Corrected Transcript

26-Jan-2017

Radian Group Inc. (RDN)

Q4 2016 Earnings Call

CORPORATE PARTICIPANTS

Emily Riley
Investor Relations & Media Contact, Radian Group Inc.

Sanford A. Ibrahim
Chief Executive Officer & Director, Radian Group Inc.

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

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

Derek V. Brummer
Chief Risk Officer & Executive Vice President, Radian Group Inc.

OTHER PARTICIPANTS

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

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

Randy Binner
Analyst, FBR Capital Markets & Co.

Vic Agrawal
Analyst, Wells Fargo Securities LLC

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Mackenzie Aron
Analyst, Zelman & Associates

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Chris Gamaitoni
Analyst, Autonomous Research US LP

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Radian's Fourth Quarter 2016 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to Senior Vice President of Investor Relations and Corporate Communications, Emily Riley. Please go ahead.

Emily Riley

Investor Relations & Media Contact, Radian Group Inc.

Thank you and welcome to Radian's fourth quarter 2016 conference call. Our press release, which contains Radian's financial results for the quarter, was issued earlier this morning and is posted to the Investors section of our website at www.radian.biz. This press release includes certain non-GAAP measures, which will be discussed during today's call. A complete description of these measures and their reconciliation to GAAP may be found in press release Exhibits F and G and on the Investors section of our website.

During today's call, you will hear from S.A. Ibrahim, Radian's Chief Executive Officer; and Frank Hall, Chief Financial Officer. Also on hand for the Q&A portion of the call are Teresa Bryce Bazemore, President of Radian Guaranty; Derek Brummer, Executive Vice President and Chief Risk Officer of Radian Group; and Cathy Jackson, Corporate Controller.

Before we begin, I would like to remind you that comments made during this call will include forward-looking statements. These statements are based on certain expectations, estimates, projections and assumptions that are subject to risks and uncertainties, which may cause actual results to differ materially. For a discussion of these risks, please review the cautionary statements regarding forward-looking statements included in our earnings release and the risk factors included in our 2015 Form 10-K and subsequent reports filed with the SEC. These are also available on our website.

Now, I would like to turn the call over to S.A.

Sanford A. Ibrahim

Chief Executive Officer & Director, Radian Group Inc.

Thank you, Emily. Thank you all for joining us and for your interest in Radian. Before we discuss our fourth quarter and year-end results, I would like to look back at two important highlights from 2016. First, we wrote the highest volume of new flow Mortgage Insurance business in our company's history. Our new MI business, which is expected to generate attractive returns, helped fuel the growth in our Mortgage Insurance in-force portfolio of 4.5% year-over-year despite a relatively low interest rate environment throughout 2016 that drove high levels of refinance activity. As you know, our large high-quality in-force portfolio, which is among the largest in the industry, is the primary driver of future earnings for Radian.

Second, we grew book value by 11%, while enhancing our liquidity position and completing the capital actions we outlined at the start of the year. These combined actions helped us earn several rating agency upgrades in 2016 and the return of Radian Guaranty to investment grade. Our goal remains to return to investment grade at Radian

Group, our holding company, in order to further enhance our financial strength and expand the opportunity for our products by leveraging our core expertise in credit risk management beyond traditional GSE business. And finally, we simplified and strengthened our capital structure in 2016, improving the maturity profile of our debt, and reducing our total number of diluted shares outstanding by 9%.

Now, turning to our strong 2016 results. Earlier today, we reported net income for the fourth quarter of $61 million, or $0.27 per diluted share. For the full-year, net income was $308 million, or $1.37 per diluted share. Adjusted pre-tax operating income was $140 million for the fourth quarter and $542 million for the full-year. Adjusted diluted net operating income per share was $0.41 for the quarter and $1.56 for the year. Importantly, book value per share grew 11% over last year to $13.39.

Turning to the Mortgage Insurance segment. In 2016, we broke our quarterly record for the highest volume of flow MI in the third quarter as well as set an all-time company record for the year. I'd like to take a moment to thank our customers for their continued support and loyalty and to congratulate our entire team for their success in achieving this milestone for our company. We wrote $13.9 billion in new MI business in the fourth quarter, an increase of 53% compared to the $9.1 billion written in the fourth quarter of last year. And for the full year 2016, we wrote $50.5 billion, an increase of 22% from the $41.4 billion written in 2015. And I am pleased to say that 2017 is off to a strong start as well.

As I mentioned earlier, we grew our mortgage insurance in-force by 4.5% over the past year and we continue to expect our in-force book to grow and to further enhance our strong foundation for future earnings. Radian's success in writing a large share of high-quality and profitable new business after 2008 has helped to improve the composition of our Mortgage Insurance portfolio and serves as a differentiator within our industry among legacy peers. At the end of 2016, our total primary mortgage risk in-force consisted of 88% of business written after 2008. You may find these details on webcast Slide 10.

Slides 11 and 12 compare the loan characteristics of Radian's existing risk-in-force as of year end 2003, 2007 and 2011 with year-end 2016. These comparisons are important given that our risk-in-force composition reflects the environment in which the loan was underwritten. The high-quality loans written during the 8 years following the downturn reflects a much tighter credit environment and most stringent underwriting requirements as compared to the relatively weaker credit environment and underwriting standards experienced pre-downturn.

Turning to the mortgage origination market, we saw a slightly smaller market in the fourth quarter as compared to the third, and industry experts continued to predict a smaller overall market in 2017 than we saw in 2016. Despite this smaller market, we, at Radian, expect to write a similar amount of NIW in 2017 as we did in 2016. The primary reason for our NIW projection is that while the origination market this year is expected to consist of fewer refinancings, on a positive note, it is also expected to have more purchase originations.

In fact, the purchase origination market in 2017 is expected to be the largest in 10 years and given that private Mortgage Insurance is 3x to 4x more likely to be used for purchase than for refis, this is a positive for our MI industry. As I mentioned before, a hallmark of Radian is our ability to add new customers each year and to increase the amount of business we earn from existing customers. We continued to have success in 2016 and we expect more of the same in 2017.

Turning to business opportunities beyond traditional MI, we continue to focus on ways to leverage our core expertise in credit risk management to write more business and strengthen our MI franchise. We look forward to the FHFA's response through comment letter submitted on the front-end credit risk transfer, including deep cover MI that our industry has been advocating for.

We feel that the expansion of deep cover MI would strongly complement the programs already available in the market today and could offer substantial benefits for taxpayers, lenders and homebuyers. As a reminder, these front-end risk transfer programs are not the same as the GSE credit risk transfer programs that are in the market today. Importantly, as we seek to take advantage of new opportunities and expand our business beyond traditional MI, we believe that the combined risk analytics and business intelligence gleamed from our Radian and Clayton combination is a unique advantage for us.

Turning to the credit environment, we continued to see positive trend and in 2016, we experienced the highest cure rates in seven years. The Radian's total number of primary delinquent loans declined again with a year-over-year decrease of 18%, as you can see on Slide 17 and our primary default rate fell to 3.2%.

Turning to our Mortgage and Real Estate Services segment, we reported fourth quarter 2016 total revenues of $53 million, an increase of 33% over the fourth quarter of 2015. We saw increased activity in our single-family rental and title services business lines as well as strong activity in loan review and due diligence services. As we mentioned, the Clayton's family of companies broadens our participation in the residential mortgage market value chain with services that complement our MI business. In 2016, we generated nearly $5 million of revenue from cross-selling Clayton's services to our Radian MI customers.

Turning to the regulatory and legislative environment, we are encouraged by recent actions that indicate an even stronger support for the important role of private capital in the future of housing finance, including the suspension of the FHA premium rate cut by the newly inaugurated administration just last week. We continued to believe that a strong housing finance market includes a better balance among the FHA, GSEs and private capital than it has today.

We look forward to engaging with both existing and new policymakers on Capitol Hill regarding housing reform and the important role of private capital, including private Mortgage Insurance. Having faithfully served homebuyers for 40 years, providing credit in both good as well as challenging times, we believe that we are well positioned to help shape our industry's future and to strengthen our housing finance system.

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

J. Franklin Hall

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

Thank you, S.A. and good morning. As S.A. has mentioned, our full year 2016 results were strong and I am pleased to share more details on those results shortly. But first, I would like to highlight a small change to our reporting segments. All periods presented now align our segment reporting structure to recent changes in personnel reporting lines and management oversight, related to contract underwriting performed on behalf of the third parties. Therefore, revenue and expenses for this business are now reflected in the Services segment.

As a result, services revenue, direct cost of services and operating expenses have increased with offsetting reductions in mortgage insurance, other income and other operating expenses for all periods presented. For the fourth quarter, these changes increased the Services segment's revenue, direct cost of services and other operating expenses by $3.8 million, $2.3 million and $1 million, respectively.

So with that clarification, I will move to our operating results. I will start with the key drivers of our revenue. New insurance written was $13.9 billion during the quarter, compared to $15.7 billion last quarter and $9.1 billion in the fourth quarter of 2015. The new business we are writing today continues to be supported by loans with excellent credit characteristics.

For example, more than 63% of NIW in the fourth quarter consisted of loans with FICO scores greater than or equal to 740 and only 5% with FICO scores below 680. As S.A. mentioned, new insurance written for the full year was $50.5 billion as compared to $41.4 billion for 2015. We expect to write a similar amount of new business in 2017 as we did in 2016.

Direct single premium business represented 27% of our total NIW in the fourth quarter, which was flat to the third quarter. Our retained single premium exposure this quarter was 17%, net of the insurance ceded with our singles-only quota share reinsurance transaction. Refinancings increased to 27% of volume this quarter compared to 22% last quarter and were up from 17% a year ago.

Our 12-month persistency decreased from 78.4% in the third quarter of 2016 to 76.7% in the fourth quarter of 2016 as noted on Exhibit L. Our normalized persistency expectations of low-80s remain unchanged, but given the recent refinance activities due to continued low interest rates, we may not see that level return for several periods.

Our expectation for persistency in 2017 is a gradual increase throughout the year, but that will depend largely on interest rates and the mix of mortgage production. Primary insurance in force increased to $183.5 billion at the end of the quarter, a 4.5% increase over the same period last year. Our expectation for 2017 is that insurance in force will continue to grow, given the expected increase in persistency.

Net earned premiums for the quarter decreased to $233.6 million in the fourth quarter of 2016 from $238.1 million in the third quarter of 2016. This decrease was primarily the result of a decrease in the accelerated recognition of unearned premiums on single premium policy cancellations of $2.7 million and approximately $0.5 million in related profit commissions under the single premium QSR as noted on Exhibit D.

Investment income remained relatively flat in the quarter. We did however, experience a decrease in the unrealized gains on the investment portfolio, as a result of rising rates, which negatively impacted our book value per share and GAAP earnings, but is not included in our adjusted pre-tax operating income.

It should also be noted that the duration of the portfolio has remained relatively unchanged in approximately 5 years, with a portfolio yield of 2.8% at quarter-end. Additionally, we have virtually no exposure to tax exempt municipal bonds. We will monitor any potential tax reform impact and adjust our investment strategy accordingly.

Total services revenue for our Mortgage and Real Estate Services segment was up over comparable quarters at approximately $53 million for the fourth quarter as compared to $48 million in the third quarter and $39 million in the fourth quarter of last year. This was the highest quarterly revenue from Clayton since our acquisition of the company in mid-2014.

Importantly, we have begun to see an increase in volume for the single-family rental securitization market that positively impacted our real estate valuation and component services businesses. In addition, we experienced solid revenue growth from loan review and due diligence activity.

Moving now to our loss provision and credit quality, we remain optimistic about the trends we see in our credit quality. As such, it is important to note that our primary risk in force consist of only 12% legacy business originated before 2009 and that those vintages are contributing positively to earnings as you can see on Slide 13.

This portfolio composition is unique and it can skew overall performance metrics in total where a legacy versus non-legacy analysis may be more informative. For example, we continue to see the majority of our new defaults coming from our legacy portfolio, which represented 69% of the new defaults in the fourth quarter. While total new defaults declined 6% year-over-year, new defaults from our legacy book fell 17%.

We have now separated our new default for legacy and non-legacy books on Slide 17. It is also important to note that only 17% of total primary defaults are from non-legacy loans written after 2008 and these books are producing a very low level of losses as you can see on Slide 14.

And as these newer books of business reach peak default years, we are seeing an expected increase in defaults activity from those books though at very low rates. In fact, many books are actually past their peak and have performed very well, again, as noted on Slide 14.

We continue to see improvement in credit trends and fundamentals in our overall portfolio. For example, our cure rate has continued to improve on a year-over-year basis. For the fourth quarter, our cure rate was 16.2%. In 2016, we experienced the highest cure rates in 7 years.

As noted on Slide 15, during the fourth quarter, we had positive development on prior period defaults of $4.1 million. There were some modest positive trends observed in aged defaults that resulted in a reduction in the default-to-claim rate on age defaults during the fourth quarter. This decrease was partially offset by a small decrease in the estimated benefit from recessions and denials.

Our estimated claim rate on new defaults remained unchanged this quarter at 12%. Claims paid in the fourth quarter of 2016 were elevated due to increased efficiencies in our claims processing, which resulted in an acceleration of paid claims and contributed to a 38% decline in primary pending claim inventory from the third quarter of 2016.

During the third quarter, we implemented an enhanced technology solution. And given our enhanced process, we expect to pay claims more rapidly after they are received. Total pending claim inventory is now at its lowest point since March 2002. This significant reduction in pending claim inventory was also the primary driver of our reduction in reserve for defaults and overall average estimated severity. Additionally, the reduction in pending claims contributed to the decrease in the overall average net default-to-claim rate, which declined to 42% from 45% at the end of the third quarter.

For 2017, we expect paid claims to be between $300 million and $325 million. Overall, the performance of our portfolio remains very good with positive trends continuing, further evidence of the strong credit profile of both post-crisis business as well as greater predictability around the legacy portfolio.

And now turning to expenses, our reported other operating expenses for the quarter were $62.4 million as compared to $62.1 million in the third quarter of 2016 and $58.6 million in the fourth quarter of 2015. We have exercised discipline and thoughtfulness while managing our expenses, while retaining the flexibility to take advantage of varying market conditions.

At Radian, we have a culture of continuous process improvement, which serves our customers, our shareholders and our employees very well. We have achieved the planned 3% to 5% reduction related to our targeted expense initiatives that we established in late 2015.

During 2016, the planned expense initiatives that we implemented include technology improvements that have reduced expenses associated with underwriting and reductions in several large contract renewals by leveraging our combined purchasing power of Radian, Clayton, Red Bell and ValuAmerica. Most of the improvements are individually immaterial to our financial statements, but aggregate to the achievement of our planned 3% to 5% reduction.

As noted at the time, the expenses for the fourth quarter of 2015 were positively impacted by several items that were immaterial individually, but aggregated to approximately $6 million. These items, which were largely comprised of year-end accounting adjustments did not have a material impact in the fourth quarter of 2016.

For 2017, we will continue to demonstrate operating discipline, although our GAAP expenses may include the impact of further strategic investments in technology and process redesign as we execute on our 2017 strategic priorities.

And moving now to taxes, our effective tax rate for the fourth quarter of 2016 was 37.5%. Our expectation for 2017 is approximately the statutory rate of 35%. And lastly, our capital activities have demonstrated discipline and prudence to-date and we will continue to be opportunistic and deliberate in our management of capital. We have also largely completed the capital plan that we outlined in late 2015, whereby we sought to improve our capital structure by removing the convertible notes and distributing our debt maturities more evenly as we continue to move forward on our path to returning to investment grade at the holding company.

As S.A. mentioned, we have received ratings upgrades for both Radian Group and Radian Guaranty by both Moody's and S&P during 2016. The plan to execute our $125 million common equity share repurchase program was announced on June 29, 2016. Subsequent to that announcement and during the third quarter, the company adopted a Rule 10b5-1 plan to implement the program. Radian did not repurchase any shares of its common stock during either the third or the fourth quarter of 2016. As the parameters of the plan are value-based, the pace of any potential repurchases is uncertain and is largely dependent on our share price, which has increased more than 80% in the second half of 2016.

Under the Private Mortgage Insurers Eligibility Requirements or PMIERs, Radian Guaranty had available assets of $4 billion and our minimum required assets were $3.8 billion as of the end of the fourth quarter 2016. The $210 million excess available assets over the minimum required assets, represents a 5% PMIERs cushion at Radian Guaranty. In addition, holding company liquidity could be utilized to enhance the cushion.

The net quarterly decline in our PMIERs cushion from $249 million to $210 million was primarily driven by a change in the PMIERs guidance issued by the GSEs effective December 31, 2016. Excluding the impact of this change in guidance, our organic growth in our cushion was approximately $30 million. We expect that we will remain compliant with PMIERs without the need to contribute additional capital to Radian Guaranty from Radian Group. It is also expected that Radian Guaranty will continue to build available assets organically.

It is also important to remind investors that our 2016 capital transactions reduced our fully diluted share count by 23.3 million shares or 9%. This share count reduction is an ongoing benefit to our shareholders.

Furthermore, after the settlement of the 2019 convertible notes expected to occur tomorrow, we will have largely eliminated the convertible notes that are a remaining legacy of a crisis era capital structure.

All of our outstanding senior notes are on investment grade terms and are more indicative of a healthy financial services company. After we redeemed the remaining 2019 convertible notes, we will have decreased our total number of diluted shares outstanding from December 31, 2015 by 12% and will have reduced our debt-to-total capital ratio to 26%.

After consideration of the settlements of the redemption of the remaining 2019 convertible senior notes tomorrow, our available holding company liquidity will be approximately $350 million and we will have no significant remaining debt maturities until June of 2019.

Our plans for future capital actions will be continue to be in the context of positioning the company for future growth, while being mindful of further rating agency upgrades and shareholder preferences. We expect further significant improvement in our capital position over time given the health of our company and we will keep investors well informed of our plans.

I will now turn the call back over to S.A.

Sanford A. Ibrahim
Chief Executive Officer & Director, Radian Group Inc.

Thank you, Frank. Before we open the call to your questions, let me remind you that we set a record for Radian in 2016 by writing the highest volume of new flow MI business in the Company's history. This new business helps grow our insurance in force and extends our earnings momentum. We grew book value per share by 11% over last year, and we improved our capital structure. And our actions in 2016 collectively decreased our total number of diluted shares by 9%.

Now operator, we would like to open the call to questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question will come from the line of Phil Stefano with Deutsche Bank. Please go ahead.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Thanks and good morning. I was hoping you could speak a little bit around prospects of the path for the operating company's upstreaming dividends to the holding company. Maybe speaking around that, is this something that it's important to the rating agencies on the path back to investment grade, or maybe is it less important just because of the allocation of corporate expenses you have in place?

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

A

Yes. Phil, so good morning and thank you for the question. I think there are a couple of things that play in the question that you just asked. Certainly, we are mindful of several things that the rating agencies are looking for, and we've sought to address those proactively in our capital plan, things such as spreading out the debt maturities and getting the convertible notes out of the capital structure.

We do have, as you alluded to, an expense and interest sharing arrangement in place with our insurance regulator in that we are able to provide support for holding company expenses through that agreement without the need for dividends from the operating company.

So all that said, we do expect to continue to build capital and PMIERs cushion at the operating company over time. And at some point, it would make sense for us to evaluate requesting a dividend from the writing company up to the parent company. The timing of that really isn't certain for us, but as we've mentioned, we do continue to build that PMIERs cushion, and as you look at effectively what our risk to capital ratio is now at the writing company, it's very low. And as we continue to build capital at the writing company at some point, it certainly makes sense for us to request that dividend.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc. Q

And is there a cushion at the operating company that you start to more strategically think about this, or is there a "right" cushion?

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

Yes, I would say there's no hard trigger in place, but certainly as we look out over the next several years, it will start to build beyond what I would call the – our expectation for organic growth. So we will have excess.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc. Q

Okay. And hopefully one more quick one here. The average claim payment came down a little bit in the quarter. I understand there is some volatility around that just on a normal basis. But did the claims – the increased efficiencies in the claims processing have any impact on this? I guess, to the extent you are able to pay claims more efficiently and quickly, could there be an average claim payment benefit from that?

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

Yes. No is the short answer there. The decrease was due to a one-time improvement in recoveries, so that's the volatility that you are seeing there.

Phil M. Stefano
Analyst, Deutsche Bank Securities, Inc. Q

Okay, understood. Thanks.

Operator: Our next question will come from the line of Mark DeVries with Barclays. Please go ahead.

Mark C. DeVries
Analyst, Barclays Capital, Inc. Q

Yes. Thanks. I was hoping to get all the clear sense of kind of the path forward on capital management, I mean it sounds like given where the valuation threshold you set up for 10b5-1, you are not a buyer of everyone's stock here at these levels. And also it sounds like you've kind of cleaned up the debt side of your balance sheet, retired the converts. So, how should we think about how you're going to prioritize the use of capital or excess cash at the holdco?

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

A

Sure. So a couple of things to keep in mind there, Mark. First is that we actually have taken a number of steps this year to reduce the overall share count. So when you take into account the activities related to taking out the converts as it relates to our diluted share count, we have taken out as we have mentioned 9% after the impact of the 2017 redemption. We're looking at close to 12% of our diluted share count that's come out. And when we translate that into an approximate share price of what those shares are coming out at, it's roughly $13.20 a share.

So even though it hasn't fallen within the clear boundaries of a discrete share repurchase program, we have been very attentive to the need and desire to bring that share count down. So all of that being said, the prioritization of our future capital actions are always to support organic growth. And we want to make sure first and foremost, that we have enough capital to support writing more high quality MI business and the landscape certainly supports a continuation of that.

And then as you look beyond supporting for that objective, we are mindful of other ways to return value to our shareholders. We've done it historically through a share repurchase program, and that is certainly one tool in the toolbox, if you will. And then another caller certainly asked about the potential for dividends in the future from the writing company up to the parent company, that is certainly a discussion to be had, but at a future date.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. But given the need to support organic growth, I guess where your returns are now, you're going to be accreting enough capital I think to do that. Does that mean you're thinking about the potential for new business opportunities like more risk sharing with the GSEs that would create kind of a step up in the amount of risk that you would be able to take on in a given year?

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

A

Yes. So we are always looking for ways to leverage our mortgage expertise in a variety of ways beyond traditional MI. And what you mentioned there certainly is one way to do that. And we just want to be prepared to take advantage of other opportunities if the returns are there for us.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay, got it. And then just turning to some of your comments around the growth outlook for 2017, I think you indicated flat NIW on a year-over-year basis. What does that assume in terms of FHA price cuts? And also I think you also indicated you expect insurance in force to continue to grow given what you said about persistency. But would you expect overall insurance in force to grow then under that scenario at a pace in excess of the roughly 4% you saw year-over-year in 2016?

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

A

Yes. So I'll take the persistency part of the question and then turn it over to Teresa for some market color and pricing discussion. But certainly, the insurance in force is impacted by our expectations around persistency. We do expect persistency to increase. And I said in my prepared remarks expect it to increase gradually throughout the year. So, that certainly is a considerable driver in insurance in force growth.

And then, Teresa, if you want to comment on the NIW?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

Certainly. Good morning. With respect to our views on NIW for this year, it does assume that the FHA premium cut remains suspended, if you will, indefinitely. And so the focus really is on the fact that the purchase market is increasing, that we have, as an industry, a better persistency – a better penetration there of three to four times. And we're going to continue on the strategy that has been successful for us in 2016 and prior of increasing the number of customers that we have, and also penetrating our existing customers with increasing share. So that's the reason why we believe we can stay essentially about flat to 2016.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. And just following up on that, again, assuming kind of flat NIW and then persistency moving higher, is it reasonable to assume that insurance in force should grow at a faster pace in 2017 than the 4% we saw in 2016?

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

A

Yes, that is reasonable to assume.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you.

Operator: Next we will go to the line of Bose George with KBW. Please go ahead.

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

Q

Hey good morning. Just one more clarification on the NIW comments, does that assume any benefit from fallout from the Arch/UG merger?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

Yes, it does assume that part of – when I talked about gaining new customers or growing share with existing customers, it does factor in that as a portion of it, yes.

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

Q

Okay. Thanks. then actually just switching over to expenses for next year, what's a reasonable way to think about the incentive comp expense for next year? And can you also remind us just on the technology upgrade expense, where that should be for next year?

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

A

Sure. So, noted on Schedule D is the total incentive comp. And not to get too deep into the mechanics of how that is calculated, we accrue for that at a target level and make adjustments throughout the year based on our expectations of changes from that target level. So, the reason we provide the history that we do on Schedule D is to help you sort of make your own assessment of where you think that's going as far as what's considered to be a normalized versus a unique expense in the quarter. So, that, on the incentive comp, that's probably my best answer to help you there.

On the technology spend, we are still in the midst of our modernization exercise, and we are starting to see some of those elements to come online. Some of the highlights in my prepared comments spoke to that in certain areas of the Company. It has been a great success for us thus far, providing improvements to customer service, et cetera. We are still spending money, and so you will see a build in the expense related to the technology and modernization. For next year, we will continue to call that out. Expectations right now are call it $1 million or so a quarter, but, again, that will be an item that we will continue to call out on Schedule D.

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

Q

Okay. Thanks. Actually, I had one more just on the share count. Can you just, on the convert redemption, can you just remind us what that does to the share count?

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

A

For which one?

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

Q

The 2017.

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

A

For the upcoming one?

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

Q

Yes.

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

A

Yes, it's about $6.4 million reduction in diluted shares.

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

Q

6.4 million shares.

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

A

Excuse me, 6.4 million shares. Thank you.

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

Q

Great. Thank you.

Operator: Next question comes from the line of Randy Binner with FBR. Please go ahead.

Randy Binner
Analyst, FBR Capital Markets & Co.

Q

Hey, good morning. Thanks. I wanted to ask a question about the services segment. Notwithstanding the adjustments that were laid out in the opening comments, the revenues there still seem to be ahead of our expectation, and it's a small part of the business but it's very return-friendly. So I'd be interested in kind of commentary on whether or not the growth you've seen, and I think you said loan review, due diligence and some rental operations, is that sustainable? Could it lever higher? And kind of what's your 2017 and 2018 outlook for growth opportunity in the services?

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

A

Sure. So I would certainly say that we are optimistic about the outlook for the revenue in 2017 and 2018. We are not going to provide specific guidance on it, but I would just tell you that under the leadership of Jeff Tennyson, he and his team have done a great job of acquiring new clients and really building that revenue up nicely. So, we certainly would expect to see that continue and we think the market conditions are such that it should support it.

Randy Binner
Analyst, FBR Capital Markets & Co.

Q

And that assumption there is all organic, right? I mean, are there possible inorganic opportunities in that area that are kind of low-hanging?

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

A

No. We have acquired into that segment. We think certainly most of the capabilities that we would need to deliver the products and services that we expect to deliver. Now, that doesn't mean that there might be an opportunistic acquisition opportunity to help accelerate the timeline of some organic plans, but for the most part, we expect that to be organic.

Randy Binner
Analyst, FBR Capital Markets & Co.

Q

And just one more if I could on the – you mentioned that there was a change in GSE guidance around PMIERs at the end of last year. And can you just briefly review what that change was? And is there an expectation of further changes that kind of factors into the capital adequacy and upstream comments you made earlier?

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

A

Sure. So, the change is that we are effective as of December 31, 2016. First of all, we are applicable to all mortgage insurers. And it really for Radian, it impacted two key areas in particular. And one was corporate-owned life insurance was one of the particular assets that is now an available asset that previously was not an available asset. The other relates to the way that they look at reinsurance and the funds withheld from reinsurance, that was previously available and now it is not an available asset any longer. So, those were the two primary changes. As far as on an ongoing basis, PMIERs when it first came out mentioned that it will be updated every 2 years. And so 2016 was the first year of applicability for PMIERs for mortgage insurers. And so we would expect to see some update to PMIERs for an effective date of December 31, 2017.

Randy Binner
Analyst, FBR Capital Markets & Co.

Q

All right, perfect. Thank you.

Operator: And next we go to the line of Vic Agrawal with Wells Fargo. Please go ahead.

Vic Agrawal
Analyst, Wells Fargo Securities LLC

Q

Hi, good morning. Thanks for taking my question. I think in your prepared remarks you said that you had 18% decline in the number of loans and default in 2016, can you talk a little bit about what your – what trends you are seeing in judicial states and do you think that there is a possibility of both loans working through more quickly in 2017?

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

A

Yes. Derek, you want to...

Derek V. Brummer
Chief Risk Officer & Executive Vice President, Radian Group Inc.

A

Yes, I mean, I think over time, obviously our default inventory has become more concentrated in judicial states. I think maybe a marginal pickup. I don't expect to see anything kind of dramatic. I think we cleared out some of our pending claim inventories. I don't expect to see any significant changes in terms of what we've been seeing really over the last year.

Vic Agrawal
Analyst, Wells Fargo Securities LLC

Q

Okay, that's it from me.

Operator: Our next question comes from the line of Doug Harter with Credit Suisse. Please go ahead.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. Can you talk about your expectations for new notices of default in 2017, and how we should think about how that trends over time?

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

A

Yes. So I think our expectation there is just continued improvement in the trends over time.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

I guess any way to help think about what is – kind of what is a normalized level of NODs and kind of if or how long it takes to kind of get to that level?

Derek V. Brummer
Chief Risk Officer & Executive Vice President, Radian Group Inc.

A

In terms of new notices, I mean, we have seen that steady decline over time with respect to that. And I think what you are seeing is just a shift. So in the legacy portfolio, we continue to see a decline year-over-year, the new books moving in. So in terms of normalized, a lot of it just going to depend upon the distribution of the portfolio over time in that shift. So, it's a little hard to give guidance as to that number. It really depends on kind of the distribution of the book over time.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

All right. Thank you.

Operator: And next we go to the line of Mackenzie Aron with Zelman & Associates. Please go ahead.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Thanks. Good morning.

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

A

Good morning.

Mackenzie Aron
Analyst, Zelman & Associates

Q

First question just on volume trends that you have been seeing post the election in the rate increase, can you give any color around whether following the election, there was a pickup in applications or any demand? Just wondering if there was possibly a pull-forward because the volume was so strong in the quarter or anything also was notable that we might be aware of?

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

A

So, Teresa?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

Mackenzie, I don't think we have seen anything that would indicate that there was a pickup related to that. There may have been a little bit related to interest rates going up and some concerns with sort of getting deals done before their future interest rate increases, but I don't think anything that we could materially point to.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Okay. And just a comment that was made during the opening remarks that 2017 appears to be off to a strong start, is there any differentiation between the purchase and refi side?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

In terms of whether or not we are seeing sort of a pickup on the purchase side or?

Mackenzie Aron
Analyst, Zelman & Associates

Q

Yes, or if maybe refis are starting to falloff quicker than you would have expected or maybe just staying flat?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

No, I think that we expected to see the refis starting to reduce and I think we are starting to see that happening. So, so far the expectation that we will see lower refinances in a stronger pickup on purchases seems to be holding.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Okay, perfect. And then Teresa just one more, could you just give us an update on pricing maybe by product whether it's monthly or the singles or maybe if there is any changes in the credit union channel?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

Yes, there haven't been – I mean, the good news is that we have seen pricing be relatively stable and rationale over the last few quarters. And we had always said that, if that were the case that we thought we could grow our business, because we could focus on relationships and service, which is what we have been doing. So the good news, I think at this point is that any – there is maybe little price competition around the edges, but we haven't really seen any sort of any issues there.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Okay, great. Well, thanks again and congrats on the quarter.

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

Thank you.

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

A

Thank you.

Operator: Our next question comes from the line of Mihir Bhatia with Bank of America. Please go ahead.

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Hi and good morning.

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

A

Good morning.

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Thanks for taking my question. Just to start – maybe can you just provide a little bit more color on the net loss on the investments this quarter? Was it related to a particular investment or type of security or just anymore color you can provide on that?

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

A

Yes. So if you take a look at the details of our portfolio, which we have in our quarterly filings, you will see that our investment portfolio is a very high quality portfolio, and so what you will see with a portfolio of high quality fixed income securities with roughly a five-year duration, any time there's a tick up in interest rates, that's going to have a fairly sizable impact on the market value of the securities.

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Right, I mean, in terms of just – but these are recognized gains, or losses, like the securities [indiscernible] (0:50:28). Okay, so it's all unrec. Got it.

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

A

All unrecognized, that's correct.

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Okay, just want to make sure on that. And then just following up on the earlier question with Mackenzie, if I could just expand that out in terms of the competition seen not just in the credit unions but across the board maybe, I appreciate that MI is always a competitive industry, but maybe just if you can talk about it relative to maybe this time last year, if you are seeing any differences in trends or what your competitors are doing?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

I think, if anything, it's stabilized and it's become more rational. So when we were in the first quarter of last year, we were seeing a lot of price competition that sort of didn't make sense from an industry point of view, and that seemed to sort of level out starting at the beginning of the second quarter. It had stayed pretty much in alignment there since then.

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Got it. And in terms of the effects of that competition, which led to new rate cuts and stuff, has that mostly worked its way through your financials I guess by the end of Q1 or early in Q2? Because we saw a little bit of a reduction in the premium rate this quarter. I'm just wondering. What are your expectations for premium rate for the rest of the year, assuming no changes in pricing?

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

A

This is Frank. Our expectations are around pricing really are, as Teresa alluded to, stability on a relative basis to a year ago. But as you look at new vintages coming on, they are coming on at a slightly lower premium rate, and that's due largely to the fact that we write very high-quality business. And because we have a risk-adjusted rate card with higher quality business, it has lower premium rate. But also keep in mind, because it is higher-quality business, it also has lower loss – expected loss content.

So as you look at return expectation, the returns, which is what we manage to, are really – there's no change in expectation on the return, at least in any material way.

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Got it. And then just the last question on your tax rate. It picked up a little bit this quarter. For 2017, what should we be expecting?

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

A

Yes. So, for 2017, and this is as of today, we expect it to be at the statutory rate of 35%.

Mihir Sudhir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Okay, great. Thank you.

Operator: And our next question will come from the line of Chris Gamaitoni with Autonomous Research. Please go ahead.

Chris Gamaitoni
Analyst, Autonomous Research US LP

Q

Good afternoon. Thanks for taking my call. I wanted to follow up on one of Mackenzie's questions. The – your purchase NIW was up 34% year-over-year. The other peer that's reported so far was up 20%, and kind of consensus forecasts have put the fourth quarter at plus 5% for overall purchase market. I'm wondering. What's driving the acceleration we are seeing in growth in the MI channel? Is it share in the FHA related to 97's? Is it shares already shifted from, you know, Guaranty, or is it just something else?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

Certainly, we have been very focused, I think, as an industry, on growing the amount of business that we are getting vis-à-vis the FHA. I think some of that is related to the 97s. We've seen an increase in requests for training from lenders and so forth. So, we think some of it is definitely coming from that point. With respect to the UG kind of merger, that really we don't know yet. It's too soon. It really culminated at the end of the year, and so I think we will see if there's any opportunity there over the next few months.

Chris Gamaitoni
Analyst, Autonomous Research US LP

Q

Okay, so there's nothing clear on why the growth in purchase is kind of five to six times what the industry is seeing overall for MI so far?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

Other than what I just offered up in terms of the 97s, and just our general focus on continuing to train loan officers and real estate agents saw the benefits of MI. When you think about it, there's continued to be a concern amongst lenders about the False Claims Act and issues that they could see. With the Justice Department, you've seen a lot of settlements coming out. And so I think that has helped with our efforts to try to increase the use of private MI versus FHA. And we've continued to also market the fact that private MI is cancelable when FHA is not. So, we continue those efforts. We think that's all helped.

Sanford A. Ibrahim
Chief Executive Officer & Director, Radian Group Inc.

A

And let me add a little bit of that from years of experience in dealing with mortgage brokers and loan officers. They are creatures of habit to some extent. And during the downturn, they got into the habit of referring a lot more loans to the FHA side. And we've been working hard as an industry in educating them on the advantages of going the GSE/MI route. And I think they are benefiting from that. It took a long time to get them to switch and we are benefiting from that, and we have been benefiting to some extent because the lender preference, pricing changes notwithstanding, has shifted to doing business with the GSEs/MIs versus the FHA because of some of the reasons we discussed in the past calls.

Chris Gamaitoni
Analyst, Autonomous Research US LP

Q

That makes a lot of sense. And then do you guys have any sense of – I know you said you persistency will increase slowly throughout the year, given the current forward curve. Do you have any sense of kind of where that will peak out at naturally over the next year, or two years, assuming nothing changes in the rate outlook?

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

A

Yes, so we have said historically that low to mid 80s% is sort of call it a normalized range. Certainly the mid-80s% would be on the high end. So, low 80s% is really what we expect to see as far as a normalized level. I think the pace to return to that level is hard to predict, but we do expect to see some increases from our current level in 2017.

Chris Gamaitoni
Analyst, Autonomous Research US LP

Q

Thank you so much.

Operator: [Operator Instructions] Next we will go to the line of Geoffrey Dunn with Dowling & Partners. Please go ahead.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Thanks. Good morning.

Sanford A. Ibrahim
Chief Executive Officer & Director, Radian Group Inc.

A

Good morning Geoff.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

First, can you confirm the incident rate was unchanged at 12% this quarter?

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

A

Yes, we can.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. And then second, I want to go back to the premium rate. If you strip out the impact of all the reinsurance and profit commission refundings, it's still been bouncing around a fair amount. Is that kind of gross volatility due to single premium amortizations, or is there something else in there? I understand we have a new pricing contract in April, but it's still bouncing around.

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

A

Yes, it is single premium acceleration.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

So when we think about that rate, let's just use the under 52 BPS in the fourth quarter, should we, just under the new pricing construct, expect that that's going to trend down towards 50 or 49? Is that a fair assumption even with the volatility around single premium, or as you think about the single premium rollout, do we have to think about something different than that pattern?

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

A

No, I think you are right in the 50-49 direction, that is – that's the safe assumption.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay, all right. Thank you.

Operator: And our last question will come from the line of Jack Micenko with SIG. Please go ahead.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

Hi, good morning. Obviously, you're seeing the benefits from the improved claim processing efficiencies on the numbers. But I'm wondering, from a competitive standpoint, I can see where that could potentially be a competitive advantage. Would you characterize your new practice as leading the industry, are you playing catch-up, or how would you position yourself relative to your peers in terms of your new process on the claims side?

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

A

Yes. I don't know that I would characterize it as leading or lagging. It's appropriate for us and certainly appropriate and consistent with what we have outlined for the goals of our system modernization efforts.

Sanford A. Ibrahim
Chief Executive Officer & Director, Radian Group Inc.

A

I would call it adjusting to a more normal claims environment than what we see during the downturn and we are now finally leveling off at a normal same environment. But to your point in terms of competitive practice, I think everybody should be getting to the same point. We all have the goal of getting them out as quickly as possible. That said, our technology did help us in terms of the underwriting side as Frank said in coping with the larger volume levels being able to offer the – offer competitive turnaround times which are very important to capturing business.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

Okay. And then given I guess the change in tenure in Washington, I guess we got the FHFA rollback within about 15 minutes of the new administration. Teresa, what parts of the proposal to the FHFA can be implemented without Congress acting or passing any definitive GSE reform or maybe a change of leadership with the FHFA?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

So they can continue to do more credit risk transfer, which we will continue to see them do. They could continue to focus on CSP and making those changes. I think in terms of being able to actually do reform itself, they consider to go along the path they have been going with essentially decreasing the risk that the GSEs are taking. But in terms of the structure itself, I think that's really going to have to come back to Congress to do. And to your point about leadership, certainly Director Watt has said that he think that it's Congress' job to do that whether or not someone different, would take a different tack, I don't know, but I think that's certainly where we are today.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

So you're saying in other words deeper cover is probably a congressional development?

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

I think deeper cover could be done by the FHFA. And certainly, they are evaluating the comments on that that were submitted in the fall and evaluating that as well as other ways of doing credit risk transfer. So I do think that is something that they can move forward with.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

Okay, all right. Thank you.

Teresa Bryce Bazemore
President, Radian Guaranty Inc., Radian Group Inc.

A

Sure.

Sanford A. Ibrahim
Chief Executive Officer & Director, Radian Group Inc.

A

And I think we are done with questions at this point, operator?

Operator: At this time, there are no further questions.

Sanford A. Ibrahim
Chief Executive Officer & Director, Radian Group Inc.

So I would like to thank you all for participating in Radian's fourth quarter and full year 2016 call. Thank you for your interest in Radian.

Operator: Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation and for using AT&T Teleconference Service. You may now disconnect.