RADIAN GROUP INC
Form 10-Q
August 10, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from to

Commission File Number 1-11356

Radian Group Inc.

(Exact name of registrant as specified in its charter)

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

(215) 231-1000

(Registrant s telephone number, including area code)

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 82,612,170 shares of common stock, $0.001 par value per share, outstanding on August 3, 2009.

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Forward-Looking Statements Safe Harbor Provisions

All statements in this report that address events, developments or results that we expect or anticipate may occur in the future are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1934 and the U.S. Private Securities Litigation Reform Act of 1995. In most cases, forward-looking statements may be identified by words such as anticipate, may, should, expect, intend, plan, goal, contemplate, believe, estimate, predict, project, potential, continue, or the negative or words and other similar expressions. These statements, which include, without limitation, projections regarding our future performance and financial condition are made on the basis of management s current views and assumptions with respect to future events. Any forward-looking statement is not a guarantee of future performance and actual results could differ materially from those contained in the forward-looking information. The forward-looking statements, as well as our prospects as a whole, are subject to risks and uncertainties, including the following:

changes in general financial and political conditions, such as a deepening of the existing national economic recession, further decreases in housing demand, mortgage originations or housing values (in particular, further deterioration in the housing, mortgage and related credit markets, which would harm our future consolidated results of operations and could cause losses for our businesses to be worse than expected), a further reduction in the liquidity in the capital markets and further contraction of credit markets, further increases in unemployment rates, changes or volatility in interest rates or consumer confidence, changes in credit spreads, changes in the way investors perceive the strength of private mortgage insurers or financial guaranty providers, investor concern over the credit quality and specific risks faced by the particular businesses, municipalities or pools of assets covered by our insurance;

catastrophic events or further economic changes in geographic regions where our mortgage insurance or financial guaranty insurance in force is more concentrated;

our ability to successfully execute upon our internally sourced capital plan for our mortgage insurance business (which depends, in part, on the performance of our financial guaranty portfolio), and if necessary, to obtain additional capital to support new business writings in our mortgage insurance business and the long-term liquidity needs of our holding company (including significant payment obligations in 2010 and 2011) and to protect our credit ratings and the financial strength ratings of Radian Guaranty Inc., our principal mortgage insurance subsidiary, from further downgrades;

a further decrease in the volume of home mortgage originations due to reduced liquidity in the lending market, tighter underwriting standards and the ongoing deterioration in housing markets throughout the U.S.;

our ability to maintain adequate risk-to-capital ratios and surplus requirements in our mortgage insurance business in light of ongoing losses in this business and in our financial guaranty portfolio, which, in the absence of new capital, may depend on our ability to execute strategies for which regulatory and other approvals are required and may not be obtained;

our ability to continue to effectively mitigate our mortgage insurance losses, which mitigation efforts recently have resulted in increased levels of rescissions and denials that may not be sustainable and could lead to an increased risk of litigation;

the concentration of our mortgage insurance business among a relatively small number of large customers;

disruption in the servicing of mortgages covered by our insurance policies;

the aging of our mortgage insurance portfolio and changes in severity or frequency of losses associated with certain of our products that are riskier than traditional mortgage insurance or financial guaranty insurance policies;

the performance of our insured portfolio of higher risk loans, such as Alternative-A (Alt-A) and subprime loans, and of adjustable rate products, such as adjustable rate mortgages and interest-only mortgages, which have resulted in increased losses and are expected to result in further losses;

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changes in persistency rates of our mortgage insurance policies;

an increase in the risk profile of our existing mortgage insurance portfolio due to mortgage refinancing in the current housing market;

further downgrades or threatened downgrades of, or other ratings actions with respect to, our credit ratings or the ratings assigned by the major rating agencies to any of our rated insurance subsidiaries at any time (in particular, the credit rating of Radian Group Inc. and the financial strength ratings assigned to Radian Guaranty Inc.);

heightened competition for our mortgage insurance business from others such as the Federal Housing Administration and the Veterans Administration or other private mortgage insurers (in particular those that have been assigned higher ratings from the major rating agencies);

changes in the charters or business practices of Federal National Mortgage Association (Fannie Mae) and Freddie Mac, the largest purchasers of mortgage loans that we insure, and our ability to remain an eligible provider to both Freddie Mac and Fannie Mae;

the application of existing federal or state consumer, lending, insurance, securities and other applicable laws and regulations, or changes in these laws and regulations or the way they are interpreted; including, without limitation: (i) the outcome of existing investigations or the possibility of private lawsuits or other formal investigations by state insurance departments and state attorneys general alleging that services offered by the mortgage insurance industry, such as captive reinsurance, pool insurance and contract underwriting, are violative of the Real Estate Settlement Procedures Act and/or similar state regulations or (ii) legislative and regulatory changes affecting demand for private mortgage insurance, limiting or restricting our use of (or requirements for) additional capital, the products we may offer, the form in which we may execute the credit protection we provide or the aggregate notional amount of any product we may offer for any one transaction or in the aggregate;

the possibility that we may fail to estimate accurately the likelihood, magnitude and timing of losses in connection with establishing loss reserves for our mortgage insurance or financial guaranty businesses or premium deficiencies for our mortgage insurance businesses, or to estimate accurately the fair value amounts of derivative contracts in our mortgage insurance and financial guaranty businesses in determining gains and losses on these contracts;

the ability of our primary insurance customers in our financial guaranty reinsurance business to provide appropriate surveillance and to mitigate losses adequately with respect to our assumed insurance portfolio; and the significant concentration of our financial guaranty reinsurance business in customers under common control;

volatility in our earnings caused by changes in the fair value of our derivative instruments and our need to reevaluate the premium deficiency in our mortgage insurance business on a quarterly basis;

changes in accounting guidance from the SEC or the Financial Accounting Standards Board;

legal and other limitations on amounts we may receive from our subsidiaries as dividends or through our tax and expense-sharing arrangements with our subsidiaries; and

- our investment in Sherman Financial Group LLC, which could be negatively affected in the current credit environment if Sherman is unable to maintain sufficient sources of funding for its business activities or remain in compliance with its credit facilities.

For more information regarding these risks and uncertainties as well as certain additional risks that we face, you should refer to the Risk Factors detailed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2008 and in Item 1A of Part II in this Quarterly Report on Form 10-Q. We caution you not to place undue reliance on these forward-looking statements, which are current only as of the date on which we filed this report. We do not intend to, and we disclaim any duty or obligation to, update or revise any forward-looking statements made in this report to reflect new information or future events or for any other reason.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements. (Unaudited)

Radian Group Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share and per share amounts)	June 30 2009	December 31 2008
ASSETS		
Investments		
Fixed maturities held to maturity at amortized cost (fair value $31,308 and $37,486)	$ 30,225	$ 36,628
Fixed maturities available for sale at fair value (amortized cost $2,371,366 and $3,899,487)	2,158,523	3,647,269
Trading securities at fair value (amortized cost $2,460,768 and $670,835)	2,474,923	654,699
Equity securities available for sale at fair value (cost $217,585 and $212,620)	175,570	165,099
Hybrid securities at fair value (amortized cost $469,239 and $499,929)	450,016	426,640
Short-term investments	1,082,016	1,029,285
Other invested assets (cost $23,256 and $21,388)	23,406	21,933
Total investments	6,394,679	5,981,553
Cash	64,554	79,048
Investment in affiliates	108,767	99,712
Deferred policy acquisition costs	208,882	160,526
Prepaid federal income taxes		248,828
Accrued investment income	48,112	61,722
Accounts and notes receivable (less allowance of $68,537 and $61,168)	243,785	90,158
Property and equipment, at cost (less accumulated depreciation of $87,835 and $84,911)	15,760	18,178
Derivative assets	179,837	179,515
Deferred income taxes, net	368,281	446,102
Reinsurance recoverables	570,245	492,359
Other assets	252,600	258,418
Total assets	$ 8,455,502	$ 8,116,119
LIABILITIES AND STOCKHOLDERS EQUITY		
Unearned premiums	$ 1,120,359	$ 916,724
Reserve for losses and loss adjustment expenses (LAE)	3,304,236	3,224,542
Reserve for premium deficiency	40,861	86,861
Long-term debt and other borrowings	856,848	857,802
Variable interest entity debt at fair value	283,242	160,035
Derivative liabilities	379,270	519,260
Accounts payable and accrued expenses	404,432	320,185
Total liabilities	6,389,248	6,085,409
Commitments and Contingencies (Note 15)		
Stockholders equity		
Common stock: par value $.001 per share; 325,000,000 shares authorized; 99,460,173 and 98,223,210 shares issued at June 30, 2009 and December 31, 2008, respectively; 82,252,266 and 81,034,883 shares outstanding at June 30, 2009 and December 31, 2008, respectively	99	98
Treasury stock, at cost: 17,207,907 and 17,188,327 shares at June 30, 2009 and December 31, 2008, respectively	(889,142)	(888,057)

Additional paid-in capital	1,358,440	1,350,704
Retained earnings	1,764,878	1,766,946
Accumulated other comprehensive loss, net	(168,021)	(198,981)
Total stockholders equity	2,066,254	2,030,710
Total liabilities and stockholders equity	$ 8,455,502	$ 8,116,119

See accompanying notes to unaudited condensed consolidated financial statements.

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Radian Group Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30		Six Months Ended June 30	
(In thousands, except per share amounts)	**2009**	**2008**	**2009**	**2008**
Revenues:				
Premiums written insurance:				
Direct	$ 193,854	$ 248,660	$ 392,223	$ 511,266
Assumed	8,127	13,043	3,198	37,314
Ceded	(40,080)	(39,058)	(76,764)	(81,629)
Net premiums written	161,901	222,645	318,657	466,951
Decrease in unearned premiums	31,728	26,492	86,187	24,107
Net premiums earned insurance	193,629	249,137	404,844	491,058
Net investment income	53,251	65,128	109,534	131,107
Change in fair value of derivative instruments	272,318	56,226	(12,098)	764,035
Net gains (losses) on other financial instruments	54,384	14,801	79,264	(26,040)
Total other-than-temporary impairment losses	(46)	(23,052)	(680)	(37,095)
Losses recognized in other comprehensive income (loss)				
Net impairment losses recognized in earnings	(46)	(23,052)	(680)	(37,095)
Other income	3,888	3,221	8,020	6,835
Total revenues	577,424	365,461	588,884	1,329,900
Expenses:				
Provision for losses	132,750	458,879	459,504	1,041,590
Provision for premium deficiency	2,184	369,807	(46,000)	387,897
Policy acquisition costs	25,967	75,952	39,921	99,858
Other operating expenses	55,635	63,849	107,237	118,990
Interest expense	12,295	13,832	24,594	26,325
Total expenses	228,831	982,319	585,256	1,674,660
Equity in net income of affiliates	5,110	15,704	15,662	28,230
Pretax income (loss)	353,703	(601,154)	19,290	(316,530)
Income tax provision (benefit)	121,828	(208,630)	4,852	(119,644)
Net income (loss)	$ 231,875	$ (392,524)	$ 14,438	$ (196,886)
Basic net income (loss) per share	$ 2.85	$ (4.91)	$ 0.18	$ (2.46)
Diluted net income (loss) per share	$ 2.82	$ (4.91)	$ 0.18	$ (2.46)
Weighted-average number of common shares outstanding basic	81,396	79,967	81,400	79,960
Weighted-average number of common and common equivalent shares outstanding diluted	82,240	79,967	82,236	79,960

Dividends per share	$	0.0025	$	0.02	$	0.0050	$	0.04

See accompanying notes to unaudited condensed consolidated financial statements

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Radian Group Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON STOCKHOLDERS EQUITY (UNAUDITED)

					Accumulated Other Comprehensive Income (Loss)			
(In thousands)	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Foreign Currency Translation Adjustment	Unrealized Holding Gains (Losses)	Other	Total
BALANCE, JANUARY 1, 2008	$ 98	$ (889,478)	$ 1,331,790	$ 2,181,191	$ 12,142	$ 86,619	$ (1,626)	$ 2,720,736
Comprehensive loss:								
Net loss				(196,886)				(196,886)
Unrealized foreign currency translation adjustment, net of tax of $2,225					4,133			4,133
Unrealized holding losses arising during period, net of tax benefit of $51,383						(95,425)		
Less: Reclassification adjustment for net losses included in net loss, net of tax benefit of $11,260						20,190		
Net unrealized loss on investments, net of tax benefit of $40,123						(74,515)		(74,515)
Comprehensive loss								(267,268)
Repurchases of common stock under incentive plans		(574)	856					282
Issuance of restricted stock			78					78
Amortization of restricted stock			3,788					3,788
Stock-based compensation expense			1,550					1,550
Dividends declared				(3,259)				(3,259)
BALANCE, JUNE 30, 2008	$ 98	$ (890,052)	$ 1,338,062	$ 1,981,046	$ 16,275	$ 12,104	$ (1,626)	$ 2,455,907
BALANCE prior to implementation effects JANUARY 1, 2009	$ 98	$ (888,057)	$ 1,350,704	$ 1,766,946	$ 13,966	$ (196,480)	$ (16,467)	$ 2,030,710
Cumulative effect of adoption of SFAS No. 163 (see Note 1)				(37,587)				(37,587)
BALANCE, JANUARY 1, 2009, as adjusted	$ 98	$ (888,057)	$ 1,350,704	$ 1,729,359	$ 13,966	$ (196,480)	$ (16,467)	$ 1,993,123
Cumulative effect of adoption of FSP FAS 115-2/124-2 (see Note 1)				21,490		(21,490)		
Comprehensive income:								
Net income				14,438				14,438
Unrealized foreign currency translation adjustment, net of tax of $1,193					2,215			2,215
Unrealized holding gains arising during the period, net of tax of $41,338						76,772		
Less: Reclassification adjustment for net gains included in net income, net of tax of $14,300						(26,558)		
Net unrealized gain on investments, net of tax of $27,038						50,214		50,214
Comprehensive income								66,867
Repurchases of common stock under incentive plans		(1,085)	1,085					
Issuance of stock under benefit plans	1		1,848					1,849
Amortization of restricted stock			2,234					2,234
Stock-based compensation expense			2,569					2,569
Dividends declared				(409)				(409)

Net actuarial loss							21	21
BALANCE, JUNE 30, 2009	$ 99	$ (889,142)	$ 1,358,440	$ 1,764,878	$ 16,181	$ (167,756)	$ (16,446)	$ 2,066,254

See accompanying notes to unaudited condensed consolidated financial statements.

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Radian Group Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	**Six Months Ended June 30 2009**	**2008**
Cash flows used in operating activities	$ (1,581,401)	$ (185,245)
Cash flows from investing activities:		
Proceeds from sales of fixed-maturity investments available for sale	1,683,501	193,536
Proceeds from sales of equity securities available for sale	3,256	5,792
Proceeds from sales of hybrid securities	105,857	205,206
Proceeds from redemptions of fixed-maturity investments available for sale	240,733	93,094
Proceeds from redemptions of fixed-maturity investments held to maturity	6,890	7,481
Proceeds from redemptions of hybrid securities	9,304	29,347
Purchases of fixed-maturity investments available for sale	(308,994)	(340,218)
Purchases of equity securities available for sale	(8,701)	(85,289)
Purchases of hybrid securities	(117,733)	(242,954)
(Purchases) sales of short-term investments, net	(45,889)	263,492
Purchases of other invested assets, net	(1,473)	(1,249)
Purchases of property and equipment, net	(910)	(3,283)
Net cash provided by investing activities	1,565,841	124,955
Cash flows from financing activities:		
Dividends paid	(409)	(3,259)
Proceeds from termination of interest rate swap		12,800
Net cash (used in) provided by financing activities	(409)	9,541
Effect of exchange rate changes on cash	1,475	(1,710)
Decrease in cash	(14,494)	(52,459)
Cash, beginning of period	79,048	200,787
Cash, end of period	$ 64,554	$ 148,328
Supplemental disclosures of cash flow information:		
Income taxes received	$ (339,719)	$ (227,753)
Interest paid	$ 25,999	$ 28,428
Supplemental disclosures of non-cash items:		
Stock-based compensation, net of tax	$ 4,224	$ 5,173

See accompanying notes to unaudited condensed consolidated financial statements.

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Radian Group Inc

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Condensed Consolidated Financial Statements Basis of Presentation

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

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and include the accounts of all wholly-owned subsidiaries. We have condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with GAAP pursuant to the instructions of Article 10 of Regulation S-X of the Securities and Exchange Commission s (SEC) rules and regulations.

The financial information presented for interim periods is unaudited; however, such information reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the financial position, results of operations, and cash flows for the interim periods. These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year or for any other period. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

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

Basic net income per share is based on the weighted-average number of common shares outstanding, while diluted net income per share is based on the weighted-average number of common shares outstanding and common share equivalents that would be issuable upon the exercise of stock options and other stock-based compensation. For the three and six months ended June 30, 2009, 3,780,500 shares of our common stock issued under our stock-based compensations plans were not included in the calculation of diluted net income per share because they were anti-dilutive. As a result of our net loss for the three and six months ended June 30, 2008, 4,371,633 shares of our common stock issued under our stock-based compensation plans were not included in the calculation of diluted net loss per share because they were anti-dilutive.

We adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurement (SFAS No. 157) effective January 1, 2008 with respect to financial assets and liabilities measured at fair value. SFAS No. 157 (i) defines fair value, (ii) establishes a framework for measuring fair value in accordance with GAAP, and (iii) expands disclosure requirements about fair value measurements. SFAS No. 157 is effective for all financial statements issued for fiscal years beginning after November 15, 2007 on a prospective basis. There was no cumulative impact on retained earnings as a result of the adoption. In accordance with Financial Accounting Standards Board (FASB) Staff Position (FSP) SFAS No. 157-2, Effective Date of FASB Statement No. 157 we elected to defer the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities until January 1, 2009. The adoption of SFAS No. 157 with respect to non-financial assets and non-financial liabilities effective January 1, 2009 did not have a significant impact on our condensed consolidated financial statements.

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

We adopted FSP Emerging Issues Task Force (EITF) 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities effective January 1, 2009. This FSP requires companies to consider unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents as participating securities, which shall be included in the calculation of basic and diluted earnings per share. Our restricted stock awards meet the definition of participating securities. The adoption of this EITF did not have a material impact on our condensed consolidated financial statements.

We adopted SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161) effective January 1, 2009. SFAS No. 161 requires increased qualitative, quantitative and credit-risk disclosures including: (a) how and why an entity is using a derivative instrument or hedging activity; (b) how the entity is accounting for its derivative instruments and hedged items under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133); and (c) how the instruments affect the entity s financial position, financial performance and cash flows. SFAS No. 161 also amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments (SFAS No. 107) to clarify that derivative instruments are subject to SFAS No. 107 s concentration-of-credit-risk disclosures. See Notes 3, 4 and 5 for further information.

We adopted SFAS No. 163, Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60 (SFAS No. 163) effective January 1, 2009. SFAS No. 163 clarifies how SFAS No. 60, Accounting and Reporting by Insurance Enterprises (SFAS No. 60) applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. The scope of SFAS No. 163 is limited to financial guarantee insurance (and reinsurance) contracts issued by insurance enterprises included within the scope of SFAS No. 60. SFAS No. 163 does not apply to financial guarantee insurance contracts accounted for as derivative contracts under SFAS No. 133. As a result of the implementation of SFAS No. 163, we recognized the cumulative effect of adoption as a reduction in retained earnings of $37.6 million, after tax, effective January 1, 2009. See Note 10, Financial Guaranty Insurance Contracts for further information.

We adopted FSP FAS 107-1 and Accounting Principles Board (APB) 28-1, Interim Disclosures about Fair Value of Financial Instruments (APB 28-1) effective April 1, 2009. This FSP amends SFAS No. 107 to require disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require fair value disclosures to be included in summarized financial information at interim reporting periods. See Note 4, Fair Value of Financial Instruments for further information.

We adopted FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2) effective April 1, 2009. This FSP amends the other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. The adoption of this FSP resulted in a $21.5 million increase in retained earnings and a corresponding decrease in accumulated other comprehensive income, net upon adoption. See Note 6, Investments for further information.

We adopted FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4) effective April 1, 2009. This FSP provides additional guidance for estimating fair value in accordance with SFAS No. 157, when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. The adoption of this FSP did not have a significant impact on our condensed consolidated financial statements.

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

2. Segment Reporting

We have three reportable segments: Mortgage Insurance, Financial Guaranty and Financial Services. We allocate corporate income and expenses to our mortgage insurance and financial guaranty segments based on either an allocated percentage of time spent or internally allocated capital. We evaluate operating segment performance based principally on net income. Summarized financial information concerning our operating segments, as of and for the year-to-date periods indicated, are as follows:

Mortgage Insurance (In thousands)	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Net premiums written insurance	$ 154,919	$ 199,030	$ 316,878	$ 410,281
Net premiums earned insurance	$ 170,047	$ 205,096	$ 347,930	$ 409,361
Net investment income	32,298	38,941	63,643	77,786
Change in fair value of derivative instruments	(6,557)	25,173	(35,133)	96,942
Net gains (losses) on other financial instruments	12,590	18,155	25,500	(11,404)
Net impairment losses recognized in earnings	(46)	(7,711)	(680)	(14,885)
Other income	3,748	2,999	7,566	6,490
Total revenues	212,080	282,653	408,826	564,290
Provision for losses	142,802	449,296	464,486	1,020,304
Provision for premium deficiency	2,184	369,807	(46,000)	387,897
Policy acquisition costs	7,921	63,686	13,660	77,146
Other operating expenses	35,590	48,703	71,284	82,873
Interest expense	2,619	7,332	8,313	14,422
Total expenses	191,116	938,824	511,743	1,582,642
Equity in net income of affiliates				
Pretax income (loss)	20,964	(656,171)	(102,917)	(1,018,352)
Income tax provision (benefit)	7,948	(221,988)	(27,136)	(357,713)
Net income (loss)	$ 13,016	$ (434,183)	$ (75,781)	$ (660,639)
Cash and investments	$ 3,919,403	$ 4,054,264		
Deferred policy acquisition costs	28,674	11,554		
Total assets	5,073,729	5,037,309		
Unearned premiums	304,336	359,080		
Reserve for losses and loss adjustment expenses	3,122,444	2,120,577		
Derivative liabilities	23,086	308,543		

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Financial Guaranty (In thousands)	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Net premiums written insurance	$ 6,982	$ 23,615	$ 1,779	$ 56,670
Net premiums earned insurance	$ 23,582	$ 44,041	$ 56,914	$ 81,697
Net investment income	20,951	26,187	45,889	53,307
Change in fair value of derivative instruments	278,875	31,053	23,035	667,093
Net gains (losses) on other financial instruments	41,794	(3,393)	53,764	(14,673)
Net impairment losses recognized in earnings		(15,341)		(22,210)
Other income	66	58	219	179
Total revenues	365,268	82,605	179,821	765,393
Provision for losses	(10,052)	9,583	(4,982)	21,286
Provision for premium deficiency				
Policy acquisition costs	18,046	12,266	26,261	22,712
Other operating expenses	19,909	15,019	35,742	35,757
Interest expense	9,676	6,500	16,281	11,654
Total expenses	37,579	43,368	73,302	91,409
Equity in net income of affiliates				
Pretax income	327,689	39,237	106,519	673,984
Income tax provision	112,019	6,768	26,249	225,987
Net income	$ 215,670	$ 32,469	$ 80,270	$ 447,997
Cash and investments	$ 2,539,830	$ 2,481,133		
Deferred policy acquisition costs	180,208	173,211		
Total assets	3,259,249	3,166,316		
Unearned premiums	816,023	688,984		
Reserve for losses and loss adjustment expenses	181,792	167,165		
Derivative liabilities	356,184	348,883		

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Financial Services (In thousands)	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Net premiums written insurance	$	$	$	$
Net premiums earned insurance	$	$	$	$
Net investment income	2		2	14
Change in fair value of derivative instruments				
Net gains on other financial instruments		39		37
Net impairment losses recognized in earnings				
Other income	74	164	235	166
Total revenues	76	203	237	217
Provision for losses				
Provision for premium deficiency				
Policy acquisition costs				
Other operating expenses	136	127	211	360
Interest expense				249
Total expenses	136	127	211	609
Equity in net income of affiliates	5,110	15,704	15,662	28,230
Pretax income	5,050	15,780	15,688	27,838
Income tax provision	1,861	6,590	5,739	12,082
Net income	$ 3,189	$ 9,190	$ 9,949	$ 15,756
Cash and investments	$	$		
Deferred policy acquisition costs				
Total assets	122,524	205,792		
Unearned premiums				
Reserve for losses and loss adjustment expenses				
Derivative liabilities				

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

Consolidated (In thousands)	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Net income (loss):				
Mortgage Insurance	$ 13,016	$ (434,183)	$ (75,781)	$ (660,639)
Financial Guaranty	215,670	32,469	80,270	447,997
Financial Services	3,189	9,190	9,949	15,756

Total	$ 231,875	$ (392,524)	$ 14,438	$ (196,886)

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

3. Derivative Instruments and Hedging Activities

A summary of our derivative assets and liabilities, as of and for the periods indicated, is as follows. Certain contracts are in an asset position because the net present value of the contractual premium exceeds the net present value of our estimate of the expected future premiums that a financial guarantor of similar credit quality to us would charge to provide the same credit protection assuming a transfer of our obligation to such financial guarantor as of the measurement date.

Balance Sheets (In millions)	June 30 2009	December 31 2008
Derivative assets:		
Financial Guaranty credit derivative assets	$ 19.4	$ 22.8
Net interest margin securities (NIMS) assets	10.4	5.8
Put options on Money Market committed preferred custodial trust securities (CPS)	150.0	150.0
Mortgage Insurance domestic and international credit default swaps (CDS) assets		0.9
Total derivative assets	179.8	179.5
Derivative liabilities:		
Financial Guaranty credit derivative liabilities	356.2	357.4
NIMS liabilities (1)		84.3
Mortgage Insurance domestic and international CDS liabilities	23.1	77.6
Total derivative liabilities	379.3	519.3
Total derivative liabilities, net	$ (199.5)	$ (339.8)

(1) All NIMS trusts required consolidation at June 30, 2009, resulting in the fair value being reported as variable interest entity (VIE) debt and derivative assets. The fair value of the VIE debt was $283.2 million and $160.0 million at June 30, 2009 and December 31, 2008, respectively.

Amounts set forth in the table above represent gross unrealized gains and gross unrealized losses on derivative assets and liabilities. The notional value of our derivative contracts at June 30, 2009 and December 31, 2008 was $50.3 billion and $51.8 billion, respectively.

The components of the gain (loss) included in change in fair value of derivative instruments are as follows:

Statements of Operations (In millions)	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Net premiums earned derivatives	$ 14.5	$ 20.9	$ 29.2	$ 46.1
Financial Guaranty credit derivative liabilities	265.8	(13.1)	(2.0)	567.8
NIMS	(5.2)	58.5	(9.5)	155.0
Mortgage Insurance domestic and international CDS	(0.1)	(38.9)	(21.5)	(71.2)

Put options on CPS	(0.9)	30.6	(1.8)	72.0
Other	(1.8)	(1.8)	(6.5)	(5.7)
Change in fair value of derivative instruments	$ 272.3	$ 56.2	$ (12.1)	$ 764.0

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The application of SFAS No. 133, as amended, results in volatility from period to period in gains and losses as reported on our condensed consolidated statements of operations. Generally, these gains and losses result from changes in corporate credit or asset-backed spreads and changes in the creditworthiness of underlying corporate entities or the credit performance of the assets underlying an asset-backed security. Any incurred gains or losses on our financial guaranty contracts that are accounted for as derivatives are recognized as a change in the fair value of derivative instruments. Beginning in the first quarter of 2008, as required by the provisions of SFAS No. 157, we also incorporated our own non-performance risk into our fair valuation methodology. Our fair value estimates may result in significant volatility in our financial position or results of operations for future periods.

The following table shows selected information about our derivative contracts:

Product	Number of Contracts	June 30 2009 Par/Notional Exposure (In millions)	Total Net Asset/ (Liability)
Put options on CPS	3	$ 150.0	$ 150.0
NIMS related (1)	(2)	(2)	10.4
Corporate collateralized debt obligations (CDOs)	101	37,467.5	(170.5)
Non-Corporate CDOs and other derivative transactions:			
Trust Preferred Securities (TruPs) on a first-to-pay basis	18	2,166.0	(6.7)
CDO of commercial mortgage-backed securities (CMBS)	4	1,831.0	(37.2)
CDO of asset-backed securities (ABS)	2	621.3	(93.2)
Other:			
Structured finance (3)	19	1,507.5	(11.4)
Public finance	28	1,579.5	(0.8)
Total Other	47	3,087.0	(12.2)
Total Non-Corporate CDOs and other derivative transactions	71	7,705.3	(149.3)
Assumed financial guaranty credit derivatives:			
Structured finance	311	1,466.5	(14.8)
Public finance	16	308.2	(2.2)
Total Assumed	327	1,774.7	(17.0)
Mortgage Insurance international CDS	2	3,247.2	(23.1)
Grand Total	504	$ 50,344.7	$ (199.5)

(1) This represents NIMS VIE derivative assets and NIMS bonds purchased.
(2) NIMS related derivative assets represent assets associated with the consolidation of NIMS and does not represent additional exposure, as would be the case in a financial guaranty contract.
(3) Includes $166.8 million of TruPs in a second-to-pay position.

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

4. Fair Value of Financial Instruments

The following is a list of those assets and liabilities that are measured at fair value by hierarchy level as of June 30, 2009:

(In millions)

Assets and Liabilities at Fair Value	Level I	Level II	Level III	Total	Investments Not Carried at Fair Value	Total Investments
Investment Portfolio:						
U.S. government and agency securities	$	$ 526.6	$	$ 526.6	$	$ 526.6
Municipal and state securities		1,570.3		1,570.3		1,570.3
Money market instruments	1,058.8			1,058.8		1,058.8
Corporate bonds		1,080.1		1,080.1		1,080.1
Asset-backed securities		1,316.7	7.1	1,323.8		1,323.8
Foreign government securities		81.2		81.2		81.2
Hybrid securities		449.6	0.4	450.0		450.0
Equity securities	120.4	107.8	1.5	229.7		229.7
Other investments			4.1	4.1		4.1
Other investments not carried at fair value					70.1(1)	70.1
Total Investments	1,179.2	5,132.3	13.1	6,324.6	$ 70.1	$ 6,394.7
Derivative Assets			179.8	179.8		
Total Assets at Fair Value	$ 1,179.2	$ 5,132.3	$ 192.9	$ 6,504.4		
Derivative Liabilities	$	$	$ 379.3	$ 379.3		
VIE debt (2)			283.2	283.2		
Total Liabilities at Fair Value	$	$	$ 662.5	$ 662.5		

(1) Comprised of fixed-maturities held to maturity ($30.2 million carried at cost), short-term investments ($16.5 million), and other invested assets ($23.4 million) accounted for as equity-method investments and not measured at fair value.
(2) Represents consolidated debt issued by the NIMS VIE that required consolidation upon our becoming the primary beneficiary of the VIE.

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The following is a list of assets and liabilities that are measured at fair value by hierarchy level as of December 31, 2008:

(In millions) Assets and Liabilities at Fair Value	Level I	Level II	Level III	Total	Investments Not Carried at Fair Value	Total Investments
Investment Portfolio:						
U.S. government and agency securities	$	$ 159.8	$	$ 159.8	$	$ 159.8
Municipal and state securities		3,607.0		3,607.0		3,607.0
Money market instruments	836.7			836.7		836.7
Corporate bonds		176.8		176.8		176.8
Asset-backed securities		308.4		308.4		308.4
Foreign government securities		64.9		64.9		64.9
Hybrid securities		422.1	4.5	426.6		426.6
Equity securities	117.3	72.5	0.8	190.6		190.6
Other investments		1.4	5.1	6.5		6.5
Other investments not carried at fair value					204.2(1)	204.2
Total Investments	954.0	4,812.9	10.4	5,777.3	$ 204.2	$ 5,981.5
Derivative Assets			179.5	179.5		
Total Assets at Fair Value	$ 954.0	$ 4,812.9	$ 189.9	$ 5,956.8		
Derivative Liabilities	$	$	$ 519.3	$ 519.3		
VIE debt (2)			160.0	160.0		
Total Liabilities at Fair Value	$	$	$ 679.3	$ 679.3		

(1) Comprised of fixed-maturities held to maturity ($36.6 million carried at cost), short-term investments ($145.7 million), and other invested assets ($21.9 million) accounted for as equity-method investments and not measured at fair value.

(2) Represents consolidated debt issued by the NIMS VIE that required consolidation upon our becoming the primary beneficiary of the VIE.

The following table is a rollforward of Level III assets and liabilities measured at fair value for the quarter ended June 30, 2009:

(In millions)	Beginning Balance at April 1 2009	Realized and Unrealized Gains (Losses) Recorded in Earnings	Purchases, Sales, Issuances & Settlements	Transfers Into (Out of) Level III (1)	Ending Balance at June 30 2009
Investments:					
Asset-backed securities	$	$ 0.1	$ 7.0	$	$ 7.1
Hybrid securities	0.4				0.4

Equity Securities.		1.4		0.2				(0.1)		1.5
Other investments		4.4				(0.3)				4.1
Total Level III Investments	$	6.2	$	0.3	$	6.7	$	(0.1)	$	13.1
Derivative liabilities, net	$	(571.6)	$	276.4(2)	$	95.7	$		$	(199.5)
NIMS VIE debt		(206.5)		(33.2)		(43.5)(3)				(283.2)
Total Level III liabilities, net	$	(778.1)	$	243.2	$	52.2	$		$	(482.7)

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(1) Transfers are assumed to be made at the end of the period.
(2) All related to gains on derivatives still held at June 30, 2009.
(3) This amount primarily represents derivative liabilities transferred to VIE debt related to NIMS trusts that we were required to consolidate during the period.

The following is a rollforward of Level III assets and liabilities measured at fair value for the six months ended June 30, 2009:

(In millions)	Beginning Balance at January 1 2009	Realized and Unrealized Gains (Losses) Recorded in Earnings	Purchases, Sales, Issuances & Settlements	Transfers Into (Out of) Level III (1)	Ending Balance at June 30 2009
Investments:					
Asset-backed securities	$	$ 0.1	$ 7.0	$	$ 7.1
Hybrid securities	4.5	4.8	(9.3)	0.4	0.4
Equity securities	0.8	0.5		0.2	1.5
Other investments	5.1	0.1	(1.1)		4.1
Total Level III Investments	$ 10.4	$ 5.5	$ (3.4)	$ 0.6	$ 13.1
Derivative liabilities, net	$ (339.8)	$ (3.6)(2)	$ 143.9	$	$ (199.5)
NIMS VIE debt	(160.0)	(27.0)	(96.2)(3)		(283.2)
Total Level III liabilities, net	$ (499.8)	$ (30.6)	$ 47.7	$	$ (482.7)

(1) Transfers are assumed to be made at the end of the period.
(2) Of this amount, $9.9 million relates to losses on derivatives no longer held at June 30, 2009, and $6.3 million relates to gains on derivatives still held at June 30, 2009.
(3) This amount primarily represents derivative liabilities transferred to VIE debt related to NIMS trusts that we were required to consolidate during the period.

At June 30, 2009, our total Level III assets approximated 3.2% of total assets measured at fair value and our total Level III liabilities accounted for 100% of total liabilities measured at fair value. Realized and unrealized gains and losses on Level III assets and liabilities in the rollforward represent gains and losses for the periods in which they were classified as Level III.

The following table is a rollforward of Level III assets and liabilities measured at fair value for the quarter ended June 30, 2008:

(In millions)	Beginning Balance at April 1 2008	Realized and Unrealized Gains (Losses) Recorded in Earnings	Purchases, Sales, Issuances & Settlements	Transfers Into (Out of) Level III (1)	Ending Balance at June 30 2008

Investments:					
Corporate bonds	$	$	$	$ 0.3	$ 0.3
Hybrid securities			1.0		1.0
Equity securities	0.1			0.9	1.0
Other investments	9.3	(1.9)	0.7		8.1
Total Level III Investments	$ 9.4	$ (1.9)	$ 1.7	$ 1.2	$ 10.4
Derivative liabilities, net	$ (470.7)	$ 49.5	$ 14.8	$	$ (406.4)
NIMS VIE debt	(100.2)	29.5	(15.0)		(85.7)
Total Level III liabilities, net	$ (570.9)	$ 79.0	$ (0.2)	$	$ (492.1)

(1) Transfers are assumed to be made at the end of the period.

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The following table is a rollforward of Level III assets and liabilities measured at fair value for the six months ended June 30, 2008:

(In millions)	Beginning Balance at January 1 2008	Unearned Premiums Reclass January 1 2008 (1)	Realized and Unrealized Gains (Losses) Recorded in Earnings	Purchases, Sales, Issuances & Settlements	Transfers Into (Out of) Level III (2)	Ending Balance at June 30 2008
Investments:						
Corporate bonds	$	$	$	$	$ 0.3	$ 0.3
Hybrid securities	6.7			1.0	(6.7)	1.0
Equity securities	0.1				0.9	1.0
Other investments	12.1		(5.3)	1.3		8.1
Total Level II Investments	$ 18.9		$ (5.3)	$ 2.3	$ (5.5)	$ 10.4
Derivative liabilities, net	$ (1,262.5)	$ (23.3)	$ 761.1	$ 118.3	$	$ (406.4)
NIMS VIE debt			29.5	(115.2)		(85.7)
Total Level III liabilities, net	$ (1,262.5)	$ (23.3)	$ 790.6	$ 3.1	$	$ (492.1)

(1) These unearned premiums were reclassified after adoption of an agreement with member companies of the Association of Financial Guaranty Investors (AFGI) in consultation with the staffs of the Office of the Chief Accountant and the Division of Corporate Finance of the SEC. This reclassification was implemented in order to increase comparability of our financial guaranty companies with derivative contracts.

(2) Transfers are assumed to be made at the end of the period.

The following table quantifies the impact of our non-performance risk on our derivative assets, derivative liabilities and NIMS VIE debt (in aggregate by type) presented in our condensed consolidated balance sheets. Our five-year CDS spread is representative of the market s view of our non-performance risk; the CDS spread used in the valuation of these specific assets or liabilities is typically based on the remaining term of the instrument.

	January 1 2008	June 30 2008	December 31 2008	June 30 2009
Radian Group five-year CDS spread	628	2,530	2,466	1,598
(in basis points)				

Product (In millions)	Cumulative Unrealized Gain at December 31 2008	Cumulative Unrealized Gain at June 30 2009

Corporate CDOs	$	4,197.1	$	1,917.1
Non-Corporate CDOs		948.7		830.3
NIMS and other		440.0		266.0
Total	$	5,585.8	$	3,013.4

The unrealized gain attributable to the market s perception of our non-performance risk decreased by $2.6 billion during the first half of 2009, as presented in the table above. This decrease was primarily the result of the tightening of our CDS spread, which decreased by 868 basis points during the six months ended June 30, 2009.

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

VIE Debt-NIMS

NIMS VIE debt represents the consolidated NIMS trust obligations that we were required to consolidate in accordance with FASB Interpretation (FIN) 46R, Consolidation of Variable Interest Entities (revised) an interpretation of Accounting Research Bulletin (ARB) No. 51 (FIN 46R) as June 30, 2009 and December 31, 2008. In 2008, we elected in accordance with SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159) to record at fair value the consolidated NIMS VIE debt. The VIE debt recorded represents our obligation to pay the NIMS guaranteed cash flows expected to be paid to the NIMS bondholders. At June 30, 2009, all NIMS trust obligations that we have guaranteed have been consolidated. The face value of our consolidated liability was $443.1 million and includes $24.8 million that has been issued by the consolidated trusts which is not guaranteed by us.

Other Fair Value Disclosure

On our condensed consolidated balance sheets, we disclose the carrying value and fair value of assets and liabilities which are reported at fair value. The carrying value and estimated fair value of other selected assets and liabilities that are not carried at fair value on our condensed consolidated balance sheets are as follows:

	June 30 2009		December 31 2008	
(In millions)	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Assets:				
Fixed-maturities held to maturity	$ 30.2	$ 31.3	$ 36.6	$ 37.5
Short-term investments (carried at cost)	16.5	16.5	145.7	145.7
Other invested assets.	23.4	23.3	21.9	21.4
Liabilities:				
Long-term debt and other borrowings	856.8	423.8	857.8	410.6
Non-derivative financial guaranty liabilities	653.3	807.3	800.3	756.9

Fixed-Maturity Held to Maturity The fair values of fixed-maturity securities are obtained from independent pricing services that use observed market transactions, including broker-dealer quotes and actual trade activity as a basis for valuation.

Short-Term Investments Carried at Cost The fair value of short-term investments carried at cost is estimated using market quotes or actual fair value estimates.

Other Invested Assets The fair value of other invested assets is based on the present value of the estimated net future cash flows. The carrying value of equity-method investment and cost-method investments approximates fair value.

Long-Term Debt and Other Borrowings The fair value is estimated based on the quoted market prices for the same or similar issue or on the current rates offered to us for debt of the same remaining maturities.

Non-Derivative Financial Guaranty Liabilities We estimate the fair value of these non-derivative financial guarantees in accordance with SFAS No. 157 in a hypothetical market where market participants include other monoline mortgage and financial guaranty insurers with similar credit quality to us, assuming that the net liability related to these insurance contracts could be transferred to these other mortgage and financial guaranty insurance and reinsurance companies.

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

This fair value estimate of non-derivative financial guarantees includes direct and assumed contracts written, and is based on the difference between the present value of (1) the expected future contractual premiums and (2) the fair premium amount to provide the same credit protection assuming a transfer of our obligation to such guarantor as of the measurement date.

The key variables considered in estimating fair value include par amounts outstanding (including future periods for the estimation of future installment premiums), expected term, unearned premiums, expected losses and our CDS spread. Estimates of future installment premiums received are based on contractual premium rates.

With respect to the fair premium amount, SFAS No. 157 requires that the non-performance risk of a financial liability be included in the estimation of fair value. Accordingly, the fair premium amount for financial guarantee insurance contracts includes consideration of our credit quality as represented by our CDS spread.

Our ability to accurately estimate the fair value of our non-derivative financial guarantees is limited. There are no observable market data points as a result of the current disruption in the credit markets and we have experienced recent rating agency actions. These factors have significantly limited the amount of new financial guaranty business we have written recently. We believe that in the absence of a principal market, our estimate of fair value described above in a hypothetical market provides the most relevant information with respect to fair value estimates given the information currently available to us. Due to the volume and geographic diversification of our financial guaranty exposures, in the future we may need to consider other key variables that may influence the fair value estimate. Variables not currently incorporated in our current fair value estimate of non-derivative financial guarantees include the credit spreads of the underlying insured obligations, the underlying ratings of those insured obligations and assumptions about current financial guarantee premium levels relative to the underlying insured obligations credit spreads.

The carrying value of our non-derivative financial guaranty liabilities consists of unearned premiums, premiums receivable, deferred policy acquisition costs, and reserve for losses and LAE as reported on our condensed consolidated balance sheets.

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Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

5. Special Purpose Entities (SPEs)

The following is a summary of the financial impact on our condensed consolidated balance sheet, our condensed consolidated statement of operations and our condensed consolidated statement of cash flows as of and for the six months ended June 30, 2009, as it relates to VIEs in which we have a significant variable interest and qualified special purpose entities (QSPEs) sponsored by us:

	Significant Interests in VIEs				Sponsored QSPE
(In millions)	NIMS	Financial Guaranty Insurance and Credit Derivatives	CPS	International CDS	Smart Home
Balance Sheet:					
Reinsurance recoverables	$	$	$	$	$ 96.3(1)
Derivative assets	10.4		150.0		
Unearned premiums		10.7			
Reserves for losses and LAE		5.4			
Derivative liabilities				23.1	
VIE consolidated debt	283.2				
Other comprehensive income (loss) (OCI)				(0.2)	
Statement of Operations:					
Change in fair value of derivative instruments gain (loss)	(8.5)		(1.8)	(10.3)	
Provision for losses		8.2			5.2(2)
Net gain on other financial instruments	(25.5)				
Net premiums earned	0.5	1.9		0.4	(5.6)
Cash Inflow (Outflow) Impact:					
Net (payments) receipts related to credit derivatives	(17.3)(3)		(1.8)	0.4	
Net receipts related to VIE consolidated debt	0.4				
Premiums received (paid)		1.7			(5.6)
Losses paid.		(6.1)			

(1) Represents ceded loss reserves recorded as reinsurance loss recoverables.
(2) Represents ceded provision for losses.
(3) Represents the amount paid for interest and the amount paid for the purchase of NIMS bonds we insure, offset by premiums received.

For all VIEs in which we have a variable interest, we perform an evaluation to determine whether we are the primary beneficiary. In making this determination, we first qualitatively assess whether we have a sufficiently large variable interest in the VIE to be a potential primary beneficiary. In instances where it is not clear who the primary beneficiary is, we perform an analysis of the present value of expected losses to determine whether we would absorb more than 50% of those losses. Other than our NIMS transactions, we are not the primary beneficiary of any VIE as determined by our qualitative and quantitative analyses.

Radian Group Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

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NIMS

As of June 30, 2009, the amount included in derivative assets and VIE debt related to the NIMS trusts was $10.4 million and $283.2 million, respectively. As of December 31, 2008, the amount included in derivative assets and VIE debt related to the NIMS trusts was $5.8 million and $160.0 million, respectively. We consolidate the assets and liabilities associated with these VIEs when we gain control over the trust assets and liabilities as a result of our contractual provisions. The consolidated NIMS assets are treated as derivatives in accordance with SFAS No. 133, and recorded at fair value. The consolidated NIMS VIE debt is recorded at fair value as allowed by SFAS No. 159.

As a risk mitigation initiative, we have purchased, at a discount to par, some of our insured NIMS bonds. The NIMS purchased are accounted for as derivative assets and are recorded at fair value in accordance with SFAS No. 133. Upon purchase, and prior to consolidation, our liability representing the unrealized loss associated with the purchased NIMS is eliminated. The difference between the amount we pay for the NIMS and the sum of the fair value of the NIMS and the eliminated liability represents the net impact to earnings. The overall impact to our consolidated results of operations as a result of these purchases has been immaterial.

The following is summary information related to all NIMS trusts as of the dates indicated:

(In millions)	**June 30, 2009**			**December 31, 2008**		
VIE Assets	**Total NIMS Trust Assets**	**Maximum Principal Exposure (1)**	**Average Rating of Collateral at Inception**	**Total NIMS Trust Assets**	**Maximum Principal Exposure**	**Average Rating of Collateral at Inception**
NIMS	$ 539.8	$ 418.3	BBB to BB	$ 556.6	$ 438.3	BBB to BB

(1) Represents maximum exposure related to derivative liabilities and consolidated VIE assets and liabilities.

There was $418.3 million of risk in force associated with NIMS at June 30, 2009 comprised of 30 transactions. The average expiration of our existing NIMS transactions is approximately three years. At June 30, 2009, all of the NIMS transactions required consolidation in our condensed consolidated balance sheets.

Financial Guaranty Insurance and Credit Derivatives

The following table sets forth our financial guaranty total assets and maximum exposure to loss associated with VIEs in which we held significant variable interests:

	June 30 2009		**December 31 2008**	
(In millions)	**Total Assets**	**Maximum Exposure**	**Total Assets**	**Maximum Exposure**
Asset-Backed Obligations	$ 2,106.1	$ 331.3	$ 2,349.6	$ 371.8
Other Structured Finance	6,031.9	434.9	8,736.9	544.0
Total	$ 8,138.0	$ 766.2	$ 11,086.5	$ 915.8

Put Options

In September 2003, our principal financial guaranty subsidiary, Radian Asset Assurance Inc. (Radian Asset Assurance), completed a transaction for $150 million of CPS, pursuant to which it entered into a series of three perpetual put options on its own preferred stock to Radian Asset Securities Inc. (Radian Asset Securities), our

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wholly-owned subsidiary. Radian Asset Securities in turn entered into a series of three perpetual put options on its own preferred stock (on substantially identical terms to the Radian Asset Assurance preferred stock). The counterparties to the Radian Asset Securities put options are three trusts. The trusts were created as a vehicle for providing capital support to Radian Asset Assurance by allowing Radian Asset Assurance to obtain immediate access to additional capital at its sole discretion at any time through the exercise of one or more of the put options and the corresponding exercise of one or more corresponding Radian Asset Securities put options. Our put options are perpetual in nature, allowing us to put or call our preferred stock solely at our discretion and call our preferred stock subsequent to its issuance. Specifically, there is no limit to the number of times that Radian Asset Assurance (and, correspondingly, Radian Asset Securities) may put its preferred stock to Radian Asset Securities (and, correspondingly, from the custodial trusts), fully redeem its preferred stock from Radian Asset Securities (and, correspondingly, from the custodial trusts), and put it back to Radian Asset Securities (and, correspondingly, the custodial trusts).

If the Radian Asset Assurance put options were exercised, Radian Asset Securities, through the Radian Asset Assurance preferred stock thereby acquired, and investors, through their equity investment in the Radian Asset Securities preferred stock, would have rights to the assets of Radian Asset Assurance as an equity investor in Radian Asset Assurance. Such rights would be subordinate to policyholders claims, as well as to claims of general unsecured creditors of Radian Asset Assurance, but senior to any claim of Radian Guaranty Inc. (Radian Guaranty), as the owner of the common stock of Radian Asset Assurance. If all the Radian Asset Assurance put options were exercised, Radian Asset Assurance would receive up to $150 million in return for the issuance of its own perpetual preferred stock, the proceeds of which could be used for any purpose, including the payment of claims. Dividend payments on the preferred stock will be cumulative only if Radian Asset Assurance pays dividends on its common stock.

We performed an analysis of these trusts and determined that these trusts are significant variable interest entities which are evaluated under FIN 46R. Since we are not considered to be the primary beneficiary of these trusts under the FIN 46R framework, we do not consolidate these trusts; therefore, there is no impact to our consolidated balance sheets, statements of operations, statements in changes in common stockholders equity or statements of cash flows. The aggregate fair value of the put options is classified as a derivative asset, and changes in the fair value of the put options are classified as a change in fair value of derivative instruments.

International CDS

We provide credit enhancement in the form of credit default swaps in the international markets and have one international CDS transaction involving a VIE in which we have a significant interest. At June 30, 2009, total exposure to this international CDS transaction was $3.1 billion and our total derivative liability was $23.1 million. At December 31, 2008, our total exposure to this international CDS transaction was $3.2 billion and our total derivative liability was $14.2 million.

Sponsored QSPE Smart Home

We have completed four Smart Home reinsurance transactions, with the last of these transactions closing in May 2006. Details of these transactions (aggregated) as of the initial closing of each transaction and as of June 30, 2009 are as follows:

	Initial	As of June 30 2009
Pool of mortgages (par value)	$ 14.7 billion	$ 4.8 billion
Risk in force (par value)	$ 3.9 billion	$ 1.2 billion
Notes sold to investors/risk ceded (principal amount)	$ 718.6 million	$ 557.6 million

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6. Investments

Our investment portfolio consisted of the following at June 30, 2009 and December 31, 2008:

	Cost/Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
		(In thousands)		
June 30, 2009:				
Fixed-maturities held to maturity:				
Bonds and notes:				
State and municipal obligations	$ 30,225	$ 31,308	$ 1,138	$ 55
	$ 30,225	$ 31,308	$ 1,138	$ 55
Fixed-maturities available for sale:				
Bonds and notes:				
U.S. government securities	$ 81,351	$ 85,127	$ 3,776	$
U.S. government-sponsored enterprises	34,247	34,882	635	
State and municipal obligations	1,692,527	1,481,445	12,101	223,183
Corporate	173,266	170,761	4,006	6,511
Other securities available for sale:				
Asset-backed securities	297,181	293,776	5,381	8,786
Private placements	14,719	13,718	360	1,361
Foreign governments	78,075	78,814	1,444	705
	$ 2,371,366	$ 2,158,523	$ 27,703	$ 240,546
Short-term investments	$ 1,081,948	$ 1,082,016	$ 101	$ 33
Equity securities available for sale	$ 217,585	$ 175,570	$ 1,867	$ 43,882
Trading securities	$ 2,460,768	$ 2,474,923	$ 37,217	$ 23,062
Hybrid securities	$ 469,239	$ 450,016	$ 17,511	$ 36,734
Other invested assets	$ 23,256	$ 23,406	$ 150	$

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	Cost/Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
		(In thousands)		
December 31, 2008:				
Fixed-maturities held to maturity:				
Bonds and notes:				
State and municipal obligations	$ 36,628	$ 37,486	$ 1,293	$ 435
	$ 36,628	$ 37,486	$ 1,293	$ 435
Fixed-maturities available for sale:				
Bonds and notes:				
U.S. government securities	$ 81,636	$ 93,206	$ 11,739	$ 169
U.S. government-sponsored enterprises	20,089	21,636	1,547	
State and municipal obligations	3,235,053	2,977,919	54,768	311,902
Corporate	176,085	169,510	2,974	9,549
Other securities available for sale:				
Asset-backed securities	310,269	307,150	8,416	11,535
Private placements	13,652	12,992	522	1,182
Foreign governments	62,703	64,856	2,216	63
	$ 3,899,487	$ 3,647,269	$ 82,182	$ 334,400
Short-term investments	$ 1,029,167	$ 1,029,285	$ 118	$
Equity securities available for sale	$ 212,620	$ 165,099	$ 1,011	$ 48,532
Trading securities	$ 670,835	$ 654,699	$ 7,118	$ 23,254
Hybrid securities	$ 499,929	$ 426,640	$ 7,530	$ 80,819
Other invested assets	$ 21,388	$ 21,933	$ 545	$

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The following table shows the gross unrealized losses and fair value of our investments (in thousands), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

Description of Securities	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
			(In thousands)			
June 30, 2009:						
State and municipal obligations	$ 172,797	$ 50,484	$ 1,082,526	$ 172,754	$ 1,255,323	$ 223,238
Corporate bonds and notes	38,247	2,282	37,042	4,260	75,289	6,542
Asset-backed securities	8,130	445	48,742	8,341	56,872	8,786
Private placements	3,554	379	4,971	982	8,525	1,361
Foreign governments	37,764	702	9,250	5	47,014	707
Equity securities	124,368	34,169	37,553	9,713	161,921	43,882
Total	$ 384,860	$ 88,461	$ 1,220,084	$ 196,055	$ 1,604,944	$ 284,516

Description of Securities	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
			(In thousands)			
December 31, 2008						
U.S. government securities	$ 6,981	$ 169	$	$	$ 6,981	$ 169
State and municipal obligations	847,638	88,372	838,786	223,965	1,686,424	312,337
Corporate bonds and notes	73,259	6,532	15,551	3,017	88,810	9,549
Asset-backed securities	40,691	4,210	43,923	7,325	84,614	11,535
Private placements	7,516	1,028	1,143	154	8,659	1,182
Foreign governments	6,083	39	10,285	24	16,368	63
Equity securities	150,584	48,532			150,584	48,532
Total	$ 1,132,752	$ 148,882	$ 909,688	$ 234,485	$ 2,042,440	$ 383,367

The contractual maturity of securities in an unrealized loss position at June 30, 2009 was as follows:

(In thousands)	Fair Value	Amortized Cost	Unrealized Losses
2009	$ 12,272	$ 12,305	$ 33
2010 2013	52,495	54,058	1,563
2014 2018	78,084	81,877	3,793
2019 and later	1,300,172	1,535,417	235,245
Equity securities	161,921	205,803	43,882
Total	$ 1,604,944	$ 1,889,460	$ 284,516

Effective with the adoption of FSP FAS 115-2 and FAS 124-2 on April 1, 2009, we analyzed our debt securities for impairment under the new FSP. In accordance with this new guidance, if an entity intends to sell or if it is more likely than not that it will be required to sell an impaired security prior to recovery of its amortized

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cost basis, the security is other-than-temporarily impaired and the full amount of the impairment is recognized as a loss in the statement of operations. Otherwise, losses on securities which are other-than-temporarily impaired are separated into: (i) the portion of loss which represents the credit loss; and (ii) the portion which is due to other factors. The credit loss portion is recognized as a loss in the statement of operations while the loss due to other factors is recognized in other comprehensive income (loss), net of taxes and related amortization. The credit loss is determined to exist if the present value of cash flows expected to be collected from the security is less than the cost basis of the security. The present value of cash flows is determined using the original yield of the security. For securities held as of April 1, 2009 that have previously been other-than-temporarily impaired, a pre-tax transition adjustment of $33.1 million was booked to reclassify these impairments from retained earnings to other comprehensive income.

The following table provides a rollforward of the amount related to credit losses recognized in earnings for which a portion of an other-than-temporary impairment (OTTI) was recognized in OCI for the second quarter of 2009 (in thousands):

	Three Months Ended June 30 2009
Debt securities credit losses, beginning balance at April 1, 2009	$ 868
Additions:	
Credit losses on previously impaired securities	
Credit losses for which an OTTI was not previously recognized	
Credit losses for which an OTTI was previously recognized	
Reductions:	
Credit losses on securities	
Increases in expected cash flows on previously impaired securities	
For securities sold during the period	
Debt securities credit losses, ending balance at June 30, 2009	$ 868

At June 30, 2009, we did not have the intent to sell any debt securities in an unrealized loss position, and determined that it is more likely than not that we will not be required to sell the securities before recovery of their cost basis.

In evaluating whether a decline in value is other-than-temporary, we consider several factors, including, but not limited to, the following:

- the extent and the duration of the decline in value;
- the reasons for the decline in value (credit event, interest related or market fluctuations);
- the financial position and access to capital of the issuer, including the current and future impact of any specific events;
- our intent to sell the security, or whether it is more likely than not that we will be required to sell it before recovery; and

the financial condition of and near term prospects of the issuer.

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A debt security impairment is deemed other-than-temporary if:

- we either intend to sell the security, or it is more likely than not that we will be required to sell the security before expected recovery of amortized cost; or

- we will be unable to collect cash flows sufficient to recover the amortized cost basis of the security.

Impairments due to deterioration in credit that result in a conclusion that the present value of cash flows expected to be collected will not be sufficient to recover the amortized cost basis of the security are considered other-than-temporary. Other declines in fair value (for example, due to interest rate changes, sector credit rating changes or company-specific rating changes) that result in a conclusion that the present value of cash flows expected to be collected will not be sufficient to recover the amortized cost basis of the security may also result in a conclusion that an other-than-temporary impairment has occurred. To the extent we determine that a security is deemed to be other-than-temporarily impaired, an impairment loss is recognized.

We have securities that have been in an unrealized loss position for 12 months or more that we did not consider to be other-than-temporarily impaired due to the qualitative factors explained below.

State and municipal obligations

The unrealized losses of 12 months or greater duration as of June 30, 2009 on our investments in tax-exempt state and municipal securities were caused primarily by interest rate movement. Certain securities, mainly those insured by monoline insurance companies, experienced credit spread widening during 2008 and 2009 as a result of the deterioration in the financial condition of those monolines. Because as of June 30, 2009, we did not intend to sell these investments, nor did we believe we will more likely than not be required to sell before recovery of our amortized cost basis, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at June 30, 2009.

Corporate bonds and notes

The unrealized losses of 12 months or greater duration as of June 30, 2009 on the majority of the securities in this category were caused by market interest rate movement. Certain securities, mainly those issued by financial firms with exposure to subprime residential mortgages, experienced spread widening during 2008 and 2009. Because as of June 30, 2009, we did not intend to sell these investments, nor did we believe we will more likely than not be required to sell before recovery of our amortized cost basis, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at June 30, 2009.

Asset-backed securities

The unrealized losses of 12 months or greater duration as of June 30, 2009 on the securities in this category were caused by market interest rate movement. The ABS in our investments are primarily AAA rated senior tranche positions, collateralized by pools of credit card, auto loan and equipment lease receivables. The ratings of these investments are supported by credit enhancements which include financial guarantor insurance, subordination, over-collateralization and reserve accounts. Most of our ABS investments have retained AAA ratings. Because as of June 30, 2009, we did not intend to sell these investments, nor did we believe we will more likely than not be required to sell before recovery of our amortized cost basis, we did not consider the investment in these securities to be other-than-temporarily impaired at June 30, 2009.

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Private placements

The unrealized losses of 12 months or greater duration as of June 30, 2009 on the majority of the securities in this category were caused by market interest rate movement. Because we did not intend to sell these investments, nor did we believe we will more likely than not be required to sell before recovery of our amortized cost basis, we did not consider the investment in these securities to be other-than-temporarily impaired at June 30, 2009.

Foreign governments

The unrealized losses of 12 months or greater duration as of June 30, 2009 on the majority of the securities in this category were caused by market interest rate movement. We believe that credit quality did not impact security pricing due to the relative high quality of the holdings (i.e., the majority of the securities were highly-rated governments and government agencies or corporate issues with minimum ratings of single-A). Because as of June 30, 2009, we did not intend to sell these investments, nor did we believe we will more likely than not be required to sell before recovery of our amortized cost basis, we did not consider these investments to be other-than-temporarily impaired at June 30, 2009.

For all investment categories, unrealized losses of less than 12 months in duration were generally attributable to interest rate or equity market indices movements. In addition, certain securities experienced spread widening due to issuers exposure to subprime residential mortgages. All securities were evaluated in accordance with our impairment recognition policy covering various time and price decline scenarios. Because as of June 30, 2009, we did not intend to sell these investments, nor did we believe we will more likely than not be required to sell before recovery of our amortized cost basis, we did not consider the investment in these securities to be other-than-temporarily impaired at June 30, 2009.

7. Investment in Affiliates

We own a 28.7% interest in Sherman Financial Group LLC (Sherman) and a 46% interest in Credit-Based Asset Servicing and Securitization LLC (C-BASS), each of which are credit-based consumer asset businesses. As a consequence of the complete write-off of our investment in C-BASS in 2007, we have no continuing interest of value in C-BASS. All of C-BASS s business is currently in run-off and we anticipate that all future cash flows of C-BASS will be used to service the outstanding debt. The likelihood that we will recoup any of our investment is extremely remote. Accordingly, we believe that the likelihood that our investment in C-BASS will have anything more than a negligible impact on our financial position, results of operations or cash flows at any time in the future is extremely remote.

The following table shows the components of our investment in affiliates balance:

(In thousands)	June 30 2009	December 31 2008
Sherman	$ 108,719	$ 99,656
Other	48	56
Total	$ 108,767	$ 99,712

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(In thousands)	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Investment in Affiliates-Selected Information:				
Sherman				
Balance, beginning of period	$ 103,236	$ 116,929	$ 99,656	$ 104,315
Share of net income for period	5,110	15,704	15,662	28,230
Dividends received		19,499	6,441	19,499
Other comprehensive income	373	(490)	(158)	(402)
Balance, end of period	$ 108,719	$ 112,644	$ 108,719	$ 112,644
Portfolio Information:				
Sherman				
Total assets	$ 2,103,158	$ 2,432,122		
Total liabilities	1,696,471	1,960,667		
Summary Income Statement:				
Sherman				
Income				
Revenues from receivable portfolios net of amortization	$ 311,446	$ 382,783	$ 653,714	$ 772,487
Other revenues	389	5,381	5,842	12,972
Derivative mark-to-market	8,614	10,210	8,927	4,883
Total revenues	320,449	398,374	668,483	790,342
Expenses				
Operating and servicing expenses	129,483	177,882	278,090	370,372
Provision for loan losses	95,606	105,571	208,848	209,311
Interest	28,263	25,230	53,367	48,812
Other	32,627	11,938	53,705	20,147
Total expenses	285,979	320,621	594,010	648,642
Net income	$ 34,470	$ 77,753	$ 74,473	$ 141,700

8. Reserve for losses and LAE Mortgage Insurance

The following table reconciles our mortgage insurance segment s beginning and ending reserves for losses and LAE for the three and six months ended June 30, 2009:

(In thousands)	Three Months Ended June 30 2009	Six Months Ended June 30 2009
Mortgage Insurance		
Balance at beginning of period	$ 3,116,553	$ 2,989,994

Less Reinsurance recoverables	536,777	491,836
Balance at beginning of period, net	2,579,776	2,498,158
Add total losses and LAE incurred in respect of default notices reported and unreported	142,802	464,486
Deduct total losses and LAE paid	167,685	407,751
Balance at end of period, net	2,554,893	2,554,893
Add Reinsurance recoverables	567,551	567,551
Balance at end of period	$ 3,122,444	$ 3,122,444

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We have protected against some of the losses that may occur related to riskier products, including non-prime products, by reinsuring our exposure through transactions (referred to as Smart Home) that effectively transfer risk to investors in the capital markets. Smart Home ceded losses recoverable were $96.3 million at June 30, 2009. In addition to Smart Home, we transfer a portion of our primary mortgage insurance risk to captive reinsurance companies affiliated with our lender-customers. Ceded losses recoverable related to captive transactions were $471.3 million at June 30, 2009. The change in reinsurance recoverables on Smart Home and captive transactions is reflected in our provision for losses.

While we have experienced an increase in outstanding delinquencies in the quarter, the effect of this increase on reserves for losses and LAE was substantially offset by an increase in expected insurance rescissions and claim denials on insured loans. Our loss mitigation efforts to review more claims have resulted in higher rescissions and denials than we have experienced in the past, which is reflected in our estimate of reserves for losses and LAE at June 30, 2009. Our default to claim rate decreased from 46% at December 31, 2008 to 37% at June 30, 2009, primarily as a result of our estimate of expected rescissions and denials. The increase in rescissions and denials may lead to an increased risk of litigation by the lenders and policyholders challenging our right to rescind coverage or deny claims. Such challenges may be made several years after we have rescinded insurance or denied a claim. Although we believe that our rescissions and denials are valid under our policies, if we are not successful in defending the rescissions and denials in any potential legal action, we may need to reassume the risk on, and reestablish loss reserves for, those loans.

We considered the sensitivity of mortgage insurance loss reserve estimates at June 30, 2009 by assessing the potential changes resulting from a parallel shift in severity and default to claim rate. For example, assuming all other factors remain constant, for every one percentage point change in claim severity (28% of unpaid principal balance at June 30, 2009), we estimated that our loss reserves would change by approximately $121 million at June 30, 2009. For every one percentage point change in our default to claim rate (37% at June 30, 2009, including our assumptions related to rescissions and denials), we estimated a $90 million change in our loss reserves at June 30, 2009.

9. Reserve for Premium Deficiency

We perform a quarterly evaluation of our expected profitability for our existing mortgage insurance portfolio, by business line, over the remaining life of the portfolio. A premium deficiency reserve (PDR) is established when the present value of expected losses and expenses for a particular product line exceeds the present value of expected future premiums and existing reserves for that product line. We consider first- and second-lien products separate lines of business as each product is managed separately, priced differently and has a different customer base.

As of June 30, 2009, the net present value of expected losses and expenses on our first-lien business was $3.8 billion, offset by the present value of expected premiums of $2.4 billion and already established reserves (net of reinsurance recoverables) of $2.5 billion. Because the combination of the net present value of expected premiums and already established reserves (net of reinsurance recoverables) exceeds the net present value of expected losses and expenses, a first-lien PDR was not required as of June 30, 2009. Expected losses are based on an assumed paid claim rate of approximately 12% on our total primary first-lien mortgage insurance portfolio, including 8% on prime, 32% on subprime and 23% on Alternative-A (Alt-A). While deterioration in the macroeconomic environment has resulted in an increase in expected losses, new business originated during the second half of 2008 and first half of 2009 is expected to be profitable, which has contributed to the overall expected net profitability of our first-lien portfolio. In addition, an increase in expected rescissions and denials on

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insured loans as part of our loss mitigation efforts is expected to offset the impact of expected defaults and claims to some extent.

Numerous factors affect our ultimate paid claim rates, including home price depreciation, unemployment, the impact of our loss mitigation efforts and interest rates, as well as potential benefits associated with recently announced lender and governmental initiatives to modify loans and ultimately reduce foreclosures. To assess the need for a PDR on our first-lien mortgage insurance portfolio, we develop loss projections based on modeled loan defaults in our current risk in force. This projection is based on recent trends in default experience, severity, and rates of delinquent loans moving to claim (such default to claim rates are net of our estimates of rescissions and denials), as well as recent trends in prepayment speeds. As of June 30, 2009, our modeled loan default projections assume that recent observed default rates will increase through the end of 2009, will remain stable through the middle of 2010, and will gradually return to normal historical levels over the subsequent two years. If our modeled loan default projections were stressed such that recent observed increases in defaults were to continue until the end of 2010, remain stable through the middle of 2012, and gradually return to normal historical levels over the subsequent three years, we estimate that the combination of the net present value of expected premiums and already established reserves (net of reinsurance recoverables) would exceed the net present value of expected losses and expenses by approximately $0.6 billion; therefore, no PDR would be required in this scenario.

During 2009, our second-lien PDR decreased by approximately $46.0 million to $40.9 million as a result of the transfer of premium deficiency reserves to loss reserves, offset by a slight increase in expected future losses. The net present value of expected losses and expenses on our second-lien business at June 30, 2009 was $146.5 million, partially offset by the net present value of expected premiums of $13.3 million and already established reserves of $99.0 million.

The following table reconciles our mortgage insurance segment s beginning and ending second-lien PDR for the three and six months ended June 30, 2009 (in thousands):

Second-lien PDR:	**Three Months Ended June 30 2009**	**Six Months Ended June 30 2009**
Balance at beginning of period	$ 38,677	$ 86,861
Incurred losses recognized in loss reserves	(4,458)	(65,997)
Premiums recognized in earned premiums	2,150	3,385
Changes in underlying assumptions	7,154	20,260
Accretion of discount and other	(2,662)	(3,648)
Balance at end of period	$ 40,861	$ 40,861

10. Financial Guaranty Insurance Contracts

In January 2009, we adopted SFAS No. 163 for all non-derivative financial guaranty insurance policies. SFAS No. 163 requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation, and when the present value of the expected claim loss will exceed the unearned premium revenue. The expected claim loss is based on the probability-weighted present value of expected net cash outflows to be paid under the policy. In measuring the claim liability, we develop the present value of expected net cash outflows by using our own assumptions about the likelihood of all possible outcomes, based on information currently available. We determine the existence of payment defaults on directly insured policies based on periodic reporting from the

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insured party, indenture trustee or servicer, or based on our surveillance efforts. The expected cash outflows are discounted using the risk-free rate at the time the claim liability is initially recognized. Our assumptions about the likelihood of outcomes, expected cash outflows and the appropriate risk-free rate are updated each reporting period. For assumed policies, we rely on information provided by the primary insurer as confirmed by us, as well as our specific knowledge of the credit, for determining expected loss.

SFAS No. 163 requires that an insurance enterprise record the initial unearned premium liability on installment policies equal to the present value of the premiums due or expected to be collected over either the period of the policy or the expected period of risk. In determining the present value of premiums due, we use a discount rate that reflects the risk-free rate as of the implementation date of SFAS No. 163. Under SFAS No. 163, premiums paid in full at inception are recorded as unearned premiums. Consequently, unearned premiums, premiums receivable and deferred acquisition costs increased by $263.5 million, $161.4 million and $62.3 million, respectively, and retained earnings decreased by $28.8 million, net of tax upon the implementation of SFAS No. 163.

In addition, SFAS No. 163 requires the recognition of the remaining unearned premium revenue when bonds issued are redeemed or otherwise retired (a refunding) that results in the extinguishment of the financial guaranty policies insuring such bonds. A refunding that is effected through the deposit of cash or permitted securities into an irrevocable trust for repayment when permitted under the applicable bond indenture (a legal defeasance) does not qualify for immediate revenue recognition since the defeased obligation legally remains outstanding and covered by our insurance. Consequently, $3.6 billion of net par outstanding on defeased refundings was reversed upon the implementation of SFAS No. 163. As a result, unearned premiums and deferred acquisition costs increased by $29.3 million and $3.7 million, respectively, and retained earnings decreased by $17.0 million, net of tax.

The risk management function in our financial guaranty business is responsible for the identification, analysis, measurement and surveillance of credit, market, legal and operational risk associated with our financial guaranty insurance contracts. Risk management, working with our legal group, is also primarily responsible for claims prevention and loss mitigation strategies. This discipline is applied at the point of origination of a transaction and during the ongoing monitoring and surveillance of each exposure in the portfolio.

There are both performing and non-performing credits in our financial guaranty portfolio. Performing credits generally have investment-grade internal ratings. However, claim liabilities could be established for performing credits if the expected losses on the credit exceed the unearned premium revenue for the contract based on the present value of the expected net cash outflows. When our risk management department concludes that a directly insured transaction should no longer be considered performing, it is placed in one of three designated categories for deteriorating credits: Special Mention, Intensified Surveillance or Case Reserve. Assumed exposures in financial guaranty s reinsurance portfolio are generally placed in one of these categories if the primary insurer for such transaction downgrades it to an equivalent watch list classification. However, if our financial guaranty risk management group disagrees with the risk rating assigned by the ceding company, we may assign our own risk rating rather than using the risk rating assigned by the ceding company.

Our risk management department uses internal ratings in monitoring our insured transactions. We determine our internal ratings for a transaction by utilizing all relevant information available to us, including: periodic reports supplied by the issuer, trustee or servicer for the transaction; publicly available information regarding the issuer, the transaction, the underlying collateral or asset class of the transaction and/or collateral; communications with the issuer, trustee, collateral manager and servicer for the transaction; and when available,

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public or private ratings assigned to our insured transactions or to other obligations that have substantially similar risk characteristics to our transactions without the benefit of financial guaranty or similar credit insurance. When we deem it appropriate, we also utilize nationally recognized rating agency models and methodologies to assist in such analysis. We use this information to develop an independent judgment regarding the risk and loss characteristics for our insured transactions. If public or private ratings have been used, our risk management analysts express a view regarding the rating agency opinion and analysis. When our analyses of the transaction results in a materially different view of the risk and loss characteristics of an insured transaction, we will assign a different internal rating than that assigned by the rating agency.

Our rating scale is comparable to the rating scales utilized by the nationally recognized rating agencies (Standard & Poor s Rating Service (S&P) and Moody s Investor Service (Moody s)), meaning that an obligation with an internal rating comparable to that of the rating agencies (e.g. AAA internally versus AAA by S&P or Aaa by Moody s) has approximately the equivalent credit quality indicated by such a rating. Our internal ratings estimates are subject to revision at any time and may differ from the credit ratings ultimately assigned by the rating agencies.

The initial impact of the adoption of SFAS No. 163 on January 1, 2009, on our condensed consolidated financial statements is shown in the table below (in millions):

Increase in unearned premiums	$ (292.8)
Increase in premiums receivable	161.4
Increase in deferred policy acquisition costs	66.0
Decrease in reserves for losses and LAE	8.2
Decrease in deferred income taxes, net	20.2
Increase in premium taxes payable	(0.6)
Decrease in retained earnings, net of taxes	$ (37.6)

The following table includes additional information as of June 30, 2009 regarding our financial guaranty claim liabilities segregated by the surveillance categories described above:

Surveillance Categories

($ in millions)	Performing	Special Mention	Intensified Surveillance	Case Reserve	Total
Number of policies	70	195	103	75	443
Remaining weighted-average contract period (in years)	20	18	26	28	22
Insured contractual payments outstanding:					
Principal	$ 610.5	$ 1,301.6	$ 1,039.0	$ 543.2	$ 3,494.3
Interest	435.9	526.1	855.0	407.1	2,224.1
Total	$ 1,046.4	$ 1,827.7	$ 1,894.0	$ 950.3	$ 5,718.4
Gross claim liability	$ 27.8	$ 16.7	$ 136.5	$ 146.4	$ 327.4
Less:					
Gross potential recoveries	16.3	6.7			