RADIAN GROUP INC
Form 10-Q
August 09, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 1-11356

Radian Group Inc.
(Exact name of registrant as specified in its charter)

Delaware	23-2691170
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1601 Market Street, Philadelphia, PA	19103
(Address of principal executive offices)	(Zip Code)

(215) 231-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 173,090,665 shares of common stock, $0.001 par value per share, outstanding on August 1, 2013.

Radian Group Inc.
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Forward Looking Statements—Safe Harbor Provisions

All statements in this report that address events, developments or results that we expect or anticipate may occur in the future are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1934 and the United States ("U.S.") Private Securities Litigation Reform Act of 1995. In most cases, forward-looking statements may be identified by words such as "anticipate," "may," "will," "could," "should," "would," "expect," "intend," "plan," "goal," "contemplate," "believe," "estimate," "predict," "project," "potential," "continue," or other variations on these words and other similar expressions. These statements, which may include, without limitation, projections regarding our future performance and financial condition, are made on the basis of management's current views and assumptions with respect to future events. Any forward-looking statement is not a guarantee of future performance and actual results could differ materially from those contained in the forward-looking statement. These statements speak only as of the date they were made, and we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. We operate in a changing environment. New risks emerge from time to time and it is not possible for us to predict all risks that may affect us. The forward-looking statements, as well as our prospects as a whole, are subject to risks and uncertainties that could cause actual results to differ materially from those set forth in the forward-looking statements including:

- changes in general economic and political conditions, including high unemployment rates and weakness in the U.S. housing and mortgage credit markets, a significant downturn in the U.S. or global economies, a lack of meaningful liquidity in the capital or credit markets, changes or volatility in interest rates or consumer confidence and changes in credit spreads, each of which may be accelerated or intensified by, among other things, legislative activity or inactivity or actual or threatened downgrades of U.S. credit ratings;
- changes in the way customers, investors, regulators or legislators perceive the strength of private mortgage insurers or financial guaranty providers, in particular in light of the fact that certain of our former competitors have ceased writing new insurance business and have been placed under supervision or receivership by insurance regulators;
- catastrophic events or economic changes in geographic regions where our mortgage insurance exposure is more concentrated or where we have financial guaranty exposure;
- our ability to maintain sufficient holding company liquidity to meet our short- and long-term liquidity needs;
- a reduction in, or prolonged period of depressed levels of, home mortgage originations due to reduced liquidity in the lending market, tighter underwriting standards, and general reduced housing demand in the U.S., which may be exacerbated by regulations impacting home mortgage originations, including requirements established under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act");
- our ability to maintain an adequate risk-to-capital position, minimum policyholder position and other surplus requirements for Radian Guaranty Inc. ("Radian Guaranty"), our principal mortgage insurance subsidiary, and an adequate minimum policyholder position and surplus for those insurance subsidiaries that provide reinsurance to Radian Guaranty;
- our ability to continue to effectively mitigate our mortgage insurance and financial guaranty losses;
- a more rapid than expected decrease in the current elevated levels of mortgage insurance rescissions and claim denials, which have reduced our paid losses and resulted in a significant reduction in our loss reserves, including a decrease in net rescissions or denials resulting from an increase in the number of successful challenges to previously rescinded policies or claim denials, or by the government-sponsored entities ("GSEs") intervening in or otherwise limiting our loss mitigation practices, including settlements of disputes regarding loss mitigation activities;

- the negative impact that our loss mitigation activities may have on our relationships with our customers and potential customers, including the potential loss of current or future business and the heightened risk of disputes and litigation;
- the need, in the event that we are unsuccessful in defending our loss mitigation activities, to increase our loss reserves for, and reassume risk on, rescinded or cancelled loans or denied claims, and to pay additional claims, including amounts previously curtailed;
- any disruption in the servicing of mortgages covered by our insurance policies, as well as poor servicer performance;
- adverse changes in the severity or frequency of losses associated with certain products that we formerly offered (and which remain in our insured portfolio) that are riskier than traditional mortgage insurance or financial guaranty insurance policies;
- a decrease in the persistency rates of our mortgage insurance policies, which has the effect of reducing our premium income on our monthly premium policies and could decrease the profitability of our mortgage insurance business;
- heightened competition for our mortgage insurance business from others such as the FHA, the U.S. Department of Veterans Affairs and other private mortgage insurers, including in particular, those that have been assigned higher ratings than we have, that may have access to greater amounts of capital than we do, that are less dependent on capital support from their subsidiaries than we are or that are new entrants to the industry, and therefore, are not burdened by legacy obligations;
- changes in requirements to remain an eligible insurer to the GSEs (which are expected to be released by the end of 2013 and implemented following a transition period), which may include more stringent risk-to-capital ratio requirements, higher capital requirements for loans insured prior to 2009 and a limitation on the amount of capital credit available for our subsidiaries, including capital attributable to our financial guaranty business;
- changes in the charters or business practices of, or rules or regulations applicable to, the GSEs;
- changes to the current system of housing finance, including the possibility of a new system in which private mortgage insurers are not required or their products are significantly limited in effect or scope;
- the effect of the Dodd-Frank Act on the financial services industry in general, and on our mortgage insurance and financial guaranty businesses in particular, including whether and to what extent loans with private mortgage insurance may be considered “qualified residential mortgages” for purposes of the Dodd-Frank Act securitization provisions;
- the application of existing federal or state laws and regulations, or changes in these laws and regulations or the way they are interpreted, including, without limitation: (i) the resolution of existing, or the possibility of additional, lawsuits or investigations (including in particular investigations and litigation relating to captive reinsurance arrangements under the Real Estate Settlement Practices Act of 1974); and (ii) legislative and regulatory changes (a) impacting the demand for private mortgage insurance, (b) limiting or restricting the products we may offer or increasing the amount of capital we are required to hold, (c) affecting the form in which we execute credit protection, or (d) otherwise impacting our existing businesses;
- the amount and timing of potential payments or adjustments associated with federal or other tax examinations, including adjustments proposed by the IRS resulting from the examination of our 2000 through 2007 tax years;
- the possibility that we may fail to estimate accurately the likelihood, magnitude and timing of losses in connection with establishing loss reserves for our mortgage insurance or financial guaranty businesses, or to estimate accurately the fair value amounts of derivative instruments in determining gains and losses on these instruments;

- volatility in our earnings caused by changes in the fair value of our assets and liabilities carried at fair value, including our derivative instruments, substantially all of our investment portfolio and certain of our long-term incentive compensation awards;
- our ability to realize some or all of the tax benefits associated with our gross deferred tax assets, which will depend on our ability to generate sufficient sustainable taxable income in future periods;
- changes in accounting principles generally accepted in the United States of America or statutory accounting principles, rules and guidance, or their interpretation; and
- legal and other limitations on amounts we may receive from our subsidiaries as dividends or through our tax- and expense-sharing arrangements with our subsidiaries.

For more information regarding these risks and uncertainties as well as certain additional risks that we face, you should refer to the Risk Factors detailed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2012, Item 1A of Part II of this Quarterly Report on Form 10-Q, and subsequent reports and registration statements filed from time to time with the U.S. Securities and Exchange Commission. We caution you not to place undue reliance on these forward-looking statements, which are current only as of the date on which we filed this report. We do not intend to, and we disclaim any duty or obligation to, update or revise any forward-looking statements made in this report to reflect new information or future events or for any other reason.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements. (Unaudited)

Radian Group Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share and per share amounts)	June 30, 2013	December 31, 2012
ASSETS		
Investments		
Fixed-maturities held to maturity—at amortized cost (fair value $420 and $676)	$427	$679
Fixed-maturities available for sale—at fair value (amortized cost $22,112 and $39,481)	21,880	40,696
Equity securities available for sale—at fair value (cost $78,106 and $88,260)	115,978	112,139
Trading securities—at fair value	3,722,975	4,094,622
Short-term investments—at fair value	1,332,090	777,532
Other invested assets (including variable interest entity (“VIE”) assets of $76,959 and $78,006)	117,961	126,750
Total investments	5,311,311	5,152,418
Cash	31,831	31,555
Restricted cash	23,491	24,226
Deferred policy acquisition costs	70,427	88,202
Accrued investment income	33,106	34,349
Accounts and notes receivable	85,703	87,519
Property and equipment, at cost (less accumulated depreciation of $100,181 and $98,909)	6,672	7,456
Derivative assets (including VIE derivative assets of $1,575 and $1,585)	9,379	13,609
Deferred income taxes, net	17,902	—
Reinsurance recoverables	65,750	89,204
Other assets (including VIE other assets of $96,125 and $99,337)	398,428	374,662
Total assets	$6,054,000	$5,903,200
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Unearned premiums	$712,706	$648,682
Reserve for losses and loss adjustment expenses (“LAE”)	2,716,490	3,149,936
Reserve for premium deficiency (“PDR”)	4,308	3,685
Long-term debt	913,952	663,571
VIE debt—at fair value	106,767	108,858
Derivative liabilities (including VIE derivative liabilities of $64,637 and $70,467)	350,576	266,873
Accounts payable and accrued expenses (including VIE accounts payable of $338 and $366)	346,335	325,270
Total liabilities	5,151,134	5,166,875
Commitments and Contingencies (Note 15)		
Stockholders’ equity		
Common stock: par value $.001 per share; 485,000,000 and 325,000,000 shares authorized at June 30, 2013 and December 31, 2012, respectively;190,565,887 and 151,131,173 shares issued at June 30, 2013 and December 31, 2012, respectively; 173,028,101 and 133,647,216 shares outstanding at June 30, 2013 and December 31, 2012, respectively	191	151
Treasury stock, at cost: 17,537,786 and 17,483,957 shares at June 30, 2013 and December 31, 2012, respectively	(892,810)	(892,094)
Additional paid-in capital	2,346,932	1,967,414
Retained deficit	(575,913)	(355,241)
Accumulated other comprehensive income	24,466	16,095

Total stockholders' equity	902,866	736,325
Total liabilities and stockholders' equity	$6,054,000	$5,903,200

See Notes to Unaudited Condensed Consolidated Financial Statements.

Radian Group Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share amounts)	2013	2012	2013	2012
Revenues:				
Premiums written—insurance:				
Direct	$269,827	$214,349	$515,294	$418,102
Assumed	(206)	(1,028)	(10,603)	(88,516)
Ceded	(18,392)	(31,389)	(46,277)	(69,976)
Net premiums written	251,229	181,932	458,414	259,610
(Increase) decrease in unearned premiums	(38,105)	4,847	(52,702)	94,534
Net premiums earned—insurance	213,124	186,779	405,712	354,144
Net investment income	27,615	30,877	54,488	65,590
Net (losses) gains on investments	(130,254)	26,419	(135,759)	93,878
Change in fair value of derivative instruments	86,535	(33,124)	(81,135)	(105,881)
Net gains (losses) on other financial instruments	1,188	(61,862)	(4,487)	(79,714)
Gain on sale of affiliate	—	7,708	—	7,708
Other income	2,234	1,395	4,005	2,835
Total revenues	200,442	158,192	242,824	338,560
Expenses:				
Provision for losses	140,291	210,868	272,350	477,022
Change in PDR	1,251	559	622	539
Policy acquisition costs	10,006	10,805	27,201	38,851
Other operating expenses	60,981	40,193	141,081	90,347
Interest expense	19,420	12,581	35,301	26,729
Total expenses	231,949	275,006	476,555	633,488
Equity in net (loss) income of affiliates	—	(2)	1	(13)
Pretax loss	(31,507)	(116,816)	(233,730)	(294,941)
Income tax provision (benefit)	1,665	2,443	(13,058)	(6,450)
Net loss	$(33,172)	$(119,259)	$(220,672)	$(288,491)
Basic net loss per share	$(0.19)	$(0.90)	$(1.40)	$(2.18)
Diluted net loss per share	$(0.19)	$(0.90)	$(1.40)	$(2.18)
Weighted-average number of common shares outstanding—basic	171,783	132,346	158,180	132,350
Weighted-average number of common and common equivalent shares outstanding—diluted	171,783	132,346	158,180	132,350
Dividends per share	$0.0025	$0.0025	$0.0050	$0.0050

See Notes to Unaudited Condensed Consolidated Financial Statements.

Radian Group Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2013	2012	2013	2012
Net loss	$(33,172)	$(119,259)	$(220,672)	$(288,491)
Other comprehensive income (loss), net of tax (see Note 11):				
Foreign currency translation adjustments:				
Unrealized foreign currency translation adjustment, net of tax	—	(8)	—	(8)
Less: Reclassification adjustment for net gains (losses) included in net income (loss), net of tax	—	—	—	—
Net foreign currency translation adjustment, net of tax	—	(8)	—	(8)
Unrealized gains (losses) on investments:				
Unrealized holding gains (losses) arising during the period, net of tax	1,480	(1,419)	8,946	15,795
Less: Reclassification adjustment for net gains (losses) included in net loss, net of tax	554	(741)	575	8,869
Net unrealized gains (losses) on investments, net of tax	926	(678)	8,371	6,926
Other comprehensive income (loss)	926	(686)	8,371	6,918
Comprehensive loss	$(32,246)	$(119,945)	$(212,301)	$(281,573)

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Radian Group Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON STOCKHOLDERS' EQUITY (UNAUDITED)

(In thousands)	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings/(Deficit)	Accumulated Other Comprehensive Income	Total
BALANCE, JANUARY 1, 2012	$151	$(892,052)	$1,966,565	$ 96,227	$ 11,400	$1,182,291
Net loss	—	—	—	(288,491)	—	(288,491)
Net foreign currency translation adjustment, net of tax	—	—	—	—	(8)	(8)
Net unrealized gain on investments, net of tax	—	—	—	—	6,926	6,926
Repurchases of common stock under incentive plans	—	(32)	—	—	—	(32)
Issuance of common stock under benefit plans	—	—	213	—	—	213
Amortization of restricted stock	—	—	1,101	—	—	1,101
Stock-based compensation expense	—	—	(446)	—	—	(446)
Dividends declared	—	—	(666)	—	—	(666)
BALANCE, JUNE 30, 2012	$151	$(892,084)	$1,966,767	$ (192,264)	$ 18,318	$900,888
BALANCE, JANUARY 1, 2013	$151	$(892,094)	$1,967,414	$ (355,241)	$ 16,095	$736,325
Net loss	—	—	—	(220,672)	—	(220,672)
Net unrealized gain on investments, net of tax	—	—	—	—	8,371	8,371
Repurchases of common stock under incentive plans	—	(716)	—	—	—	(716)
Issuance of common stock - stock offering	39	—	299,503	—	—	299,542
Issuance of common stock under benefit plans	—	—	298	—	—	298
Issuance of common stock under incentive plans	1	—	62	—	—	63
Amortization of restricted stock	—	—	3,375	—	—	3,375
Issuance of convertible debt (See Note 10)	—	—	77,026	—	—	77,026
Stock-based compensation expense	—	—	21	—	—	21
Dividends declared	—	—	(767)	—	—	(767)
BALANCE, JUNE 30, 2013	$191	$(892,810)	$2,346,932	$ (575,913)	$ 24,466	$902,866

See Notes to Unaudited Condensed Consolidated Financial Statements.

Radian Group Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	Six Months Ended June 30, 2013	2012
Cash flows used in operating activities	$(291,570)	$(361,899)
Cash flows from investing activities:		
Proceeds from sales of fixed-maturity investments available for sale	16,049	44,935
Proceeds from sales of equity securities available for sale	—	30,727
Proceeds from sales of trading securities	630,435	2,066,088
Proceeds from redemptions of fixed-maturity investments available for sale	2,415	3,738
Proceeds from redemptions of fixed-maturity investments held to maturity	255	250
Proceeds from redemptions of equity securities available for sale	10,503	—
Purchases of trading securities	(429,001)	(2,137,677)
(Purchases)/sales and redemptions of short-term investments, net	(554,429)	556,048
Sales (purchases) of other invested assets, net	15,210	(74,999)
Proceeds from sale of investment in affiliate	—	14,700
Purchases of property and equipment, net	(712)	(452)
Net cash (used in) provided by investing activities	(309,275)	503,358
Cash flows from financing activities:		
Dividends paid	(767)	(666)
Proceeds/payments related to issuance or exchange of debt, net	381,165	—
Redemption of long-term debt	(79,372)	(143,770)
Issuance of common stock	299,542	—
Excess tax benefits from stock-based awards	553	—
Net cash provided by (used in) financing activities	601,121	(144,436)
Effect of exchange rate changes on cash	—	5
Increase (decrease) in cash	276	(2,972)
Cash, beginning of period	31,555	35,589
Cash, end of period	$31,831	$32,617
Supplemental disclosures of cash flow information:		
Income taxes paid	$1,785	$1,498
Interest paid	$15,970	$21,820

See Notes to Unaudited Condensed Consolidated Financial Statements.

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements

1. Condensed Consolidated Financial Statements—Basis of Presentation and Business Overview

Our condensed consolidated financial statements include the accounts of Radian Group Inc. and its subsidiaries. We refer to Radian Group Inc. together with its consolidated subsidiaries as "Radian," "we," "us" or "our," unless the context requires otherwise. We generally refer to Radian Group Inc. alone, without its consolidated subsidiaries, as "Radian Group."

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of all wholly-owned subsidiaries. Companies in which we, or one of our subsidiaries, exercise significant influence (generally ownership interests ranging from 20% to 50%), are accounted for in accordance with the equity method of accounting. VIEs for which we are the primary beneficiary are consolidated, as described in Note 5. All intercompany accounts and transactions, and intercompany profits and losses, have been eliminated. We have condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with GAAP pursuant to the instructions set forth in Article 10 of Regulation S-X of the United States ("U.S.") Securities and Exchange Commission.

The financial information presented for interim periods is unaudited; however, such information reflects all adjustments that are, in the opinion of management, necessary for the fair statement of the financial position, results of operations, comprehensive income and cash flows for the interim periods presented. Such adjustments are of a normal recurring nature. These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012 (the "2012 Form 10-K"). The results of operations for interim periods are not necessarily indicative of results to be expected for the full year or for any other period. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. While the amounts included in our condensed consolidated financial statements include our best estimates and assumptions, actual results may vary materially.

Basic net loss per share is based on the weighted-average number of common shares outstanding, while diluted net loss per share is based on the weighted-average number of common shares outstanding and common stock equivalents that would be issuable upon the exercise of stock options, other stock-based compensation arrangements, and the dilutive effect of our convertible debt. As a result of our net loss for the three and six months ended June 30, 2013, 39,476,796 and 5,556,916 shares, respectively, of our common stock equivalents issued under our stock-based compensation arrangements and convertible debt were not included in the calculation of diluted net loss per share as of such dates because they were anti-dilutive. As a result of our net loss for the three and six months ended June 30, 2012, 5,964,726 shares of our common stock equivalents issued under our stock-based compensation arrangements were not included in the calculation of diluted net loss per share as of such dates because they were anti-dilutive.

In February 2013, the Financial Accounting Standards Board ("FASB") issued an update to the accounting standard regarding comprehensive income. This update requires an entity to present, either on the face of the financial statements or as a separate disclosure, the changes in the accumulated balances for each component of other comprehensive income included in that separate component of equity. In addition to the presentation of changes in accumulated balances, an entity is required to present separately for each component of other comprehensive income, current period reclassifications out of accumulated other comprehensive income and other amounts of current period other comprehensive income. We adopted this update effective January 1, 2013, and in Note 11, we present the changes in the accumulated balances for each component of other comprehensive income as well as current period reclassifications out of accumulated other comprehensive income and other amounts of current period other comprehensive income.

In July 2013, the FASB issued an update to the accounting standard regarding income taxes. This update provides guidance concerning the balance sheet presentation of an unrecognized tax benefit when a net operating loss carryforward or a tax credit carryforward (the "Carryforwards") is available. This accounting standard requires an entity to net its liability related to unrecognized tax benefits against the related deferred tax assets for the Carryforwards. A gross presentation will be required when the Carryforwards are not available under the tax law of the applicable jurisdiction or when the Carryforwards would not be used by the entity to settle any additional income taxes resulting from disallowance of the uncertain tax position. This update is effective for fiscal years and interim periods within such years beginning after December 15, 2013. We are currently evaluating the impact this new guidance will have on our consolidated financial statements and disclosures.

Business Overview

We are a credit enhancement company with a primary strategic focus on domestic, residential mortgage insurance on first-lien loans ("first-liens"). We have two business segments—mortgage insurance and financial guaranty.

Mortgage Insurance

Our mortgage insurance segment provides credit-related insurance coverage, principally through private mortgage insurance, and risk management services to mortgage lending institutions. We provide these products and services mainly through our wholly-owned subsidiary, Radian Guaranty Inc. ("Radian Guaranty"). Private mortgage insurance protects mortgage lenders from all or a portion of default-related losses on residential mortgage loans made to home buyers who generally make downpayments of less than 20% of the home's purchase price. Private mortgage insurance also facilitates the sale of these mortgage loans in the secondary mortgage market, most of which are sold to Freddie Mac and Fannie Mae. We refer to Freddie Mac and Fannie Mae together as "Government Sponsored Enterprises" or "GSEs."

Our mortgage insurance segment offers primary mortgage insurance coverage on residential first-liens. At June 30, 2013, primary insurance on first-liens comprised approximately 95.2% of our $39.1 billion total direct risk in force ("RIF"). In the past, we also wrote pool insurance, which at June 30, 2013, comprised approximately 4.4% of our total direct RIF and offered other forms of credit enhancement on residential mortgage assets. These products included mortgage insurance on second-lien mortgages, credit enhancement on net interest margin securities ("NIMS"), and primary mortgage insurance on international mortgages (collectively, we refer to the risk associated with these transactions as "non-traditional"). We stopped writing non-traditional business in 2007, other than a small amount of international mortgage insurance, which we discontinued writing in 2008. Our non-traditional RIF was $125 million as of June 30, 2013, representing less than 1% of our total direct RIF.

Financial Guaranty

Our financial guaranty segment has provided direct insurance and reinsurance on credit-based risks through Radian Asset Assurance Inc. ("Radian Asset Assurance"). Radian Asset Assurance is a wholly-owned subsidiary of Radian Guaranty, which allows our financial guaranty business to serve as a source of capital for Radian Guaranty. We have provided financial guaranty credit protection in several forms, including through the issuance of financial guaranty policies, by insuring the obligations under one or more credit default swaps ("CDS") and through the reinsurance of both types of obligations. In 2008, we ceased writing or assuming new financial guaranty business and since then, we have significantly reduced our financial guaranty operations. In addition, we have been proactive in reducing our financial guaranty exposures through commutations and other transaction settlements in order to mitigate uncertainty, maximize the ultimate capital available for our mortgage insurance business and accelerate access to that capital.

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements — (Continued)

Business Conditions

As a seller of credit protection, our results are subject to macroeconomic conditions and specific events that impact the origination environment and the credit performance of our underlying insured assets. The downturn in the housing and related credit markets that began in 2007 had a significant negative impact on the operating environment and results of operations for each of our businesses. This negative operating environment was characterized by a decrease in mortgage originations, a broad decline in home prices, mortgage servicing and foreclosure delays, and ongoing deterioration in the credit performance of mortgage and other assets originated prior to 2009, together with macroeconomic factors such as high unemployment, limited economic growth and a lack of meaningful liquidity in many sectors of the capital markets. Our results of operations continue to be negatively impacted by the mortgage insurance we wrote during the poor underwriting years of 2005 through 2008 (we refer to this portion of our mortgage insurance portfolio, together with business written prior to 2005, as our “legacy portfolio”).

In recent years, the operating environment for our businesses has shown signs of improvement. Although the U.S. economy and housing market remain weak compared to historical standards, home prices have been appreciating on a broad basis throughout the U.S., foreclosure activity has declined and the credit quality of recent mortgage market originations continues to be significantly better than the credit quality of our legacy portfolio. In addition, there are signs of a broader recovery in the U.S. economy, including importantly, some reduction in unemployment rates. As a consequence of these and other factors, in 2012, we experienced improvement in our results of operations, with a 22% decline in new primary mortgage insurance defaults. Our new primary mortgage insurance defaults have continued to decline in 2013, including a 19% decline in the first six months of 2013 compared to the number of new primary defaults in the first six months of 2012. Although uncertainty remains with respect to the ultimate losses we will experience in our legacy portfolio, as we continue to write a significant volume of new insurance on high-quality mortgages, our legacy portfolio has become a smaller percentage of our total portfolio, and we expect this to continue. Our legacy portfolio now represents less than 50% of our total primary mortgage insurance RIF.

Currently, our business strategy primarily is focused on: (1) growing our mortgage insurance business by writing insurance on high-quality mortgages in the U.S.; (2) continuing to manage losses in our legacy mortgage insurance and financial guaranty portfolios; (3) continuing to reduce our legacy mortgage insurance and financial guaranty exposures; and (4) continuing to effectively manage our capital and liquidity positions.

Our businesses also are significantly impacted by, and our future success may be affected by, legislative and regulatory developments impacting the housing finance industry. The GSEs are the primary beneficiaries of the majority of our mortgage insurance policies and the Federal Housing Administration (“FHA”) remains our primary competitor outside of the private mortgage insurance industry. The GSEs’ current federal charters generally prohibit them from purchasing any mortgage with a loan amount that exceeds 80% of a home’s value, unless that mortgage is insured by a qualified insurer or the mortgage seller retains at least a 10% participation in the loan or agrees to repurchase the loan in the event of a default. As a result, high-loan-to-value (“LTV”) mortgages purchased by the GSEs generally are insured with private mortgage insurance. Changes in the charters or business practices of the GSEs, including the pursuit of alternatives to private mortgage insurance as a condition to purchasing high-LTV loans, could reduce the number of mortgages they purchase that are insured by us and consequently diminish our franchise value. Since 2011, there have been numerous legislative proposals and recommendations focused on reforming the U.S. housing finance industry, including proposals that are intended to wind down the GSEs or to otherwise limit or restrict the activities and businesses of the GSEs. As a result, the future structure of the residential housing finance system, as well as the impact of any such changes on our business, remain uncertain. Although we believe that traditional private mortgage insurance will continue to play an important role in any future housing finance structure, it is possible that new federal legislation could reduce the level of private mortgage insurance coverage used by the GSEs as credit enhancement, or even eliminate the requirement altogether, which would reduce our available market and could adversely affect our mortgage insurance business and our franchise value. In addition, the mortgage origination market and private mortgage insurers could be adversely impacted by regulatory requirements being developed under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements — (Continued)

Capital Preservation and Liquidity Management Initiatives

Since 2008, we have engaged in a number of strategic actions and initiatives in response to the negative economic and market conditions impacting our businesses. As a result of our strategic actions and an improving operating environment, we believe we are positioned to return to long-term profitability.

Thus far in 2013, we have made further progress toward our objectives and in support of our business strategy, including by taking the following actions:

- Radian Asset Assurance continued to proactively reduce its financial guaranty portfolio through a series of risk commutations, transaction settlements and terminations.
  - In January 2013, $6.7 million of contingency reserves were released due to the commutation of the remaining $822.2 million net par reinsured by Radian Asset Assurance from Financial Guaranty Insurance Company (the “FGIC Commutation”), including substantially all of our exposure to general obligation bonds issued by the City of Detroit;
  - In February 2013, the New York State Department of Financial Services approved the release of an additional $61.1 million of contingency reserves resulting from the reduction in Radian Asset Assurance’s net par outstanding;
  - During the first half of 2013, in our financial guaranty business, four of our CDS counterparties exercised their termination rights with respect to nine collateralized debt obligations (“CDOs”) that we insured, and we agreed to the commutation of an additional CDO with another CDS counterparty (collectively, the “2013 CDO Terminations”), which reduced our net par outstanding by $3.4 billion in the aggregate; and
  - In July 2013, Radian Asset Assurance paid an ordinary dividend of $36 million to Radian Guaranty.
- During the first six months of 2013, Radian Group exchanged $195.5 million of its outstanding 5.375% Senior Notes due June 2015 for a new series of 9.000% Senior Notes due June 2017 in order to improve its debt maturity profile. See Note 10 for further information.
- In March 2013, Radian Group issued $400 million principal amount of 2.250% convertible unsecured senior notes due March 2019 (the “2019 Convertible Senior Notes”) and received net proceeds of approximately $389.8 million. See Note 10 for further information.
- In March 2013, Radian Group sold 39.1 million shares of common stock at a public offering price of $8.00 per share and received net proceeds of approximately $299.5 million.

At June 30, 2013, Radian Group had immediately available unrestricted cash and liquid investments of $918.6 million. Approximately $102.6 million (of which approximately $14.3 million relates to payments we expect to make in 2013) of future expected corporate expenses and interest payments have been accrued for and paid by certain subsidiaries to Radian Group as of June 30, 2013, and therefore, the total unrestricted cash and liquid investments held by Radian Group as of June 30, 2013 include these amounts. Net of these advances, our available holding company liquidity is $816.0 million. We expect to use a portion of our available liquidity to support Radian Guaranty’s capital position, including to maintain Radian Guaranty’s risk-to-capital ratio at 20 to 1 or below for the foreseeable future.

2. Segment Reporting

Our mortgage insurance and financial guaranty segments are strategic business units that are managed separately. We allocate corporate income and expenses to our mortgage insurance and financial guaranty segments based on either an allocated percentage of time spent on each segment or internally allocated capital, which is based on the relative GAAP equity of each segment. We allocate corporate cash and investments to our segments based on internally allocated capital, which also is based on relative GAAP equity. The results for each segment for each reporting period can cause significant volatility in internally allocated capital based on relative GAAP equity, which can impact the allocations of income and expenses to our segments.

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements — (Continued)

Management has determined that the allocation of our consolidated provision for taxes to the segments is no longer material to the evaluation of our business results. Therefore, beginning with the first quarter of 2013, financial information for our business segments is disclosed on a pretax basis as pretax results are used by senior management in the allocation of resources and in assessing the performance of the segments.

Summarized financial information concerning our segments, as of and for the periods indicated, are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2013	2012	2013	2012
Mortgage Insurance				
Net premiums written—insurance	$251,159	$182,518	$468,445	$379,371
Net premiums earned—insurance	$197,952	$170,763	$380,944	$344,214
Net investment income	15,266	17,608	30,368	35,619
Net (losses) gains on investments	(83,386)	26,662	(86,623)	58,840
Change in fair value of derivative instruments	—	(52)	—	(31)
Net gains (losses) on other financial instruments	74	42	(1,803)	(667)
Other income	2,159	1,304	3,871	2,648
Total revenues	132,065	216,327	326,757	440,623
Provision for losses	136,410	208,078	268,366	442,807
Change in PDR	1,251	559	622	539
Policy acquisition costs	6,501	7,890	18,233	16,536
Other operating expenses	51,295	31,272	117,075	67,537
Interest expense	3,704	1,723	6,373	3,445
Total expenses	199,161	249,522	410,669	530,864
Pretax loss	$(67,096)	$(33,195)	$(83,912)	$(90,241)
Cash and investments	$2,962,997	$3,176,027		
Deferred policy acquisition costs	29,138	44,240		
Total assets	3,431,444	3,388,524		
Unearned premiums	483,303	290,880		
Reserve for losses and LAE	2,690,861	3,155,343		
VIE debt	10,963	7,500		
Derivative liabilities	—	—		
New Insurance Written (“NIW”) (in millions)	$13,377	$8,335	$24,283	$14,800

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements — (Continued)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2013	2012	2013	2012
Financial Guaranty				
Net premiums written—insurance	$70	$(586)	$(10,031)	$(119,761)
Net premiums earned—insurance	$15,172	$16,016	$24,768	$9,930
Net investment income	12,349	13,269	24,120	29,971
Net (losses) gains on investments	(46,868)	(243)	(49,136)	35,038
Change in fair value of derivative instruments	86,535	(33,072)	(81,135)	(105,850)
Net gains (losses) on other financial instruments	1,114	(61,904)	(2,684)	(79,047)
Gain on sale of affiliate	—	7,708	—	7,708
Other income	75	91	134	187
Total revenues	68,377	(58,135)	(83,933)	(102,063)
Provision for losses	3,881	2,790	3,984	34,215
Change in PDR	—	—	—	—
Policy acquisition costs	3,505	2,915	8,968	22,315
Other operating expenses	9,686	8,921	24,006	22,810
Interest expense	15,716	10,858	28,928	23,284
Total expenses	32,788	25,484	65,886	102,624
Equity in net (loss) income of affiliates	—	(2)	1	(13)
Pretax income (loss)	$35,589	$(83,621)	$(149,818)	$(204,700)
Cash and investments	$2,403,636	$2,137,956		
Deferred policy acquisition costs	41,289	55,146		
Total assets	2,622,556	2,643,006		
Unearned premiums	229,403	297,551		
Reserve for losses and LAE	25,629	94,937		
VIE debt	95,804	100,333		
Derivative liabilities	350,576	219,960		

A reconciliation of segment pretax income (loss) to consolidated net loss is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2013	2012	2013	2012
Mortgage Insurance pretax loss	$(67,096)	$(33,195)	$(83,912)	$(90,241)
Financial Guaranty pretax income (loss)	35,589	(83,621)	(149,818)	(204,700)
Income tax provision (benefit)	1,665	2,443	(13,058)	(6,450)
Consolidated net loss	$(33,172)	$(119,259)	$(220,672)	$(288,491)

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements — (Continued)

3. Derivative Instruments
We provide a significant portion of our credit protection within our financial guaranty segment in the form of CDS. In many of our CDS transactions, primarily our corporate CDOs, we generally are required to make payments to our counterparty above a specified level of subordination, upon the occurrence of credit events related to the borrowings or bankruptcy of obligors contained within pools of corporate obligations or, in the case of pools of mortgage or other asset-backed obligations, upon the occurrence of credit events related to the specific obligations in the pool. When we provide a CDS providing protection on a specific obligation, we generally guarantee the full and timely payment of principal and interest when due on such obligation. These derivatives have various maturity dates, but the majority of the net par outstanding of our remaining insured CDS transactions, including all of our corporate CDOs, mature within five years.
The following table sets forth our gross unrealized gains and gross unrealized losses on derivative assets and liabilities as of the dates indicated. Certain contracts are in an asset position because the net present value of the contractual premium we receive exceeds the net present value of our estimate of the expected future premiums that a financial guarantor of similar credit quality to us would charge to provide the same credit protection, assuming a transfer of our obligation to such financial guarantor as of the measurement date.

(In thousands)	June 30, 2013	December 31, 2012
Balance Sheets		
Derivative assets:		
Financial Guaranty credit derivative assets	$7,036	$12,024
NIMS related and other	2,343	1,585
Total derivative assets	9,379	13,609
Derivative liabilities:		
Financial Guaranty credit derivative liabilities	285,939	196,406
Financial Guaranty VIE derivative liabilities	64,637	70,467
Total derivative liabilities	350,576	266,873
Total derivative liabilities, net	$341,197	$253,264

The notional value of our derivative contracts at June 30, 2013 and December 31, 2012 was $14.7 billion and $19.2 billion, respectively.
The components of the (losses) gains included in the change in fair value of derivative instruments are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2013	2012	2013	2012
Statements of Operations				
Net premiums earned—derivatives	$4,857	$7,224	$9,849	$15,872
Financial Guaranty credit derivatives	80,293	(39,161)	(95,431)	(119,380)
Financial Guaranty VIE derivatives	1,477	(1,136)	4,539	(2,363)
NIMS related and other	(92)	(51)	(92)	(10)
Change in fair value of derivative instruments	$86,535	$(33,124)	$(81,135)	$(105,881)

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements — (Continued)

The valuation of derivative instruments may result in significant volatility from period to period in gains and losses as reported on our condensed consolidated statements of operations. Generally, these gains and losses result, in part, from changes in corporate credit or asset-backed spreads and changes in the market's perception of the creditworthiness of any: (i) underlying corporate entities; (ii) the credit performance of the assets underlying asset-backed securities ("ABS"); or (iii) primary obligors of obligations for which we provide second-to-pay credit protection. Additionally, when determining the fair value of our liabilities, we are required to incorporate into the fair value of those liabilities an adjustment that reflects our own non-performance risk, and consequently, changes in the market's perception of our non-performance risk can also result in gains and losses on our derivative instruments. Any incurred gains or losses (which include any claim payments) on our financial guaranty contracts that are accounted for as derivatives are recognized as a change in fair value of derivative instruments. Because our fair value determinations for derivative and other financial instruments are based on assumptions and estimates that are inherently subject to risk and uncertainty, our fair value amounts could vary significantly from period to period. See Note 4 for more information on the fair value of our financial instruments.

The following table shows selected information about our derivative contracts:

	June 30, 2013		
($ in thousands)	Number of Contracts	Par/ Notional Exposure	Total Net Asset/ (Liability)
Product			
NIMS related and other (1)	—	$—	$ 2,343
Corporate CDOs	24	9,553,298	1,584
Non-Corporate CDOs and other derivative transactions:			
Trust Preferred Securities ("TruPs")	13	1,053,987	(21,792)
CDOs of commercial mortgage-backed securities ("CMBS")	4	1,831,000	(102,330)
Other:			
Structured finance	5	559,955	(84,002)
Public finance	22	1,297,729	(55,881)
Total Non-Corporate CDOs and other derivative transactions	44	4,742,671	(264,005)
Assumed financial guaranty credit derivatives:			
Structured finance	32	187,015	(15,883)
Public finance	5	104,800	(599)
Total Assumed	37	291,815	(16,482)
Financial Guaranty VIE derivative liabilities (2)	1	77,236	(64,637)
Grand Total	106	$14,665,020	$ (341,197)

(1) Represents NIMS derivative assets related to consolidated NIMS VIEs and common stock warrants. Because these investments represent financial guaranty contracts that we issued, they cannot become liabilities, and therefore, do not represent additional par exposure.

(2) Represents the fair value of a CDS included in a VIE that we have consolidated. See Note 5 for more information on this transaction, the underlying reference securities and our maximum exposure to loss from this consolidated financial guaranty transaction. The assets in the VIE represent the only funds available to pay the CDS counterparty for amounts due under the contract; therefore, the notional exposure presented for the CDS is limited to the current trust assets.

4. Fair Value of Financial Instruments

Certain assets and liabilities are recorded at fair value. These include: available for sale securities, trading securities, VIE debt, derivative instruments, and certain other assets. All derivative instruments and contracts are recognized in our condensed consolidated balance sheets as either derivative assets or derivative liabilities. All changes in fair value of trading securities, VIE debt, derivative instruments, and certain other assets are included in our condensed consolidated statements of operations. All changes in the fair value of available for sale securities are recorded in accumulated other comprehensive income (loss).

Our estimated fair value measurements are intended to reflect the assumptions market participants would use in pricing an asset or liability based on the best information available. Assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and the risks inherent in the inputs to the model. Changes in economic conditions and capital market conditions, including but not limited to, credit spread changes, benchmark interest rate changes, market volatility and changes in the value of underlying collateral or of any third-party guaranty or insurance, could cause actual results to differ materially from our estimated fair value measurements. We define fair value as the current amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In the event that our investments or derivative contracts were sold, commuted, terminated or settled with a counterparty or transferred in a forced liquidation, the amounts received or paid may be materially different from those determined in accordance with the accounting standard regarding fair value measurements. Differences may also arise between our recorded fair value and the settlement or termination value with a counterparty based upon consideration of information that may not be available to another market participant. Those differences, which may be material, are recorded as realized gains/(losses) in our condensed consolidated statements of operations in the period in which the transaction occurs. There were no significant changes to our fair value methodologies during the six months ended June 30, 2013.

We established a fair value hierarchy by prioritizing the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level I measurements) and the lowest priority to unobservable inputs (Level III measurements). The three levels of the fair value hierarchy under this standard are described below:

Level I	— Unadjusted quoted prices for identical assets or liabilities in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
Level II	— Prices or valuations based on observable inputs other than quoted prices in active markets for identical assets and liabilities; and
Level III	— Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

The level of market activity used to determine the fair value hierarchy is based on the availability of observable inputs market participants would use to price an asset or a liability, including market value price observations. We provide a qualitative description of the valuation techniques and inputs used for Level II recurring and non-recurring fair value measurements in our audited annual financial statements as of December 31, 2012. For a complete understanding of those valuation techniques and inputs used as of June 30, 2013, these unaudited condensed consolidated financial statements should be read in conjunction with the audited annual financial statements and notes thereto included in our 2012 Form 10-K.

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements — (Continued)

The following is a list of those assets and liabilities that are measured at fair value by hierarchy level as of June 30, 2013:

(In millions)	Level I	Level II	Level III	Total
Assets and Liabilities at Fair Value				
Investment Portfolio:				
U.S. government and agency securities	$625.5	$420.8	$—	$1,046.3
State and municipal obligations	—	633.2	19.4	652.6
Money market instruments	704.9	—	—	704.9
Corporate bonds and notes	—	1,315.0	—	1,315.0
Residential mortgage-backed securities (“RMBS”)	—	533.3	—	533.3
CMBS	—	300.0	—	300.0
Other ABS	—	204.4	1.2	205.6
Hybrid securities	—	152.8	—	152.8
Equity securities (1)	131.6	147.4	0.4	279.4
Other investments (2)	—	2.6	77.4	80.0
Total Investments at Fair Value (3)	1,462.0	3,709.5	98.4	5,269.9
Derivative Assets	—	0.8	8.6	9.4
Other Assets (4)	—	—	96.0	96.0
Total Assets at Fair Value	$1,462.0	$3,710.3	$203.0	$5,375.3
Derivative Liabilities	$—	$—	$350.6	$350.6
VIE debt (5)	—	—	106.8	106.8
Total Liabilities at Fair Value	$—	$—	$457.4	$457.4

(1) Comprising broadly diversified domestic equity mutual funds included within Level I and various preferred and common stocks invested across numerous companies and industries included within Levels II and III.
(2) Comprising TruPs ($0.9 million) and short-term certificates of deposit (“CDs”) ($1.7 million) included within Level II, and lottery annuities ($0.4 million) and a guaranteed investment contract held by a consolidated VIE ($77.0 million) within Level III.
(3) Does not include fixed-maturities held to maturity ($0.4 million) and certain other invested assets ($41.0 million), primarily invested in limited partnerships, accounted for as cost-method investments and not measured at fair value.
(4) Primarily comprising manufactured housing loan collateral related to two consolidated financial guaranty VIEs.
(5) Comprising consolidated debt related to NIMS VIEs ($11.0 million) and amounts related to financial guaranty VIEs ($95.8 million).

Radian Group Inc.
Notes to Unaudited Condensed Consolidated Financial Statements — (Continued)

The following is a list of those assets and liabilities that are measured at fair value by hierarchy level as of December 31, 2012:

(In millions)	Level I	Level II	Level III	Total
Assets and Liabilities at Fair Value				
Investment Portfolio:				
U.S. government and agency securities	$137.8	$433.8	$—	$571.6
State and municipal obligations	—	669.0	19.0	688.0
Money market instruments	638.0	—	—	638.0
Corporate bonds and notes	—	1,373.6	—	1,373.6
RMBS	—	663.4	—	663.4
CMBS	—	237.3	—	237.3
Other ABS	—	252.4	1.7	254.1
Foreign government securities	—	117.7	—	117.7
Hybrid securities	—	211.9	—	211.9
Equity securities (1)	98.9	166.0	1.0	265.9
Other investments (2)	—	2.5	79.0	81.5
Total Investments at Fair Value (3)	874.7	4,127.6		