

# Research

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## Research Update:

# Various Upgrades And Outlook Revisions On MGIC, Radian, Genworth, And UGC MI On Positive Operating Performance

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## Overview

- Cure activity for various mortgage insurers has improved significantly from prior years, even as their delinquency inventories continue to drop year-over-year.
- As a result, these companies' operating performances have exceeded our expectations.
- We are raising our ratings on the insurers, reflecting these fundamental improvements, and either maintaining the current outlooks or revising the outlook to positive from stable.
- The positive outlooks largely reflect our expectation for continued improvement in these companies' operating earnings.

## Rating Action

On Feb. 27, 2014, Standard & Poor's Ratings Services raised its financial strength (FSR) and issuer credit ratings (ICR) on Mortgage Guaranty Insurance Corp. (MGIC) and MGIC Indemnity Co. (MIC) to 'BB' from 'B', as well as its unsolicited issue-level rating and ICR on MGIC Investment Corp. to 'B' from 'B-'; we are revising the outlook on MGIC Investment to positive from stable, and the outlooks on MGIC and MIC remain positive.

We also raised our FSR and ICR on Radian Guaranty Inc. and its related mortgage insurance subsidiaries (collectively, Radian) to 'BB-' from 'B' and affirmed our ICR on Radian Group Inc. (the holding company) at 'B-'. We revised the outlook to positive from stable.

We also raised our FSR on Genworth Mortgage Insurance Corp. and Genworth Residential Mortgage Insurance Corp. of North Carolina to 'BB-' from 'B' and ICR on Genworth Mortgage Insurance to 'BB-' from 'B'. We revised the outlook to positive from stable.

In addition, we raised our FSRs on United Guaranty Residential Insurance Co. and United Guaranty Mortgage Indemnity Co. (collectively, UGC MI) to 'A-' from 'BBB+' and ICR on United Guaranty Residential Insurance to 'A-' from 'BBB+'. The outlook remains stable.

We also raised our FSR and ICR on Arch Mortgage Insurance Co. (Arch MI; formerly CMG Mortgage Insurance Co.) to 'BBB+' from 'BBB-' and revised the outlook to stable from positive.

## **Rationale**

The rating actions reflect these mortgage insurers' improved recent and prospective operating earnings arising from the overall positive macroeconomic trends in the U.S. Our view stems largely from the continued reduction of incurred losses that are based on the decline in the number of new notices of delinquencies (NODs) and rate of development of delinquencies to claim. The current ratings incorporate the potential for adverse business, financial, economic, and regulatory conditions, including potentially higher capital requirements, from government-sponsored entities (GSEs) that we expect to see later in 2014.

### **MGIC**

The ratings actions on MGIC reflect our view of the group's operating performance and our expectation that MGIC will generate positive operating earnings in 2014 and show accelerated earnings in 2015 based on our projection for lower losses. Liquidity at the operating company continues to remain robust despite claims paid of \$1.8 billion in 2013 and \$2.5 billion in 2012. We view liquidity at the holding company as sufficient to provide its insurance companies additional capital to sustain the risk to capital (RTC) ratio at acceptable levels following the institution of new capital rules by the various government and regulatory entities. MGIC's competitive position is good at the current rating, based on its sustained market share in the private mortgage insurance industry, conservative RTC targets, and significantly lower operating leverage (that is, lower expense ratio) that we believe will boost operating profit margins on its insured portfolio. MGIC's financial flexibility has improved dramatically following an offering of about \$1.2 billion in debt and equity in 2013 and its entrance into a 30%-40%-reinsurance quota share agreement (in April and amended in December). We believe additional flexibility may be available to MGIC if necessary in order to increase its risk-in-force (RIF) if profitable market share is attainable.

### **Radian**

The ratings on Radian reflect our view of the group's operating performance and our expectation that Radian will be profitable in 2014 and 2015. Incurred losses should continue to decline as NODs and the rate of development of delinquencies to claim fall. The risk and materiality of reserve strengthening decreases as 2009 and earlier vintages become a smaller portion of overall RIF (currently 40% and shrinking). This was bolstered by Radian's agreement with Freddie Mac in third-quarter 2013, eliminating \$840 million of legacy exposure. We believe reserve strengthening may reduce Radian's short-term profitability, but it's unlikely to significantly reduce profitability and capitalization in the next several years. Rescissions coming back on the book may also reduce short-term profits. On the other hand, Radian has been growing new business. New insurance written (NIW) was \$47.3 billion for 2013, and Radian held a 27% market share. We have observed that its NIW is of high quality with high FICO scores. Fast-growing and profitable NIW can reduce the

adverse impact from the group's legacy business. Partly offsetting this positive view is the fact that a material amount of the group's NIW is single-premium business and the associated profitability may be lower than for its monthly-recurring premium business. We expect competition to likely increase as recent entrants and existing mortgage insurers compete in the mortgage-origination market as the refinancing business wanes in the next few years; this is somewhat offset as the Federal Housing Administration reduces its share of the market.

The quality of Radian's capital remains a key negative point of differentiation with its peers. Radian Guaranty's statutory capital and surplus was \$1.24 billion as of third-quarter 2013, of which \$1.2 billion was in Radian Asset. The organizational structure limits Radian Guaranty's ability to use Radian Asset's capital to pay claims. The improvement in financial flexibility partially mitigates the quality of its capital. Radian's access to capital market for external resources has improved as the financial health of the sector, as well as the group, continues to improve. Radian raised \$689 million in 2013 and downstreamed a portion to the operating company to maintain the current 19.5x and target of about 20.0x RTC ratios. The group can also use the capital it raised to pay off holding company obligations. But pending GSE capital requirements may require Radian to increase capitalization at its operating companies. In our view, it's likely that Radian will have sufficient financial flexibility through existing resources, reinsurance, and access to capital markets to meet its obligations--an element of execution risk less faced by its industry peers.

## **Genworth**

The upgrade on GMICO reflects its recently improved and prospective operating performance, as well as its capital and competitive position. GMICO reported generally accepted accounting principles (GAAP) net income of \$37 million in 2013 versus a net loss of \$138 million in 2012, beating our expectations of a return to profitability in 2014. The improvements stemmed from the lower-than-expected NODs arising from overall positive macroeconomic trends and the continued roll-off of the 2005-2008 vintages. We expect GMICO to continue to boost profitability in 2014 and 2015. In December 2013, Genworth Financial Inc. (GNW) completed a \$400 million senior notes offering and contributed \$100 million of the proceeds to GMICO and \$300 million to Genworth Mortgage Holdings LLC in anticipation of higher capital requirements by GSEs. The group also added \$75 million in admitted statutory deferred taxes. At year-end 2013, GMICO's RTC was about 19.5x, below the 25x requirement of state regulators, and the group is permitted to write business in all states. With a lower RTC ratio, GMICO is less reliant on waivers from GSEs and state regulators to continue writing new business.

## **UGC MI**

The upgrades on UGC MI largely reflect the group's recently improved, as well as its prospective, operating performance. While we expected a return to positive statutory net income by 2014, UGC MI generated \$74.1 million

statutory net income through Sept. 30, 2013, according to Fannie-Freddie reports for the consolidated first-lien United Guaranty companies, and we expect positive statutory net income in the fourth quarter as well. In 2012, the group reported a statutory net loss of \$167.9 million, mainly due to the commutation of its MG Re reinsurance contract with parent AIG Inc. to take on any loss exposures written before 2009. Improvements came on lower-than-expected NODs and the continued roll-off of the 2005-2008 vintages. UGC MI boosted its NIW in 2013 to a record (for the group) \$49.4 billion. We expect UGC MI to continue to boost profits in 2014 and 2015. The ratings further reflect the group's strategic importance to AIG and its subsidiaries.

## **Arch MI**

The FSR and ICR reflect Arch MI's improved operating performance and capitalization, as well as its moderately strategic status within the group. The company reported \$7.4 million in statutory net income in 2013, compared with a \$0.4 million net loss in 2012. As a result of Arch MI's completion of its acquisition of CMG Mortgage Insurance Co. (CMG), Arch MI made a capital contribution of \$52.0 million to CMG in 2013, and entered into a 50%-quota share agreement with Arch Reinsurance Ltd., reducing the consolidated RTC ratio to 9.2x. The reinsurance agreement covers all nondelinquent policies in force at closing, as well as all new policies written in the future. In addition the NODs, incurred losses and severity continue to improve. This reflects improving conditions within the housing market and the declining proportion of risk exposure to pre-2009 policies. As of year-end 2013, about 60% of consolidated RIF was from policies written in 2009 or later.

## **Outlook**

For the mortgage insurance sector, we expect the high-quality NIW and improvement in the U.S. housing market and economy to result in near-term profitability and capital accretion. While we do not foresee a recession in our base-case forecast, if one were to occur, the declining NOD trend could reverse, and claim frequency could increase to an extent that would prevent mortgage insurers from raising or generating capital to continue writing business through the downturn.

## **MGIC**

We continue to maintain a positive outlook on MGIC to reflect the potential growth in its NIW and market share. Our current estimation on MGIC's operating performance focuses on an expected decline in incurred losses over 2014 and 2015 with relatively stable NIW and premium yields. The positive outlook means we could upgrade the company based on growth in its NIW and a reduction in incurred losses based on our belief that MGIC has a 33% probability of continued nonvolatile positive earnings over the next couple of years. We could revise the outlook to stable if MGIC's 2014 or 2015 incurred losses remain elevated contrary to our expectations.

## **Radian**

The outlook is positive reflecting our expectation that the Radian's operating performance will continue to improve in 2014 as the risk of adverse reserve development falls. We also expect positive statutory earnings to incrementally improve the quality of capital at Radian Guaranty. We could upgrade the company if the mortgage insurance segment's pretax operating income exceeds \$200 million and the company shows that earnings will consistently improve. We also believe that, at the same time, the quality of its capital will improve while maintaining an RTC ratio of approximately 20x. We could revise the outlook to stable if Radian does not meet our earnings expectation and the quality of its capital does not improved over the next two years.

## **Genworth**

The outlook is positive reflecting our expectation that earnings will improve in 2014 and 2015 due to lower NODs and the continued roll-off of older vintages. The positive outlook means we could upgrade the company based on continued improvement in its operating performance and capital, because we believe there is a 33% probability of performance coming in above our expectations over the next couple of years. We could revise the outlook to stable if GMICO's 2014 or 2015 incurred losses do not fall as we expect.

## **UGC MI**

The outlook is stable reflecting our expectation that earnings will improve in 2014 and 2015 due to lower NODs and the continued roll-off of the 2005-2008 vintages. We could raise our ratings on UGC MI if conditions in the housing market and the overall economy continue to improve, and if the company's problematic legacy books of business continue to roll off without significant adverse development. We could lower the rating if incurred losses do not decline to our expectations.

## **Arch MI**

The outlook is stable. Although we expect the company's default and loss ratios will continue to improve, Arch MI faces risk in executing its new business strategy of not working with credit unions. The successful execution of this strategy could result in an upgrade, reflecting the additional group support the company may receive as Arch MI becomes a significant contributor to the overall group's earnings and the integration risks of the new entity decline. In addition, we could raise the underlying rating if the company's operating performance and competitive positions improve due to the addition of new profitable business. Although unlikely, we could lower the rating if incurred losses were to increase or there was significant adverse reserve development.

## Related Criteria And Research

- Group Rating Methodology, Nov. 19, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### Upgraded

	To	From
Mortgage Guaranty Insurance Corp. MGIC Indemnity Co. Counterparty Credit Rating Local Currency	BB/Positive/--	B/Positive/--
Financial Strength Rating Local Currency	BB/Positive/--	B/Positive/--
MGIC Investment Corp. (Unsolicited Ratings) Senior Unsecured	B	B-
Junior Subordinated	CCC	CCC-

### Upgraded; Outlook Action

	To	From
MGIC Investment Corp. (Unsolicited Ratings) Counterparty Credit Rating Local Currency	B/Positive/--	B-/Stable/--

### Ratings Affirmed

Radian Group Inc. Senior Unsecured	B-	
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### Ratings Affirmed; Outlook Action

	To	From
Radian Group Inc. Counterparty Credit Rating Local Currency	B-/Positive/--	B-/Stable/--

### Upgraded; Outlook Action

	To	From
Radian Guaranty Inc. Radian Mortgage Insurance Inc. Radian Mortgage Assurance Inc. Counterparty Credit Rating Local Currency	BB-/Positive/--	B/Stable/--

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Positive Operating Performance*

Financial Strength Rating		
Local Currency	BB-/Positive/--	B/Stable/--
Upgraded; Outlook Action		
	To	From
Genworth Mortgage Insurance Corp.		
Counterparty Credit Rating		
Local Currency	BB-/Positive/--	B/Stable/--
Genworth Mortgage Insurance Corp.		
Genworth Residential Mortgage Insurance Corp. of North Carolina		
Financial Strength Rating		
Local Currency	BB-/Positive/--	B/Stable/--
Upgraded		
	To	From
United Guaranty Residential Insurance Co.		
Counterparty Credit Rating		
Local Currency	A-/Stable/--	BBB+/Stable/--
United Guaranty Residential Insurance Co.		
United Guaranty Mortgage Indemnity Co.		
Financial Strength Rating		
Local Currency	A-/Stable/--	BBB+/Stable/--
Upgraded; Outlook Action		
	To	From
Arch Mortgage Insurance Co.		
Counterparty Credit Rating		
Local Currency	BBB+/Stable/--	BBB-/Positive/--
Financial Strength Rating		
Local Currency	BBB+/Stable/--	BBB-/Positive/--

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