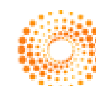

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CORPORATE PARTICIPANTS

S.A. Ibrahim *Radian Group Inc - CEO*

Cathy Jackson *Radian Group Inc - SVP & Corporate Controller*

CONFERENCE CALL PARTICIPANTS

Operator

Mark DeVries *Barclays - Analyst*

PRESENTATION

Mark DeVries - *Barclays - Analyst*

Thank you for joining us. Next up, we're very pleased to have the management team from Radian Group with us. I'm up on the podium presenting the CEO, S.A. Ibrahim and joining him is Cathy Jackson, is SVP and Corporate Controller. Recent investor attention has been almost exclusively focused on the new pioneer standards. So it's a very timely presentation I've Radian here. Day after they release their official comments around it. So with that really looking forward to hearing their comments, I'll hand it off to S.A.

S.A. Ibrahim - *Radian Group Inc - CEO*

Thank you, Mark and hope we'll be able to cover more than just PMIERs. Good morning and thank you all for joining us today. In addition to GAAP P&I, we've Emily Riley, who is our Director of Investor Relations in the ence here. So this morning, I'll focus the presentation on the premiums and earnings growth drivers of our business today, because Mark talk about PMIERs being important I think this is equally if that more important. Including the earnings power of large mortgage insurance book and our recent acquisition of Clayton Holdings. I'll also discuss opportunities for future growth. You may find a replay of this webcast and the accompanying slides on our website at radian.biz.

Some of the statements made this -- that I'll make this morning, will be forward looking these statements as well as Radian's prospects are subject to certain risks and uncertainties and you can read about these risks from slides two, three and four. So, let's jump to two, three and four fast. So as I mentioned, I'll cover the earnings growth drivers for Radian today including the large high quality and my book of business, we've written for the past several years.

Our recent acquisition of Clayton Holdings will also contribute to our earnings in the near-term. And then, I'll comment also on opportunities for future growth that are in addition to our MI business, but leverage our collective expertise in mortgage-finance, risk management and real estate services. Many of you here already know Radian, but for anyone here who is new to Radian. Radian provides private mortgage insurance, risk management services and products and real estate services to financial institutions nationwide. Our private mortgage insurance company Radian Guaranty is the largest mortgage insurer in terms of insurance in force and has been in business for more than 35 years.

In June of this year, we acquired Clayton Holdings, a provider of comprehensive outsourced solutions that expands Radian's participation in the mortgage value chain. We believe our company today is in a strong financial and competitive position with embedded earnings power and we believe our future is bright and that we're in a very strong position in what has been and continues to be a good business environment for private mortgage insurance as well as other real estate and mortgage services.

Slide seven provides an overview of our financial segments. Mortgage insurance is the primary segment and we have a financial guarantee segment. Radian asset, our primary financial guaranty subsidiary is no longer writing new business and is wholly owned by our principal mortgage insurance subsidiary, Radian Guaranty. We'll discuss the GSEs and they proposed Private Mortgage Insurer Eligibility Requirements or PMIERs later in the presentation, but it's important to note that we plan to monetize or otherwise utilize Radian asset in order to maximize its value under the PMIERs framework.

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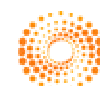

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Finally beginning in the third quarter this year we will include the results of operations for Clayton in the new mortgage and real estate services financial segment that transaction as you know lowest the end of the second quarter. So this will be the first quarter under our watch.

Slide eight, provides highlights of our improving financials including our substantial holding company cash. I'm turning to slide nine, while market size and new business volume always remain at top of mind. Our ability to grow our mortgage insurance for us is the most important. Radian's persistency, which is the amount of business that remains on our books over a 12-month period reached 83.1% in the second quarter of 2014 compared to 80.3% in the second quarter of 2013. In the second quarter of 2014, our insurance in force grew 9% from second quarter of last year and we once again led our industry as the largest mortgage insurance company with $165 billion of insurance in force.

At the same time as we turn to slide 10, you'll see that outstanding success in writing new business improved the credit profile of our portfolio. The high quality books of mortgage insurance business written after 2008 including loans completing the HARP refinance, represented 76% of our primary mortgage insurance portfolio as of June 30 2014. This again is one of the key drivers of a future financial results. We expect the business written during these years particularly in 2011, 2012 and 2013 to produce the most stellar returns our Company and our industry have ever seen with loss ratio is well below the approximate 30%, we've historically experienced. Well time will tell what the actual losses from these books turn out to be, you'll see in many of the slides we review today that the developing loss experience on these books of business is extremely low.

And also the legacy book continues to shrink with the most problematic 2006 and 2007 books now down to less than 12% of the total portfolio. As our legacy portfolio shrinks and improves, an important indicator of its resiliency is the fact that approximately 70% of our performing loans from to 2005 to 2008 have never been delinquent.

Slide 11, which many ways is one of my favorite slides only because I created it, illustrates not only the volume of MI business you've written after 2008, but how it's becoming a larger and more important performance driver for our total portfolio. I actually created it back in the day when we could only look forward to the hope of this [happening] and before it became reality since great to see and [not] turn into reality. We believe this will continue to improve over time as the losses from our legacy book continue to decline and become less meaningful and we'd like more strong credit quality business.

So that's what you see on the left hand side of the slide. Now turning to the right hand side, you'll note that the earned premiums less incurred losses from our 2009 and later MI vintages what $227 million dollars for the six months ended June 30, 2014. What you can also see that steadily increasing positive impact of our business mix that represents an impressive gains -- impressive increases from the $148 million for the first six months in 2013 and $95.7 million for the same period in 2012. You see annual numbers there. So just to compare the six months. I'm referring to six months numbers that are comparable. It's also noteworthy to mention that the 2008 and prior vintages, which had the bottom there have now turned positive and are now $69 million. And finally, it's worth noting that our net operating loss carry-forwards allow us to earn on a tax-free basis until they are fully utilized. Right.

Slide 12, which is again a very interesting slide shows that the low default counts on our newest books of business that I mentioned earlier, which we expect to result to the lowest loss ratios we've seen in our company history and how they're developing. This slide illustrates the continued -- also illustrates the continued burnout in certain legacy vintages, for example, you see the 2007, 2006 books coming down and look at there the first thing I talked about which is the more recent books by comparison to our vintages.

The next slide, slide 13 is the proverbial (inaudible) through the [python] slides and shows how our primary default rate has been declining steadily since its 2009 peak and (inaudible) to 5.8% in the second quarter of 2014. This is the lowest rate we've seen since 2007 and it reflects both the outstanding performance of the newer books of business, as well as the improving legacy MI book. The next slide shows that our primary default account decreased to 48,904 loans in the second quarter of 2014. Marking a new milestone of fewer than 50,000 defaults that we've been waiting for. Our total number of primary delinquent loans dropped by 38% year-over-year as you can see here. While this trend continued in July and August we did see an uptick in new defaults, which is typical during the summer months after a seasonally strong March and April period.

What's important to note here is that 80% of the new defaults for August were in fact repeat defaults and we're concentrated in the legacy book of business. And as we said in the past the defaults have demonstrated and ability to pure and therefore have a lower propensity to result in a future claims.

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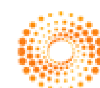

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Now turning to financial guaranty, this business continues with the reduction as of June 30, 2014 at 82% of exposure since 2008, including in many of the riskiest segments in our financial guaranty book of business. The credit performance has been generally stable and we continue to proactively reduce our exposure, which decreased to $20 billion in the second quarter.

Also after receiving approval from the New York Department of Financial Services Radian asset made an extraordinary dividend or Radian Guaranty (inaudible) of $150 million in July. We expect to request an additional extraordinary dividend next year. We continue to believe that Radian Guaranty is a solid over capitalized company with strong economic value. This slide clearly illustrates how our statutory surplus levels have increased even as we've reduced our net par outstanding. As we said earlier, we are actively working to monetize or otherwise utilize Radian asset in a way that will maximize its value consistent with the proposed PMIERs.

Turning to another growth driver for Radian. We completed our acquisition of Clayton in the second quarter and this adds a diversified source of unregulated fee-based revenue for our company. And also broadens our participation in the residential mortgage market value chain with services that complement our MI business. Clayton is a strong stand-alone business with unique industry leading products in due diligence, surveillance, complement and short sales services and in the third quarter, we will report results of operations for Clayton in our financial results.

While Clayton is a strong company on its own, we're working to leverage the synergies between our two businesses in order to provide a competitive advantage for Radian and another way to differentiate ourselves from our mortgage insurance peers.

Providing origination services and servicer surveillance solutions our two ways in which we can expand our suite of services that we offer to Radian is now extensive customer base. Customers today, after the downturn are particularly concerned -- increasingly concerned about offering secondary market investors with credit risk protection, but also in addition to that with greater assurance with respect to operational risks such as the risk or defects in loan manufacturing and the risks of negligence in loan servicing. We believe that the combined expertise of Radian and Clayton is a unique value proposition, that serves both the lenders and originators as well as investors and we look forward to providing a new breadth and depth of service to our customers. Turning now to the draft PMIERs that I mentioned earlier. These PMIERs were developed by Fannie and Freddie and I intended to provide revised requirements for private MI companies to be eligible insurers of loans purchased by Fannie and Freddie. Most of you know that these PMIERs were released by the FHFA in July for public comment and that comment period ended yesterday. Radiant provided a comment letter to the FHFA regarding several areas of PMIERs, but with the primary focus on the (inaudible) for unpaid premiums already received in cash, legacy loans that have bit stood the latest downturn and the lack of consideration for loan seasoning. Our comment letter is posted on our company's website on a dedicated PMIERs page. What is most important to remember is that we believe that we will be allowed an extended transition period of more than two years to comply with the financial requirements and we expect to have the ability to fully comply before that transition period ends without need to raise external capital.

Before we take your questions, let me provide a look at the future growth opportunities for Radian. While we will continue to benefit from the positive contribution to earnings from Radiant's existing book of MI business and shrinking legacy exposure as well as unregulated cash flow from Clayton, we believe there are opportunities for new products and investments on the horizon that build on the range of expertise in mortgage insurance, credit and operational risk management as well as real estate and product services that we now have. And as private capital, takes on a larger role in the future of mortgage-finance, which is something we here accord in Washington again and again as the one team that everybody agrees on as part of the future of the housing finance system, we believe there will be an increased emphasis in that scenario on the credit, manufacturing and servicing quality of loans emerging from the lessons learned from the downturn and the need for greater comfort and confidence on the part of investors. And we believe that Radian is well-positioned in terms of its depth and breadth of expertise to help customers and investors navigate through the still evolving housing finance environment.

Overall, we believe Radian is in a strong financial and competitive position today with embedded earnings power and we believe our future is bright and we continue to be in a very strong position in what has been and continues to be a good business environment for private mortgage insurance as well as the other real estate and mortgage services that we now offer.

With that I'll be glad to take your questions.

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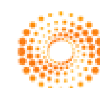

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Mark DeVries - *Barclays - Analyst*

Before we take questions, just wanted to quickly do the audience response section of presentation. So, if everyone could grab their card in front and register their response.

First question, what do you view as the biggest catalyst for Radian over the next year? One, declining loss ratios. Two, clarity on capital requirements. Three, growing volumes and new insurance written. Four, stable or improving pricing. Five, other.

So overwhelming 72% indicates clarity on capital requirement.

Next question. If a new GSE eligibility requirements are implemented as proposed. Radian shares should, one, sell off. Two, be unchanged. Three, rally from the removal of the overhang.

Okay. We'll (inaudible) the new response we got from the [MGSE] presentation. But still more thinking that it's a positive event rather than the negative event.

Next question. What do you view as the biggest risk to the shares here. One, competitive pricing pressure. Two, weaker-than-expected credit. Three, weaker than expected new insurance written. Four, no changes to the proposed new GSE eligibility standards. Five, other.

Mark DeVries - *Barclays - Analyst*

Okay. Pretty evenly split across all the answers. Slight advantage to [weaker] been expected credit, which is surprising.

Next question. Over the next year, would you expect your position in Radian to one, increase. Two, decrease. Three, remain the same?

We're very bullish in the (inaudible). I think the same story was, an MGSE. I think Radian and MGSE had played through the most bullish response last year. That seems to held over to this year.

So with that concludes the audience response section. Happy to open it up to questions, if there are any from the audience.

Well, people think those up. I'll kick it off.

Let's say there's been a lot made to the initial lack of unanimity among industry players in response to the PMIERs, but could you talk a little bit about where it seems that everyone seems to be an agreement and their response and the comments that you've seen so far?

S.A. Ibrahim - *Radian Group Inc - CEO*

The first thing that we all agree on is the need for greater clarity of capital standards and we believe that stronger capital require -- stronger counterparty, confidence in counterparty standards is warranted. I think where we as an industry have taken a standard is that being said, some of the requirements proposed are too onerous. Now the legacy players or the players that have a legacy portfolio that is going to be impacted by some of the owner's requirement, so you would expect anybody other than the legacy where as to focus that part of the requirements and there's been a high degree of unanimity and common view and even common data in terms of us questioning the justification for some of those standards. Beyond that with rare exceptions, most of the players in the MI industry also have a concern about the implications one either pricing or volume or returns depending on what happens as a result of the purported requirements on expanding home ownership and MI opportunities to borrowers who are still credit worthy, but whose FICO scores are below [630] and whose LTV is above 90%.

Cathy, would you like to add something up to that.

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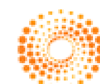

Cathy Jackson - *Radian Group Inc - SVP & Corporate Controller*

Just to reiterate, I think that in terms of the consistency and view, I think that a lot of, we commented on, on a lot of the provisions associated with the PMIERs, but some of our most significant comments really relates to legacy loan. So these required assets factors for non-performing loans. So, lack of a loan seasoning impact and then the (inaudible) factors that are being applied to the [always] performing legacy loans in 2005 to 2008, if I mention in this presentation that 70% of our legacy portfolio has been always performing.

So we (inaudible) a harder on those provisions and I think that the other legacy players also have fairly consistent views with respect to those acquired assets factors. I think the non-legacy players just haven't really weighed in on that (inaudible).

Mark DeVries - *Barclays - Analyst*

Okay. I think we (inaudible) last night. It seems like one of the more reasonable arguments is that they should be considering future premiums and or unearned premiums. Could you just talk a little bit about in the calculation available at last, could you talk about what would happen in your capital shortfall, if they moderate their position there consistent with what you proposed?

Cathy Jackson - *Radian Group Inc - SVP & Corporate Controller*

Sure. We kind of laid out our capital shortfall in July when we had our call, but I'll just refresh here. As of June 30, if we run the current requirements and our portfolio, we would have available assets of $3 billion, we would have required assets of $4.8 billion and then that shortfall, which could be further reduced by our cash at the Holdco [$770 million] and then also in July the extraordinary dividend that we received from Radiant asset was further reduced that to about short fall of about $880 million, the premium credit and what we've commented (inaudible) as well is that there is no credit given to unknown premiums, that has been received and our non-refundable, received in cash represent liquid assets available to pay claims, they've been excluded from the available asset calculation as of June, 30 that represents for us about $450 million, so it's fairly significant in relation to the overall shortfall. And then secondly with respect to premium, we've also suggested that some credit should be given to future premiums on monthly, because the framework requires holding capital against losses that are expected over the life of the loans don't get credit for other than legacy our future premiums don't give any credit for future premiums. So we think even with a conservative assumption with respect to future premiums on non-legacy that could take care, we take care of the remaining shortfall that exists.

Mark DeVries - *Barclays - Analyst*

Great, can you come a little bit on how much pricing might need to move into this new [lower of buckets] if they don't make any adjustments to the factors?

Cathy Jackson - *Radian Group Inc - SVP & Corporate Controller*

Yes, I think that overall on a blended basis, we can still see mid-teen returns on the overall portfolio, given the current requirements, especially with the loss ratios that we're seeing now that are as that they mentioned lower than our historical standards, but to the extends that because the requirements are very onerous with respect to high LTV and low FICO to extend that there is a shift in the mix of business it could be very -- the overall return could be very sensitive to that. So I think just to give you an idea if we would retain our current returns on that lower FICO, high LTV business premiums could have increased by 50% or so.

S.A. Ibrahim - *Radian Group Inc - CEO*

And keep in mind any loan that goes delinquent is subject to fairly onerous capital requirements on top of that. So while calculating the expected return and the capital needs you have to take into consideration is that some of the loans will go delinquent and you have to factoring the potential capital required for that.

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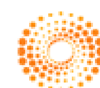

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Mark DeVries - *Barclays - Analyst*

Last question on PMIERs I promise, if you were kind of compelled to make those type of pricing adjustments on the lower FICO, higher LTV loans which I think clearly on those loans would make the FHA the cheaper alternative, what would you expect their competitive response commitment, could has been a policy objectives of trying to push more and more volume back towards private capital, at least on the more truly affordability products for lower FICO, higher LTV bars, this would have the opposite reactions kind of thoughts on that?

S.A. Ibrahim - *Radian Group Inc - CEO*

This won't be the first time where the stated goal by everybody in Washington off reducing the role played by that is where supported entities like the FHA and the actions taken our country to one other. The FHA from everything we can tell is still committed to playing a smaller role in the future that being said, they have their own political constitute they have to deal with in providing liquidity to their segment, so it'll be interesting to see whether this causes them to raise their premiums in response. However, they also seems to be separately, set of comments building up in Washington among various housing activists and industry groups like the NBA, which suggest that that some counter action in terms of pricing taken by the MIs may have to come on the part of the GSEs themselves and lowering the loan fees that they add-on or the GSEs, because if you -- and that's in our comment letters also you can read that, because if you take the rationale that part of the reason why those GSEs where are, what they are is because they incorporate at higher level of risk in the PMIERs environment associated with counterparty risk and that risk is going to be significantly diminished if not completely significantly diminished if not completely eliminated them the cost of that risk has to come out of the GSE (inaudible) or loan level [latter] and if that happens, we could remain in a competitive environment with respect the FHFA.

Mark DeVries - *Barclays - Analyst*

But, so it makes sense. How do you think, how viable do you view that as kind of politically the notion of the GSEs kind of pulling back on some of the risk-based pricing?

S.A. Ibrahim - *Radian Group Inc - CEO*

It's hard to guess exactly how Washington will act, but the only thing that I'd draw strong encouragement farm is the breadth of the comments coming from so many different entities and constituencies and the remarkable consistency in terms of everybody making the same three or four points. So that has to create a pretty powerful voice in Washington.

Mark DeVries - *Barclays - Analyst*

Great. Moving on, could you talk about some of the primary drivers of the Clayton business and how you see that benefiting Radian stock going forward?

S.A. Ibrahim - *Radian Group Inc - CEO*

I look at the Clayton business in three parts as we look ahead. First is the business that they had prior to our acquisition of Clayton, which as we said in our last call, we expect the revenues to remain stable for the rest of the year. And that's a business that is in the correct environment of very little private label business being done. The second is -- so that business based itself. So we've got Clayton which stand-alone earns or return that's acceptable. On top of that you layer on the potential opportunity that is created by the securitization market coming back in some way or shape or form. And we believe that could be very attractive in a big positive (inaudible).

And then the third piece that layer on that is the synergy opportunities between Clayton and Radian, (inaudible) all the way from Radian using Clayton in place of some of the other vendors that we currently, third-party vendors we use in transferring business to Clayton and turning what

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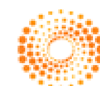

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is business going to someone else to Clayton as well as Radian looking at things that we do internally within Radian guarantee and having Clayton do that cheaper and turning Radian expenses in to revenue opportunities for Clayton. And on top of that new products and opportunities that we are in the middle of looking at that can be offered by linking some of Clayton's expertise to Radian expertise particularly in an environment well both lenders and investors are highly concerned about loans that have otherwise on the surface have otherwise very strong criteria not performing well, because they were not manufactured well or they're not being service well.

Mark DeVries - *Barclays - Analyst*

Great. And we have got a question from the audience.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Two things in my mind. One is about message really. Without trying to vilified the CFPB that fairly clearly have made it obvious that they are seeking to apply disparate impact broadly across credit underwriting and I am wondering given the impossibility of introducing qualitative risks letters and any kind of credit algorithm without producing a disparate impact on some sub group used this weakening presently or for the medium-term future, is it weakening the methodology available to use either directly or indirectly the information that you use in terms of the underwriting that you do on the mortgage insurance product?

S.A. Ibrahim - *Radian Group Inc - CEO*

By design, the mortgage insurance product is design to allow borrowers who otherwise do not have access to housing, to have access to not just have access to housing finance, but have access to Fannie and Freddie mortgages and housing finance; it tends to be the most lowest price mortgages. So we if anything play a role in opening the doors and reducing some of that desperate impact. In terms of our criteria not discriminating themselves are standards, not discriminating themselves among borrowers, we obviously are very sensitive to that. But I think by the nature of our business itself, we actually serve the goal that the CFPB and others are trying to achieve in terms of making sure credit is available more broadly to borrowers, who are creditworthy because in our case, we have an incentive of doing that because if you make any mistakes we have to meet them.

Unidentified Audience Member

The other question is, if this is going to sell that a little contentious, but it's really not meant that way I drew from your comments, a thread of fault that was -- we will in the future for us is in the past, but certainly in the future be systemically improving the quality of mortgage risk, we will be part of that overall evolution, this is part of what rating and I have a trouble thinking that figuring out how the product gets where it is now to that new place because I look at you as having pretty much of commodity priced cost of capital with a product which has a commodity price that there is no value added that takes it removes the burden of it's being tied to an economic cycle. How do we get to this new higher value added qualitative products that has systemic benefit above and beyond its ability to absorb similarity which is always had?

S.A. Ibrahim - *Radian Group Inc - CEO*

One way to look at it is if you look at the mix of products and look at the alternatives to MI in the past, one of the biggest alternatives to MI was piggyback mortgages. So, in a systematic fashion or systemic fashion if you have an MI mortgage insurance product, we've got a not only a second pair of eyes independently looking at the risk of that product and making great decision, but a product is a better substitute for piggyback mortgages. Data has shown that I think that's a 50% better performance for mortgage insurance covered loans at high LTVs than piggyback mortgages.

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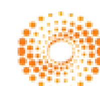

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So that alone a viable private mortgage insurance product as an alternative to piggyback seconds is an improvement. And then the other thing I said was one of the things that came out of the downturn, a big lessons for all of us including people would been in the industry for a long time is for too long. We did not place as much importance on defective loans and loans being negligently service as we realize the off to have during the downturn. It started out with our looking at loans and saying they have acceptable credit standards, why aren't they performing and finding out that they had not been originated properly, we're or not being serviced properly. To the extent that the industry can get better at understanding managing surveilling and staying on top of that risk. We think we can systematically improve the industry performance, that's been a neglected area.

Mark DeVries - *Barclays - Analyst*

We have to conclude on that note that management will be available for a breakout following this on the Morgan's suite. With that, please join me and thanking them for their time.

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