

FINAL TRANSCRIPT

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RDN - Q2 2006 Radian Group Earnings Conference Call

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PRESENTATION

Operator

Welcome to the Radian Group, Incorporated second-quarter 2006 earnings conference call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at that time. (OPERATOR INSTRUCTIONS) As a reminder this conference call is being recorded.

I would like to now turn conference over to our host for today, Ms. Mona Zeehandelaar. You may begin.

Mona Zeehandelaar - *Radian Group, Inc. - IR*

Thank you, and thank you for joining us today. With me on the call are S.A. Ibrahim, Chief Executive Officer of Radian; Bob Quint, Chief Financial Officer; Mark Casale, President of our Domestic Mortgage Business; Steve Cooke, President of our Financial Guaranty Business; and Roy Kasmar, President of Radian Group and heading up international mortgage. Today we will follow

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

our normal format. S.A. will begin followed by Bob who will review key quarterly financial metrics. And then we will take your questions.

For those logged onto the webcast at www.Radian.biz, the slides are provided as background and should complement our remarks today. A reconciliation of certain non-GAAP measures that will be discussed in today's call is provided on those slides, such as adjusted book value and this quarter we added direct adjusted gross written premiums for our Financial Guaranty business. Also, there is a brief primer on those slides on Smart Home.

Please hold November 9 for our industry day which will be held in Philadelphia. Details to follow but presentations will be made by Radian, C-BASS and Sherman management.

As I do every quarter, let me remind you that today's conference call will contain statements that are forward-looking. As you know these statements are based on current expectations that are subject to risk and uncertainty and Radian's actual results may differ materially from those expressed or projected in these forward-looking statements. Factors that could cause Radian's actual results to be materially different than those in the forward-looking statements are described in the Safe Harbor statement that is included with our webcast and in items 1-A of our annual report on Form 10-K for the 2005 fiscal year.

Now it is my pleasure to introduce to you, S.A.

S.A. Ibrahim - *Radian Group, Inc. - CEO*

Thank you, Mona. Good morning and thank you for joining us for today's call. Radian continued to produce solid earnings this quarter, back to book value and exceeded our return on equity target. This performance is a validation of the strategy we outlined to you last year. As I have said we have the right strategy, we're implementing it at the right pace and we have seen the desired results. Specifically in the second quarter, net income was up more than 5% from a year earlier, diluted net income per share was up more than 14% from a year earlier and book value and adjusted book value rose 11.6% and 12.8% respectively year-over-year.

As Mona mentioned, you can view our webcast slides on our website at www.Radian.biz for a reconciliation of book value to adjusted book value.

As most of you know, the Radian achieved an important milestone last month for our Financial Guaranty business when SMP affirmed the AA financial strength rating for Radian Asset Assurance and [derived] its outlook upward to stable. This important milestone validates our AA franchise and we will continue building on our strong risk management culture while shifting our focus to growing the business. We're excited and energized by the opportunities ahead in our AA niche.

I would like to begin by reiterating some of our strategic initiatives which have been mentioned previously but are nevertheless worth repeating as they provide important context for viewing our progress. First having successfully imported our Financial Guaranty knowledge into Radian's mortgage insurance business, one of our key goals is to now leverage that blended expertise to benefit customers and more effectively manage and distribute our own credit risk exposure. What this means for Radian is that we can effectively apply a range of mortgage risk solutions across changing market conditions and to meet a variety of needs.

A powerful example is our Smart Home solution which allows us to distribute risk which would otherwise have been retained into the Capital Markets. We completed our fourth Smart Home transaction in the quarter and for those of you viewing our webcast today, you will find more details on Smart Home in the slides.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

Check-in, managing capital efficiently remains a key priority as we strive to achieve our target returns on equity of 12% to 15%. We are focused on maintaining the right balance between holding sufficient capital to cover the risk we take in our business and identifying additional ways to deploy our capital profitably.

One example of our capital management strategy is our share repurchase program. In the quarter we repurchased a total of 1 million shares for a total cost of \$61.7 million. During the last 18 months, Radian has repurchased 12.8 million shares or 13.8% of the shares that were outstanding 18 months ago. These two points are important to remember as we look at a strong second quarter both in mortgage insurance and Financial Guaranty, our two main businesses, as well as for C-BASS and Sherman.

Beginning with our mortgage insurance business, credit was favorable and we experienced strong volume in both our flow and structured products. Primary insurance in force grew to \$116 billion compared to \$108 billion as of June 30 last year. Total defaults and paid claims continued to decline. As always, I have been interacting with various customers, not just with the senior executives but also at the level at which product and secondary marketing decisions are made. Last week I was at the Western secondary market conference in California where we discussed the challenges and opportunities facing the lenders.

While the MBA is projecting mortgage originations to decline they also expect the purchase market to remain very strong. Origination volume is forecasted to continue downward from \$2.9 trillion in 2005 to \$2.4 trillion in '06 and \$2.2 trillion in 2007. Compared to a record \$4 trillion origination year in 2003 where purchases were only \$1.3 trillion, the MBA projects purchase volume to be \$1.5 trillion this year and pretty close to that over the next two years. This purchase demand is expected to come from nontraditional borrowers who typically, in my experience, do not have the ability to make large downpayments. With the current level of interest rates and the shape of the yield curve, a greater proportion of these home buyers may very well find it attractive to go for a larger first with MI than a smaller first with a piggyback.

In a declining and more competitive market, lenders going after this purchase business are looking at various options including mortgage insurance solutions such as lender paid MI, as well as more sophisticated mortgage risk solutions such as second to pay full policies. Radian is well positioned to provide a wider range of mortgage risk solutions finding the right fit for our customers based on the prevailing market conditions as well as the lender's risk appetite and sophistication.

Remember that for all of these products we're taking risk on the same mortgage collateral as our traditional MI products but executing through different forms; in all cases leveraging and combining our mortgage credit risk experience and expertise with our structure capabilities.

Home prices seem to be moderating in a disciplined manner and the employment picture continues to look strong. We have also benefited from lower second-quarter defaults and claims and Bob will add more color to this in his comments. While we are encouraged by the strong employment picture and the purchase forecast, there is also more uncertainty about housing and credit. Given this, we remain cautious about the remainder of 2006 and 2007.

It is also worth noting that while the overall mortgage volume is projected to decline and purchase volume to remain strong, the MBA still forecast a REFI share that is in the 35% to 40% range. This is lower than the peak 70% range we saw in 2002 and 2003 but much higher than the teens we saw in 1995 and briefly in 2002. This suggests as we have been saying that while we have seen persistency levels increase from the bottom levels of the recent past, they are unlikely to get to the historical peak levels.

What is more interesting in my view is that REFI's in the next couple of years will not be driven by low rates but rather by the migration of borrowers to products that even in a higher rate environment might provide them with a lower monthly payment alternative that in some cases is the result of their improving credit history. This could translate into persistency disparities between various loan and borrower types.

We are protecting ourselves from a potential housing slowdown scenario by shaping our portfolio to be less vulnerable. We're doing this by writing more second loss business and by providing a layer of protection from unexpected loss through both

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

Smart Home technology and captive reinsurance. By leveraging these structures, we have transferred the unexpected risk associated with unproven products while also reducing our counterparty and geographic concentration. In fact, \$12.4 billion or 48.3% of our risk in force at the end of the second quarter is covered by either a captive or Smart Home transaction.

Turning to Financial Guaranty, S&P's revised outlook certainly was the highlight of the quarter. Operationally the Financial Guaranty production story is equally impressive. The second quarter was a stellar quarter in terms of net written premiums. In large part these results were driven by our continuing focus on execution of well-defined strategies in each of our key product sectors enabling us to earn attractive risk-adjusted returns on our capital. This was accomplished notwithstanding the persistence of tight credit spreads and increasing competitive pressures and demonstrates the viability of our AA franchise.

We had a particularly active quarter in the public finance reinsurance market. The structured finance and [credit] market is growing faster than the funded market allowing us to provide the AA credit enhancement solutions which have been at the core of our success. On the public finance side, we continue to have great success in our traditional niches while pursuing new opportunities in California. We are bolstering our analytical capabilities in public finance in both the underwriting and risk management areas as our public finance and short portfolio continues to grow.

I would like to draw your attention to a new metric for our direct business that we are now disclosing; adjusted gross written premiums or AGWP. AGWP is a non-GAAP measure which includes both the upfront premiums written and the present value of estimated future installment premiums for new direct business writing. It is an important measure widely used in the Financial Guaranty insurance industry and a reconciliation to net written premium is provided in our webcast slides.

In our financial services segment we again are extremely pleased with the performance of both C-BASS and Sherman which continue to be strong contributors to Radian's results. Given that both C-BASS and Sherman are privately held, we believe our investors have a unique opportunity to benefit from the continued strong performance of both of these companies. As we have been emphasizing, Radian maintains an active involvement in strategic activities at both companies. We believe both have outstanding prospects and we are actively exploring new opportunities with each.

On the international front I'm pleased to report that S&P assigned a AA stable rating to our recently licensed mortgage insurance company, Radian Europe Limited in the UK. We continue to conservatively build our international mortgage business by leveraging our mortgage risk solutions, and forming strategic relationships with the right business partners.

Overall, we are pleased with Radian's performance and prospects. Bob will now provide additional information on our results for the second quarter. Following his remarks we will take your questions and then I will close with a few remarks. Bob?

Bob Quint - Radian Group, Inc. - CFO

Thank you, S.A., and good morning. As always I'm going to be providing some detail and color about our second-quarter financial results.

On the MI premium side as we have mentioned before, we have recently written more single premium business which we like a lot because it builds up our unearned premium reserve creating a future annuity stream and takes away the prepayment risk from such business. When loans in these deals cancel in the normal course of business there is an acceleration of earned premium and this has become a normal part of our MI earn premium every quarter. The future number will likely bounce around a little bit but we expect that it will stay within a fairly consistent range.

Persistency has trended up, however, as we mentioned last quarter, the shift over the last few years to a larger proportion of bulk business will likely hold down future overall persistency rates as there is a meaningful difference between persistency on the bulk and flow business; the bulk being 51% and the flow 66% for the last 12 months.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

Although the percentage of our new business included in structured primary and nontraditional other risk written continues to be substantial the rapid runoff of second business and NIM have caused a premium reduction in other risk products this quarter. In examining the structured primary transactions written during the quarter there continues to be a much lower average premium rate on this business than our traditional rate because substantially all of the structured business written had a deductible in front of our risk position. This is even more dramatic than in the first quarter where deep MI with higher premium rates represented some of the business we wrote. In turn, the capital associated with these transactions is lower which is commensurate with the more remote risk. And as S.A. mentioned, we believe these products are less vulnerable to a housing decline than the higher premium first loss product.

We continue to be satisfied with the returns on capital these deals provide trade, however, premium growth will not match the insurance growth due to the low premium product. The combination of lower persistency on bulk, lower premium rates on the new structured business and increases in premiums from Smart Home will make it difficult for us to grow earned premium over the rest of the year.

Although we have used much of our excess cash flow to buy back our common stock during the quarter, investment income still jumped significantly during the quarter. This is primarily a result of realized earnings from our two private equity investments that we made as part of our small allocation to noninvestment grade investments. Future items like this are very difficult to project and are not expected to be a major contributor to overall investment (inaudible).

The provision for losses on the MI side continues to be positively impacted by relatively low claims paid along with delinquencies that continued to decline during the quarter after declining a lot in the first quarter. Hurricanes Katrina and Rita related delinquencies for the Freddie Mac designated area at year-end represented 6208 delinquencies with a related loss reserve of \$46.2 million and are currently down to 4104 delinquencies with a related reserve of \$37.4 million including 1302 delinquencies with a reserve of \$12.4 million in heavily damaged areas. This demonstrates that many of the hurricane-related delinquencies are curing over time. We continue to treat the remaining hurricane area delinquencies just like any other delinquency in our loss reserve model.

Continuing with what we introduced two quarters ago, you will see that we have highlighted delinquencies and deals where there is no current loss reserve necessary. These delinquencies currently highlighted are mostly from pool insurance transactions written during the last year where there is a deductible in front of our risk position. We have also recently written a substantial amount of primary structured insurance that contains deductibles so you will likely be seeing more delinquencies on the primary side that contain no reserve and we will highlight them.

As of June 30, 2006, there were 551 primary delinquencies and 9867 full delinquencies that had no reserve. Claims during the quarter were lower than we expected especially in the [all-day] and second business and in looking at our claims inventory and outlook we expect that claims will pick up only a little bit throughout the rest of the year. We are, however, starting to see a reduced ability to mitigate loss as a result of slowing house price appreciation which could possibly impact claims into 2007 and beyond.

Our balance sheet loss reserve is at a slightly higher point within our modeled range as compared to the first quarter, above the mid point because of our continued uncertainty in the housing market particularly in certain overheated markets and in the Midwest.

Please also note that \$5 million of our loss reserve this quarter is offset by a ceded reinsurance recoverable asset which is the result of the quarter share reinsurance arrangement on second business that began in 2005. This is essentially a gross up where the reserve is included in loss reserves but a corresponding asset is booked as a recoverable. So when comparing our loss reserve to prior period, this \$5 million needs to be netted out of this quarter's number.

We completed a new Smart Home transaction during the quarter. It continues to be our goal to use Smart Home execution to cap our downside in some of the riskier business we write. At year-end, approximately 8% of our primary risk in force was covered

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

by a Smart Home transaction. Currently that figure is 12% and we believe that is very meaningful especially when we believe we are covering higher risk loans, concentrated position, and unproven product. Note that we say covered by Smart Home or captive for that matter, that doesn't mean that every dollar of risk is ceded. But it means that meaningful layers of risk within that risk are ceded. In both of these vehicles, we still retain the first loss layer and the catastrophic layer of risk.

Expenses related to Smart Home were \$2.5 million and are included in MI other operating expenses this quarter. Expenses on the MI side were impacted by a \$1.7 million challenge for stock option expense in the second quarter compared to \$1.5 million in the first quarter. Total Company expense for stock options in the quarter were \$2.7 million which was slightly less than the first quarter and \$1 million of this was deferred as an acquisition cost and will be amortized with the other acquisition cost.

In addition, we had a small acceleration of deferred acquisition cost amortization this quarter as a result of our change in persistency expectation. We still expect that overall operating expenses could increase modestly over the balance of the year as we look to add resources in the international business and structured products area in both production and risk management.

Financial Guaranty had a great quarter of written premium further demonstrating the franchise viability of continued top spread environment. Excluding trade credits, revenues are expected to increase modestly over the rest of the year as the book fully grows and the stable loss and expense activity we experienced this quarter is expected to remain in the current range for the balance of the year. In addition to our Conseco claims paid and trade credit claims paid, we did pay a Financial Guaranty claim this quarter for about \$7 million on a credit that had been fully reserved for the last two years.

Financial services again performed exceptionally well this quarter. For C-BASS the spread environment remains strong for security [issuance]. For Sherman, collections on their charged off portfolios remain strong and the origination business has grown a turn. We expect solid results for C-BASS and Sherman in the second half of the year, steady in the case of Sherman and down in the case of C-BASS in expectation of lower income generated from transaction. Please note that these businesses have built up a nice portion of their earnings from recurring sources and it is a goal of both companies to keep building upon that.

After a prolonged period of credit spread tightening wage which produced mark-to-market gains in our derivative Financial Guaranty business, and that is primarily our credit default swap on [pull] with investment-grade corporate credit. Credit spreads widened some in the second quarter particularly in June which produced a mark-to-market loss for the quarter of approximately \$19 million. There was also a \$6 million loss as a result of stock market movement in the quarter which impacted the equity component of our convertible security which are accounted for as derivatives and therefore contain a mark-to-market component. In our opinion very little or none of the mark-to-market loss booked during the quarter was a result of credit deterioration in our Financial Guaranty transaction. Only from spread changes.

With respect to stock repurchase, we expect that the volume of repurchase activity in the third and fourth quarters will approximate the first and second quarter activity as we steadily work to fill the current 4 million share repurchase authorization. We continue to expect to receive modest dividends from our operating subs in 2006 and at this point we do not expect to request any special dividend. We believe we are on moderate excess capital position in both businesses in the range of 100 to \$300 million for each business.

Finally, you all saw that our tax rate this quarter is significantly lower than normal as some of our prior year tax exposures expired and thus the reserve against these exposures were reversed and taken into income this quarter and that reversal was about \$10 million. We expect our tax rate to resume to a more normalized rate next quarter.

We would now like to open the conference for questions.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

QUESTIONS AND ANSWERS

Operator

Thank you, sir. (OPERATOR INSTRUCTIONS) Michael Grasher from Piper Jaffray Company.

Michael Grasher - Piper Jaffray - Analyst

Thank you. S.A., just wondering if you could expand a little bit on your comment about getting more cautious here for the remainder of '06 and into '07?

S.A. Ibrahim - Radian Group, Inc. - CEO

Okay. As you know, Michael, I said that while we are encouraged by the trends that what we have seen in our numbers, there is also a lot of uncertainty if you read the press in terms of the housing and (indiscernible). And we in that environment feel that we have to do everything we can in terms of the business we underwrite and as Bob and I both talked about, our writing business we believe that makes us less vulnerable. We are continuing with our Smart Home transactions which we believe protect us. And we shared with you the percentage that is covered. And we continue to maintain strong reserves. I can ask Mark if he wants to add any more color to that.

Mark Casale - Radian Group, Inc. - President, Domestic Mortgage

No, I think I would echo S.A.'s sentiments. I mean we are as a management group still cautiously guarding where we are in the housing cycle and are approaching the business in that manner.

Michael Grasher - Piper Jaffray - Analyst

Is it more -- is the uncertainty coming more from the -- part of the overall macro cycle where we are in terms of payrolls, employment -- in that perspective versus the affordability aspect of it all?

S.A. Ibrahim - Radian Group, Inc. - CEO

The multiple drivers, largely external, which are very hard to read into because everybody listens who has a difference spin on what the future is going to be. So there is some piece of information that are encouraging; there are some pieces of information that are depressing. If you take all of them into balance, all we can say is the environment in the future in terms of housing and credit is hard to predict. While we are encouraged by what we see internally, we have to be -- we have to position our business to deal with the continued uncertainty. In the event somebody externally in either direction is right, and that means running our business in a cautious manner and that means making the hard decisions in terms of sacrificing some of our revenues through Smart Home and to the way we write business.

Michael Grasher - Piper Jaffray - Analyst

Okay. And then just a follow-up on the Smart Home. Has there been any change in appetite positively or negatively in terms of investors?

S.A. Ibrahim - Radian Group, Inc. - CEO

I will turn to Mark for that Answer.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

Mark Casale - Radian Group, Inc. - President, Domestic Mortgage

Yes. I think, Michael, that is a good question. In one of the things, a follow-up to S.A.'s answer. The one thing we are seeing is a little bit of a dichotomy in terms of where we see, if we're cautious on the front end in terms of the market, the credit spreads, although they widened it a little bit in June are still significantly tighter from where they were at the end of last year. And we were able to take advantage of that. So where it is hurting us a little bit on the front end, we are remaining cautious. It has actually helped us on the Smart Home. So our Smart Home execution in the second quarter was actually much better than it was in the fourth quarter of last year.

Michael Grasher - Piper Jaffray - Analyst

Thank you.

Mona Zeehandelaar - Radian Group, Inc. - IR

Operator, this is Mona. We are getting feedback on our end. Are our callers hearing that?

Operator

That might have been Mr. Grasher's line, he may be on a speaker line. Geoffrey Dunn from KBW.

Geoffrey Dunn - Keefe, Bruyette & Woods - Analyst

Thanks, good morning. Bob, this one is probably for you. You guys have done a good job outlining how you are trying to change your profile of your mortgage book versus the overall market and protect yourself in a downturn. Can you talk about the C-BASS exposure? Specifically I believe they have a practice of keeping residuals. How can we get comfortable about potential risk that resides there not having full clarity into what kind of book they have?

Bob Quint - Radian Group, Inc. - CFO

Well, you are right. I mean C-BASS takes mortgage credit risk so to the extent that credit suffers there, their holding will suffer somewhat. However, one of their big advantages is written loan servicing which does an incredible job on the servicing side in mitigating loss, in working things out. They are very proactive with regard to things like ARM resets where they are not waiting for ARMs to reset, they are projecting which of their loans are going to have ARM resets and they are proactively contacting borrowers. So we believe they have an advantage in the marketplace in a downturn although certainly they take credit risk and they are exposed to a housing downturn just like we are.

Geoffrey Dunn - Keefe, Bruyette & Woods - Analyst

Are you able to quantify the residual assets on their book?

Mark Casale - Radian Group, Inc. - President, Domestic Mortgage

I mean, Geoff, the bottom line is we are limited from an exposure standpoint to our investment in C-BASS. But I would echo Bob's comment, those guys -- if you look at the growth in the sub prime market over the past five years, their growth has been

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

very moderate and very prudent. And they are actually better positioned in a downturn when they can take advantage of -- if there is a dislocation in the housing market, they are probably in the best position to take advantage of that.

Geoffrey Dunn - *Keefe, Bruyette & Woods - Analyst*

Okay, great, thanks. S.A., one of your key focuses I think in the last year has been improving the Financial Guaranty operations and you did see that development from the rating agency in the quarter. Can you talk more specifically about how your efforts on rightsizing capital and expense levels are going since the last couple of months?

S.A. Ibrahim - *Radian Group, Inc. - CEO*

Yes, I would be happy to, Geoff, and I will ask Steve to also and Bob to add more color as appropriate. But first of all from my point of view, when we a year ago made some of the difficult changes in the Financial Guaranty business in terms of leadership in terms of telling our investors that we were going to focus it on areas where we believe we could be successful and we were going to streamline the expenses. We set about a very challenging task. And I'm very pleased with the fact that that was recognized by S&P and more pleased than S&P by the fact that it has been recognized in terms of our results. So I will turn to Steve to talk about the business side and Bob to talk about the capital aspect of it.

Steve Cooke - *Radian Group, Inc. - President, Financial Guaranty*

Focusing specifically on your question, Geoff. In terms of a specific expense control, we've spent time an awful lot of time on looking at expense control and operating efficiencies such that even when you look at the numbers from this quarter and for the half on some of the key measures in terms of on a year-over-year basis, in terms of our policy acquisition costs, some of our other operating expenses, our deferred policy acquisition costs, those are improving trends. In part driven I think in part by the amount of additional business we're doing but also because we are remaining flat with expenses. And also improving overall underwriting efficiency.

Bob Quint - *Radian Group, Inc. - CFO*

Yes, on capital, Geoff, clearly we are overcapitalized in the business a little bit. Now we also have written a substantial amount of business so we are using some of that excess capital in our new writings. A lot of the new business we are writing is a very, very high AAA so it doesn't require that much capital. The capital management in that business has to be done carefully and slowly. It's not going to be a situation where we take a lot of capital out of the business immediately because we're working with counterparties, we're committed to the business. However, you will see us do it slowly and according to more of a three-year plan as opposed to right away. So we are managing the capital very carefully and doing it in conjunction with the business projection.

Geoffrey Dunn - *Keefe, Bruyette & Woods - Analyst*

Thank you.

Operator

(OPERATOR INSTRUCTIONS) Brad Ball from Citigroup.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

Brad Ball - Citigroup - Analyst

Thanks. Bob, I wonder if you could comment on the portion of claims paid that was impacted by the bankruptcy law change last October?

Bob Quint - Radian Group, Inc. - CFO

Yes, Brad, we looked at that. In October of '05 when the bankruptcy accelerations occurred, we did have a small increase in the amount of bankruptcies we saw. However, since then there has been no impact on our claims in any quarter including this one as a result of bankruptcy.

Brad Ball - Citigroup - Analyst

So your guidance as you look out to the balance of this year you are not expecting a bankruptcy related claim impact?

Bob Quint - Radian Group, Inc. - CFO

Nothing on our outlook expects any material change from bankruptcy, no.

Brad Ball - Citigroup - Analyst

Okay. And then separately I wonder if you could elaborate on your comments about the average earned premium rates and how premiums earned are not likely to grow as fast as insurance in force? Can you give us a sense as to the magnitude of the decline in earned premiums? Or earned premium rates?

Bob Quint - Radian Group, Inc. - CFO

It is very difficult, Brad. You know you have a bunch of factors going on. You have primary insurance in force grew which is good but it grew basically because we wrote structured business in the second quarter that had lower premium rates. Now we are also writing pool insurance which isn't in that number which is generating premiums. We're writing nontraditional business which is included in our premium.

So to try to -- we understand that when you use that average earned premium rate, that really takes a numerator that earned premium and denominator that is primary insurance in force and it is really not totally apples to apples. You've got offsetting kinds of factors. I guess what we are saying is one, a lot of the primary growth has come from lower premium business. Two, we are ceding more premiums via Smart Home, however, as we have said for several quarters, we are writing a lot of second business, we're writing pool insurance business and other nontraditional products all of which contribute to earned premium and isn't included in the primary insurance in force number. So that is an offsetting factor. It is very difficult to try to project.

Brad Ball - Citigroup - Analyst

And just to follow up on your comments on deductibles. Do you think deductibles will be an increasing portion of your new insurance written?

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

Mark Casale - Radian Group, Inc. - President, Domestic Mortgage

Brad, it is Mark. I think for the remainder of a year, yes, that does ebb and flow. And when we talked about deductibles, -- most of the structured business we wrote in the second quarter was really risk transfer from the GSEs which has deductibles, which shows up in primary but it has much lower premium rate than 50% or 60% of the structure business we wrote in the first quarter which was sub prime bulk MI which is obviously a first loss position and has a much higher premium rate.

So over the second part of the year, where we were seeing in terms of -- again, when you sum a lot of this stuff up, as Bob says, what we think we're doing and we believe we are doing is pricing this in a better risk adjusted manner. And that is what we strive for everyday when we look at these different pools because we look at the cash flows. And again one of the things we think we do better than most folks out there is we can play up-and-down the capital structure. And where we see just better risk reward characteristics right now is a little bit higher up in the capital structure. And that could change -- as spreads widen out significantly at the lower part of the capital structure we could go down in rate primary. But to Bob's point, it is very difficult for us to sit here and tell you quarter to quarter where we are going be playing because it depends -- it is very dependent on the capital markets.

Brad Ball - Citigroup - Analyst

Okay, thank you.

Operator

David Hochstim from Bear Stearns.

David Hochstim - Bear Stearns - Analyst

Thanks. I wonder could you talk about what you are seeing in the way of claims severity or delinquency curates in the Midwest in the part of your Midwest book that is not in Chicago, which is obviously a big piece of it? And then the second question was just what kind of constraints are there on doing more Smart Home transactions, more quickly and more frequently at this point?

Bob Quint - Radian Group, Inc. - CFO

Again, Dave, I will take the Midwestern one. Certainly the fault rate in the Midwest are higher than average, the claims in the Midwest are higher than average. They haven't increased dramatically but they've been kind of steadily higher than our norm for the last year and a half. And if we look at the trend, again it is not getting worse, it is really staying at a level that is higher than our averages. But not trending downward.

David Hochstim - Bear Stearns - Analyst

But is the average claim there is higher because of less depreciation but the average loans there must be older and the average loan balance must be less than in some places?

Bob Quint - Radian Group, Inc. - CFO

Yes, absolutely. I think when we -- I think people use severity in different ways when you can look at the average number which clearly takes loan amounts into account. And if you look at severity in that regard, obviously the Midwest is going to be little bit lower because of the loan sizes. But if you look at severity as a percentage of what you could have paid, then it might be a little bit higher because of the inability to mitigate as well. So you really have to look at how you are defining severity.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

David Hochstim - *Bear Stearns - Analyst*

Okay, thanks.

Mark Casale - *Radian Group, Inc. - President, Domestic Mortgage*

David, it is Mark. I can your answer question relative to Smart Home. There is no impediments per se I think from our standpoint as we are looking at establishing Smart Home as a program out in the secondary market, which over time you'll see more frequent issuances. We have done four to date and we expect to do one, possibly two for the remainder of the year. And again that is highly dependent also on market conditions. We want to be in the high spread environment. We want to be writing business and not offloading risk. We want to be offloading risk like we did in the second quarter when spreads are tight.

With that being said, we went to establish this more as a program in the secondary market so investors who buy these bonds can come to see us on a regular basis and expect the program to be there.

David Hochstim - *Bear Stearns - Analyst*

Okay. And then one other question. Just could either of you talk a little more specifically about the reserves you established in the hurricane areas and I guess the most severely damaged areas probably need those reserves more than in the others? And at what point do you figure out that you are really not a risk that the properties either aren't going to be repaired and it's not your problem or they are not going to claim?

Bob Quint - *Radian Group, Inc. - CFO*

Well, we really made the decision last year to treat these delinquencies as normal delinquencies in the model because we didn't have clear visibility to lead up to some conclusions. Now the thought all along was that over the next year or two they will work themselves out, they will either become claims, which some of them have, or they will cure, in which the reserve will go away. We still think that is the right way to handle this.

Now the heavily damaged areas likely unless the properties get repaired will ultimately not be claimed. But it is possible that there are homes in heavily damaged areas that aren't fully damaged and maybe we will have to (technical difficulty). I think that is proving out as the amount of delinquencies, the amount of reserves related to these things has come down. And probably over the next year, it will be less meaningful and it will work itself out as opposed to us up front making some judgments based on information we really didn't have.

David Hochstim - *Bear Stearns - Analyst*

Right. But so far how much of the reserves have you actually had to use in the event of claims? It seems that most of those reserves probably won't be used.

Bob Quint - *Radian Group, Inc. - CFO*

Well, we can't really say that. At this point some of those reserves have been claimed; we have had claims in these areas. But many of them have cured as well. But that is typical of all of our delinquencies, most of our delinquencies typically cure and some become claims. I think in this area more have cured probably than average. But still some have gone to claim as well.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

David Hochstim - *Bear Stearns - Analyst*

But just remind us, in these areas the home has to be restored to original condition doesn't it? Even if --?

Bob Quint - *Radian Group, Inc. - CFO*

Potentially. Potentially. There are rules we have to follow. But we don't cover damage, that is the primary.

David Hochstim - *Bear Stearns - Analyst*

Okay.

Mark Casale - *Radian Group, Inc. - President, Domestic Mortgage*

David, it is Mark. That is one of the reasons to be prudent in terms of the reserves because if a home has to be repaired and there is a claim, then we would eventually pay it.

David Hochstim - *Bear Stearns - Analyst*

Right, I understand. It just seems you are being pretty conservative which is good. Thank you.

Operator

Paul Miller from Friedman, Billings, Ramsey.

Paul Miller - *Friedman, Billings, Ramsey - Analyst*

Thank you very much. Hey, S.A., a competitor of yours talked about paid losses bump up in their quarter because of the bankruptcy law change about six to nine months ago, I think it was in October of last year. And we didn't see it with your guys at all. Did the bankruptcy change have any impact on your business? And could we maybe see impact in the third quarter?

S.A. Ibrahim - *Radian Group, Inc. - CEO*

Paul, as you know everybody as you know has different book of business and sees it differently. As Bob answered the question, based on what we have seen to date and that is a very different experience unless Bob once again completes the --?

Bob Quint - *Radian Group, Inc. - CFO*

Yes, Paul, you know we did see a small bump up in bankruptcies in October '05 but it hasn't impacted claims materially over the last several quarters and we don't expect it to in the future.

Paul Miller - *Friedman, Billings, Ramsey - Analyst*

I believe you made this comment, Bob, but I want to double-check it. You don't really expect paid claims to really go up that much in the second half of the year?

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

Bob Quint - *Radian Group, Inc. - CFO*

We expect it to go up just a little bit for the rest of the year, yes.

Paul Miller - *Friedman, Billings, Ramsey - Analyst*

And how does that kind of bode with the cautiousness that S.A. talks about into '07? You expect paid claims to be relatively flat but yet again you tend to be speaking really -- I know you are just being conservative, I'm just trying to tie the two together.

S.A. Ibrahim - *Radian Group, Inc. - CEO*

Paul, being cautious is sort of more a business approach and a conscious approach we are taking. Our view is that in an environment where we cannot forecast what is going to happen in the market factors outside our control that will determine what happens in housing and credit markets, we have to look at how we can deal with the things that we do control. And what we do control is the kind of business we choose to do. We do control to some extent based on markets still, factors still, how much we choose to Smart Home or protect in other ways. And we believe therefore in light of the uncertain market environment it is incumbent on us to be more careful and more cautious and position ourselves for what could happen under certain scenarios. Not that we expect those scenarios to happen and not that our experience to date suggests those scenarios would happen but just being wise and prudent given the -- all the noise about what could happen and not happen in the housing impaired markets.

Bob Quint - *Radian Group, Inc. - CFO*

And Paul, with regard to claims, you know, claims is one thing we do give outlook on every quarter because we have more visibility on that because we have claims in-house and we pay claims in a certain amount of time. So I think the outlook on the claims is based on what we have right now, it's already the end of July. The cautious outlook is going to be more looking at future delinquencies and claims would be subsequent to that in '07 and thereafter.

Paul Miller - *Friedman, Billings, Ramsey - Analyst*

And you really haven't built up your reserves in the last two quarters. Do you expect to build -- you guys have I think you have adequate reserves. Do you think you are going to increase reserves in the second half of the year or just keep paid claims with incurred losses?

Bob Quint - *Radian Group, Inc. - CFO*

The reserves first of all, reserves are set by a model that we have that looks at the delinquencies. And delinquencies have declined fairly significantly. So clearly that has a lot to do with the reserve number. What we can do is make a judgment about our cautiousness about the future and reserve at somewhat above the midpoint which we have done. And the other thing if you look at the kind of the measures of our reserves, reserve per delinquency, claims, quarters of claims coverage, reserve per dollar of risk in force, all of the commonly used metrics with regard to reserves, I think we are very, very well reserved. I think you can really see that in the numbers.

Paul Miller - *Friedman, Billings, Ramsey - Analyst*

Hey, thank you very much, gentlemen.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

Operator

Robert Ryan from Merrill Lynch.

Robert Ryan - Merrill Lynch - Analyst

Good morning. S.A., would you review for us the current approach to international mortgage insurance and where you see the opportunities?

S.A. Ibrahim - Radian Group, Inc. - CEO

Yes, I would be glad to. As we said, this is an area we see the glass -- we are seeing it half or you know 9/10 empty, we see it as an opportunity for growth. Having said that we also have the view that international markets are markets where we need to be very selective and very measured and take an approach in many cases of partnering with the right partners who know and understand the markets. For example, you are all very familiar with the fact that in Hong Kong we've partnered with Standard Chartered and in fact it is helping us to some extent right now because there is a view on Standard Chartered's part right now that Hong Kong is a market where they want to sit back for a little bit and therefore we take guidance from them and we sit back. They know that market far better than we do.

So we want to be very careful, very choosy in terms of the markets we focus on and who we partner with in those markets. Having said that, we are putting a lot of resources and a lot of effort into preparing to go after the international business and the timeframe we are looking at is more a medium- to long-term timeframe in terms of success within the short-term continuing to put resources, continuing to place small bets and see how they play out. And then go after those opportunities that we find work for us in a proven way.

I will turn to Roy who is -- the other thing we have done is we've taken a very senior person, Roy Kasmar, who is the President of Radian Group and we are now focusing him exclusively on the international effort because we believe that given the long-term value that these efforts can generate and the fact that we want to be very measured and careful that they require a very senior person's attention. And I will turn to Roy now to comment on -- to add more color to my comments.

Roy Kasmar - Radian Group, Inc. - President, Strategic International Mortgage

Yes, S.A., I think you are right on. We are taking a disciplined approach in a handful of locations across the world. And we are carefully selecting those markets and carefully building infrastructure in I think a prudent fashion trying to be careful not to get expenses out in front of revenues. And we are optimistic over some interim term here that we can generate a meaningful amount of growth in revenue and net debt income.

Robert Ryan - Merrill Lynch - Analyst

Okay, great. On a completely unrelated follow-up, Bob, could you describe the second-quarter level of mortgage insurance operating expenses in the context of the run rates recently and the run rate that you suggested earlier this year?

Bob Quint - Radian Group, Inc. - CFO

Yes, the MI operating expenses and the reason that we said that we expect that they will go up a little bit, it is really the same reason as last quarter. And it is just occurred a little bit slower as we are expecting to build infrastructure and invest in certain

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

things, structured business, international business, that investment has just occurred a little bit more slowly than we anticipated. So this quarter you are not seeing those expenses because they weren't there yet.

The other thing is that we do expect to do -- resume Smart Home and so the Smart Home expenses will be consistent throughout the rest of the year. In the first quarter we had some payroll expenses that didn't repeat in the second quarter. So we do think the second quarter is a little bit lower than the run rate we expect for the rest of the year.

Robert Ryan - Merrill Lynch - Analyst

Thank you.

Operator

Mark Devries from Lehman Brothers.

Mark Devries - Lehman Brothers - Analyst

I'm sorry if you covered this, but could you comment on what caused investment income to jump so much during the quarter?

Bob Quint - Radian Group, Inc. - CFO

Yes, Mark. There was an usual item and that was a result of two private equity investments that we've made over the last few years. And they produced realized gains this quarter which are included in investment income. And those are not recurring kind of items. We're very happy that they showed up and we are happy with the returns that these investments have generated. But it is not the kind of thing that happens every quarter.

Mark Devries - Lehman Brothers - Analyst

Okay. And can you disclose how much that contributed?

Bob Quint - Radian Group, Inc. - CFO

It was most of the increase from the prior quarter.

Mark Devries - Lehman Brothers - Analyst

Okay. And a second question, I think you are clearly generating a lot of value through these risk sharing transactions but it is not that tangible to a lot of investors because if anything it drags down earnings. Can you talk about what type of loss scenario you would have to see to really trigger some of these loss sharings in your Smart Home and in your captive agreement? Would it be a two times current experience scenario or something above that?

Bob Quint - Radian Group, Inc. - CFO

I can talk to captives and then I will let Mark talk about Smart Home. On a captive you are not talking about two times, it is less than two times. So it is anywhere between 1.5, maybe 1.5 to 1.75 times expected. So clearly it is higher-than-expected but these are not scenarios -- they haven't occurred in the past and they are not scenarios that we believe can't occur in the future. So

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

you have to understand that I think the last several years has been loss scenarios which are lower than expected so the attachment points haven't been close to being hit. But if you look at history, history has shown that these attachment points certainly can be hit. And I think on average on the captive side, we are really looking at 1.5 to 1.75 times expected.

Mark Casale - *Radian Group, Inc. - President, Domestic Mortgage*

On Smart Home, the range is similar. It is probably 1.5, it may be a little bit less. But keep in mind a lot of the assets that have gone into Smart Home have been on the nonprime and subprime variety where the performance is much more volatile. So it is a little bit misleading comparing the two. But in captive where it is more prime, the 1.5 is probably a little bit harder to attach. As you have seen or we have seen in the sub prime market over the last 15 years in certain segments, 1.5 times expected losses is easily pierced. So we feel like we are protected.

Mark Devries - *Lehman Brothers - Analyst*

Great, thank you.

Operator

Mr. Quint, there are no further questions at this time. Please continue.

S.A. Ibrahim - *Radian Group, Inc. - CEO*

Since there are no further questions at this time, we will make closing comments and wrap up. Thank you for your time today and your interest in Radian. I would to quickly recap some of the points that I believe are the most important.

First, we have successfully leveraged our blended expertise in mortgage insurance and Financial Guaranty to provide a range of mortgage solutions. Second, we continue to remain focused on and committed to capital management. Third, we are delivering on the strategy we previously outlined and we look forward to continue to deliver strong earnings and profitable book value. Thank you all for participating in the call.

Operator

Ladies and gentlemen, this conference will be available for replay starting today, July 20, 2006 at 12:30 PM through August 3, 2006, 11:59 PM. You may access the AT&T teleconference replay system at any time by dialing 1-800-475-6701 and entering the access code 834519. For all international participants that have dialed in, please dial 320-365-3844. Those numbers again are for the U.S. participants 1-800-475-6701, and for the international participants, 320-365-3844 and the access code is 834519.

That does conclude our conference for today. Thank you for participating and for using AT&T executive teleconference. You may now disconnect.

Jul. 20. 2006 / 9:00AM, RDN - Q2 2006 Radian Group Earnings Conference Call

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