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RDN - Radian Group Inc. at KBW Mortgage Finance Conference

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PRESENTATION

Bose George - *Keefe, Bruyette & Woods - Analyst*

Next up we have Radian, one of the largest mortgage insurers in the country. From Radian we have Bob Quint, the CFO; and Emily Riley, Senior Vice President of Investor Relations. And I will hand it over first to Emily before I jump into Q&A.

Emily Riley - *Radian Group Inc. - SVP of IR*

So I get the best part of today -- I get to read the disclaimer before we get started. So we've begun confidential discussions with the FHFA and Fannie Mae and Freddie Mac regarding revisions to mortgage insurance eligibility standards, and we'll have no further comment on the topic until they are made public.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Unfortunately, there go half of my questions. Let me just ask the audience -- what do you think? (laughter)

Let me just start with a couple of questions on the core mortgage business. Can you just talk about where the mortgage insurance share for you guys was in the first quarter? Where you see that trending over time?

Bob Quint - *Radian Group Inc. - EVP and CFO*

So Radian -- I will just go back several years. Radian historically had a share kind of in the midteens, and we made a big effort during the downturn to add sales force and expand our customer base. We actually came out of the downturn with the largest share in the industry at 28% to 29%.

So we were very fortunate in that some of the more recent years of writing which will be the most profitable, we were writing a significant share of the industry. Since then more capital has come into the industry. There have been some new players in the industry, and our share is down a little bit.

First quarter we think it was in the 24% range. And it's a very competitive MI environment, with seven players in the industry. But we're confident that we can maintain our share, and we are going to do everything we can to maintain a share of what is a very good environment right now.

Bose George - *Keefe, Bruyette & Woods - Analyst*

And then just on the pricing side, there was some pricing pressure towards the end of last year. Can you just talk about the pricing environment over the last few months?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes. The pricing environment -- despite the extreme competitiveness in the industry, the pricing environment has been pretty stable. So the general pricing has not changed. I think most of the MI players know that if there is a widespread price cut across the board, chances are there is going to be a matching of that, and no one will ultimately benefit from that. I think people understand that.

Our pricing is good now; it's certainly good for the risk we are writing. On the margin we have seen a little bit of targeted pricing movement in the lender-paid arena. But it's been very targeted, very few and far between, and certainly manageable. We're very happy with the pricing environment now and the stability that we've seen since the end of 2013.

Bose George - *Keefe, Bruyette & Woods - Analyst*

And then just in terms of the ROEs on the new business you are writing, can you just talk about where that is -- actually, both on the singles and on the monthly separately?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes. So the blended returns are in the midteens, and we are certainly pleased with that profile. And we use 18 to 1 risk-to-capital in order to produce these projected returns. We've been doing that for quite some time.

The single product is a discounted product, so the projected returns on the singles are going to be less than that. The projected returns on the monthlies is going to be a little bit more than that. But you have to remember, projected returns are just that -- they are projected based on expected market-based duration. And we've seen over the past several years that the actual duration can differ greatly from expected duration.

So we like and we've been saying consistently we'd like a mix of our business in -- something like an 80%/20% mix or a 75%/25% mix in terms of monthlies to singles is a good mix, because no one can project where interest rates are going and where durations are going. On a blended basis, that mid-teen ROE projection is solid. And we're happy with that.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Actually, in terms of the singles as a percentage of the overall market, do you know where that stands now? Has that come down as repos have declined?

Bob Quint - *Radian Group Inc. - EVP and CFO*

It has definitely come down. It's definitely come down as a percentage of our business. Our business peaked in terms of singles at something like 40% a few years ago. Today we're down to about 27%.

Part of that is the mix shift of purchased refis as well as our de-emphasis a little bit of the single product. So as the purchase market becomes an even greater component of the market, we should see the singles component come down even further.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Good. With the recent declines we've had in interest rates, have you -- in terms of new interactions with lenders, etc., is there any pickup in new insurance written as a result of that? Or is it still -- seems pretty quiet?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Well, we reported this morning an increase in new insurance written for the month of May to just about $3 billion, which is up from prior months. So we are seeing a pickup.

Now, is that interest rate related? Probably not. It's probably more seasonal. Interest rates are low, regardless. On the margin, a minor change in interest rates shouldn't change the purchase market that much.

But I think the important thing we're seeing is a pickup in volume. We expect the second half of the year to be stronger in terms of volume, and that will be led by the purchase market.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Great. Let me switch to Clayton and just ask a few questions on that. Can you just talk about the potential synergies there relative to your core business?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Sure. For those who don't know, we announced recently the future acquisition of Clayton Holdings. That acquisition should be completed sometime this summer.

Clayton is a mortgage service provider across the spectrum. So they are providing all kinds of mortgage services to mortgage originators, mortgage servicers, mortgage investors, government agencies. So they really play all over the mortgage world. It's a very, very strong fit with Radian, which is a mortgage credit risk provider.

So if we think about the risk of the mortgage business, mortgage insurance covers the creditor's side. Clayton covers the operational risk side. It covers the compliance and the regulatory risk side.

So it will really transform Radian to a full risk provider or risk mitigator to the mortgage business in its entirety. The synergies are plentiful, significant.

I think our biggest question today is going to be where to prioritize in focusing the business, and how to take advantage early and often after the acquisition has been completed. Certainly going to our plentiful number of Radian MI customers with the Clayton product, suite of products, will be a big one; and using Clayton to expand the services that we provide to our customers.

That's a huge synergy and a huge opportunity for Radian to take advantage of that. As well, Radian buys outside services that Clayton also provides. Clayton has a full array of underwriting services and underwriters that can help Radian perform its business better.

There are numerous opportunities to take advantage. We think the fit within Radian is very, very strong. Clayton is a successful business on its own and has been a strong performer on its own, but fitting it with Radian and combining it with Radian gives it many more opportunities. And we're going to do our best to take advantage of that.

The other thing about Clayton that is a little bit different from the core Radian businesses is Clayton is a fee-based business; it's a service provider; and it's an unregulated source of cash flow for our holding Company. The rest of Radian's businesses are insurance companies that are much more heavily regulated.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Can we just check if there are any questions from the audience?

Unidentified Audience Member

Just want to switch gears to the insurance side of the equation in terms of capital management. I guess, number one, do you still see increased broad access availability?

And number two, does that extend down the spectrum with regard to your legacy?

Bose George - *Keefe, Bruyette & Woods - Analyst*

Would you mind repeating the question?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes. So the question is relating to the insurance, and are there plentiful reinsurance opportunities for us? And if so, does that extend beyond the new book of business or the newer higher-credit-quality book of business into the legacy book which we have? Even though it's a smaller part of our business, we still have legacy risk.

And the answer is really yes, across the board. The reinsurance opportunities seem to be plentiful. There is capital in the reinsurance market. And the MIs, including Radian, have used reinsurance and expect to continue to be able to use reinsurance if we so desire. So as an opportunity to manage capital, manage risk, do other things within our market, reinsurance is clearly something we expect to be able to have the opportunity to do.

And in terms of which business -- whereas a couple of years ago, you couldn't have even asked for reinsurers to think about reinsuring the legacy book, I think that opportunity is much greater today. Certainly not a certainty, but there is likely an opportunity to reinsure our whole book of business, if that's what we want to do and if the terms are acceptable.

Unidentified Audience Member

Are there any limits to what percentage of your overall cash flow to capital could come from reinsurance?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Not really. Certainly none today. So we could reinsure a big part of our risk as long as the reinsurance qualifies. There are a lot of rules around qualifying reinsurance; qualifying the reinsurer; if the reinsurer is domiciled in your state or not. If not, how do you have to structure the reinsurance?

So, clearly, there are a lot of rules and regulations regarding the reinsurance. But as far as I know, there's no limitations on how much we can reinsure at this time. Might there be, down the road? Certainly, there could be.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Actually, let me just switch to a regulatory question. The FHFA came out with a new scorecard a couple weeks ago, and I was just curious what your thoughts are about what they've said on credit availability and how it could potentially impact your market?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes. So everything that was talked about with regard to the FHFA scorecard seems to be either neutral or positive to the MI industry, which is obviously a very good thing. Certainly, more access to creditworthy borrowers to available credit is perfectly aligned with what we do. We provide credit risk protection on high-LTV mortgages, and that is totally aligned.

So to the extent that the market is open to more borrowers -- creditworthy borrowers that don't have access today, that's our market. And we play in that market, and that's a really good thing.

To the extent that the FHFA has a mandate to reduce risk to the government via risk share, that's another item that plays right into our strength, which is we are private and we take credit risk. So we want that exposure. Of course we want it prudently; of course we want it priced appropriately to produce the proper returns for us. But that can be done conceivably in a variety of ways, whether it be on lower-LTV loans, or to a greater extent, on the exposure that the GSEs are currently taking.

That produces an opportunity for the MI industry, so that's another very good thing. With regard to -- for certainty of coverage, clarity of coverage, making sure that the coverage that we provided there has been addressed via the new master policy that the MI industry has worked collaboratively with on the FHFA and the GSEs on.

When that is implemented, which is sometime later this year, the clarity with which our coverage is there and will be there, and with which we will pay claims, will be a lot stronger. There will be less gray and more definitive terms. So that is going to also help in terms of the FHFA desire to have that clarity.

The last thing we talked about was the futurization platform, potentially. I think it's certainly not a negative for our industry and our business, but shouldn't be much of a change. We currently provide almost all of our insurance to the GSEs today. And that shouldn't change.

Bose George - *Keefe, Bruyette & Woods - Analyst*

There's been some discussion about potentially loan level price adjustments being reduced and maybe offset by guaranty fees. Do you have any thoughts on how that could play out?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes. The LLPA and the guaranty fees play into our share, meaning the GSE/MI share of the low down payment industry versus the FHA. So to the extent the execution has changed as more favorable for a GSE loan, that's a positive. And that would enable the MI industry, the private mortgage industry, to regain more share from the FHA. So certainly that's a positive.

You have to then look behind that, and look at the numbers, and how that changes execution. So the fees that are charged by the GSEs, if they are lowered, will more business move toward conventional loan than FHA loans? Could certainly that happen, and that would be bigger market for us. That would be a good thing.

But it's all about sort of the numbers and the execution, how that will actually play out. It's too early to make sort of a proclamation about how that's going to play out. But again, the initial discussions; and Director Watt, in terms of his speech at the Brookings Institute -- all of that seems to play well and be positive for the MI industry.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Let me just check if there are any questions from the audience.

Unidentified Audience Member

If I could go back to Clayton for a minute, does the acquisition bring you in line with some of the services your peers are offering? Or do you leapfrog them in bundled services for buyers of MI?

Bob Quint - *Radian Group Inc. - EVP and CFO*

As far as I know, we don't have competitors that own service companies like Clayton. So this is unique; it will be unique. A lot of our customers are the same, and a lot of the people that we deal with are the same. So there's a conformity there, but I don't know where the competition has comparable services to Clayton within their service provision.

Unidentified Audience Member

Do you anticipate new bundled MI services, or is it just too broad and too different products in two stages of mortgage insurance?

Bob Quint - *Radian Group Inc. - EVP and CFO*

It would be more the latter. Bundling is really not -- the objective is to use our customer base. And Clayton will be standing on its own, independently, with its servers at an arm's-length price, providing what is -- you know, in a lot of parts of the mortgage industry today, services that are in demand. Real estate services, compliance services, servicer oversight, due diligence. Things that are being requested, but it's not a vision, bottom line.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Any other questions?

Unidentified Audience Member

Could you talk about the revenue mix that's at Clayton? And then what you are thinking about your growth for the servicer segment, especially on the private-label securitization steps?

Bob Quint - *Radian Group Inc. - EVP and CFO*

So today -- so they've got three main segments. One is the due diligence and underwriting, and that would be the one that would really be positioned well for the return of the private-label market.

The second is surveillance. Historically, that was the service for surveillance done on behalf of investors in the securitization. Today that's more compliance work, some servicer oversight and review, that kind of thing.

And then the third segment is the real estate services and component services. Rental securitization services. Today all three of those are producing similar levels of revenue, so they are kind of equal. That could change depending on how the market changes.

Clearly, the first one, the due diligence, will change when the private-label market comes back. It could become a much, much greater component of the total. Surveillance has a very good future, because compliance and regulation, and servicer oversight, and servicer regulatory environment is very strict right now and very relevant right now. So the opportunities there are very strong.

On the real estate side, there are certain parts of the business that -- you know, the REO, the short sale, that stuff -- because the inventory of REOs is shrinking, that part of the business is not growing. However, the rental securitization market has been a big area of growth for them.

So I think it's really going to depend on how the market moves. But we see good areas of opportunity for all of the different segments, and I think we are positioned well no matter what happens and when it happens.

One of the things with regard to private label securitization -- I think most people believe that market will return. Today it's virtually anemic compared to where it's been.

But we can have the patience to wait. It might be a year, it might be two years, it might be three years before the necessary talents are in the marketplace return that market to any semblance of prominence.

So we'll wait. And they still have a good business today, even though that's not a part of it. So we're very, very happy with the Clayton acquisition. And we believe -- we view it as a -- the downside is low because it's a strong, successful business today. And the upside is really very, very good.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Let me switch to FHA. Where you think do you think the split between private mortgage insurance and FHA will trend? And also, if you could just comment about -- what percentage of the FHA book do you think gets a better execution now on the private MI side?

Bob Quint - *Radian Group Inc. - EVP and CFO*

So in terms of the split between private MI and FHA, I think we're still in the camp that it's about two-thirds, one-third, ideally. We can do -- we, the MI industry -- can do about two-thirds. Some people will say even up to 70% or so, maybe even 75% at the most.

So I think that's kind of the level that we can get to. And we were on the way towards getting there, and that momentum shift toward the MI industry has been stalled a little bit in the first quarter. We still think it will get there. It may -- we need some catalysts in terms of pricing changes or some of the stuff we were just talking about before in terms of LLPA, etc., to move the needle a little bit.

I think that would certainly help. If not, it will probably take a little bit longer than we thought it would take. We may have thought we would be there by the beginning of 2015. It looks today like we are probably not on the trajectory to get there by then.

But there's still -- you know, the borrower payment is still lower for a lot of what the FHA is still doing. I would say down to 680, the MI is a better execution for the borrower. The monthly payment is lower. That doesn't mean it's a better execution for the lender, but the borrower payment is lower.

And we're selling that very heavily through training, as are our MI competition. And we think that will make headway over time. But certainly, some of the stuff in terms of pricing, that could change and become more of a catalyst -- can accelerate that shift.

Bose George - *Keefe, Bruyette & Woods - Analyst*

And in terms of lender behavior, do you feel like part of the issue is just lenders got used to doing FHAs; it just takes time for them to shift out and do more MI? Or do you think the economic incentive to the lender is part of it, as well?

Bob Quint - *Radian Group Inc. - EVP and CFO*

I think both are part of it. The being used to doing business with the FHA is part of it. The system integration, having one -- you know, if you are doing conventional loan, chances are you don't have one MI provider. You have two or three or four.

Even though we're similar in a lot of ways, there are differences. So operationally it's an adjustment to be doing business with the MIs. So that's part of it.

And then the execution of an FHA-insured loan -- that's also part of it. So there are several reasons. The big reason that we sell is: it's better for the borrower. It's a better deal for the borrower. And that is clearly a big deal when it comes to consumer protection and things like that.

Bose George - *Keefe, Bruyette & Woods - Analyst*

FHA recently rolled out a program -- the HUD program for borrowers who receive counseling, they get a rebate. Do you think that's going to be meaningful in terms of areas that could overlap with you? Or do you think it will be kind of further down on the FICO spectrum?

Bob Quint - *Radian Group Inc. - EVP and CFO*

It will be a little bit further down -- is it below 680? So it's below 680. We play in that arena, but it's not a big place. We play -- it's part of the place that we can recover more business, so it might slow down the recovery from the FHA. It's probably not going to impact what we're doing today very much. And I think -- you know, we've run the numbers, and on the margin it helps the FHA execution, but not materially.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Any questions? There is one over there.

Unidentified Audience Member

Can you tell me when we should expect or that you expect them to declare it a reality -- capital rules? And the various attributes you all have had to meet capital requirements for (inaudible)?

Bob Quint - *Radian Group Inc. - EVP and CFO*

So with regard to when it's going to happen, all we're really saying is that we're engaging with them currently, and they will be made public at some time, and we will all see them. But the timing of which we are not talking about.

With regard to how we can deal with more stringent capital rules, if that's the way they come out: these are the same things we've talked about pretty consistently for the last couple of years. The holding Company funds are certainly a very strong asset for us. At quarter end it was about $615 million.

It's more than that today, because we've raised capital to fund the Clayton acquisition in excess of what we need to cover that and to repay our 2015 debt. So we are going to have on the order of $800 million of holding Company capital cash liquidity. That's a big number and a big deal for us.

Reinsurance -- we talked about reinsurance just before in this meeting. Reinsurance is an opportunity for the MI industry and for Radian, if need be -- we have used it in the past to manage our capital, and we think we could use it in the future.

Time is another thing we've talked about in terms of there could be an implementation period, and over time, might that implementation period give us time to generate internal capital? We have talked about that. And external capital is always an option. It might be the most expensive option, and not our first choice, but it's an option to have out there. It's good to know.

So in terms of tools that Radian has, I think they are plentiful. The magnitude a strong. We have requested an extraordinary dividend from the state of New York, and we'll find out about that at some point. And we'll make that public when we do. That's an area that monetizing the financial guaranty business is something we've talked about for quite some time.

There's nothing really new other than the opportunities are strong and plentiful, and we feel good about our position. And in terms of the timing of eligibility, we'll all see that when it comes out.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay. Great. Thanks. Could you make it a real quick one?

Unidentified Audience Member

Is it something where once the public comment or the public release of the requirements come out, that you would actually respond with more detail about different steps that you would claim to use? Or do we need to get all the way through the public comment period and everything else before you would be willing to actually start to show the market how much cash, how much reinsurance, etc.?

Bob Quint - *Radian Group Inc. - EVP and CFO*

We really can't say anything about that now, other than we can talk about the tools we have today, if necessary. But in terms of how, when any reaction is going to be, we really can't talk about it.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay. Great. That's all we have time for. Thank you.

Bob Quint - *Radian Group Inc. - EVP and CFO*

Okay. Thanks very much.
