FitchRatings

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# Fitch Publishes Radian Guaranty's 'A-' IFS Rating, Outlook Negative on Coronavirus Review

Fitch Ratings-Chicago-12 May 2020:

Fitch Ratings has published its 'A-' Insurer Financial Strength (IFS) rating of Radian Guaranty Inc. (Radian Guaranty) and the 'BBB' Long-term Issuer Default Rating of Radian Group Inc. (Radian Group). Fitch has also published the 'BBB-' rating of Radian Group's senior unsecured debt and proposed new senior debt offering. The Rating Outlook is Negative.

## Key Rating Drivers

The ratings consider Fitch's current assessment of the impact of the coronavirus pandemic, including its economic impact, under a set of ratings assumptions related to interest-rate levels; declines in the market values of stocks, bonds, derivatives and other capital market instruments typically owned or traded by insurance companies; market liquidity; and the magnitude of claim/benefit exposures related to the coronavirus pandemic. These assumptions were used by Fitch to develop pro forma financial metrics for Radian Group that Fitch compared with both rating guidelines defined in its criteria, and relative to established Rating Sensitivities.

The Negative Outlook reflects Fitch's concern regarding the impact of the economic effects of the pandemic on Radian Guaranty's balance sheet and financial performance over the next one to two years. Fitch's primary concerns over the near term include rising unemployment rates and increases in the number of mortgage delinquencies. Longer-term concerns include the possibility of an extended macroeconomic downturn.

Based on Fitch's assumptions, Radian Guaranty's Private Mortgage Insurer Eligibility Requirements (PMIERs) coverage ratio could be pressured by delinquencies caused by the high unemployment levels resulting from the coronavirus pandemic. Such delinquencies could cause the pro forma coverage ratio to fall to Fitch's 'BBB-' benchmark. Radian Group currently has $680 million of liquidity at the holding company level, which partially mitigates this concern. Holding company liquidity will also be augmented by Radian Group's new senior debt offering. Fitch currently expects the coronavirus pandemic to have a relatively modest effect on Radian Guaranty's earnings and cash flow over the next two years.

Radian Guaranty is one of four legacy U.S. mortgage insurers (USMIs) who wrote business prior to 2009. With 18.6% market share, it is the second largest of the six active USMIs, based on new insurance written in 2019. Radian Guaranty wrote business prior to the 2007-2009 recession. As a result, Radian Guaranty has residual exposure to mortgages written under the previous underwriting standards. Fitch considers Radian Guaranty's business profile ranking to be favorable.

Radian Guaranty's reported risk-adjusted capital, based on the PMIERs coverage ratio, is consistent with the rating level. Additionally, Radian Group maintains a capital buffer at the holding company level. Fitch believes the Radian Group's capital buffer is sufficient to cover the holding company's expense obligations (including interest on debt) and to contribute capital to Radian Guaranty, if needed.

Although Radian Guaranty has generated a statutory profit in each of the last five years, at YE19 it reported negative unassigned surplus of $503.3 million. Radian Guaranty will not be able to pay a dividend to Radian Group without regulatory approval until it has positive unassigned surplus. The current expectation is that Radian Guaranty will likely not be in a positive unassigned surplus position until it is able to begin releasing contingency reserves, probably in 2024.

The U.S. mortgage insurance sector is relatively concentrated and highly competitive. Currently, six mortgage insurers write 97% of the sector's direct premium. Mortgage insurers compete based on price, underwriting guidelines, service, customer relationships, financial strength and brand. Private mortgage insurers also compete against government agencies. Barriers to entry include capital requirements and scale advantages, which favor established competitors. Conversely, established insurers still have exposure to mortgages written before 2009, which have higher default rates and carry higher capital charges. These mortgages were made under less stringent underwriting standards that led to significant insured losses in the 2008-2009 recession, marring the competitive positioning of established insurers relative to insurers entering the sector post-recession.

In response to losses from the 2008-2009 recession, the oversight framework for mortgage insurers was enhanced and substantially more stringent risk-based capital requirements were introduced. These changes greatly improved the industry profile and operating environment. The competitive profile of established US mortgage insurers is also expected to continue to improve as pre-2009 mortgages amortize.

KEY ASSUMPTIONS

Assumptions for Coronavirus Impact (Rating Case):

Fitch used the following key assumptions, which are designed to identify areas of vulnerability, in support of the pro forma ratings analysis discussed above:

--Pro forma focuses mainly on areas of vulnerability; mitigants are primarily considered in the Rating Sensitivities;

--Decline in key stock market indices by 35% relative to Jan. 1, 2020.

--Increase in two-year cumulative high-yield bond default rate to 16%, applied to current non-investment grade assets, as well as a portion of 'BBB' assets.

--Both upward and downward pressure on interest rates, with spreads widening (including high yield by 400 bps) coupled with notable declines in government rates.

--Capital markets access is limited for issuers at senior debt levels of 'BBB' and below.

--Average unemployment rate of 9.4% in 2020.

## RATING SENSITIVITIES

The ratings remain sensitive to any material change in Fitch's Rating Case assumptions with respect the coronavirus pandemic. Periodic updates to our assumptions are possible given the rapid pace of changes in government actions in response to the pandemic, and the pace with which new information is available on the medical aspects of the outbreak. A discussion of how ratings would be expected to be impacted under a set of Stress Case assumptions is included at the end of this section to help frame sensitivities to a severe downside scenario.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A material adverse change in Fitch's Ratings Assumptions with respect to the coronavirus impact;

--Due to its monoline nature, any strongly negative event for the mortgage insurance industry could weaken the industry and result in a lower industry profile and operating environment score. This could include levels of new defaults, incurred losses, paid claims and cure rates that deviate significantly from historical rates;

--A decline in capital strength, such as a decline in the reported PMIERs coverage ratio below Fitch's 'bbb+' benchmark, or an indication that holding company capital is not available to support the insurance entities, could result in a lower rating;

--Stagnation or deterioration in statutory or cash coverage, especially if Radian Group's tax- and expense-sharing arrangement was revoked, could result in a lower rating.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A material positive change in Fitch's Ratings Assumptions with respect to the coronavirus impact;

--A positive rating action is prefaced by Fitch's ability to reliably forecast the impact of the coronavirus pandemic on the financial profile of both the non-life sector in the U.S. of the insurance industry and Radian Guaranty;

--An increase in capital strength, as measured by the PMIERs coverage ratio, could result in a higher rating. This could occur if the reported PMIERs coverage ratio at the operating company increased and the holding company capital buffer was maintained;

--Due to its monoline nature, any strongly positive event for the mortgage insurance industry could accelerate the recovery of the industry and result in a higher industry profile and operating environment score. This could improve the business profile ranking for Radian Guaranty which could lead to a higher rating.

An improvement in statutory or cash coverage could result in a higher rating.

Stress Case Sensitivity Analysis

--Fitch's Stress Case assumes a 60% stock market decline, two-year cumulative high yield bond default rate of 22%, high yield bond spreads widening by 600 bps and more prolonged declines in government rates, heightened pressure on capital markets access, average unemployment rate of 14.6% in 2020, an adverse non-life, industry-level loss ratio impact of seven percentage points for claims from the coronavirus partially offset by a favorable two points for personal and commercial auto.

--The implied rating impact under the Stress Case would be a downgrade of up to one or two notches.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

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The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Radian Guaranty Inc.; Insurer Financial Strength; Publish; A-; RO:Neg
Radian Group Inc.; Long Term Issuer Default Rating; Publish; BBB; RO:Neg
----senior unsecured; Long Term Rating; Publish; BBB-

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Additional information is available on www.fitchratings.com

**Applicable Criteria**

Insurance Rating Criteria (pub. 02 Mar 2020) (including rating assumption sensitivity)

**Additional Disclosures**

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