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Radian Group Inc. (RDN)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Radian First Quarter 2020 Earnings Call. My name is Yanin. I'll be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. [Operator Instructions] Please note that this conference is being recorded.

I will now turn the call over to Senior Vice President of Investor Relations, John Damian. You may begin.

John W. Damian

Senior Vice President & Head-Corporate Development Strategic and Financial Planning, Radian Group Inc.

Thank you and welcome to Radian's first quarter 2020 conference call. Our press release, which contains Radian's financial results for the quarter was issued last evening and is posted to the Investor section of our website at www.radian.biz. This press release includes certain non-GAAP measures which we will be discussed during the today's call including adjusted pre-tax operating income, adjusted diluted net operating income per share, adjusted net operating return on equity, and real estate adjusted EBITDA.

A complete description of these measures and the reconciliation to GAAP may be found in press release Exhibits F and G and on the Investor section of our website. In addition, we have also presented a related non-GAAP measure, real estate adjusted EBITDA margin, which we calculate by dividing real estate adjusted EBITDA by GAAP total revenue for the Real Estate segment.

This morning, 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 is Derek Brummer, President of Radian Mortgage. Due to the current environment, all of our speakers this morning are remote. I would ask that you please excuse any sound quality or technical issues that may arise during the call.

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 2019 Form 10-K as updated in our quarterly report on Form 10-Q for the first quarter of 2020 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, John, and good morning. Thank you, all, for joining us today and for your interest in Radian. I am pleased to share with you the results of an excellent quarter for our company. These results are testament to the strength of our business model and the power of One Radian unified team. While the focus of today's call is on the first quarter of 2020, we recognize that primary interest is on how the COVID-19 pandemic environment will impact our business going forward. And I plan to share our latest thoughts and insights. Our goal is to provide you with the best information we have available.

Before I begin, I want to take a minute to thank our team for the incredible resilience and commitment they have demonstrated throughout this time. Our business continuity plans were in place. Our technology infrastructure was ready and our employees migrated to a work-from-home model in mid-March seamlessly without missing a beat.

During this unexpected and unprecedented environment, our team has continued to operate effectively in a very high level with minimal disruption to our businesses or the services we provide to our customers. I'm very proud of how our entire team at Radian has responded to the challenge.

Let's start with our first quarter results. I'm pleased to report another excellent quarter for our company with a focus on several key highlights. We reported net income of $140.5 million or $0.70 per share, adjusted pre-tax operating income was $204.6 million, and our adjusted diluted net operating income per share was $0.80. Return on equity was 14.2% and adjusted net operating return on equity was 16.3%.

For our Mortgage segment, we wrote $16.7 billion of NIW in the first quarter, which helped grow our primary insurance in force to $241.6 billion.

For our Real Estate segment, we grew revenues to $28.6 million, a 24% increase compared to the first quarter of 2019. Following the sale of Clayton in the first quarter, we've narrowed our focus to growing our title, valuation, asset management, and real estate services businesses. Frank will provide additional details on the quarter and our financial position.

I want to turn now to the mortgage and real estate market environment. There's no doubt that we are going through an unprecedented time in our country and across the globe. It is too early to predict the full impact that the COVID-19 pandemic will have on our customers and our company, but it remains clear that the economic fallout will have significant impact on the housing finance and real estate markets.

Given the current environment, we expect to see a slowdown in purchasing volume across the mortgage market. However, given the overall low level of rates, we are seeing a significant increase in mortgage finance volumes which will result in lower persistency across our insurance portfolio.

The impact of the pandemic including federal, state and local requirements that have been put in place has had a major effect on many industries and businesses and their employees, resulting in a dramatic increase in unemployment rates.

With the combination of increased unemployment and the mortgage relief opportunity provided by the CARES Act mortgage forbearance programs, we expect industry-wide mortgage defaults to increase significantly during the second quarter and in the future periods. These forbearance programs are designed to support borrowers during this temporary hardship, help them remain in their homes, which is clearly a positive for our company and our industry.

While entering these forbearance programs will not impact the borrower's credit. Any loan that has missed two payments technically constitutes a default in our portfolio regardless of whether those payments are missed because of forbearance. Therefore, we'll see an increased number of reported mortgage defaults in our insured portfolio, which will drive an increase of PMIERs capital to be held against those loans. I will address PMIERs capital in more detail shortly.

Given that we are early in the cycle, it's important to remember that the absolute level, timing and duration of those defaults are difficult to predict. I believe it is very important to highlight that this economic crisis was led by a global health crisis. The important point is that unlike the last financial crisis, which was led by housing, we entered this economic downturn with a strong and healthy housing market in terms of demand, supply, home values and mortgage underwriting and servicing standards. In addition, we believe that many borrowers are in a more sustainable home ownership position during the cycle where they have built up significant equity in their home. We expect that this will better insulate the mortgage insurance industry from claims and ultimate losses.

In response to the COVID-19 environment, we have taken several actions related to our business operations. Our highest priority has been on protecting our people and managing the continuity of our business operations. As I mentioned, we activated our business continuity program in mid-March to enable our employees to safely work virtually from home, which has gone smoothly. And it's important to note that we made this transition very quickly at the time when our businesses are extremely busy, a remarkable team effort.

From a customer and business partner perspective, we've been focused on staying connected through virtual tools – phone calls or Web meetings – rather than in-person, which has proven to be highly effective and very successful.

From an MI pricing and risk management perspective, we've increased our risk-based pricing and have made adjustments to our underwriting guidelines to account for the increased risk and uncertainty in the market today. Based on the dynamic nature of our radar rates pricing model, we were able to move quickly to align our pricing to the new environment and support our customers with competitive rates despite these sudden and unexpected changes in our business environment.

We've evaluated and aligned our business with the temporary underwriting and servicing guidelines announced by the GSEs, which we believe are appropriate and constructive. We remain highly focused on meeting our strong relationship with the servicers of our insured loans. We are closely monitoring how they navigate through the dramatic increase in defaults and prepare to resolve these defaults through various investor and borrower workout models.

In addition to the regular communication and dialogue that we maintained with the GSEs and servicers, we are also working on enhanced reporting and benchmarking related to the most recent forbearance programs. Given the current environment, there is clearly uncertainty related to the forecast for mortgage industry activity and volume. But based on what we know today, including a strong NIW commitment pipeline, we expect to write new MI business in 2020 of more than $60 billion.

At our Real Estate businesses, we are continually refining our service delivery models to adjust to the social distancing requirements and including how property valuations are completed and how real estate transactions are closed.

Our ability to leverage our data, analytics and technology platforms, combined with our team's ability to quickly respond innovatively, have been well received by our customers. Overall, I'm proud to say our businesses are operating well with strong momentum during this unprecedented time. Given today's macro environment and the expected increase in defaulted loans, our capital position is critical.

At Radian, we have remained focused on optimizing our capital position, enhancing our return on capital and increasing our financial flexibility in order to address any volatility in market and economic cycles. As the economic impact of COVID-19 became more uncertain, we suspended our share repurchase program as of March 19, At March 31, Radian Group maintained a strong capital position with $648 million of available liquidity.

We also have a $265.5 million credit facility, which we extended this month through January 2022. We are focused on a couple of key capital management factors and near-term increase in our PMIERs minimum required assets from growing COVID-19 forbearance defaults and estimating the longer term potential claims and losses that may ultimately result from these defaults.

The PMIERs capital requirements implemented after the financial crisis provide a capital structure built to withstand an extreme stress scenario.

With regards to our current PMIERs position, Radian Guaranty Available Assets under PMIERs were approximately $4.1 billion at March 31, resulting in a cushion of approximately $1.1 billion or 38% above our minimum required assets. I want to highlight that our minimum required assets were reduced by $1.6 billion at March 31 as a result of the 68% of Radian Guaranty 's primary mortgage insurance risk in-force that is subject to some form of risk distribution through the reinsurance and capital markets.

In evaluating our PMIERs minimum required assets, it's important to note that COVID-19 is treated under PMIERs as a FEMA-declared major disaster event. And therefore, the PMIERs capital charge for loans defaulting during this event, including those in a forbearance plan, is reduced by 70% in recognition that these defaults are expected to have a higher likelihood of curing following the event. To date, all states and the District of Columbia have been designated FEMA-declared major disaster areas, so there's capital reductions now being applied nationwide. You may read more about this criteria and our assumptions in our 10-Q, which was filed last evening and is available on our website.

Based on the most recent MBA survey, approximately 6% of GSE mortgages are in forbearance. We do expect a larger percentage of forbearance for loans that we insure where the LTV is 80% and above. Although the ultimate level of PMIERs capital requirements related to the COVID-19 forbearance defaults is difficult to predict, based on our current projections for our financial position as of June 30, 2020, we have the consolidated resources to support a default rate as of June 30, 2020 of up to approximately 25% of our estimated mortgage insurance portfolio. This is based on our PMIERs cushion and our resources available at our holding company as shown on webcast slide 19.

Turning to the estimation of potential claims and losses, it's important to remember that private mortgage insurers do not pay a claim till title to the property is transferred, primarily through foreclosure. Whether a default ultimately will result in a paid claim, it will depend upon a variety of factors, including the depth and breadth of the macroeconomic decline resulting from the COVID-19 pandemic and the potential positive impact of the government and investor programs put in place to support borrowers.

We believe that government programs [indiscernible] (00:14:32) to the CARES Act, including financial assistance through the taxpayer stimulus and increased unemployment benefits, mortgage forbearance programs and loss mitigation workout options, and the suspension of foreclosures and evictions, serve to align our industry to a common goal supporting borrowers to this temporary hardship and helping them remain in their homes.

Given that we expect a time line for developing losses and paying claims will span multiple years, we believe that our current capital resources, combined with the continued future financial contribution from our valuable insurance portfolio, positions us well. So, net-net, despite the risk and uncertainties posed by the COVID-19 pandemic, we believe that we are well-positioned to serve our role as a private mortgage insurer.

I always like to note that our industry is the only committed source of permanent private capital and has continued to consistently underwrite and support mortgage credit risk through the market cycles. We continue to write new business today, supporting our customers and their borrowers, and we expect to continue to write through the cycle, leveraging our strong risk management discipline to build economic value and achieve our targeted risk-adjusted returns.

The steps we have taken over the past few years to prepare for an economic downturn such as improving our debt maturity profile, leveraging economic value to construct our portfolio, proactively managing our customer relationships, implementing greater risk-based granularity into our pricing, and increasing our use of risk distribution strategies to lower the risk profile and financial volatility of our Mortgage Insurance portfolio combined with building our PMIERs cushion and Radian Group liquidity, have strengthened our capital and financial position and positioned us to navigate this unprecedented environment.

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

J. Franklin Hall

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

Thank you, Rick, and good morning, everyone. As Rick mentioned, our first quarter 2020 results were excellent and I am pleased to share more details on those results shortly. I will also touch on some of the potential risks to our future operating performance expected as a result of the COVID-19 pandemic at the end of my remarks. But it is important to note that our results for the first quarter were relatively unaffected by the impact of COVID-19.

As a reminder, given that the GAAP accounting standard for Mortgage Insurance establishes reserves only after a borrower has missed two loan payments, the financial impact from expected delinquencies associated with COVID-19 forbearance programs are likely to occur beginning in the second quarter.

So turning now to our first quarter results, I would like to highlight changes to our reporting segments as reflected in our release. These segment reporting changes aligned with the recent changes in personnel reporting lines, management oversight and branding following the sale of Clayton in January of this year. Reflecting these changes, we now have two reportable segments, mortgage and real estate. Among other changes, real estate. Among other changes, the historical results for Clayton have been removed and are now included in a separate all other category to aid in the analysis of trends for our two reportable segments. The segment information included in press release Exhibit E has been recast to this new structure for all periods presented.

Additional background on these changes can also be found in our press release. To recap our financial results issued yesterday evening, we reported GAAP net income of $140.5 million or $0.70 per diluted share for the first quarter of 2020 as compared to$0.79 per diluted share in the fourth quarter of 2019 and $0.78 per diluted share in the first quarter of 2019.

Adjusted diluted net operating income was $0.80 per share in the first quarter of 2020, a decrease of 7% from the fourth quarter of 2019 and an increase of 10% over the same quarter last year.

I'll now turn to the key drivers of our revenue. As Rick mentioned earlier, our new insurance written was $16.7 billion during the quarter compared to $20 billion last quarter and $10.9 billion in the first quarter of 2019. Direct monthly and other recurring premium policies were 81% of our new insurance written this quarter, a slight decrease from 82% for the fourth quarter of 2019 and 83% for the first quarter a year ago.

In total, borrower paid policies were 97% of our new business for the first quarter. Primary insurance enforced increased to $241.6 billion at the end of the quarter with year-over-year insurance enforced growth of 8% with year-over-year insurance in force growth of 8%. It is important to note that monthly premium insurance in force increased 11% year-over-year and has grown by approximately $33 billion over the past two years.

Given the current mortgage rate environment, changing industry forecast and the overall COVID-19 operating environment, it is expected that persistency will be more volatile in the near term and therefore difficult to predict that will likely decrease. Our 12-month persistency rate of 75.4% decreased from 78.2% in the prior quarter and 83.4% in the first quarter of 2019. A quarterly annualized persistency rate was 76.5% this quarter, an increase from 75% in the fourth quarter of 2019 and a decrease from 85.4% in the first quarter of 2019. The year-over-year declining quarterly annualized persistency is primarily driven by increased refinance activity observed in the quarter.

Moving now to our portfolio premium yield, our direct in force premium yield was 46.1 basis points this quarter compared to 47.1 basis points last quarter and 48.6 basis points in the first quarter of 2019. Our level of single premium policy cancellations accounted for 4 basis points of yield in the first quarter compared to 4.4 basis points in the prior quarter and 1.8 basis points in the same quarter a year ago.

As noted in previous quarters, we expect our in force portfolio yield to continue to decline as recent trends of lower persistency and higher levels of new insurance written contribute to a faster rate of turnover of our mortgage insurance portfolio, which accelerate mortgage insurance portfolio which accelerate this premium yield decline. The timing and magnitude of future portfolio yield changes will continue to depend on several factors including the volume, mix, and pricing of a new business relative to volume and mix of cancellations and prepayments in our portfolio.

With regard to our pricing on new business, we remain focused on maximizing economic value and generating attractive risk-adjusted returns in the mid-teens. These projected returns do not include the impact of insurance-linked notes but do incorporate the impact of our single premium quota share reinsurance program which is a forward commitment by our panel of re-insurers and is in place at the time of loan origination.

Radian Guaranty continued to execute its risk distribution strategy in the first quarter of 2020 by entering into the 2020 single-premium QSR program which covers the 2020 and 2021 vintages of single-premium production.

Net mortgage insurance premiums earned were $277.4 million in the first quarter of 2020 compared to $301.5 million in the fourth quarter of 2019 and $263.5 million in the first quarter of 2019. The decrease of 8% on a linked quarter basis is primarily attributable to a $17.4 million impact from the recognition of deferred initial premiums on monthly policies recognized in the fourth quarter of 2019.

Excluding the impact of the fourth quarter 2019 adjustment, our linked quarter decrease was approximately 2%. Our net premiums earned increased 5% compared to the first quarter of 2019, primarily attributable to the growth in our insurance in force as well as the increase in single premium policy cancellations.

Total real estate segment revenue was $28.6 million for the first quarter of 2020, representing a 6% increase compared to $27 million for the fourth quarter of 2019 and a 24% increase compared to $23 million from the first quarter of 2019. Our reported real estate adjusted EBITDA for the first quarter of 2020 was impacted by several immaterial transition-related expenses and recorded a loss of $365,000.

Our investment income this quarter of $41 million was down 1% from the prior quarter and 7% from the same quarter prior year due to lower investment yields, which were partially offset by higher balances in our investment portfolio. At quarter-end, the investment portfolio duration was approximately four years, consistent with the prior quarter.

Moving now to our loss provision and credit quality. As noted on slide 14, the provision for losses for the first quarter of 2020 includes positive development on prior-period defaults of $5.9 million, a decrease from favorable reserve development on prior-period defaults of $18.2 million recognized in the first quarter of 2019. The positive development in the first quarter of 2020 was driven by cures and other activity on foreclosures and other aged defaults.

As noted on slide 15, observed trends in claims submissions Observed trends in claim submissions and cures during the first quarter of 2020 were favorable in comparison to prior quarters. However, we did not make any material adjustments to our reserve assumptions during the period primarily due to uncertainty, the previous favorable trends would persist given the potential impact of the COVID-19 pandemic.

The default-to-claim assumption on new defaults remained at 7.5% during the first quarter of 2020, consistent with the fourth quarter of 2019. It is expected however that the impact of forbearance programs related to COVID-19 will materially change the reported delinquencies in the second quarter of 2020. And our default-to-claim rate assumptions on new defaults will be re-evaluated in the context of available information at that time.

Now, turning to expenses, other operating expenses were $69.1 million in the first quarter of 2020 compared to $80.9 million in the fourth quarter of 2019 and $78.8 million in the first quarter of 2019. The decrease in operating expenses on a linked quarter basis was primarily driven by lower incentive expense in this quarter relative to last quarter.

The decrease in expenses compared to the first quarter of 2019 were primarily driven by higher seating commissions due to single premium policy cancellations which reduce our expenses as well as a decrease in legal and other professional services expense.

Now moving to capital, for Radian Guaranty in January, we closed on our third insurance linked note transaction of approximately $488 million. This brings the total insurance length note issuance by Eagle Re to approximately $1.5 billion with remaining coverage outstanding of approximately $1.2 billion, covering originations from January 2017 to September 2019 for our monthly premium business.

In total, we have reduced Radian Guaranty's PMIERs capital requirements by $1.6 billion as of the first quarter 2020 by distributing risk through both the capital markets and third-party reinsurance execution as noted on press release exhibit L.

As a reminder, in the first quarter, we terminated our inter-company reinsurance agreement with Radian Reinsurance, resulting in a transfer of $6 billion of risk from Radian Reinsurance to Radian Guaranty along with a $465 million return of capital from Radian Reinsurance to Radian Group, and the transfer of $200 million of cash and marketable securities from Radian Group to Radian Guaranty in exchange for a surplus note. Following these steps, Radian Guaranty now holds all of our traditional mortgage insurance risks, and Radian Reinsurance exclusively holds our exposure to the GSE's credit risk transfer programs.

For Radian Group, as of March 31, 2020, we maintained $648 million of available liquidity. Total liquidity, which includes the company's $267.5 million unsecured revolving credit facility, was $916 million as of March 31, 2020. And just yesterday, we extended our $267.5 million credit facility by 15 months to January of 2022.

During the first quarter of 2020, Radian Group repurchased approximately 11 million shares of our common stock for approximately $226.3 million including commissions under the August 2019 share repurchase program. And during the quarter, we announced the suspension of our share repurchase program by canceling the 10b5-1 plan effective March 19, 2020. The current share repurchase authorization expires on August 31, 2021 and has purchase authority remaining of up to $199 million.

And now to the expected impact of COVID-19. The impact of COVID-19 on our operating results is expected to have both short-term and long-term impacts. We expect to experience a short-term impact over the next couple of quarters when we expect to see higher delinquencies driven by government-supported forbearance programs.

While we expect these programs to be beneficial in terms of ultimate losses, these delinquencies will trigger both an increase in the minimum required assets, factors of PMIERs, and for our GAAP financial statements through our initial estimate of the ultimate claim rates, which will drive higher provision expense and higher reserve levels.

The expected longer term impact for PMIERs will be driven by the overall number of delinquencies and how these delinquencies age or cure. The expected longer term impacts for our GAAP financials will depend on what our actual claims experience on COVID-19-based defaults will be relative to our second quarter and subsequent period reserve estimates. And as Rick mentioned earlier, actual claims could take years.

While PMIERs is frequently referred to as a capital framework, it is actually an asset-based framework that is calibrated to a significant stress scenario and has little or no impact on our GAAP financial statements, but rather focuses on the maintenance of sufficient high-quality assets to pay claims. Minimum required asset factors for both performing loans and delinquent loans are defined within PMIERs and are expressed as percentages of the risk held. As delinquent loans age through older delinquency or missed payment buckets, the minimum required asset factor increases. The highest percentage change in asset factor occurs in the initial delinquency bucket of two to three missed payments where the minimum required asset factor removes from an approximate 6% to 7% level for performing loans up to 55% for initial defaults.

In the FEMA-declared major disaster areas, this 55% asset factor is reduced by 70% to 16.5%, still a significant increase from the base 6% to 7%. So, as Rick mentioned, we expect to be able to absorb up to 25% of our portfolio in delinquent loans as of June 30, 2020 depending on the level of holding company resources we use. This is simply the application of the relevant PMIERs minimum required asset factor for our projected portfolio with escalating delinquencies at that time relative to our then projected excess of available assets over minimum required assets.

Generally speaking, minimum required assets can be reduced by reinsurance and other risk transfer and available assets can be increased by contributions from holding company to the operating company as well as from positive operating cash flows over time. Our GAAP financial statements are impacted by our own estimates of ultimate losses not the formulaic and [ph] static (00:33:30) factors of PMIERs. It is critical to understand this difference primarily because movements in PMIERs' minimum required assets may imply a different view of ultimate expected losses than our own.

It is also important to remember that our initial loss estimates will be based upon the best information we have at the time to estimate a default to claim rate. However, our initial estimates may be materially different from what ultimately rolls to claim. These estimates are updated in every reporting period and could cause material fluctuations in our provision expense in each period.

Despite the increased risks and uncertainties posed by the COVID-19 pandemic, the quality of our Mortgage Insurance portfolio and the steps we have taken in recent years to enhance our financial strength and flexibility have positioned us well for an economic downturn, and we believe will help us weather the macroeconomic stresses ahead.

Some of these industry and Radian-specific mitigants include maintaining over $900 million in total liquidity at our holding company and no debt maturities until October 2024. The risk-based capital framework of PMIERs has been fully implemented by all mortgage insurers and has increased to the available resources of the industry to withstand stress events.

At Radian Guaranty, we have $1.1 billion in the excess PMIERs available assets. We also have significant benefit from risk distribution transactions on more recent vintages, and our older vintages have benefited from significant home price appreciation providing another potential barrier to loss. Loan originations since the last financial crisis have been underwritten in a more disciplined environment driven in large part by the qualified mortgage loan requirements under the Dodd-Frank Act and are of much higher quality than those written during 2008 and prior. There have also been significant advancements in the risk-based pricing framework that has helped increase the flexibility of the mortgage insurance industry in recent years

The shift away from a predominantly rate card-based pricing model and the increase in black box and other pricing frameworks such as our RADAR Rates tool, provides a more dynamic pricing capability that allows for more frequent and targeted pricing changes throughout the mortgage insurance industry and the ability to respond to macroeconomic shifts more quickly. Because of this, we at Radian have been able to institute significant price increases in response to the greater risks and uncertainties to the macroeconomic environment resulting from the COVID-19 pandemic. And as Rick mentioned, there are policy changes occurring now and potentially in the future that will likely support keeping people in their homes and preventing foreclosure. And while these strategic and systemic defenses will not provide complete immunity to the expected upcoming negative effects to our results, we believe that we are much better positioned to absorb the impact of economic stress than in the global financial crisis.

I will now turn the call back over to Rick.

Richard G. Thornberry

Chief Executive Officer & Director, Radian Group Inc.

Before we take your questions, I'd like to remind you of a few items. The first quarter of 2020 was a very strong quarter for the company. We believe that we are well positioned to weather this negative economic environment resulting from the COVID-19 pandemic with strong PMIERs capital and Radian Group available liquidity, plus the unrecognized future value in our Insurance portfolio.

While the market has changed dramatically and our team is working currently remotely, we believe we have the resources and capabilities to continue to deliver our broad array of products and services to our customers and come of out of this environment in a strong position.

I also want to note that while we are managing our business in the new normal, we are also focused on making sure that we support our communities through thoughtful and high-impact charitable contribution programs, both as a company and in support of our employees.

Operator, we are ready to take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Mihir Bhatia from BoA.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Hi. Good morning and thanks for taking my questions. Hope everyone is staying safe and healthy. Just wanted to start with – on the forbearance loans and default claim rate assumptions. I understand it's probably too early to give specific numbers, but could you maybe just contrast the range that you see between maybe what you saw in the crisis on your prime loans and the crisis in terms of default claim versus what you see coming out of a natural disaster? Just to help us frame what a reasonable range of outcomes can be on that default claim.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. This is Derek. In terms of the crisis, it's a little hard to use that as a proxy, one, given the fact that that was a housing-led downturn, also fundamental home prices were significantly overvalued at that point; also the underwriting quality; and credit quality was much worse. So on those defaults, they roll at a much higher level.

I think that a better proxy is if you look at hurricane propensities to roll to claim after default. Those were significantly lower. And if you look at our experience with Harvey and Irma, you would see kind of a roll to claim rate more in that 2% range. So the question I don't think you would use the financial crisis as a probably a good proxy for a roll to claim, what you would look at is there's a bit of a combination of, I would say, a natural disaster induced. So you would see that as a bit of a proxy for a roll to claim. But as part of this, you also have real economic stress. But it's important to keep in mind that economic stress is on much better quality loans with better underwriting and also much more temporary in nature in terms of its dislocation from an economic perspective which would also push down the probability that those loans would ultimately roll to claims.

So that's why I think you'd looked at more above run-of-the-mill recession and also more of are disaster experience and a combination of those things that you use to get your ultimate, I would say roll to claim rate.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Understood. Now, that's helpful. Thank you. And then just another question, I was curious do you – are there any statistics that you can share around just borrow a level industry exposure that you may have just – clearly certain segments of the economy are more impacted. So I'm just trying to – as we think about recovery rates and how quickly the default-to-claim can come down just from your borrow [indiscernible] (00:40:57)?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. It's a little hard, I would say, give you a statistic. I think what we can see and I think we see some of this in the data, those who are applying for unemployment in the initial wave are probably more skewed towards income segments that would be less represented in terms of the mortgage borrower universe and less representative mortgage power universe and less representative in our portfolio. So, that makes it somewhat difficult to use traditional measures like unemployment and translate that into a default rate because it's skewed a bit away from our portfolio, same thing from an industry perspective.

It's more concentrated in sectors such as restaurants, leisure, and so things like that; also are going to be less represented. And that's important because the other thing we do is we take that into account in terms of our pricing. So, as we think about our pricing adjustments, what we're doing from a geographic perspective is increasing pricing more on a relative basis in those geos where they have more concentration in those sectors. So, I would say compared to probably history, I would say that the unemployment forbearance is probably – it's kind of pushed away from, I would say, our segment more so than has historically been the case.

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

A

And Mihir, this is Rick. If I might just add one comment to Derek's comment which he alluded which is really just trying to understand the split between renters and homeowners in that unemployment number and given Derek's characteristic of that group, we really are watching the rent roll rates as much as we are forbearance because from all the statistics we can see is this is hitting renters potentially pretty hard as well. So, again, more information to come and we all need more data. But I think it's something that we're watching very carefully as well.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch

Q

That is helpful. Thank you. And then just last question before I'll jump back in queue, but I had a question on the disaster relief, on the 70%, the 30% multiplier, if you will, the disaster relief capital charge discount. There's a line in your 10-Q about the GSE is potentially interpreting that less favorably. I'm just curious, what do you mean by that? I guess my understanding like when you look at the PMIERs [ph] it's there (00:43:24), so what is up for interpretation on that? Thank you.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. I think that in terms of the risk factors, some of it has to do with just the application of the haircut going forward. So to get a little bit technical here, the way it works is you essentially identify the loans that are given that initial haircut and you look at the event and you go 30 days before and 90 days after and that's your population. The one question is how long that multiplier continues to apply. And if you look at the PMIERs what you look at are FEMA-declared disaster areas that are subject or eligible for individual assistance.

Now, this is less significant a risk for us because at this point, about 90% of our risk is actually in FEMA-declared disaster areas eligible for individual assistance. And why that matters is to the extent it's in one of those areas and it's under a forbearance plan, then you get that haircut of 70% for as long as it continues in forbearance. So one question is what happens with that remaining 9% that's not in areas that are eligible for individual assistance?

So I would say that is probably, I would say, the risk around that right now. And you have some technical aspects such as, in this case, as opposed to a hurricane that has a point in time where you can give a date for the event, this is more of a rolling natural disaster. So where do you kind of take the event? Again, more kind of technical nuances, I think, in terms of the particulars within the PMIERs is what we're talking about at this point.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Okay. Just to clarify, so there isn't a risk that they would say, hey, I don't know, this 70%, this isn't what we meant when we said natural disaster like that would actually be – they'd have to make a change to PMIERs to say that. Like the best guess, it is safe to assume that it does apply because it's FEMA-designated and...

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Right. Yes. Pretty clear on the language. These are declared disaster. It's very clear which ones are subject or eligible for individual assistance. So it would have to be a fundamental change with respect to how they're approaching the PMIERs for that change to be made.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Understood. Thank you. I'll jump back in queue. Thank you.

Operator: And our next question comes from Bose George from KBW.

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

Q

Yes. Good morning. Just wanted to follow up again on capital. It looks like this year with the forbearance, good discount multiplier, you guys are very well-positioned obviously for a very high forbearance rate. Moving forward into next year once these forbearance are over, if there is an organic recession where delinquencies are very high, there could be a need for capital [indiscernible] (00:46:14). So I'm just curious how are you thinking about that? Are there thoughts to look at ways to potentially sort of have capital available if it's necessary in the future?

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

A

Sure. Thanks, Bose. This is Frank. Yeah. I think when it comes to the capital planning associated with the environment that we're in right now, we're going to continue to be flexible. We're going to continue to position our capital in a way where we can be nimble and address the situation as it evolves. And so that could be further utilization of reinsurance of ILNs. When you look at our available resources just as they sit today from a PMIERs standpoint, we have technically excess available resources of $2 billion, which is roughly 68% cushion for us right now. So, as this continues to develop, we'll respond accordingly and make sure that we are positioned well.

But, yeah, I think, fortunately, as Derek just went through, the haircut certainly helps. And I think we'll just have to see, even from our governmental policy standpoint, how things continue to evolve. I think there is just a general appreciation for the fact that they would like to have people stay in their homes. And so, if it's a foreclosure holiday or something like that, that continues and, of course, helps us out from an ultimate claim perspective. And so, we'll just see how all of these things align and operate on a go-forward basis. But the range of possibilities that we're looking at is vast, and we just want to make sure that we can look as far forward with the best information that we have available and make sure that we're well-positioned again to maintain the strength and flexibility that we've demonstrated over time.

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

Q

Okay. That makes sense. Thanks. And then, actually going back to the comments you've made about price increases, can you give us an idea of the magnitude of the increases? And also just in terms of the ROE that's essentially still targeting the same ROE but the higher prices just incorporate the higher risk now in terms of returns?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yes. This is Derek. And it's a good question. So, that is the right way to think about it. So, as we think about it from a pricing perspective, we're adjusting the pricing, factoring in the new economic environment and the expectation that we're going to have an increase certainly in delinquencies and we're going through a stress period. So, our attempt is to adjust pricing to kind of get back to that targeted return.

So, as a result, we adjusted prices significantly across the board. And then in certain segments, and you can think about this from a credit dimension perspective, you can think about it from a geographic dimension perspective, we increased the pricing relatively more or less based upon that view of our risk to kind of get back to that expected return we're looking to generate.

And what we found in the industry is based on the data we have, we think that our competitors have also increased pricing. I think some of our competitors have perhaps done it more targeted, a more targeted basis. Like I said, we targeted certain segments but we've instituted pricing increases across the board, I would say. So we continue to monitor that because, again, trying to get a sense as to where the competitive dynamics are. And again, we're always looking for opportunities where we can find spots to maximize the economic value we're generating on that new business. That's why it's very useful to have our new pricing tool, RADAR Rates, which is very dynamic, flexible. We can make those pricing changes on a targeted basis, makes it much easier to manage the portfolio and make kind of quick changes when economic conditions change.

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

Q

Okay. And [indiscernible] (00:50:23) significant, is that sort of over 20% or you don't want to be as precise about what that means?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

I think generally, you've been seeing price changes, I would say, just industry-wide ranging, I would say, anywhere from 10% to 50% increases depending upon – again, very dependent upon the credit sectors that people are trying to target. So I would say significant double-digit price increases we've been seeing.

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

Q

Okay. Great. Thanks, guys.

Operator: Your next question comes from Mackenzie Aron from Zelman.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Thanks. Good morning.

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

Good morning.

Mackenzie Aron
Analyst, Zelman & Associates
Q

Following up on the pricing changes. Can you also give us an insight into the underwriting changes that you've made? And I know there have been some product restrictions and any way to quantify what percent of volume that [indiscernible] (00:51:16) 2019 may no longer be eligible?

Derek V. Brummer
President-Mortgage, Radian Group Inc.
A

I think from a credit overlay perspective, we start underwriting investor loans, cash-out refis. Those were pretty small percentages I think in aggregate, those have been running at definitely less than 1% of the overall portfolio. I would say a lot of the underwriting changes again is trying to balance this new environment where there's certain difficulties posed such as verifying employment, income, assets. So, a lot of it has been kind of around that, so documentation requirements around that, shortening the length of time in which documents can need to be updated and things like that.

The other thing is just additional diligence around the underwriting side. Again, this new environment, there are certain things, underwriting activities you might traditionally do, for instance, on the appraisal side that make it more difficult. So, a lot of the changes have to do with making sure we're appropriately dealing with from a risk perspective. And I would say we're working closely on this with the GSE in terms of working with them. I think we've seen some changes in terms of their automated underwriting systems as well. I would say, overall, though, in terms of the portion of business we were doing that's no longer eligible, I don't think it's significant. But I think in terms of just the underwriting processes and taking out some of that tail risk, that's where we've seen a movement.

The other thing I would point out is just from an overall risk perspective and a risk-layering perspective. And if you look at that, that's a continuation of a trend we've really seen over the last, I would say, year and a half. If you look at the percentage of our business coming in with below 680 FICO, or greater than 95 LTV, greater than 45 DTI, that's significantly increased over the last year and perhaps even more importantly layered risk where we have a combination of those factors have dramatically decreased. So I would say a continuation, also important, is a very good position to be in in terms of the more recent books of business that might have benefited from less significant. Home price appreciation has been really amongst the highest credit quality books of businesses that we have ever underwritten.

Mackenzie Aron
Analyst, Zelman & Associates
Q

That's helpful. Thank you. And then switching gears, on the Real Estate Services segment, can you talk about the expectations around that business this year given the lower transaction, impairment and how we should be thinking about the contribution?

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

Thanks, Mackenzie. Yes. Happy to comment on it. I think we've hit the year running from a business point of view with the sale of Clayton and really kind of refocusing our business around the core set of real estate assets as we think of it, focus on growing our title valuation, asset management and just other real estate services but really largely focused around real estate transactions.

And I think we appointed Eric and Brian as the co-heads in that business so that segment and integrate it across each of these four product groups, our sales and operations and technology and marketing team. So we're as focused on, I would call it, in some of those groups, the monoline players that are either valuation-focused or title-focused. Our teams are focused on winning and developing a disruptive position in their respective marketplaces.

So we're not really – given some of the uncertainty in the marketplace, we're not at a point where we would provide guidance today. But I would say the momentum in those businesses is really very strong in light of some of the refinance activity valuation, title, we're seeing those businesses grow, right? And we would – hopefully, as we get a little bit further in the year and we see this environment sold out, we can give a little clear guidance. But the momentum is strong. The team has done a remarkable job. We, as I like to say, we threw them all out of the office in mid-March and so go do growing levels of volume across our title and valuation businesses and do it in a very new setting, and they've done remarkably well.

But I'd say we're seeing a great deal of receptivity from our MI clients. We're increasing the penetration of our MI clients across multiple products and growing the number of new clients. So, today, we think narrowing the focus on the highest value elements, as I said the past quarter after we sold the Clayton business, really focusing on the high-value opportunities where we think we can be a next-generation player in these markets that are very, very closely connected to our MI partnerships. So, it's – right now, I'm actually very pleased with the progress we're making and hope to have good news continuing good news to report in the future quarters.

Mackenzie Aron
Analyst, Zelman & Associates

Q

That's all. Thank you, Rick.

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

A

Thank you.

Operator: Our next question comes from Jack Micenko from SIG.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Hi. Good morning, everyone. Hey, Frank, I want to go back to your initial comments around the 25% DQ rate and PMIERs compliance. Does that, number one, assume the initial asset factor on the three-month delinquency or do you run that all the way out to the one year? And then second, where is that $2 billion available? You know what I'm taking about, you got thehe 68% cushion when you're layering all the debt and everything else that's untapped. How does that factored in that calculation as well?

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

A

Sure, Jack. The 25% number really is derived from an estimate at June 30. So if you think about where we stand right now with the delinquencies associated with forbearance programs by June 30, there are only in that missed two to three payment bucket. So for the most part. So that's probably the largest assumption in the calculation of that number.

And so that's what we're contemplating there. And then so the resources that we're attributing to the absorption of that number would be the full resources which are shown on slide 19, the estimated resources at June 30 as well. So it's important remember that's a June 30 number projected which would include the PMIERs cushion at the OpCo expected holding company available resources and the credit facility.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Okay. Thanks for that. And then, Rick, at the $60 billion number. Can you talk to us about what you're seeing in April on a volume basis maybe either year-over-year or split between purchase and refi – obviously refi. This is going to be a much, much bigger number than most people thought three or four months ago to kind of give you that confidence into the $60 billion full year number.

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

A

Yeah. Jack, thank you. We feel very good about the greater than, I think we said, more than $60 billion which is as we sit here today seeing, as I've mentioned in my script, a very strong new commitment pipeline, obviously, refinances are playing a bigger role in the marketplace. And as you can see just from purchases pulling back as listings are pulled out, we may see that bounce back through the year. But right now, we're assuming that there's going to be a growing percent of refinances and a reduced percentage of purchase loans in the overall market.

So, today, we are seeing increased activity across refinances. We have a strong committed pipeline. A part of the question, as we think about it, is what does the second half of the year look like, how does it develop, what happens as the government starts to have to fund all the stimulus, what happens to the interest rates, what's happens to the purchase market. So, I think we're taking a cautious view of the future if you will and thinking through how it will evolve. And I would say today based upon what we see, we feel very comfortable about the more than $60 billion. And hopefully at the end of the second quarter, Derek and I could give you a better view of how the year is shaping up. But we think it's a little too early to have a view of the second half of the year.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Okay, got it. Hey, Rick, just real quick one more if I could sneak one in on expenses and run rate. You had some volatility expense line that came in better this quarter. And I think there was some incentives and some one-timers. But as we go into this and everybody sort of activates their transition plan, there's some tax spend that probably goes up but then there's some offset, the sales forces in out entertaining and that sort of thing. How do we think about expense run rate through the balance of the year on a quarterly basis?

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

A

Sure. So, Jack, last quarter, we were sort of calibrating to a $70 million quarterly number after the sale of Clayton. I would tell you, it's probably too soon to tell what I'll call them the permanent impacts associated with the change in the landscape. So to the extent life does get back to normal, whatever that is, I would say that number's probably a good number to go with. But it really is just too early to tell right now and make any type of permanent adjustments.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Okay. Fair enough. Thanks, guys. Good luck.

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

A

Okay. Thank you.

Operator: Our next question comes from Mark DeVries from Barclays.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Yeah. Thanks. Just a follow-up question on the 25% default assumption. Frank, do you have a sense for how high the default rate can go without you having to distribute any of the excess resources at the holding company down to Radian Guaranty? Is it as simple as – since it sounds like that's about half of the available excess assets that it would be somewhere like in the 12% to 15% range.

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

A

Yeah. That actually is a good estimate for what that range is.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. And should we assume then you're just going to be hoarding [ph] tasks (01:02:35) at the holding company until you get a sense that those defaults have peaked out?

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

A

Mark, what I would describe our approach has historically been is making sure that we have positioned our cash throughout our legal entities in a way to preserve maximum flexibility. So we're certainly going to be mindful of the requirements for the operating company and we'll be responsive as we need to be there. But we're going to make sure – again, we do have maximum flexibility to holding company, but we are sensitive to that the PMIERs cushion, the OpCo as well. So, we'll see how that plays out over time as far as how that may get rebalanced in the context of new information and what the second quarter starts to shape up and look like. But that's generally how we have managed our resources just throughout the organization.

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

A

And Mark, this is Rick. I might just add to Frank's comments, one, as we released our 10-Q last night, we did get to provide great detail on the risk factors that kind of our views around the capital situation, so we have a chance to go back and take a peek at those. But I think the other part, I would say, is that we've intentionally held capital at Holdco from a capital planning point of view and to remain from – have a financial flexibility may be different than others.

And so, we've always thought of capital at Holdco as being flexible and obviously through this type of environment. So, how things develop will drive our actions as we go forward. So, we do look at capital on a consolidated basis and think through it at that level continuously.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Got it. And my next question maybe for Derek, are you able to discuss for us when you're pricing in this environment to mid-teens return what you guys are assuming in terms of [indiscernible] (01:04:51) rate and should we expect that that would be lower than you would expect to see on your existing book?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

I'm sorry. You cut out slightly there. Are we assuming what would be lower?

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

The ultimate default rate and claims rates on new insurance that you'll be writing today would be lower than what you would expect to see on your existing book.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. So the way to look at it when we're resetting price, so when we're writing the new business now, we're actually assuming in this scenario that you would have a bit higher default rates. So the way to think about it, when we're setting pricing, we're doing it on a simulation basis, right? So we're looking at multiple scenarios.

But as the economy – and this is an unusual situation where we kind of have telegraphed in front of us a recession. So in that case, when you think about the, let's say, expected or mean PAP in our simulation, that got relatively worse. So that's going to translate naturally into assumptions that you're going to have higher claim rates. And so you're adjusting pricing to essentially account for that.

In addition, having just higher claim rates, you're also assuming you're going to have just an increase in default rates which also factors in an increase in the amount of capital we have to hold against it. So you basically use those as inputs; and then your output, you basically solve for an appropriate price to get back to that return that you're looking for.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Understood. But any color you can provide on what you would assume today on those default rates and claim rates?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. I'm probably not going to go into a lot of details in that particular assumption. They're also very dynamic. I think the other thing to keep in mind, we're still early on in this so we're still gathering a lot of information particularly as we have the May payment dates coming up. So I would say we're constantly calibrating that and our pricing. So, we do that regularly. So, I give you my base case that's going to be, I would say, stale very quickly. And that's the best way to think about it when we dynamically price. We're constantly adjusting that. And it's – we're adjusting it. Obviously, there's more volatility around those adjustments in terms of our scenarios just given the nature of where we are because it's a bit unprecedented. It's not your run-of-the-mill recession.

So, trying to figure out, again we talked about this earlier, the unemployment rate, our modeling takes in account as big explanatory variables, obviously home price path unemployment, but even interpreting kind of those unemployment path where it's much bigger percentage that are applying for unemployment on a temporary basis. So, how quickly that snaps back is going to be important variables. And I would say we're constantly tweaking and updating our assumptions around that as well and then how that actually affects home prices as well.

Again, from a fundamental perspective, we think home prices, again, coming into this fundamentally is fairly valued. The supply/demand dynamics were very good. We didn't have a lot of speculative excess. So, we think that to the extent that there's pressure on home prices, we don't see a significant drop in our base case scenarios. But again at the margins, we're constantly adjusting that.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you.

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

A

I think, Mark, I would add that Derek and team have done an amazing job with RADAR Rates of being able to take those analytics real time into our pricing very, very quickly, which if you go back a year or so, two years ago, this industry would have labored over making pricing changes. Now, we can make them early very, very quickly and reflect the risk environment almost at the time it's occurring. So, what Derek's referring to gets applied real time in the marketplace

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Great. I appreciate all the color.

Operator: And our next question comes from Geoffrey Dunn from Dowling & Partners.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Thanks. Good morning.

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

A

Good morning.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Derek, I think you said earlier on maybe one way to think about this is a combination of hurricane considerations than a run-of-the-mill recession. So something like a Moody's S3. Did I catch that correctly?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. I think that is the right way to think about it. And it's hard to, I think, bifurcate those type of defaults, right? So you have to think about it in total. But that's right. And the way we see this playing out – at least the way I think of it is in the short term, it's probably more of a disaster especially in some of those early forbearances. And in a typical disaster, what happens is you have businesses turn off and they turn back on. This might be more long-dated compared to a hurricane disaster. So we think that's probably – that's a very big force within it. But again, just because of the fact that not all businesses are going to turn on and not all jobs are going to turn back on as you might see in a natural disaster, you are going to have kind of that, I would say, more of a typical recessionary impact as well.

The one thing, though, I would also keep in mind is the unprecedented government support because in a typical run-of-the-mill recession like an S3, you don't have things like expanded unemployment benefits in terms of those who are eligible, expanded unemployment benefits, checks being mailed out to people, PPP loans. So trying to factor that in. So even if you think about it as a run-of-the-mill recession, I think you also need to think about the government support which is going to end up putting downward pressure not to mention the fact that if you look at these loss mitigation workout options that the GSEs are putting in place, I think the most likely scenario for borrowers who find themselves in real difficulty being able to make up payments that they've missed because of forbearance, the most likely scenarios if they can't make those, those are put on at the end of the mortgage.

So especially in a situation like this where it's recognized that it's really driven by health issues and policy decision, there's a real effort to keep people in their homes, which is important for us since we don't pay claims until it actually goes through the foreclosure process. So that's why it's like a combination of things, a natural disaster, run-of-the-mill recession, but a run-of-the-mill recession that has a very significant government intervention that probably on scales that you've never seen.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. So what I wanted to get at is in the majority of the scenarios that Radian is running, do ILNs attach? They're typically – I mean, just a couple of years ago, I think the normalized loss assumption on pricing was 2%, 2.5% cumulative. I would just call it on average ILN attaching at 2.5%. So given your thought process on this in the various scenarios you're running, in the majority of cases, are you even attaching on ILNs?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

The expectation in most cases is we are not attaching on the ILNs. So – and I think you have some common scenarios out there, I mean, just to help since people use it as a frame of reference, for instance. If you're running Moody's S3, you're not going to see an attachment. Moody's S4, we do see some of the ILNs attach and some not attach, right? And that's going to matter. Obviously the newer ILNs because we are fortunate and issued one that covered our 2019, the first three quarters. In a scenario like that, an S3 (sic) [S4], you could see that attached in potentially a scenario like that.

But generally, I would say no those aren't attaching. Those are providing tail coverage. And in this scenario, we're seeing it outside of most reasonable scenarios.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

So, on a life of book basis, while near term could be painful, if you're not attaching ILN and you're not exceeding the 2.5% cumulative, it doesn't sound like your targeted returns are likely all that disrupted. Is that the right conclusion?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Again, I would say that there's a lot of uncertainty around it in terms of that economic path. But I do think the way to think about it is making a distinction which Frank talked a bit about, which is a short-term, I would say, PMIERs capital increase issue we have. Because as you have these delinquencies, you have to stack increased capital because PMIERs is quite pro-cyclical in that sense. But if you think about it over the long term and the probability that those go delinquent in curing and again, that natural disaster kind of scenario I talked about, you do see kind of this, I would say, front-loaded increase in delinquencies. So, you have an increase in PMIERs capital, and then you have incurred losses. But then that should be pretty front-loaded. And over the long term, again, I think that depending on the scenarios, that's why I think we feel pretty comfortable from the ultimate claim perspective and how this plays out over the long term.

But again, I would just caution there's obviously a lot of uncertainty around that because it's based upon the information we have at this point in time and that's going to be heavily dependent upon what happens, not only from an economic perspective, but what's happening from a health perspective and how quickly states get back up online and how long they stay online.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay, thanks. And then just a quick follow-up, I think the sense was at the end of last year that the penetration rate on refis was higher than we have been seeing previously as the speed of some of the originating and then refi was getting shorter. Is your sense that the refi activity we're seeing in 2020 is still seeing those more elevated refi penetration levels?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. I think that's safe to say because I think it's the same dynamic that we've talked about before, right, is because, again, rates – and as they continue to go lower, you're seeing some of those books of business that have – recent books of business that have a significant refi incentives. So, for instance, when we look at our books like the 2018 vintage, if you look at that, depending upon your assumption whether 75 or 100 basis points of kind of benefit you need, the majority of that has that incentive. So yeah, I think that phenomenon we talked about before continues and it will continue especially as you see these new historical low interest rates.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. Thank you.

Operator: And our next question comes from Chris Gamaitoni from Compass Point.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Thanks for taking my call. I'm not sure if this is for Derek or Frank. Typically in normal downturn, the delinquencies occur slowly and increase over time. And at least historically, provisions have been very dependent on the age or the amount of payments that they've missed. In this cycle, it seems like we're going to get a whole lot of delinquencies very quickly. And I guess my question is the way you're thinking about it is if we assume 100% of delinquency of forbearances coming the second quarter, are you trying to book the lifetime reserve there or are there still some aging concept of delinquency in future periods?

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

A

Yeah. This is Frank. It's a great question And that was part of what I was trying to address in the prepared remarks. The first part of that question about the timing of delinquencies, we're saying that it's likely to occur over the next couple of quarters. And it may take some time for borrowers to miss that second payment, so not sure on the timing of that.

And the other factor and Derek touched on this as well, which is the forbearance numbers themselves can be a little misleading potentially in that you can participate in a forbearance program but still be current on your payments. So that's something else to keep in mind. But at the time of that second missed payment, yes, we do need to make an estimate of what the ultimate claim rate will be on those new defaults. And Derek spoke to that early in the presentation about just the – as far as what that might look like and given our experience with natural disasters, etcetera. We're not expecting a rate higher than our current default to claim rate under default of 7.5%, but we'll have to wait and see what available information we have at the point in time when we do make those estimates, which we'll likely see a fairly significant ramp-up in the second quarter.

I don't know, Derek, if you'd add anything else.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

I think you covered it, Frank.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Okay.

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

A

Yeah, this is Rick. I might just add one other comment, which is I think just – you have to think about right now where we're at. We're very, very early in the cycle. And a Frank commented, there are people that are continuing to make their payment while they're in forbearance. We saw it in April 1. We'll see what May 1 and what June 1 do. So, the timing of all this is still early. But the interesting part is Frank covered the GAAP accounting this, as they present themselves, we reserve, right? And we don't have material IBNRs, so really those defaults have to present themselves and qualify for our reserves from a GAAP accounting point of view. So, the timing of this is still early to project. We would expect to see a dramatic increase in the second quarter just from the numbers obviously. But how that period extends and how it plays out is still early, guys. We're watching all the metrics and the numbers. Yeah.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Sure. I'm not asking you for your expectation of even what DTC is or how many forbearances. I'm just talking about the accounting. So...

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

A

Yeah.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

So, my point is, once a loan becomes delinquent or forbearance, would there be an additional reserve as those delinquencies age, meaning once you're in forbearance and you missed two payments, they have up to six months and I think automatic extension up to 12 months. As those get older, would you assume that the ultimate default-to-claim rate on those specific loans changes or because they're in a forbearance program stays the same as they get older until you see whether they cure or not?

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

A

Sure. So, a couple of technical refinements on what you said. Whether or not they're in a forbearance program doesn't impact the missed payments and the requirement under GAAP to establish the estimates of ultimate loss. But participating in a forbearance program and in having missed two payments will impact our expectation of what the ultimate loss will be. And so, that is a factor that [indiscernible] (01:20:37) comes into play. Now, the longer it stays delinquent, we're going to evaluate, are they still participating in the forbearance plan? What are the facts and circumstances around those delinquencies? What's the profile? What's the overall economic landscape, etcetera?

So it gets updated in each subsequent period and we'll make those adjustments in each period based on the information at that time. But I think maybe what you're looking for, unlike PMIERs, which has a very prescriptive after it misses its fourth payment, it now steps up to something else. Our reserving is not as prescriptive and it is based upon all available facts and circumstances at the time. And so we may adjust up or adjust down what we expect the ultimate loss may be, but that happens in each period. I hope that's helpful.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Frank, I was just going to add, just to be clear. I think in answer to your – the way to think about it, as the loans progressed, we would assign a higher default-to-claim rate for those that remain in default because the way to think about it, you set initial percentage and then a portion of them they cure; the remaining ones then you increase your default-to-claim rate as they age through time. That's the way to think of it.

[indiscernible] (01:22:11)

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

A

If we got it right upfront, then that all works its way to us as these things age, right? And wouldn't necessarily have a plus or minus to reserve. Obviously there's never that degree of perfection. But we start with an estimate and then we continue to refine and as we see what cures and what continues.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Sure. Hey, guys, my question just because this is so unique of, there's incentive or there's no call on someone to cure until six months. So whether they're three or four payments delinquent, [indiscernible] (01:22:46) the end it's just a different economic incentive per person than there typically is in this situation is why I'm so confused on how [indiscernible] (01:22:51).

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

A

That's a very interesting point. And we're watching the behavioral aspects of this very, very closely because like we said, people are going in forbearance plans and still making payments. And you got to watch the industry statistics because they're a little bit confusing. But as we get through May, we'll have a much better feel. But I think the social aspect of this is in how people – because ultimately, this is not a theme of forgiveness. This is a payment deferral. And how it comes back around – and you guys have read all the same articles, those have to be paid back at the end of forbearance, can it be deferred at all the different wonderful workout options, which are still are well defined today, but I think still evolving as to where they might be.

The behavior of people that don't want to get behind or have forbearance as part of [indiscernible] (01:23:42), I think you're going to start to see some of that separate. But again, we don't know. It's so early, and how people take advantage of this program over a month or two, 6 months, 12 months, still to be determined.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

All right. Well, thank you so much and thank you for dealing with my annoying mortgage accounting questions. I appreciate it.

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

A

Well, very good questions. Thank you.

Operator: And we will take our final question from Phil Stefano from Deutsche Bank.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thank you, guys, for extending the call for so long. Hopefully, it's just a couple [indiscernible] (01:24:18). Rick, in your prepared remarks, you had talked about the post – the sale of Clayton on the real estate side, the expectation to grow certain businesses such as title. Is that organic growth, inorganic growth, a mix of both? Strategically, over the long run, understanding the short run is much less for you, how should we think about what growth means?

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

A

Growth, we think of it as organic growth just – we feel like – if you think about the title business which many of you all know very well, it's an old legacy business driven by agency relationships. We're very, very focused on leveraging data and analytics and technology to drive. Our title business can leverage our MI relationships and our other market relationships to grow. So, Brian and Eric in our sales team and operations team have been very focused on onboarding new clients, right?

So, we're growing our business through the addition of new clients and the expansion of existing relationships, and we have our sales force – kind of our entire sales force focused on at an enterprise level looking at how we deepen relationships and expand relationships with our clients. Title and valuation are naturals right now. We may see REO asset management business come back within the cycle, SFR where we have a dominant market share in that business from a diligence perspective where we, I think, we have a strong foothold, and we see broader opportunities across technology and real estate services.

So, where we sit today, it's organic and we are head down focused on our customers. And the feedback I personally got and I share this off as feedback I personally get, Derek gets, Frank gets, we all get from our customers is they view us differently than just an MI. Does it make a difference on the MI decision? In some cases, yes; some cases, it's neutral. But from a relationship point of view, it can make the MI relationship combined with being able to serve them in a broader way. I think it provides us an opportunity to grow businesses organically.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. Okay. Thank you. And, Derek, in response to an earlier question, I got the impression and please correct me if I misheard you, but it felt like 9% of the business was outside of the potential haircut for the FEMA-disaster area. What exactly is that 9% if I understood that correctly? But in my mind, forbearance is widespread in every state of FEMA-disaster areas. So, what falls out?

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. So, when I was distinguishing, so 100% actually in those areas are given a haircut day one. So, what I was getting into is, as you progressed through time, so the distinction being is once you're beyond this initial 120 days under PMIERs after the initial update, the way it's drafted in order to continue to get that haircut, you have to be subject to a forbearance plan, and you have to be in a state or area that's eligible for individual assistance. And, right now...

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Got it.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Right. So, that's all I meant. And that's kind of – when we talked about the PMIERs amendment, that's one of the kind of those open points, I would say, PMIERs can really contemplate this. It really should be 100% of all those forbearance loans. So, more of a technicality I think in the PMIERs that we're trying to address.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

No, perfect. That makes sense. Thanks to the clarification there and hope you guys continue to be well.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Thank you.

Operator: And I will turn it over to CEO, Rick Thornberry for final remarks.

Richard G. Thornberry

Chief Executive Officer & Director, Radian Group Inc.

Thank you. And I want to thank everyone for participating in our first time ever virtual call. Derek, Frank, and John, and I are all sitting in very different places in this country right now. And our team pulled off, I think, a very successful environment. I also want to wish you all and your families, I hope everyone is staying healthy and stays well given these challenging times. Then I want to compliment our employees on just a phenomenal job.

As I mentioned earlier, we asked everybody to leave their offices very quickly and go work from home. Everything was ready. They've done an amazing job. Our customers have commented often about it. So I think with that, we look forward to continuing to have discussions as this environment plays out and look forward to talking to you all soon. Thank you for joining the call today and stay well.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.