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EDITED TRANSCRIPT

RDN - Radian Group Inc at Goldman Sachs US Financial Services Conference

EVENT DATE/TIME: DECEMBER 09, 2015 / 7:00PM GMT

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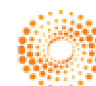

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CORPORATE PARTICIPANTS

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

CONFERENCE CALL PARTICIPANTS

Eric Beardsley *Goldman Sachs - Analyst*

PRESENTATION

Eric Beardsley *- Goldman Sachs - Analyst*

We have S.A. Ibrahim, the CEO of Radian here with us. We'll be conducting a fireside chat. Then we'll open it up to audience questions. So as most of you all know, I'm sure, Radian is one of the largest private mortgage insurers in the US, and also has a growing real estate services business that it has acquired in the past couple of years.

So first S.A., thank you for joining us. Just at a high level, I was wondering you could talk about your growth outlook for the private mortgage insurance industry over the next few years.

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

Sure. And thanks for having us. In terms of growth outlook for the last several years, let's start with this year first. This year at Radian we had said that we would write in excess of $41 billion, which makes it the second-highest year for NIW we've had in our history in terms of flow in NIW. And it's a very profitable book of business, with premiums, blended premiums, returns to ROE to shareholders, leveraged between mid to high-teens, and return on capital unleveraged in the low to mid-teens.

What we see happening next year is the overall mortgage market is expected to be down. But the mix of the market is going to be in favor of purchase versus refi. The purchase volume is actually projected to come up and go up. And given the higher penetration of the purchase business, we are at this time projecting a not-too-dramatic difference between this year and next year in terms of volume.

As we go beyond the next couple of years, the industry expects broadly-- experts broadly believe there's favorable demographics which are going to positively impact purchase demand for homes. And this demand is going to come from first-time home borrowers, largely expected to come from the minority segments, particularly the Hispanic segment. And we believe those borrowers are more likely to have lower down-payment capabilities, and therefore create a demand for mortgage insurance.

Eric Beardsley *- Goldman Sachs - Analyst*

Great. And I guess Radian's market share within the industry, there's been a lot of questions about price competition. How do you see that impacting your share today? And is there anything that you can do to defend against any changes?

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

So first off, we manage our business where we are very conscious of the power of our future earnings. We have a very large and one of the largest books of embedded-- of insurance in force within strong embedded earnings. So we're looking at growing our insurance in force, and growing it with attractive margins. And so with the comment I made earlier of the kind of margins we expect to deliver, we back into the kind of share that results in, as long as we're still growing our insurance in force.

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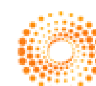

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So in terms of market share specifically, though, while we achieved that, we're also always looking for opportunities to grow share from that segment of the market, which is going to give us the attractive premiums. And there happens to be segments like we are making inroads into the community bank, the credit union segments, and going after getting business from some of the banks.

Keep in mind, while we are pretty large and we have a very large book of insurance in force, we-- looking at the glass half full and sort of half empty, even given our size, we are a company that doesn't do business with the entire spectrum of mortgage customers out there. There are others who may already be doing business with the entire mortgage segment. We do business with maybe 70% of the customers.

So we still have a focused and a dedicated salesforce that goes up and signs up these new customers. And the emphasis has been to go after segments that we believe produce higher-quality loans and are less price-sensitive.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. In terms of, I guess, any competitive impact that you've seen thus far from NMI's price competition. Is there anything that you've noticed in your business?

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

We've seen the impact of NMI's price competition primarily in the independent mortgage lender segment and [that too] in the singles part of our business to date. And part of our discipline has been to still focus on getting the blended return we target to do. Which means in many cases, or in you know-- not doing business with certain customers where we don't believe we can realize that kind of return, even in some cases if those represent a fairly meaningful percent of the (inaudible) market. Because there's no point in writing business for the sake of writing business, if it doesn't deliver the kind of returns we would like to create.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. In the borrower-paid business, have you seen any different trend?

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

It's too early-- I know [Bay] and Arch have both talked about on the borrower-paid business side, some discounting. It's too early to tell the impact there. There could be some. But keep in mind in the borrower-paid business, if you put yourself in the shoes of a lender, as opposed to the lender-paid business, typically in the lender-paid side the MI is already embedded in the loan. Any discount in pricing immediately accrues to better execution to the lender. Whereas in the borrower-paid, the borrower is the beneficiary of the lower MI payment. And it has to benefit the lender. It has to translate into a larger market share, which is more difficult to see and capture. So it will take a while to see that impact.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. And then in terms of the pricing on that business, because there's been a lot of confusion out there in terms of what a flatter rate card means. I mean is there a potential in your view for the industry, I guess, returns on borrower-paid to flatten over time, and how would you evaluate that?

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

Right. You're absolutely right. There has been a lot of confusion. And I understand some of it has been a misunderstanding of some of the comments we made. What you have to keep in mind is this is a complicated strategy. We've got very discrete pieces. You have to price the disparate pieces

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based on competitive dynamics. But you have to manage that to get a mix of business which delivers the right return. So I wouldn't get overly carried away by how an individual part of a rate card is being priced.

Because the way we price it is to deliver a mix of business each quarter. And for that matter, to actually talk about the disconnect between to the concern versus the reality, not that-- I mean we manage to a certain return. And as long as we get the return, we're pretty happy. And so not that we were attempting to grow-- because we already have pretty attractive return-- to grow our return. We've actually, as we said on the Investor Day, seen our returns grow by 80 basis points over the last few quarters. So this is in the face of all the concern about premium erosion.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. So I guess with that, is there any shift in how you're seeing when there's allocated volume? As you mentioned, it would be harder for a lender to really move around volume, based upon lower borrower-paid pricing, in that the benefit doesn't necessarily accrue directly to the lender. But with that, has there been any shift?

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

You have to look the market has different segments. You've got the large commercial banks who still primarily allocate based on a scorecard. The scorecard has many factors on it. And each one of them has a different factor. They typically like to do business with maybe three MI companies, with more MI company choices. Maybe they're now doing business with four to five.

Then you look at the next segment, which is the-- which has grown a lot in the recent times, which is the independent mortgage lenders. They tend to be the most price-sensitive. And they tend to make more use of singles in their matrix. And they tend to be more price-sensitive.

Then you look at the community banks and the credit unions. And they are really looking at the value delivered to their customers. And they, from my experience, are the ones who are most receptive to the value proposition Radian provides with the Clayton Services. So there are different considerations that go in.

So you can't generalize and say, all segments of the market use the same approach in allocating the business. And the biggest [check] to the portion of the business from the commercial-- large commercial banks is purely quarter-to-quarter decisions on scorecards that are internal scorecards on what they expect to get from the MI.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. Is there any way to quantify what percentage of your borrower-paid business comes from what we call more price-sensitive lenders like the non-banks?

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

I don't have that information handy. I would just hazard a guess off the top of my head, since the non-banks are the ones who have shifted more-- have gotten more skewed towards the lender-paid. The borrower part of our business probably comes less from that segment than the other segments.

Eric Beardsley - *Goldman Sachs - Analyst*

Okay. And just on capital buffers, at the Investor Day you talked about still needing some time to come with the appropriate capital buffer under PMIERs. Can you just walk us through what the consideration are there? Would you actually hold the buffer at the writing sub? Or would it be something that you have at the hold co, with the ability to push it down over time?

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And is there any range that you could share with us in terms of if you're required to have 14 to 1 on new business today, would the buffer be an extra 1 or 2 points of risk to capital, or if we were to think perhaps out of the hold co liquidity, you're already pushing down $320 million. Would there be an incremental amount that you'd look to push down?

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

That's a very good question, and one that deserves some careful explanation. So first comment I'd like to make is we are in a strong position where we can comply with the PMIERs requirement with a portion of the liquidity we have at the hold co level. So we have been projecting that the amount of liquidity we need to pull down from the hold co, down into the operating entity is $320 million. Now, between now and year end, those numbers can change marginally. And we've opted to wait until the last minute to put it there. Because obviously, we have more flexibility with the capital at the hold co than at the operating entity.

Now we have also said that we want to put down a cushion at the operating entity. The purpose for the cushion is to address three different issues. In the event unintentionally there are some errors in calculations, which we don't expect, but in the event there are, we need to address that.

Second is during the quarter before we look back, there could be loans that go into default, requiring more capital support. And third, new business we write is going require capital support. That said, we expect that cushion to be fairly modest, the cushion that we put down into the operating entity. Why? Because we want to keep it-- we want to make sure we have adequate cushion in there. But we want to keep it to what is just required. Because we'd like to have more flexibility at the hold co level.

And even after having said that, our current projections indicate barring something unusual either in terms of the default experience of in terms of new business volume which we would welcome, we do not project putting in any more capital from hold co into our operating entity after the first infusion of capital.

Eric Beardsley - *Goldman Sachs - Analyst*

Okay. That's great. Now is that primarily because you're creating more capital as your delinquencies decline, as you look at the PMIERs capital? Or is that because you feel like the initial $320 million is going to be sufficient for that?

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

As you know, the book of business we've written, and we have many charts that illustrate that, is extremely profitable. We've got a lot of embedded earnings in that book. And those earnings keep coming through, and we've shown a step function of the rate at which that positive contribution is developing. And even on the legacy book, the negative contribution is now become positive.

So based on that, our projection is we will continue to accrete capital at the operating entity that's sufficient to deal with the projected new defaults, which as you know, are themselves slowing down. We are continuing to see improvements in the early stage defaults. We continue to see the legacy business decline. So all of those factors will give us enough room to accommodate the new business we are writing.

Eric Beardsley - *Goldman Sachs - Analyst*

Okay. So as you think about the larger opportunity, perhaps, for call it the deeper coverage on the front end, there's been a lot of talk from the industry. We've seen the letters from the MBA and others. How do you expect that opportunity to develop over the near term? And just also curious in terms of I guess what you think the capital requirements for that might be.

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

Deeper coverage makes a lot of sense for everybody. It addresses the concern that Washington had in terms of having private capital bear more of the risk than taxpayer capital. Because deeper coverage would mean the GSEs would require less capital. And there would be less risk on the shoulders of the taxpayers. And we believe that since we're already writing that loan, it's very easy and very cost-effective for us to write [deeper MI].

And we believe, based on our projections, the borrower will benefit also. Because they'll have a slightly lower payment. So we have made our case, as you know. We've had middlemen do the analysis, which confirms our numbers, through USMI. We've shared that information with the industry and with the FHFA. And the industry found that information compelling enough to come to our side. And the MBA is strongly supporting this as the right thing to do.

So now the decision rests with the FHFA, and I cannot handicap when and what decision they would make. But I do believe from our perspective, the case is very compelling. And you should all make the case along with us.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. And I guess in terms of potential capital against that business, should it materialize?

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

Look, when we get that opportunity we'll have to calculate it. It's a good problem to have to write more business. And to the extent that there was a concern that there would be excess capital developing in the operating entity, this would use that before it required anymore capital infusion.

Also keep in mind, as you go down deeper in the LTV ladder, each successive layer has lower risk of penetration in the event of a loss. So it requires generally less capital.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. So you discussed just on your credit, you've discussed normalized claim rates of 10% versus the 14% level today. At the current pace of credit improvement, when do you expect to return to that level, and what would you need to see for additional improvement?

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

We are pleased at the way the book is developing and tracking. I already talked about the fact that the early stage defaults are improving. Our cure rates are increasing even as we enter this cycle of the year. And we've also talked about the fact that our roll rates potentially could go from our current level down to as low as 10%. And we would see it happening over the next couple years.

Beyond that, the specificity is hard to determine. We monitor that quarter by quarter. And when we are comfortable with the trends, we take an action. Remember that we have to use our best judgment every quarter to come up with the best estimate on roll rates and reserves. So we may get there at a different time than somebody else will. That's just a matter for us. Sometimes we get there first, sometimes others. But regardless, if those trends are compelling, we have very limited flexibility in not acting if those trends warrant such an action.

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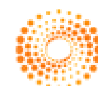

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Eric Beardsley - *Goldman Sachs - Analyst*

Great. And so if you were thinking about stress scenarios and a modest recession, where do you think the loss ratios on recent vintages could potentially peak? And just on the 20% loss ratio that a lot of people talk about in the industry as normalized, is that a through-the-cycle number in that it includes a recession? Or is that just something that we'd see in the good times?

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

The 20% number that for anybody-- for particular-- like I won't talk about others, but based on our own experience and our book, we believe 20% is a through-the-cycle number that we are using in our pricing models. We could, based on the most recent experience, use a lower number. Though I should you remind you, at least our pricing model is more sensitive to the life of the loan than it is to the loss ratio.

But same thing with the life of the loan, we could use shorter life of the loan based on most recent (inaudible) in the market. But we don't expect that to be going forward in the future. So I do believe, yes, based on our modeling and our analysis that 20% is a safe number, a through-the-cycle number to use going forward. Our actual experience is much better.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. And I guess where would you expect to see losses peak as you start to stress test the portfolio?

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

It depends on how deep in any cycle is the only thing I can-- I take some comfort from having been in the business for many years as credit is about as tight as I've seen. And if you stress any portfolios, tight credit-- and then remember, everything being done is within the QM [part], GSE eligibility. And even then, the lenders are not going as far as our criteria suggests. And the environment in general in terms of appraisals and so on is very tight.

So while I can't give you a number, I would say it's very plausible whenever the next cycle occurs, it's not going to be as deep as the previous cycle, because of the nature of the business (inaudible). Remember, one of the things we talked about on our Investor Day is if you dissect some of the drivers of the outer level of losses in the last down cycle, it came from the layered risk that was taken on loans.

So in addition to FICO, you had a combination of low FICO, high LTV, [doc types] such as stated or so on, and investor properties. The more of those you layer, the more exponentially the risk goes up. And we're not seeing any of that in the current book of business that-- not just the MI business are taking, but anybody is writing out there.

Eric Beardsley - *Goldman Sachs - Analyst*

Great. So now that you've owned Clayton for more than a year, what has surprised you most about the business?

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

Surprise is a strong word. I would say that there really aren't that many surprises. Clayton is tracking pretty close to our projections. We have different rates [to projection]. It's tracking pretty close to the middle, the range of our projections for its core business. The newer businesses that we have, such as Red Bell are tracking ahead of our projections. We don't have enough experience yet, but are very encouraged with how we think the Value America business is going to perform.

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If there is a surprise, if that [word warrants] some attention, I'd say there's a positive surprise on how well received the Red Bell book of business is. Because we have seen something like 150-plus Radian MI customers show a lot of interest in that business. And we've already signed up something like 20 of them. And some are big and some are small, and some of these business [customers] would be big, because even the bigger customers are interested.

But keep in mind, this is subscription business. This is a very different business from the rest of Clayton's business, which is-- you know, you have to earn contracts as you go. And you get contracts. So once you get the subscription, we think they have more sticking power. And also remember, Red Bell is a technology company. So the incremental cost of dealing with higher volume is relatively low.

So these are small numbers. But over time they begin to add up. But that's not what excites me most about Clayton. What excites me most about Clayton is an environment where you have a lot of MI competition where everybody looks more or less similar, it gives our sales force-- and the sales force at Radian is the most excited about the Clayton thing. They developed this value circle that they go and sell to customers.

And our goal with Clayton, as much to grow Clayton's earnings on its own, is to use the power of Clayton to develop more deeper relationships with our MI customers and use it power more MI business. We're just starting to do that. So stay tuned.

Eric Beardsley - *Goldman Sachs - Analyst*

So also at the Investor Day, I guess you talked about the potential to grow that business three times the pace of the MI business. Where do you see most of that growth coming from? And if you can talk briefly about the cross-selling opportunity, is there any specific product outside of Red Bell that you see as a meaningful contributor?

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

So we do see projections of it growing faster. Some of the growth is going to come from just they're doing more traditional business. But on the cross-sell side, in addition to Red Bell, we see Value America as an interesting opportunity. We are just starting on it. It's a fresh deal. But we've already got some traction in there. We see if a cycle of demand comes in the mortgage industry, there's demand for underwriting services. We see demand for Clayton underwriting services out of their Tampa operation.

We are starting to see interest on the compliance side. The other side of the trade concerns and so on in the industry, and the CFPB concerns is they want to be on top of the quality of loans they're originating. So we are starting to see some of that interest being shown by Radian MI customers. And we are starting to see interest come from investment managers on the Street in terms of funds, who are looking at buying pools of mortgages. And there's an opportunity to use Clayton in the underwriting of those mortgages, and the surveillance associated with those mortgages. In the absence of a private-label market, some of these fund managers are looking at increasing the amount of mortgages that they hold in their portfolio.

Eric Beardsley - *Goldman Sachs - Analyst*

Great. So with that, I'll turn it over the audience for questions.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Yes, thank you. I don't mean to beat a dead horse. But just want to go back to pricing for a second and competition in the space. I'm looking through my notes of your comments just now. And it seemed as though you mentioned that it's too early to tell with pricing in some parts of your business. And I'm not sure how to think about that in the context of some of the other comments you made related to banks being a little more-- or a little

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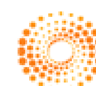

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less price sensitive, credit unions being a little price-sensitive, maybe the non-bank mortgage finance companies being a little more sensitive. But I'm not sure what you meant by it being a little too early to tell. So I just wanted to get some clarity there.

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

So the question I was answering was very specifically in terms of the recent actions on borrower-paid MI. So those have been taken very recently in terms of trying to offer discounts on borrower-paid MI. And those actions were taken very recently. And it's hard to tell what the impact of the actions on borrower-paid-- there's likely to be some action. But keep in mind the beneficiary of any discounts on borrower-paid accrue to the borrower in terms of monthly payments. So if the lender is sensitive to getting those discounts, then they have to see-- very likely they need to see more business coming to them. Because they are offering borrower a lower rate on the MI than the borrower is exclusively paying for out the money that's sent to service of this [explicit chart].

In terms of lender-paid, I've said already we've seen pricing sensitivity on the part of-- largely on the part of independent mortgage companies. Because there the borrower is getting one rate. And if the lender can get a lower rate negotiated on the MI, it improves the lender's execution. And they directly benefit from that. So that's where there's greater sensitivity. I hope that answers the question.

Eric Beardsley - *Goldman Sachs - Analyst*

So actually, just to follow up on that, S.A., so just thinking about that construct, would a lender actually have to give 100% of their borrower-paid volume to an MI in order to effectively market that MI price discount?

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

It would depend on how sophisticated the lender's systems are, so that they have to-- some lenders are more willing to reissue disclosures. But some of the large banks, the reason why they don't like pricing differences between MIs, is because they make the MI allocation decision after they have sent out the disclosures. And once they disclose a certain-- what used to be called Truth in Lending and Good Faith Estimate, now it's all embedded into it. They're very reluctant to go back an issue a different estimate if they have a different MI rate on that.

But you raise a good question. Whereas others issue that later-- they all have to do when they get the application. But they've already made the allocation decision at that point.

Eric Beardsley - *Goldman Sachs - Analyst*

Yes. So I guess as we start to think about what the impact of that pricing would be, I mean is this really just a very small subset of lenders who might even adopt some discounted form of pricing on the [BPMI]?

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

Well, you know, we need to see how it works. But I would say that lenders who are running shops that are less complex may be able to incorporate that, than the very large lenders who historically have not been comfortable with different MI premiums.

Eric Beardsley - *Goldman Sachs - Analyst*

Interesting. So are there any audience questions? I'll just ask another one here. So just again on the pricing construct, hypothetically it might be 30% of industry volume as we estimated, that's in that 760-plus borrower-paid FICO bucket. Is there any appetite at all to adjust pricing there? And would there be any way to pick it up enough in other buckets if you actually were to change pricing on that?

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

Look, we-- so in general, my reading is the larger players, the larger legacy players in the industry and some of the larger traditional newer players tend to be relatively reticent to use price as their main means of competition. That includes us. Having said that, we have some new players in the equation. We've got one very large player, which is part of a large insurance company that has been using pricing and a (inaudible). But the rest of us for the most part, have not directly competed with them on that.

There's another new player. They have just entered industry that on the single side, started using price. And we've all had to react to that, to defend and so on. But we try to react to that in a manner where we did not compromise the blended returns we go out to get.

So should the pricing on the 760 and higher FICO bucket result in somebody getting a greater percentage of that business and so on that we believe would compromise the quality of our book, then we would adjust all the levers we need to adjust to try and capture that business in a way that would still protect our blended returns.

The ultimate answer is to go through the permutations and combinations with different customers, where you're getting that blended return on an overall book of business. Because ultimately the investors, from an investor point of view, it's not how we price individual layers of business that drives the investor returns. It is what the blended return on our overall book is, as long as the individual book from a credit point of view is high integrity.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. So is there any type of market share test for, say, if you were lose 3-4-5 points a share, then that's some type of tipping point?

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

No. It's-- I mean we've already shown you have to judge a company based on its actual behavior. So we have shown that we are willing to achieve that balance doing the right things. And yes, on the margin we have given up market share. But the reason to some extent we've been comfortable with doing that is for the most part we continue to have relationships with those lenders. We are doing a smaller piece of business on that.

And we don't believe that with the reluctance or reticence of most of the players to engage in price competition. Because what it's likely to do, we've seen in the past, if somebody takes the initiative in using pricing and everybody follows very quickly, and just-- you get the same amount of business at a lower price and a lower premium, which is the concern of the industry.

And that has made for us to be very reluctant to use it unless it's the last resort. And the important thing from our point of view is to keep that relationship with the customer. Because if pricing turns out to be not a sustainable way of competing in the long run, or beyond a short period of time, then you have that relationship and you get back that customer.

So one indication of that is the newest player in the industry who started using price as a big driver of success, already signaled that they may be moving back from pricing. Why would that be the case? Because in most industries, to establish a toehold in the market, when you have-- price is the easiest way to establish a toehold. And your investors are probably measuring you in the early stages of your existence on what kind of share you have grabbed.

But pretty soon the investors will focus-- are likely to focus their attention on what kind of return are you going to deliver for them. And you're going to have to go out and raise capital. And the cost of that capital becomes expensive. And one example of expense is if you've 750 basis points over treasury or (inaudible). You know, you're going to say, pricing is something we need to back off and do other things. And please, I mean while we don't know that's exactly what's going to happen, it's a hypothesis that we're operating on.

So if that is the hypothesis and you believe this is something that is more or less temporary, you don't want to exacerbate it by playing into it.

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Now, that doesn't mean on a tactical basis here and there you're going to make those adjustments. And by the way, those judgments that constantly have been made all the time. Because you're inducing a new customer to give you some business and so on. And all of us do it. But that's not a major pricing driver.

Eric Beardsley - *Goldman Sachs - Analyst*

Great. Well, terrific. I think that's a great place to end. And thank you so much, S.A.

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

Thank you.

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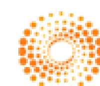

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