

Research Update:

Radian Guaranty Upgraded To 'A-' From 'BBB+' Following Revised Capital Model Criteria; Outlook Stable

January 8, 2024

Overview

- On Nov. 15, 2023, we published our revised criteria for analyzing insurers' risk-based capital (see "Insurer Risk-Based Capital Adequacy--Methodology And Assumptions").
- The implementation of the revised capital model criteria has a positive impact on our view of Radian Group Inc. and its operating subsidiary Radian Guaranty Inc.'s (collectively, Radian's) financial strength.
- Therefore, we raised our financial strength rating on Radian Guaranty to 'A-' from 'BBB+' and the holding company, Radian Group's issuer credit rating to 'BBB-' from 'BB+'.
- The stable outlook reflects our expectation that Radian will maintain sufficient capital redundancy at the 99.95% confidence level, supported by strong underwriting earnings and risk management practices.

Rating Action

On Jan. 8, 2024, S&P Global Ratings raised its long-term insurer financial strength and issuer credit ratings on Radian Guaranty Inc. to 'A-' from 'BBB+'. At the same time, we raised our long-term issuer credit rating on Radian Group Inc. to 'BBB-' from 'BB+' and the issue ratings on the outstanding senior debt to 'BBB-' from 'BB+'. The outlook is stable.

Impact Of Revised Capital Model Criteria

- The improvement in capital adequacy under the revised capital model primarily reflects our recalibration of mortgage insurance premium and reserve risk capital requirements.
- The total adjusted capital under the revised methodology has remained relatively unchanged as the benefits of loss reserve discounting (removal of haircut) and deferred acquisition cost for mortgage insurers in general are minimal.

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- Considering the mortgage insurers' monoline business model, the benefits of risk diversification, which are more explicit in our capital model, are marginal.
- The recalibration of our capital charges to higher confidence levels partly offset these improvements.

Credit Highlights

Overview

| Key strengths | Key risks |
|---|---|
| A seasoned insurer with a solid presence in the U.S. mortgage insurance sector. | Labor market stresses could result in higher mortgage delinquencies, thereby near-term loss ratios could be elevated. |
| Solid capitalization supported by robust earnings accrual, and prudent reinsurance protection strategy. | Increasing cost of capital and reinsurance protection. |
| Strong underwriting discipline backed by effective risk management practices. | Commoditized business that is vulnerable to systemic risks and exposed to potential structural changes in the housing finance market. |

Outlook

The stable outlook reflects our expectation that Radian will maintain underwriting discipline and continue to generate strong earnings that will be capital accretive. We expect the company's capitalization to remain sufficiently redundant at the 99.95% confidence level--or severe stress level on a sustained basis.

Downside scenario

We could lower our ratings in the next two years if:

- Radian's capitalization falls below a 99.95% confidence level on a sustained basis;
- Its underwriting discipline weakens and its risk profile, in our view, increases materially;
- The company's capital/risk management strategy depends heavily on reinsurance, such that it could become a competitive disadvantage;
- In an economic stress scenario, losses are higher than anticipated such that they become a capital event or operating performance is significantly worse than that of its peers; or
- The company's financial leverage nears 40%, or its fixed charge coverage falls sustainably below 4x.

Upside scenario

We do not anticipate raising our ratings during the next two years. However, we could raise the ratings if the U.S. economic and housing fundamentals are supportive, and if:

- Capitalization sustainably strengthens to a level that is sufficiently redundant at the 99.99% confidence level, and is supported by sophisticated risk management practices, or

- The company's competitive position materially improves compared with that of its peers.

Rationale

Our rating action reflects Radian's improved capitalization resulting from the implementation of our revised capital adequacy methodology, and our expectation of the company's ability to generate solid underwriting earnings that would be capital accretive. As of year-end 2022, Radian's capitalization was sufficiently redundant at the 99.95% or severe stress level, and we expect it to remain so through 2025.

S&P Global economists believe that weaker U.S. GDP growth could loosen the demand for labor and the unemployment rate could rise throughout 2024 before peaking at 4.6% in 2025. As a result, we believe mortgage delinquencies could rise, and near-term loss ratios could be elevated. In addition, considering the significant mortgage refinancing in 2020-2021, the majority of the in-force book today are from 2020-2023 vintages. As these loans undergo their regular loss emergence pattern, that would also keep the loss ratios high in the near term. Furthermore, though diminishing, the company continues to have exposure to pre-2008 vintages (about 2.9% as of Sept. 30, 2023), which are more vulnerable to economic stresses and could also pose some risk.

Nonetheless, with Radian's solid underwriting portfolio quality, significant home equity cushion, and substantial reinsurance protection, we believe the company's earnings could absorb potential losses. We expect the combined ratio in 2023 to remain between 25%-30% and thereafter elevate to 50%-55% in 2024 and 2025.

Our moderately high risk exposure assessment reflects mortgage insurers'--including Radian's--material risk concentration, along with the high severity and low frequency nature of risk that could result in potential earnings and capital volatility. However, the risk is partly offset by Radian's risk management, regulatory guardrails, prudent use of reinsurance, and the increasing use of a risk-based pricing engine that allows Radian to promptly reflect the prevailing credit trends into pricing and in their risk selection.

Radian's sizeable presence in the U.S. primary mortgage insurance sector, its national footprint, its seasoned customer relationships, and its disciplined approach to underwriting, which have produced strong underwriting results, underlies our view on its competitive position. However, the commoditized monoline business model and systemic exposure to the economy and housing market constrain our view of its business risk. Through its Homegenius segment, Radian has broadened its revenue sources. However, it contributes less meaningfully and doesn't diversify the group's earnings.

A combination of our satisfactory business risk assessment and strong financial risk assessment result in an anchor choice of 'a-/bbb+'. Our selection of the higher anchor choice reflects Radian's track record of solid underwriting profitability, in line with higher rated insurers.

Ratings Score Snapshot

| | To | From |
|--------------------------------------|----------------|---------------|
| Holding company Issuer credit rating | BBB-/Stable/-- | BB+/Stable/-- |
| Financial strength rating | A-/Stable/-- | BBB+/Stable |
| Anchor | a- | bbb+ |
| Business risk | Satisfactory | Satisfactory |

| | To | From |
|-----------------------------|-----------------|----------------|
| IICRA | Intermediate | Intermediate |
| Competitive position | Satisfactory | Satisfactory |
| Financial risk | Strong | Satisfactory |
| Capital and earnings | Very Strong | Satisfactory |
| Risk exposure | Moderately High | Moderately low |
| Funding structure | Neutral | Neutral |
| Modifiers | - | - |
| Governance | Neutral | Neutral |
| Liquidity | Exceptional | Exceptional |
| Comparable ratings analysis | - | - |
| Support | - | - |
| Group support | - | - |
| Government support | - | - |

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria

- Criteria | Insurance | General: Insurer Risk-Based Capital Adequacy--Methodology And Assumptions, Nov. 15, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Certain Issuer And Issue Ratings Placed Under Criteria Observation After Insurance Capital Model Criteria Update, Nov. 15, 2023
- U.S. Private Mortgage Insurance Sector View, April 19, 2023
- Radian Group Inc., March 22, 2023

Ratings List

Upgraded

| | To | From |
|---------------------------|----------------|----------------|
| Radian Group Inc. | | |
| Issuer Credit Rating | | |
| Local Currency | BBB-/Stable/-- | BB+/Stable/-- |
| Senior Unsecured | BBB- | BB+ |
| Radian Guaranty Inc. | | |
| Issuer Credit Rating | | |
| Local Currency | A-/Stable/-- | BBB+/Stable/-- |
| Financial Strength Rating | | |
| Local Currency | A-/Stable/-- | BBB+/Stable/-- |

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