RADIAN GROUP INC
Form 10-Q
November 10, 2008
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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 September 30, 2008

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 incorporation or organization)	**(I.R.S. Employer 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 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 x	Accelerated filer ¨	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: 81,124,288 shares of common stock, $0.001 par value per share, outstanding on November 3, 2008.

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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 extended national or regional economic recessions, changes in housing demand or mortgage originations, changes in 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), changes in the liquidity in the capital markets and the further contraction of credit markets, population trends and changes in household formation patterns, changes 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;

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

- our ability to successfully execute upon our capital plan, and if necessary, to obtain additional capital, to support our long-term liquidity needs and to protect our credit ratings and the financial strength ratings of Radian Guaranty Inc., our primary mortgage insurance subsidiary;

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

- our ability to maintain adequate risk-to-capital ratios, leverage ratios and surplus requirements in our mortgage insurance business in light of on-going losses in this business;

- 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 adjustable rate products, such as adjustable rate mortgages and interest-only mortgages, which have resulted in increased losses in 2007 and 2008 and are expected to result in further losses;

reduced opportunities for loss mitigation in markets where housing values fail to appreciate or begin to decline;

changes in persistency rates of our mortgage insurance policies caused by changes in refinancing activity, in the rate of appreciation or depreciation of home values and changes in the mortgage insurance cancellation requirements of mortgage lenders and investors;

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- 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., which are currently on Negative outlook); which risk is discussed in more detail below in Item 2 of Part I of this report on Form 10-Q;

- 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 retain our Top Tier eligibility requirement from 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, (ii) legislative and regulatory changes affecting demand for private mortgage insurance or financial guaranty insurance, or (iii) legislation and regulatory changes 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 the premium deficiencies for our first- and second-lien mortgage insurance business, 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;

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

- changes in accounting guidance from the Securities and Exchange Commission (SEC) or the Financial Accounting Standards Board;

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

- vulnerability to the performance of our investment in Sherman Financial Group LLC.

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, 2007 as well as the material changes to these risks discussed in Item 1A of Part II of our quarterly reports on Form 10Q, including the material changes discussed in this report below. 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.

Radian Group Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

($ in thousands, except per-share amounts)	September 30 2008	December 31 2007
ASSETS		
Investments		
Fixed maturities held to maturity at amortized cost (fair value $37,605 and $55,021)	$ 36,648	$ 53,310
Fixed maturities available for sale at fair value (amortized cost $4,379,209 and $4,571,998)	4,177,994	4,644,724
Trading securities at fair value (amortized cost $538,109 and $158,087)	521,641	153,634
Equity securities available for sale at fair value (cost $215,040 and $196,068)	208,158	254,869
Hybrid securities at fair value (amortized cost $552,087 and $525,607)	493,281	584,373
Short-term investments	764,285	697,271
Other invested assets (cost $20,617 and $21,087)	21,245	22,868
Total investments	6,223,252	6,411,049
Cash	106,962	200,787
Investment in affiliates	87,256	104,354
Deferred policy acquisition costs	178,581	234,955
Prepaid federal income taxes	248,828	793,486
Accrued investment income	71,070	65,362
Accounts and notes receivable (less allowance of $59,545 and $50,391)	93,127	130,773
Property and equipment, at cost (less accumulated depreciation of $87,560 and $81,930)	22,275	24,567
Derivative assets	171,116	43,214
Tax recoverables	270,775	1,816
Reinsurance recoverables	310,984	33,960
Other assets	262,010	165,866
Total assets	$ 8,046,236	$ 8,210,189
LIABILITIES AND STOCKHOLDERS EQUITY		
Unearned premiums	$ 1,000,725	$ 1,094,710
Reserve for losses and loss adjustment expenses	2,680,381	1,598,756
Reserve for premium deficiency	331,373	195,646
Long-term debt and other borrowings	908,282	953,524
Variable interest entity debt	127,624	
Deferred income taxes payable		26,705
Derivative liabilities	343,296	1,305,665
Accounts payable and accrued expenses	322,229	314,447
Total liabilities	5,713,910	5,489,453
Commitments and Contingencies (Note 15)		
Stockholders equity		
Common stock: par value $.001 per share; 325,000,000 and 200,000,000 shares authorized at September 30, 2008 and December 31, 2007; 97,792,163 and 97,631,763 shares issued at September 30, 2008 and December 31, 2007; 80,696,131 and 80,412,974 shares outstanding at September 30, 2008 and December 31, 2007, respectively	98	98

Treasury stock, at cost: 17,096,032 and 17,218,789 shares at September 30, 2008 and December 31, 2007, respectively	(883,796)	(889,478)
Additional paid-in capital	1,337,632	1,331,790
Retained earnings	2,017,542	2,181,191
Accumulated other comprehensive income	(139,150)	97,135
Total stockholders equity	2,332,326	2,720,736
Total liabilities and stockholders equity	$ 8,046,236	$ 8,210,189

See notes to unaudited condensed consolidated financial statements.

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Radian Group Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except per-share amounts)	Three Months Ended September 30 2008	Three Months Ended September 30 2007	Nine Months Ended September 30 2008	Nine Months Ended September 30 2007
Revenues:				
Premiums written insurance:				
Direct	$ 232,656	$ 307,797	$ 743,922	$ 820,409
Assumed	8,507	37,209	45,820	89,805
Ceded	(38,712)	(36,995)	(120,340)	(111,354)
Net premiums written	202,451	308,011	669,402	798,860
Decrease (increase) in unearned premiums	47,267	(62,615)	71,374	(120,947)
Net premiums earned insurance	249,718	245,396	740,776	677,913
Net investment income	65,215	64,959	196,322	188,605
Change in fair value of derivative instruments	164,757	(615,936)	928,792	(633,765)
Net (losses) gains on other financial instruments	(63,737)	14,840	(126,872)	54,279
Gain on sale of affiliate		181,734		181,734
Other income	2,756	4,599	9,591	11,519
Total revenues	418,709	(104,408)	1,748,609	480,285
Expenses:				
Provision for losses	544,915	330,504	1,586,505	611,508
Provision for premium deficiency	(252,170)	155,176	135,727	155,176
Policy acquisition costs	20,770	35,743	120,628	88,195
Other operating expenses	80,781	36,169	199,771	151,472
Interest expense	13,852	13,394	40,177	38,810
Total expenses	408,148	570,986	2,082,808	1,045,161
Equity in net income (loss) of affiliates	15,798	(448,924)	44,028	(376,645)
Pretax (loss) income	26,359	(1,124,318)	(290,171)	(941,521)
Income tax benefit	(10,340)	(420,454)	(129,984)	(372,207)
Net (loss) income	$ 36,699	$ (703,864)	$ (160,187)	$ (569,314)
Basic net (loss) income per share	$ 0.46	$ (8.82)	$ (2.01)	$ (7.16)
Diluted net (loss) income per share	$ 0.46	$ (8.82)	$ (2.01)	$ (7.16)
Weighted average number of common shares outstanding basic	79,960	79,800	79,603	79,467
Weighted average number of common and common equivalent shares outstanding diluted	80,471	79,800	79,603	79,467
Dividends per share	$ 0.0025	$ 0.02	$ 0.0425	$ 0.06

See 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 prior to implementation effects JANUARY 1, 2007	$ 97	$ (931,012)	$ 1,347,205	$ 3,489,290	$ 9,796	$ 151,934	$ 247	$ 4,067,557
Cumulative effect of adoption of FIN No. 48				(21,214)				(21,214)
Cumulative effect of adoption of SFAS No. 155				9,844		(9,844)		
BALANCE, JANUARY 1, 2007, as adjusted	97	(931,012)	1,347,205	3,477,920	9,796	142,090	247	4,046,343
Comprehensive loss:								
Net loss				(569,314)				(569,314)
Unrealized foreign currency translation adjustment, net of tax of $4,446					8,256			8,256
Unrealized holding losses arising during period, net of tax benefit of $24,743						(45,951)		
Less: Reclassification adjustment for net gains included in net income, net of tax of $4,129						(7,669)		
Net unrealized loss on investments, net of tax benefit of $28,872						(53,620)		(53,620)
Comprehensive loss								(614,678)
Issuance of common stock under incentive plans		64,727	5,943					70,670
Issuance of restricted stock			(34,662)					(34,662)
Amortization of restricted stock			6,341					6,341
Stock-based compensation expense-options			1,109					1,109
Treasury stock purchased		(22,823)						(22,823)
Dividends paid				(4,808)				(4,808)
BALANCE, SEPTEMBER 30, 2007	$ 97	$ (889,108)	$ 1,325,936	$ 2,903,798	$ 18,052	$ 88,470	$ 247	$ 3,447,492
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				(160,187)				(160,187)
Unrealized foreign currency translation adjustment, net of tax of $29					(54)			(54)
Unrealized holding losses arising during the period, net of tax benefit of $132,949						(246,905)		
Less: Reclassification adjustment for net losses included in net loss, net of tax benefit of $13,758						25,551		
Net unrealized loss on investments, net of tax benefit of $119,191						(221,354)		(221,354)
Comprehensive loss								(381,595)
Sherman equity adjustment							(16,761)	(16,761)
Pension curtailment							1,884	1,884
Repurchases of common stock under incentive plans		5,682	(5,992)					(310)
Issuance of restricted stock			476					476
Amortization of restricted stock			6,297					6,297
Stock-based compensation expense			5,061					5,061
Dividends declared				(3,462)				(3,462)

BALANCE, SEPTEMBER 30, 2008	$ 98	$ (883,796)	$ 1,337,632	$ 2,017,542	$ 12,088	$ (134,735)	$ (16,503)	$ 2,332,326

See notes to unaudited condensed consolidated financial statements.

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Radian Group Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	Nine Months Ended September 30 2008	2007
Cash flows (used in) provided by operating activities	$ (123,957)	$ 324,058
Cash flows from investing activities:		
Proceeds from sales of fixed-maturity investments available for sale	547,718	210,850
Proceeds from sales of equity securities available for sale	93,896	44,352
Proceeds from sales of hybrid securities	264,690	261,156
Proceeds from redemptions of fixed-maturity investments available for sale	150,161	168,294
Proceeds from redemptions of fixed-maturity investments held to maturity	17,953	20,841
Proceeds from redemptions of hybrid securities	29,347	52,971
Purchases of fixed-maturity investments available for sale	(519,936)	(513,374)
Purchases of equity securities available for sale	(114,933)	(6,822)
Purchases of hybrid securities	(318,151)	(334,437)
Sales (purchases) of short-term investments, net	(73,854)	(639,360)
Purchases of other invested assets, net	(1,921)	(7,278)
Purchases of property and equipment, net	(3,991)	(2,728)
Sale (purchase) of investment in affiliates		277,882
Loan to affiliate		(50,000)
Net cash provided by (used) in investing activities	70,979	(517,653)
Cash flows from financing activities:		
Dividends paid	(3,462)	(4,808)
Proceeds from issuance of common stock under incentive plans		25,281
Proceeds from (paydown of) other borrowings	(50,000)	200,000
Excess tax benefits from stock-based awards		5,488
Purchase of treasury stock		(22,823)
Proceeds from termination of interest-rate swap	12,800	
Net cash (used in) provided by financing activities	(40,662)	203,138
Effect of exchange rate changes on cash	(185)	(4,644)
(Decrease) increase in cash	(93,825)	4,899
Cash, beginning of period	200,787	57,901
Cash, end of period	$ 106,962	$ 62,800
Supplemental disclosures of cash flow information:		
Income taxes (received) paid	$ (508,756)	$ 128,308
Interest paid	$ 38,368	$ 33,741
Supplemental disclosures of non-cash items:		
Stock-based compensation, net of tax	$ 10,914	$ 1,939

See notes to unaudited condensed consolidated financial statements.

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Radian Group Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Condensed Consolidated Financial Statements Basis of Presentation

Our condensed consolidated financial statements include the accounts of Radian Group Inc. and its subsidiaries, including its principal mortgage insurance operating subsidiaries, Radian Guaranty Inc. (Radian Guaranty), Amerin Guaranty Corporation (Amerin Guaranty) and Radian Insurance Inc. (Radian Insurance), and its principal financial guaranty operating subsidiaries, Radian Asset Assurance Inc. (Radian Asset Assurance) and Radian Asset Assurance Limited (RAAL). 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. We own a 46% interest in Credit-Based Asset Servicing and Securitization LLC (C-BASS) and a 28.7% interest in Sherman Financial Group LLC (Sherman), each of which are credit-based consumer asset businesses.

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 rules and regulations of the Securities and Exchange Commission (SEC).

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 presentation of the statement of 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, 2007. 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. As a result of our net loss for the nine months ended September 30, 2008, 5,235,491 share equivalents issued under our stock-based compensation plans were not included in the calculation of diluted earnings per share because they were anti-dilutive. For the three months ended September 30, 2008, 4,082,849 share equivalents were not included in the calculation of diluted earnings 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 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. The impact of adopting SFAS No. 157 is included in the change in fair value of derivative instruments. See Note 2. In accordance with Financial

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Radian Group Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Accounting Standards Board (FASB) Staff Position (FSP) SFAS No. 157-2, Effective Date of FASB Statement No. 157, we have elected to defer the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities until January 1, 2009.

We adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159) effective January 1, 2008. SFAS No. 159 permits entities to choose to measure financial instruments and certain other items at fair value. Items eligible for fair value measurement by this statement are (i) recognized financial assets and financial liabilities (with some exceptions), (ii) firm commitments that would otherwise not be recognized at inception and that involve only financial instruments, (iii) non-financial insurance contracts and warranties that an insurer can settle by paying a third party to provide those goods or services and (iv) host financial instruments resulting from separation of an embedded non-financial derivative instrument from a non-financial hybrid instrument. We elected to fair value the consolidated net interest margin securities (NIMS) variable interest entity (VIE) debt at the date the VIEs were consolidated during 2008.

We adopted FSP FASB Interpretation (FIN) No. 39-1 in the first quarter of 2008. FSP FIN No. 39-1, an amendment of FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts (FSP FIN No. 39-1) replaces the terms conditional contracts and exchange contracts with the term derivative instruments and permits a reporting entity to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable), or the obligation to return cash collateral (a payable), against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting arrangement that have been offset in the statement of financial position. The implementation of FSP FIN No. 39-1 did not have a material impact on our condensed consolidated financial statements at January 1, 2008.

Certain other prior period balances have been reclassified to conform to the current period presentation. Specifically, effective January 1, 2008, derivative premiums earned are now included in the change in fair value of derivative instruments. This reclassification is being adopted after agreement with member companies of the Association of Financial Guaranty Insurers (AFGI) in consultation with the staffs of the Office of the Chief Accountant and the Division of Corporate Finance of the SEC. This reclassification is being implemented in order to increase comparability of our financial statements with other financial guaranty companies with derivative contracts. The 2007 amounts have been revised to reflect this reclassification.

2. Fair Value of Financial Instruments

Effective January 1, 2008, we adopted SFAS No. 157, which as discussed in Note 1, defines fair value, establishes a fair value hierarchy and requires additional disclosures for financial assets and liabilities measured at fair value. Financial instruments reported in investments (excluding held-to-maturity securities and equity-method investments) and derivative assets and liabilities are measured at fair value. In 2008, we elected to also measure at fair value our variable interest entity debt, as allowed by the provisions of SFAS No. 159.

SFAS No. 157 defines fair value as the current amount that would be exchanged to sell an asset or transfer a liability, other than in a forced liquidation or transfer, and regardless of whether an observable liquid market price exists. SFAS No. 157 requires that a fair value measurement reflect actual or hypothetical assumptions market participants would use in pricing an asset or liability based on the best information available at the measurement date. In addition, SFAS No. 157 explicitly requires that we reflect our own non-performance risk in our fair value measurements of liabilities. We use the parent company credit spreads as our primary market-based input in estimating non-performance risk. The provisions of SFAS No. 157 are reflected prospectively in earnings beginning January 1, 2008.

Radian Group Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

As required by SFAS No. 157, we established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to financial instruments using unadjusted quoted prices in active markets for identical assets or liabilities (Level I measurements) and the lowest priority to fair value measurements using unobservable inputs (Level III measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Level I Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level II Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly;

Level III Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

The level of market activity in determining the fair value hierarchy is based on the availability of observable inputs market participants would use to price an asset or a liability, including market value price observations. For markets in which inputs are not observable or limited, we use significant judgment and assumptions that a typical market participant would use to evaluate the market price of an asset or liability. These assets and liabilities are classified in Level III of our fair value hierarchy. The estimates of fair value of our investment assets reflect the risk of non-performance.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

A financial instrument s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following is a list of those assets and liabilities that are measured at fair value by hierarchy level as of September 30, 2008:

(In millions) Assets and Liabilities at Fair Value (1)	Level I	Level II	Level III	Total
Investment Portfolio:				
Fixed maturities available for sale				
U.S. government and agency securities	$	$ 129.3	$	$ 129.3
Municipal and state securities		3,508.4		3,508.4
Corporate bonds		128.4	0.4	128.8
Asset-backed securities		315.0		315.0
Foreign government securities		91.5		91.5
Other			5.0	5.0
Total fixed maturities available for sale		4,172.6	5.4	4,178.0
Equity securities available for sale	151.6	55.0		206.6
Trading securities				
Municipal and state securities		484.9		484.9
Equity securities		35.4	1.2	36.6
Other		0.1		0.1
Total trading securities		520.4	1.2	521.6
Hybrid securities		493.3		493.3
Short-term investments				
Money market instruments	633.5			633.5
U.S. government and agency securities		44.6		44.6
Municipal and state securities		0.9		0.9
Corporate bonds				
Total short-term investments:	633.5	45.5		679.0
Total Investments at Fair Value	785.1	5,286.8	6.6	6,078.5
Derivative Assets:				
Put options on committed preferred securities (CPS)			97.0	97.0
NIMS assets			6.5	6.5
Financial Guaranty credit derivative assets:				
Corporate collateralized debt obligation (CDO) assets			47.3	47.3
Non-Corporate CDO and other derivative assets			18.9	18.9
Assumed financial guaranty credit derivative assets			0.3	0.3
Total Financial Guaranty credit derivative assets			66.5	66.5
Mortgage Insurance international credit default swaps (CDS)			1.1	1.1

Total Derivative Assets			171.1	171.1
Total Assets at Fair Value	$ 785.1	$ 5,286.8	$ 177.7	$ 6,249.6
Derivative Liabilities:				
NIMS liabilities	$	$	$ 124.9	$ 124.9
Financial Guaranty credit derivative liabilities:				
Corporate CDO liabilities			37.9	37.9
Non-Corporate CDO and other derivative liabilities			56.3	56.3
Assumed financial guaranty credit derivative liabilities			28.7	28.7
Total Financial Guaranty credit derivative liabilities			122.9	122.9
Mortgage Insurance domestic and international CDS			95.5	95.5
Total Derivative Liabilities			343.3	343.3
Variable interest entity debt (2)			127.6	127.6
Total Liabilities at Fair Value	$	$	$ 470.9	$ 470.9

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(1) Excludes fixed maturities held-to-maturity and other invested assets accounted for as equity-method investments as these investments are not measured at fair value.
(2) Represents consolidated debt issued by the VIE utilized to structure our NIMS that require consolidation upon our becoming the primary beneficiary of the VIE.

The fair value of our financial instruments is determined from market pricing when available; otherwise, fair value is based on estimates using present value or other valuation methodologies. Liability amounts include adjustments related to our own non-performance risk. These estimates result in a fair value estimate of the amount that would be exchanged to transfer the asset or liability to a third party with a similar credit rating in an orderly market, if one existed. Considerable judgment is required to interpret available market data to develop the estimates of fair value. Where market pricing is not available, fair value estimates are reconciled or calibrated to market-based information, if available to us. The estimates presented herein are not necessarily indicative of the amount we could actually realize in a current market exchange. The use of different market assumptions or estimation methodologies may have a material effect on our estimated fair value amounts. Also, changes in risk-free rates and our credit spreads over time will have a material effect on our derivative fair values. Following is a description of our valuation methodologies for financial assets and liabilities measured at fair value.

Investments

U.S. Government and agency securities The fair value of U.S government and agency securities is estimated using observed market transactions, including broker-dealer quotes and actual trade activity. As such, U.S government and agency securities are categorized in Level II of the fair value hierarchy.

Municipal and state securities The fair value of municipal and state securities is estimated using recently executed transactions, market price quotations and pricing models that factor in, where applicable, interest rate yield curves and credit spreads for similar bonds. These securities are categorized in Level II of the fair value hierarchy.

Money market instruments The fair value of money market instruments is based on daily prices which are published and available to all potential investors and market participants. As such, these securities are categorized in Level I of the fair value hierarchy.

Corporate bonds The fair value of corporate bonds is estimated using recently executed transactions and market price observations. In addition, a spread model is used to incorporate early redemption features, when applicable. These securities are categorized in Level II of the fair value hierarchy or in Level III when significant unobservable inputs are used.

Asset-Backed Securities (ABS), Commercial Mortgage-Backed Securities (CMBS) and Collateralized Mortgage Obligations (CMOs) The fair value of ABS, CMBS and CMOs is estimated based on prices of comparable securities and spreads, and observable prepayment speeds. These securities are generally categorized in Level II of the fair value hierarchy.

Foreign government securities The fair value of foreign government securities is estimated using observed market yields used to create a maturity curve and observed credit spreads from market makers and broker dealers. These securities are categorized in Level II of the fair value hierarchy.

Hybrid securities These instruments are convertible securities measured at fair value based on observed trading activity and daily quotes. In addition, on a daily basis, dealer quotes are marked against the current price of corresponding underlying stock. These securities are categorized in Level II of the fair value hierarchy. For

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

certain securities, the underlying security price may be adjusted to account for changes in the conversion and investment value from the time the quote was obtained. Such securities are categorized in Level III of the fair value hierarchy.

Equity securities The fair value of these securities is generally estimated using observable market data in active markets or bid prices from market makers and broker dealers. Generally, these securities are categorized in Level I of the fair value hierarchy as observable market data is available on these securities. Securities that are not frequently traded or are not as liquid are categorized in Level II of the fair value hierarchy.

Other investments The fair value of these securities is generally estimated by discounting estimated future cash flows. These securities are categorized in Level III of the fair value hierarchy.

Derivative Assets and Liabilities

Fair value is defined as the price that would be received in connection with the sale of an asset or that would be paid to transfer a liability. In determining an exit market, we consider the fact that most of our derivative contracts are unconditional and irrevocable, and contractually prohibit us from transferring them to other capital market participants. Accordingly, there is no principal market, as defined by SFAS No. 157, for such highly structured insured credit derivatives. In the absence of a principal market, we value these insured credit derivatives in a hypothetical market where market participants include other monoline financial guaranty insurers with similar credit quality, as if the risk of loss on these contracts could be transferred to other mortgage and financial guaranty insurance and reinsurance companies. We believe that in the absence of a principal market, this hypothetical market provides the most relevant information with respect to fair value estimates.

We determine the fair value of our derivative assets and liabilities using internally-generated models. We reconcile or calibrate key inputs to market-based information, when available. Beginning in the first quarter of 2008, in accordance with SFAS No. 157, we made an adjustment to our derivative liabilities valuation methodology to account for our own non-performance risk by incorporating our observable credit default swap spread into the determination of the fair value of our credit derivatives. Our five-year credit default swap spread widened by 591 basis points during 2007 and an additional 1,684 basis points during 2008 to 2,312 at September 30, 2008. Considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of amounts we could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a significant effect on the estimated fair value amounts.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

The following table shows selected information about our derivative contracts:

	September 30 2008 (In millions)		
Product	**Number of Contracts**	**Total Exposure**	**Total Asset/ (Liability)**
Put options on CPS	3	$ 150.0	$ 97.0
NIMS	33	455.8	(118.4) (1)
Corporate CDOs	105	38,282.9	9.4
Non-Corporate CDOs and other derivative transactions:			
Residential mortgage backed securities (RMBS)	2	635.8	(52.5)
CMBS	4	1,831.0	3.3
Trust preferred securities (TRUPS)	18	2,220.5	0.8
Other	55	3,494.7	11.0
Total Non-Corporate CDOs and other derivative transactions	79	8,182.0	(37.4)
Assumed financial guaranty credit derivatives	392	2,096.2	(28.4)
CDS:			
Domestic	6	162.1	(88.4)
International	3	7,567.5	(6.0)
Total CDS	9	7,729.6	(94.4)
Grand Total	621	$ 56,896.5	$ (172.2)

(1) This represents NIMS derivatives liabilities. In addition, we have consolidated NIMS VIE debt in the amount of $127.6 million.

Put Options on CPS

The fair value of our put options on CPS is estimated based on the present value of the spread differential between the current market rate of issuing a perpetual preferred security and the maximum rate of a perpetual preferred security as specified in our put option agreements. In determining the current market rate, consideration is given to our current CDS spread as well as market observation of similar securities issued, when available. The spread differential is assumed to be fixed in perpetuity at the balance sheet date and the annual differential cost is discounted at our current CDS spread, adjusted for a market-implied recovery rate.

The change in fair value of these put options will fluctuate with changes in our CDS spread. As discussed above, our CDS spread has widened significantly since 2007, and given this volatility, it is difficult to predict with reasonable likelihood the magnitude of future changes. The sensitivity of the fair value of our put options on CPS to our CDS spread as of September 30, 2008, assuming as of September 30, 2008 a 1,000 basis point widening, would have resulted in an unrealized loss of approximately $2 million, while a 1,000 basis point tightening would have resulted in an unrealized gain of $5 million. The put options on CPS are categorized in Level III of the fair value hierarchy.

NIMS Credit Derivatives and NIMS VIE Derivative Assets

NIMS credit derivatives are financial guarantees that we have issued on NIMS. NIMS VIE derivative assets represent derivative assets in the NIMS trusts that we are required to consolidate in accordance with FIN No. 46R, Consolidation of Variable Interest Entities (FIN No. 46R). See Note 4. The estimated fair value on these financial instruments are derived from internally-generated discounted cash flow models. We estimate

losses in each securitization underlying either the NIMS credit derivatives or the NIMS VIE derivative assets by

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applying expected default rates separately to loans that are delinquent and those that are paying currently. We then project prepayment speeds on the underlying collateral in each securitization, incorporating historical prepayment experience. The estimated loss and prepayment speeds are used to estimate the cash flows for each underlying securitization and NIMS bond, and ultimately, to produce the projected credit losses for each NIMS bond. In addition to expected credit losses, the fair value for each NIMS credit derivative is approximated by incorporating future expected premiums to be received from the NIMS trust. The projected net losses are discounted using a rate of return that incorporates our own non-performance risk, and based on our current credit default swap spread, results in a significant reduction of the derivative liability. Because NIMS guarantees are not market-traded instruments, considerable judgment is required in estimating fair value. The use of different assumptions and/or methodologies could have a significant effect on estimated fair values. The NIMS credit derivatives are categorized in Level III of the fair value hierarchy. As a result of having to consolidate several NIMS structures, the derivative assets held by the NIMS VIE are also fair valued using the same internally-generated valuation model. Expected losses are estimated for each transaction using projected default rates based on historical experience of similar transactions. There are no collateral recovery rates assumed given the loss position of the NIMS in the transaction structures.

Changes in our expected principal credit losses on NIMS could have a significant impact on our fair value estimate. The gross expected principal credit losses were $440 million as of September 30, 2008, which is our best estimate of settlement value and represents 96% of our total risk in force of $456 million. The fair value of our total net liabilities related to NIMS as of September 30, 2008, was $248 million. Our fair value estimate incorporates a discount rate that is based on our credit default swap spread, which has resulted in a fair value amount that is substantially less than the expected settlement value. Changes in the credit loss estimates will impact the fair value directly, reduced only by the present value factor, which is dependent on the timing of the expected losses and our credit spread. Expected losses are estimated for each transaction using projected default rates based on historical experience of similar transactions. There are no collateral recovery rates assumed given the loss position of the NIMS in the transaction structures. The NIMS VIE derivative assets are also categorized in Level III of the fair value hierarchy.

Corporate CDOs

The fair value of each of our Corporate CDO transactions is estimated based on the difference between (1) the present value of the expected future contractual premiums we charge and (2) the present value of our estimate of the expected future premiums that a financial guarantor of similar credit quality to us would charge (we refer to these premiums as the fair premium) to provide the same credit protection assuming a transfer of our obligation to such financial guarantor as of the measurement date. The discount rate used to estimate the present value of our contractual premium and fair premium is a risk-free rate plus our own credit default swap spread as of the measurement date.

Eighty-two percent of our Corporate CDO transactions currently provide our counterparties with the right to terminate these transactions based on certain rating agency downgrades as described in Note 15 below. In determining the fair value of these transactions, we adjust the contractual premiums for such transactions to reflect the estimated fair value of those premiums, based on our estimate of the probability of our counterparties exercising this termination right and the impact this would have on the remaining expected lifetime premium.

For each Corporate CDO transaction, we perform three principal steps in determining the fair premium amount:

First, we define a tranche on the CDX index (defined below) that equates to the risk profile of our specific transaction (we refer to this tranche as an equivalent-risk tranche);

Second, we determine the fair premium on the equivalent-risk tranche for those market participants engaged in trading on the CDX index (we refer to each of these participants as a typical market participant); and

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Third, we adjust the fair premium for a typical market participant to account for the difference between the non-performance or default risk of a typical market participant and the non-performance or default risk of a financial guarantor of similar credit quality to us (in each case, we refer to the risk of non-performance as non-performance risk).

Defining the Equivalent-Risk Tranche Direct observations of fair premiums for our transactions are not available since these transactions cannot be traded or transferred pursuant to their terms and there is currently no active market for these transactions. However, credit default swaps on tranches of a standardized index (the CDX index) are widely traded and observable, and provide relevant market data for determining the fair premium of our transactions, as described more fully below.

The CDX index is a synthetic Corporate CDO that is comprised of a list of corporate obligors and is segmented into multiple tranches of synthetic senior unsecured debt of these obligors ranging from the equity tranche (i.e., the most credit risk or first loss position) to the most senior tranche (i.e., the least credit risk). We refer to each of these tranches as a standard CDX tranche . A tranche is defined by an attachment point and detachment point, representing the range of portfolio losses for which the protection seller would be required to make a payment.

Our Corporate CDO transactions possess similar structural features to the standard CDX tranches, but often differ with respect to certain of the referenced corporate entities, term, attachment point and detachment points. Therefore, in order to determine the equivalent risk tranche for each of our Corporate CDO transactions, we determine the attachment and detachment points on the CDX index that have the same estimated probability of loss as the attachment and detachment points in our transactions. We begin by performing a simulation analysis of referenced entity defaults in our transactions to determine the probability of portfolio losses exceeding our attachment and detachment points. The referenced entity defaults are primarily determined based on the following inputs: the market observed credit default swap credit spreads of the referenced corporate entities, the correlations between each of the referenced corporate entities and the term of the transaction.

For each referenced corporate entity in our Corporate CDO transactions, the credit default swap spreads associated with the term of our transactions (credit curve) define the estimated expected loss for each entity. The credit curves on individual referenced entities are generally observable. The expected cumulative loss for the portfolio of referenced entities associated with each of our transactions is the sum of the expected losses of these individual referenced entities. With respect to the correlation of losses across the underlying reference entities, two obligors belonging to the same industry or located in the same geographical region are assumed to have a higher probability of defaulting together (i.e., they are more correlated). An increase in the correlations between the referenced entities generally causes a higher expected loss for the portfolio associated with our transactions. The estimated correlation factors that we use are derived internally based on observable third-party inputs that are based on historical data. These inputs are adjusted to levels implied by observed market pricing on the standard CDX index. The impact of our correlation assumptions currently do not have a material effect on our fair premium estimates in light of the significant impact of our non-performance risk adjustment as described below.

Once we have established the probability of portfolio losses exceeding the attachment and detachment points in our transactions, we then use the same simulation method to locate the attachment and detachment points on the CDX index with the same probabilities. These equivalent attachment and detachment points define the equivalent-risk tranche on the CDX index that we use to determine fair premium.

Determining the Typical Fair Premium The equivalent-risk tranches for our Corporate CDO transactions often are not identical to any standard CDX tranches. As a result, fair premium rates generally are not directly observable from the CDX index for the equivalent-risk tranche and must be separately determined. We make this determination through an interpolation in which we use the observed premium rates on the standard CDX tranches that most closely match our equivalent-risk tranche to derive the premium rate for the equivalent-risk tranche.

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Non-Performance Risk Adjustment on Corporate CDOs The fair premium rate estimated for the equivalent-risk tranche represents the premium rate for a typical market participant not Radian. Accordingly, the final step in our fair value estimation is to convert this fair premium rate into a fair premium for a financial guarantor of similar credit quality to us. A typical market participant is contractually bound by a requirement that collateral be posted regularly to minimize the impact of this participant s default or non performance. This collateral posting feature makes these transactions less risky to the protection buyer, and therefore, priced differently. None of our contracts require us to post collateral with our counterparties, which exposes our counterparties fully to our non-performance risk. We make an adjustment to the fair premium amount for a typical market participant to account for this contractual difference, as well as for the market s perception of our default probability which is observable through our credit default swap spread. The amount of the adjustment is computed based on the correlation between the default probability of the transaction and our default probability. Our non-performance risk adjustment currently has a material impact on our fair premium estimates. The impact for each reported period is presented in the table below.

The estimated fair value of our Corporate CDO transactions is reasonably likely to change significantly with changes in the observed standard CDX index spread. As of September 30, 2008, a 25 basis point change in the spread on an equivalent-risk tranche of the CDX index would have resulted in a change of approximately $14 million to our estimated current fair value asset of $20.7 million, assuming our own credit default swap spread remains constant. As of September 30, 2008, a 1,000 basis point widening in our credit default swap spread, assuming the CDX spread remains constant, would have resulted in an unrealized gain of $15 million to our fair value. A 1,000 basis point tightening in our credit default swap and spread assuming the CDX spread remains constant, would have resulted in an unrealized loss of $128 million change to our fair value. These credit derivatives are categorized in Level III of the fair value hierarchy.

Non-Corporate CDOs and Other Derivative Transactions

Our Non-Corporate CDO transactions include our guaranty of RMBS CDOs, CMBS CDOs, TRUPS CDOs, and CDOs backed by other asset classes such as municipal securities and synthetic financial guarantees of asset-backed securities (such as auto loans and credit card securities) and project finance transactions. The fair value of our Non-Corporate CDO and other derivative transactions is calculated as the net present value of the difference between our contractual premium and our estimate of the fair premium for these transactions. For our credit card and auto loan transactions, the fair premium is estimated using observed spreads on recent trades of securities that are similar to the securities that we guaranty. In all other instances, we utilize internal models to estimate fair premium as described below.

RMBS CDOs Our two remaining RMBS CDO transactions are derived using standard market indices and discounted cash flows, to the extent expected losses are estimable. The credit quality of the underlying referenced obligations in one of these transactions is reasonably similar to that which is included in the AAA-rated ABX.HE index, a standardized list of residential mortgage-backed security reference obligations. Accordingly, the fair premium for this transaction is derived directly from the observed spreads of this index. For our second RMBS CDO transaction, the underlying referenced obligations in this transaction have experienced significant credit deterioration, and we expect this will result in claims. Fair premium for this transaction is determined using a discounted cash flow analysis. We estimate projected claims based on our internal credit analysis which is based on the current performance of each underlying reference obligation, and our estimate of the claim rate associated with the current delinquent loans. The expected cash flows from the underlying reference obligations are then present valued using a discount rate derived from the BBB- ABX.HE index. The insured cash flows are present valued using a discount rate that is equal to our credit default swap rate plus a risk free rate.

CMBS CDOs The fair premium estimates for our CMBS CDO transactions are derived directly from the observed spreads on the CMBX indices. The CMBX indices represent standardized lists of commercial

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mortgage-backed security reference obligations. A different CMBX index exists for different types of underlying referenced obligations based on their various origination periods and credit grades. For each of our CMBS CDO transactions we use the CMBX index that most directly correlates to our transaction with respect to the origination period and credit rating of the referenced obligations included in our transactions. The fair premium rate for each of our transactions is then determined based on the observed spread of the relevant CMBX index.

TRUPS CDOs Our TRUPS transactions are synthetic CDOs where the underlying referenced obligations are preferred securities of financial institutions consisting primarily of banks and insurance companies whose individual spreads are not observable. In each case, we provide credit protection on a specific tranche of each synthetic CDO. In determining estimated fair values of our TRUPS CDO transactions, we use internally-generated models to calculate the fair premium rate based on the following inputs: our contractual premium (which is estimated to be equal to the fair premium as of the contract date), the estimated change in the spread of the underlying referenced obligations, the remaining term of the TRUPS CDOs and the deterioration (if any) of the subordination. We start with our contractual premium amounts and then make an adjustment for the estimated change in the spread of the underlying referenced obligations from inception of the transaction to the current measurement date. To determine the spread of the underlying reference obligations, which are not observable, we assume these spreads to be proportional to the weighted average credit default swap spread of a group of investment grade and high yield institutions whose market risk is determined by us to be similar to the specific financial institutions underlying our TRUPS. The relationship between the spread on these referenced obligations and the spread on the tranche we insure is then determined based on the historical observed relationship between the spread on the referenced entities of the CDX index and the spread on a senior tranche of the CDX index, because the direct relationship for TRUPS CDOs is not observable. A separate adjustment to the premium rate is then calculated for each transaction based on its remaining average life. This adjustment accounts for changes in the remaining average life of our transactions and is based on historically observed prices for corporate obligations with similar remaining maturities. A separate adjustment to the fair premium is then calculated for each transaction based on any deterioration of subordination that has occurred since origination. This adjustment is based on a relationship between subordination and fair premium for a CDO transaction according to a simulation model. This adjustment is not currently significant to our overall fair value estimate given the significant remaining subordination underlying our deals.

All Other Non-Corporate CDOs and other Derivative Transactions For all of our other Non-Corporate CDO and other derivative transactions, observed prices and market indices are not available. As a result, we utilize an internal model that estimates fair premium based on a market rate of return that would be required for a monoline insurer to undertake the contract risk. The fair premium amount is calculated as the premium required to achieve a market rate of return (net of expected losses and other expenses) over an estimated internally developed risk-based capital amount. Such market rates of return approximate historical rates of return earned by financial guarantors. Expected losses and our internally developed risk-based capital amounts are projected by our model based on the internal credit rating, term, asset class, and current par outstanding for each transaction.

For each of the Non-Corporate CDO and other derivative transactions discussed above, with the exception of the RMBS CDO transaction that is valued using a discounted cash flow analysis, we make an adjustment to the fair premium amounts described above to incorporate our own non-performance risk. The amount of the adjustment is computed based on the correlation between the default probability of the transaction and our default probability. The non-performance risk adjustment associated with our RMBS CDO is incorporated in the fair value as described above, and so no separate adjustment is required.

Changes in the estimated fair values for our Non-Corporate CDOs and other derivative transactions primarily result from changes in observed indices as discussed above, as well as changes in the market s perception of our non-performance risk. A 25 basis point change in these observed indices discussed above,

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assuming our credit default swap spread remained constant, would have resulted in an immaterial change to our fair value liability of $35 million as of September 30, 2008. As of September 30, 2008, a 1,000 basis point widening in our credit default swap spread, assuming the observed index spreads remain constant, would have resulted in an unrealized gain of $5 million to our current fair value. A 1,000 basis point tightening in our credit default swap spreads assuming the observed index spreads remain constant, would have resulted in an unrealized loss of $38 million to our current fair value. These credit derivatives are categorized in Level III of the fair value hierarchy.

	January 1 2007	January 1 2008	March 31 2008	June 30 2008	September 30 2008
Radian 5-year credit default swap spread (in basis points)	37	628	1,095	2,530	2,312

Product ($ in millions)	Impact of initial adoption 1/1/08 Unrealized gain	Cumulative Unrealized gain at 3/31/08	Cumulative Unrealized gain at 6/30/08	Cumulative Unrealized gain at 9/30/08
Corporate CDOs	$ 638.8	$ 1,584.8	$ 1,427.5	$ 1,294.8
Non-Corporate CDOs	185.8	326.2	373.0	678.3
NIMS and other	108.2	147.3	234.0	329.2
Total	$ 932.8	$ 2,058.3	$ 2,034.5	$ 2,302.3

The unrealized gain attributable to the market s perception of our non-performance risk increased during the third quarter of 2008. This change was primarily driven by a change in the fair value estimate associated with one large RMBS CDO derivative transaction. Prior to the third quarter, the estimated fair value of this transaction was determined using market-based index spreads, and we did not expect to incur any losses based on an analysis of existing credit subordination at that time. However, the fair value liability as determined by such spreads was significant. Because we used index implied spreads to estimate fair value for this particular transaction prior to the third quarter, we also used the index implied credit loss duration, which was relatively short-term. This relatively short-term implied credit loss emergence resulted in a non-performance risk adjustment that was insignificant. During the quarter, this transaction experienced significant credit deterioration, and as part of our normal loss surveillance and risk management policies, we updated our loss projections and expect to incur significant credit losses. However, based on the deal structure, these losses are not estimated to be realized by us until 2024. We have utilized a discounted cash flow methodology in order to estimate fair value of this transaction in the third quarter. The unrealized loss decreased significantly in the third quarter as a result of using our credit default swap spread to discount the projected cash flows. The impact of the change in estimate related to this transaction for the third quarter was a reduction in our unrealized loss of approximately $384.1 million, and is included in the cumulative unrealized gain of $2.3 billion in the table presented above.

Assumed Financial Guaranty Credit Derivatives

In making our own determination of fair value for these credit derivatives, we use information provided to us by our counterparties to these reinsurance transactions, which are the primary insurers (the primaries) of the underlying credits, including the primaries fair valuations for these credits. The estimated fair value of pooled corporate CDO CDS contracts is based on the primaries pricing models that use the Dow Jones CDX for domestic corporate CDS contracts and iTraxx for European corporate CDS contracts. Each index provides price quotes for standard attachment and detachment points for contracts with maturities of three, five, seven and ten years. The quoted index price is calibrated by the primaries to the typical attachment points for that type of CDS contract in order to derive the appropriate value. The value of CDS and collateralized loan obligation (CLO) contracts is estimated with reference to the all-in London Interbank Offered Rate (LIBOR) spread in the current published JP Morgan High Yield CLO Triple-A Index, which includes a credit and funding component. The primaries models used to estimate the fair values of these instruments include a number of factors, including

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credit spreads, changes in interest rates, changes in correlation assumptions, current delinquencies, recovery rates and the credit ratings of referenced entities. In establishing our fair value marks for these transactions, we assess the reasonableness of the primaries valuations by (1) reviewing the primaries publicly available information regarding their mark-to-market processes, including methodology and key assumptions; and (2) discussing the changes in fair value with the primaries where the changes appear unusual or do not appear materially consistent with credit loss related information provided by the primaries for these transactions. Despite significant volatility in relevant credit spreads during each of the four quarters ended September 30, 2008, in each of these quarters the change in fair value of our assumed financial guaranty credit derivatives represented less than 2.5% of our cumulative unrealized gains or losses on all credit derivatives, demonstrating the relative insensitivity of these transactions to spread changes. These credit derivatives are categorized in Level III of the fair value hierarchy.

Mortgage Insurance Domestic and International CDS

In determining the estimated fair value of our mortgage insurance domestic CDS, we use internal models that employ a discounted cash flow methodology. We estimate losses in each securitization by applying expected default rates separately to loans that are delinquent and those that are paying currently. We then project prepayment speeds on the underlying collateral in each securitization, incorporating historical prepayment experience. The estimated loss and prepayment speeds are used to estimate the cash flows for each underlying securitization, and ultimately, to produce the projected credit losses for each CDS. In addition to expected credit losses, the fair value for each CDS is approximated by incorporating future expected premiums to be received from the CDS. The projected net losses are discounted using a rate of return that incorporates our own non-performance risk, and based on our current credit default swap spread level, results in a significant reduction of the derivative liability. The use of different assumptions and/or methodologies could have a significant effect on estimated fair values.

In determining the estimated fair value of our mortgage insurance international CDS, we use the following information: (1) fair value quotes from our counterparties on each respective deal, which are based on quotes for transactions with similar underlying collateral from market makers and other broker dealers, and (2) in the absence of observable market data for these deals, a review of monthly information regarding the performance of the underlying collateral and discussion with our counterparties regarding any unusual or inconsistent changes in fair value. In either case, in the event there are material inconsistencies in the inputs to determination of estimated fair value, they are reviewed and a final determination is made by management in light of the specific facts and circumstances surrounding each price. These credit derivatives are categorized in Level III of the fair value hierarchy. For each of the mortgage insurance international CDS transactions discussed above, we make an adjustment to the fair value amounts described above to incorporate our own non-performance risk. The amount of the adjustment is computed based on the correlation between the default probability of the transaction and our default probability.

Changes in our expected credit losses on mortgage insurance domestic CDS could have a significant impact on our fair value estimate for this product, with a maximum principal loss exposure of $162 million and expected losses as of September 30, 2008 in the amount of $128 million. Changes in the loss estimates will impact the fair value directly, reduced only by the discount factor, which is dependent on the timing of the expected losses. However, in light of our comparatively small amount of notional exposure on mortgage insurance domestic CDS, we do not expect changes in the fair value of this product to materially impact the overall fair value of our credit derivatives. Despite significant volatility in credit spreads during each of the four quarters ended September 30, 2008, in each of these quarters the change in fair value of our mortgage insurance international CDS represented less than 4% of our cumulative unrealized gains or losses on all credit derivatives, demonstrating the relative insensitivity of these transactions to spread changes. The mortgage insurance domestic CDS are categorized in Level III of the fair value hierarchy.

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

(In millions)	Beginning Balance at June 30, 2008	Realized Gains/(Losses)	Unrealized Gains/(Losses)	Purchases, Sales, Issuances & Settlements	Transfers Into (Out of) Level III (2)	Ending Balance at September 30, 2008
Level III Assets						
Investments:						
Hybrid securities	$ 1.0	$	$ 0.1	$	$ (1.1)	$
Corporate bonds	0.3		0.1			0.4
Equity securities	1.0		(0.2)	0.4		1.2
Other investments	8.1	(0.1)	0.2	(3.2)		5.0
Total Investments	10.4	(0.1)	0.2	(2.8)	(1.1)	6.6
NIMS assets	10.7	(1.1)	(5.9)	2.8		6.5
Put options on CPS	110.1	(1.3)	(13.1)	1.3		97.0
Total Level III assets, net	$ 131.2	$ (2.5)	$ (18.8)	$ 1.3	$ (1.1)	$ 110.1
Level III Liabilities						
NIMS liabilities	$ (149.8)	$ 1.5	$ (35.8)	$ 59.2(1)	$	$ (124.9)
Variable interest entity debt	(85.7)	(1.9)	8.6	(48.6)		(127.6)
Mortgage Insurance domestic and international CDS, net	(158.7)	(17.5)	61.9	19.9		(94.4)
Financial Guaranty credit derivatives, net:						
Corporate CDOs	51.9	7.6	(43.9)	(6.2)		9.4
Non-Corporate CDOs	(242.6)	2.4	204.9	(2.1)		(37.4)
Assumed financial guaranty contracts	(28.0)		(0.4)			(28.4)
Total Financial Guaranty credit derivatives, net	(218.7)	10.0	160.6	(8.3)		(56.4)
Total Level III liabilities, net	$ (612.9)	$ (7.9)	$ 195.3	$ 22.2	$	$ (403.3)

(1) Included in this amount is an $11.5 million reduction related to our purchase of NIMS bonds that we guarantee, and a $48.6 million reduction related to the transfer of derivative liability to consolidated variable interest entity debt related to NIMS trusts that we consolidated during the period.

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

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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

(In millions)	Beginning Balance at January 1, 2008	Unearned Premiums Reclass January 1, 2008 (2)	Realized Gains/(Losses)	Unrealized Gains/(Losses)	Purchases, Sales, Issuances & Settlements	Transfers Into (Out of) Level III (3)	Ending Balance at September 30, 2008
Level III Assets							
Investments:							
Hybrid securities	$ 6.7	$	$	$ 0.1	$ 1.0	$ (7.8)	$
Corporate				0.1		0.3	0.4
Equity securities	0.1			(0.2)	0.4	0.9	1.2
Other investments	12.1		(5.4)	0.2	(1.9)		5.0
Total Investments	18.9		(5.4)	0.2	(0.5)	(6.6)	6.6
NIMS assets			(1.1)	(14.4)	22.0		6.5
Put options on CPS	35.2		(4.1)	61.7	4.2		97.0
Total Level III assets, net	$ 54.1	$	$ (10.6)	$ 47.5	$ 25.7	$ (6.6)	$ 110.1
Level III Liabilities							
NIMS liabilities	$ (433.9)	$ (4.0)	$ 11.7	$ 123.2	$ 178.1(1)	$	$ (124.9)
Variable interest entity debt			(1.9)	38.1	(163.8)		(127.6)
Mortgage Insurance domestic and international CDS, net	(86.2)	(3.6)	(14.1)	(8.2)	17.7		(94.4)
Financial Guaranty credit derivatives, net:							
Corporate CDOs	(485.5)	(14.3)	30.6	506.5	(27.9)		9.4
Non-Corporate CDOs	(277.7)	(1.4)	7.4	241.5	(7.2)		(37.4)
Assumed financial guaranty contracts	(14.4)		(6.3)	(14.0)	6.3		(28.4)
Total Financial Guaranty credit derivatives, net	(777.6)	(15.7)	31.7	734.0	(28.8)		(56.4)
Total Level III liabilities, net	$ (1,297.7)	$ (23.3)	$ 27.4	$ 887.1	$ 3.2	$	$ (403.3)

(1) Included in this amount is a $41.6 million reduction related to our purchase of NIMS bonds that we guarantee, and a $144.6 million reduction related to the transfer of derivative liability to consolidated variable interest entity debt related to NIMS trusts that we consolidated during the period.

(2) These unearned premiums were reclassified after adoption of an agreement with member companies of the 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.

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

At September 30, 2008, our total Level III assets approximated 2.9% 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. In the first nine months of 2008, credit spreads on underlying collateral, both corporate credit spreads and asset-backed spreads, widened significantly, which resulted in large unrealized losses on these positions. Offsetting these losses, due to the incorporation of our non-performance risk into our fair value measurements as required by SFAS No. 157, the fair value of our liabilities was reduced by approximately $2.3 billion, in the aggregate. The largest component of this

reduction in value related to the valuation of our Corporate CDOs. The credit protection we offer on Corporate CDOs is generally senior investment grade debt, which carries a weighted average spread of approximately 109 basis points. Based on our September 30, 2008 CDS spread of 2,312 basis points, the market valuation of our credit protection of these

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

highly rated underlying tranches is minimal at September 30, 2008, resulting in a very low discounted fair premium amount.

At September 30, 2008, we also consolidated certain NIMS transactions requiring the reversal of a $123.1 million NIMS liability and the recognition of VIE debt of $127.6 million and NIMS VIE assets of $4.5 million. During the first quarter of 2008, we transferred some of our hybrid securities from Level III to Level II. These were initially categorized as Level III because there was no active market or observable inputs when the securities were initially purchased. These securities have become more frequently traded, which provided observable inputs for our valuation. Realized and unrealized gains and losses on investments and VIE debt included in Level III are generally recorded in net gains (losses) on other financial instruments; unrealized gains and losses of certain RMBS securities included in other investments were reflected in change in fair value of derivative instruments. Realized and unrealized gains and losses on all other Level III derivative assets and liabilities are recorded in change in fair value of derivative instruments.

In 2008, we elected in accordance with SFAS No. 159, to record at fair value the consolidated NIMS VIE debt. We elected to fair value these instruments in order to more accurately reflect a value that reflects our financial guaranty obligations associated with NIMS. At September 30, 2008, the face value of our consolidated liability is $191.8 million and includes $14.8 million that has been issued by our consolidated trusts, but which is not guaranteed by us.

3. Derivative Instruments and Hedging Activities

We account for derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), as amended and interpreted. In general, SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their respective fair values and changes in fair value recorded in net income unless the derivatives qualify as hedges. If the derivatives qualify as hedges, depending on the nature of the hedge, changes in the fair value of the derivatives are either offset against the change in fair value of assets, liabilities, or firm commitments through earnings, or are recognized in accumulated other comprehensive income (loss) until the hedged item is recognized in earnings.

All our derivative instruments are recognized in our condensed consolidated balance sheets as either derivative assets or derivative liabilities, depending on the rights or obligations under the contracts. Our credit protection in the form of credit default swaps and other credit derivatives as well as NIMS within both our mortgage insurance and financial guaranty segments are not designated as hedges under SFAS No. 133, so changes in their fair value are included in current earnings in our condensed consolidated statements of operations. Net unrealized gains and losses on credit default swaps and certain other derivative contracts are included in either derivative assets or derivative liabilities on our condensed consolidated balance sheets.

We apply the guidance of SFAS No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS No. 155), an amendment of SFAS Nos. 133 and 140, which (i) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and (v) amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS No.140) to eliminate the exemption from applying the requirements of SFAS No. 133 on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Accordingly, certain securities that were previously classified as trading securities or fixed maturities available for sale on our condensed consolidated balance sheets were reclassified to hybrid securities on our condensed consolidated balance sheets at January 1, 2007, the date of adoption. In addition, as allowed under the provisions of SFAS No. 155, we elected to record convertible securities at fair value with changes in the fair value recorded as net gains or losses on other financial instruments. At adoption, we recorded an after-tax reclassification, which increased retained earnings and decreased other comprehensive income by $9.8 million, which represented the cumulative adjustment to fair value.

A summary of our derivative assets and liabilities, as of and for the periods indicated, is as follows:

Balance Sheets (In millions)	September 30 2008	December 31 2007
Derivative assets:		
Financial Guaranty credit derivative assets	$ 66.5	$ 8.0
NIMS assets	6.5	
Put options on CPS (1)	97.0	35.2
Mortgage insurance international CDS assets	1.1	
Total derivative assets	171.1	43.2
Derivative liabilities:		
Financial Guaranty credit derivative liabilities	122.9	785.6
NIMS liabilities	124.9	433.9
Mortgage insurance domestic and international CDS liabilities	95.5	86.2
Total derivative liabilities	343.3	1,305.7
Total derivative liabilities, net	$ (172.2)	$ (1,262.5)

(1) These amounts represent gross unrealized gains and gross unrealized losses on derivative assets and liabilities.
The notional value of our derivative contracts at September 30, 2008 and December 31, 2007 was $56.9 billion and $57.7 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 September 30 2008	Three Months Ended September 30 2007	Nine Months Ended September 30 2008	Nine Months Ended September 30 2007
Net premiums earned derivatives (1)	$ 18.7	$ 28.0	$ 64.8	$ 99.5
Financial Guaranty credit derivatives	156.9	(255.8)	724.7	(263.2)
NIMS	(35.9)	(366.7)	119.1	(426.3)
Mortgage insurance domestic and international CDS	40.7	(21.4)	(30.5)	(43.8)
Put options on CPS (2)	(14.4)		57.6	
Other	(1.2)		(6.9)	

Change in fair value of derivative instruments	$ 164.8	$ (615.9)	$ 928.8	$ (633.8)

(1) In previous periods, net premiums earned on derivatives were reported in premiums earned in our condensed consolidated statements of operations. This reclassification is the result of a financial guaranty industry-wide effort, in consultation with the SEC, to present the results from credit derivative transactions consistently.

(2) Prior to the fourth quarter of 2007, this amount was immaterial to the condensed consolidated financial statements.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

The application of SFAS No. 133, as amended, could result 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. This change resulted in an increase in the change in fair value of derivative instruments of $2.3 billion for the nine months ended September 30, 2008. Our fair value estimates may result in significant volatility in our financial position or results of operations for future periods.

4. Variable Interest Entities

As a provider of credit enhancement, we periodically transact with entities that may be VIEs. VIEs are corporations, trusts or partnerships that are established for a limited purpose and must be evaluated in accordance with the guidance in FASB Interpretation No. 46, Consolidation of Variable Interest Entities (revised) an interpretation of Accounting Research Bulletin (ARB) No. 51 (FIN No. 46R). Special purpose entities (SPEs), by their nature, are generally not controlled by their equity owners, and are governed solely by their establishing documents. In accordance with FIN No. 46R, we consolidate VIEs in which we are the primary beneficiary of the variable interests, or a combination of variable interests, that will either (i) absorb a majority of the VIE s expected losses, (ii) receive a majority of the VIE s expected residual returns or (iii) both. To determine if we are the primary beneficiary of a VIE, we review, among other factors, the VIE s design, capital structure, contractual terms, which interests create or absorb variability and related party relationships, if any. Additionally, we may calculate our share of the VIE s expected losses and expected residual returns based upon the VIE s contractual arrangements and/or our position in the VIE s capital structure.

Mortgage Insurance

We guaranty the payment of principal and interest on NIMS which are structured as qualifying special purpose entities. There are certain control provisions in our guaranty contracts that give us the ability to call the NIMS upon certain events of contractual non-performance of third parties. Under these circumstances, the VIE would not be exempt from consolidation considerations under FIN No. 46R. At September 30, 2008, there were 15 such transactions requiring consolidation in our condensed consolidated balance sheets. The amount included in other assets and variable interest entity debt related to these trusts was $4.5 million and $127.6 million, respectively. 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 the provisions of SFAS No. 159.

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

(in millions)	September 30, 2008		
VIE Assets	Total NIMS Trust Assets	Maximum Principal Exposure	Average Rating of Collateral at Inception
NIMS	$ 574.1	$ 455.8	BBB to BB

(in millions)	December 31, 2007		
VIE Assets	Total NIMS Trust Assets	Maximum Principal Exposure	Average Rating of Collateral at Inception
NIMS	$ 730.2	$ 603.7	BBB to BB

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Financial Guaranty

Our involvement with VIEs has a material role in our financial guaranty business as a guarantor of beneficial interests held by third party investors. Our guarantees in the financial guaranty business generally are structured as financial guarantees or credit default swaps guaranteeing principal and interest payments to beneficial interest holders. In certain of these VIEs, we could potentially be the primary beneficiary of the entity s variable interests through our participation in the VIE and certain beneficial interests. Consequently, we would be required to consolidate the assets and liabilities of the VIE. At September 30, 2008, there were no VIEs that required consolidation in our financial guaranty business.

5. Investments

We classify assets in our investment portfolio into one of three main categories: held to maturity, available for sale or trading securities. Fixed-maturity securities for which we have the positive intent and ability to hold to maturity are classified as held to maturity and reported at amortized cost. Investments classified as available for sale are reported at fair value, with unrealized gains and losses (net of tax) reported as a separate component of stockholders equity as accumulated other comprehensive income. Investments classified as trading securities are reported at fair value, with unrealized gains and losses reported as a separate component of income. Amortization and accretion are calculated principally using the interest method over the term of the investment. Realized gains and losses on investments are recognized using the specific identification method.

In accordance with SFAS No. 155, effective January 1, 2007, all changes in the fair value of the unbifurcated convertible securities are recorded as net gains or losses on other financial instruments in our condensed consolidated statements of operations. Our transition adjustment related to the adoption of SFAS No. 155 increased retained earnings at January 1, 2007 by $9.8 million, and reduced accumulated other comprehensive income by the same amount. The transition amount includes unrealized gains of $14.1 million (net of tax) and unrealized losses of $4.3 million (net of tax) related to convertible securities at December 31, 2006.

For securities in our investment portfolio, we conduct a quarterly evaluation of declines in market value of the securities to determine whether the decline is other-than-temporary. If a security s fair value is below its cost basis, and it is judged to be an other-than-temporary decline, the cost basis of the individual security is written down to fair value through earnings as a realized loss and the fair value becomes the new basis for the security. During the third quarter and nine months ended September 30, 2008, we recorded approximately $15.1 million and $52.2 million, respectively, of charges related to declines in the fair value of securities (primarily municipal and taxable bonds, and preferred stocks) considered to be other-than-temporary. During the quarter and nine months ended September 30, 2007, we recorded $0.8 million and $1.6 million, respectively, of charges related to declines in the fair value of securities considered to be other-than-temporary. At September 30, 2008 and 2007, there were no other investments held in the portfolio that were determined to be other-than-temporarily impaired.

Our evaluation of price declines in fair value for other-than-temporary impairment is performed by management on a case-by-case basis. We consider a wide range of factors regarding the security and use our best judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for near-term recovery. Considerations used by us in the impairment evaluation process include, but are not limited to: (i) the length of time and the extent to which the market value has been below cost or amortized cost, (ii) the potential for impairments of securities when the issuer is experiencing significant financial difficulties, (iii) the potential for impairments in an entire industry sector or sub-sector, (iv) the potential for impairments in certain economically depressed geographic locations, (v) the potential for impairments of securities where the issuer, series of issuers or industry has suffered a catastrophic type of loss or has exhausted natural resources, (vi) our ability and intent to hold the security for a period of time sufficient to

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

allow for the full recovery of its value to an amount equal to or greater than cost or amortized cost, (vii) unfavorable changes in forecasted cash flows on asset-backed securities, and (viii) other factors, including supply and demand imbalances, concentrations, and information obtained from regulators and rating agencies.

The following table shows the gross unrealized losses and fair value of our investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2008.

(In thousands)	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
State and municipal obligations	$ 1,408,955	$ 121,499	$ 606,194	$ 123,522	$ 2,015,149	$ 245,021
Corporate bonds and notes	116,345	9,347	10,019	2,078	126,364	11,425
Asset-backed securities	95,709	5,830	76,865	1,431	172,574	7,261
Private placements	5,708	557			5,708	557
Foreign governments	22,539	266	22,072	437	44,611	703
Equity securities	65,930	10,168			65,930	10,168
Total	$ 1,715,186	$ 147,667	$ 715,150	$ 127,468	$ 2,430,336	$ 275,135

State and municipal obligations

The unrealized losses of 12 months or greater duration as of September 30, 2008 on our investments in tax-exempt state and municipal securities were caused primarily by market interest rate movement. Some securities with exposures to certain sectors, particularly those insured by monoline insurers, experienced credit spread widening during 2007 and 2008. We do not own any securities with underlying non-investment grade ratings that are insured by monoline insurance companies. Because we have the ability and intent to hold these investments until a full recovery of fair value, which may be maturity, we do not consider these investments to be other-than-temporarily impaired at September 30, 2008.

Corporate bonds and notes

The unrealized losses of 12 months or greater duration as of September 30, 2008 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 2007 and 2008. Because we have the ability and intent to hold these investments until a full recovery of fair value, which may be maturity, we do not consider these investments to be other-than-temporarily impaired at September 30, 2008.

Asset-backed securities

The unrealized losses of 12 months or greater duration as of September 30, 2008 on the securities in this category were caused by market interest rate movement. Our investments are senior tranche positions, collateralized by pools of credit card, auto loan and equipment lease receivables. The investment grade ratings of these investments are supported by credit enhancements which include subordination, over-collateralization and reserve accounts. Because we have the ability and intent to hold these investments until a full recovery of fair value, which may be maturity, we do not consider the investment in these securities to be other-than-temporarily impaired at September 30, 2008.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Foreign governments

The unrealized losses of 12 months or greater duration as of September 30, 2008 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 we have the ability and intent to hold these investments until a full recovery of fair value, which may be maturity, we do not consider these investments to be other-than-temporarily impaired at September 30, 2008.

For all investment categories, unrealized losses of less than 12 months in duration were generally attributable to interest rate movement. 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 we have the ability and intent to hold these investments until a full recovery of fair value, which may be maturity, we do not consider the investment in these securities to be other-than-temporarily impaired at September 30, 2008.

The contractual maturity of securities in an unrealized loss position at September 30, 2008 was as follows:

(In thousands)	Fair Value	Amortized Cost	Unrealized Loss
2008	$ 5,238	$ 5,279	$ 41
2009 2012	110,896	113,354	2,458
2013 2017	188,513	195,460	6,947
2018 and later	2,059,759	2,315,280	255,521
Equity securities	65,930	76,098	10,168
Total	$ 2,430,336	$ 2,705,471	$ 275,135

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

6. Segment Reporting

We have three reportable segments: mortgage insurance, financial guaranty and financial services. We allocate corporate income and expenses to each of the segments. 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 September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Net premiums written insurance (1)	$ 188,583	$ 249,521	$ 598,864	$ 653,439
Net premiums earned insurance	$ 196,207	$ 212,998	$ 605,568	$ 578,829
Net investment income	38,017	37,437	115,803	109,283
Change in fair value of derivative instruments	8,606	(374,024)	105,548	(419,096)
Net (losses) gains on other financial instruments	(39,925)	9,312	(66,214)	39,791
Other income	2,561	3,782	9,051	9,357
Total revenues	205,466	(110,495)	769,756	318,164
Provision for losses	519,257	278,785	1,539,561	571,791
Provision for premium deficiency	(252,170)	155,176	135,727	155,176
Policy acquisition costs	5,327	24,865	82,473	53,944
Other operating expenses	43,771	26,576	126,644	109,203
Interest expense	6,718	6,764	21,140	19,959
Total expenses	322,903	492,166	1,905,545	910,073
Equity in net income of affiliates				
Pretax loss	(117,437)	(602,661)	(1,135,789)	(591,909)
Income tax benefit	(70,473)	(227,374)	(428,186)	(233,121)
Net loss	$ (46,964)	$ (375,287)	$ (707,603)	$ (358,788)
Total assets	$ 4,928,233	$ 5,232,832		
Total investments	3,816,513	3,956,943		
Deferred policy acquisition costs	17,997	62,371		
Reserve for losses and loss adjustment expenses	2,496,412	884,985		
Derivative liabilities	220,363	475,864		
Unearned premiums	351,200	322,109		
Stockholders equity	838,474	1,894,959		

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Financial Guaranty (In thousands)	Three Months Ended September 30 2008	Three Months Ended September 30 2007	Nine Months Ended September 30 2008	Nine Months Ended September 30 2007
Net premiums written insurance (1)	$ 13,868	$ 58,490	$ 70,538	$ 145,421
Net premiums earned insurance	$ 53,511	$ 32,398	$ 135,208	$ 99,084
Net investment income	27,198	27,403	80,505	79,160
Change in fair value of derivative instruments	156,151	(241,912)	823,244	(214,669)
Net (losses) gains on other financial instruments	(23,895)	5,560	(60,778)	13,993
Other income	58	517	237	783
Total revenues	213,023	(176,034)	978,416	(21,649)
Provision for losses	25,658	51,719	46,944	39,717
Provision for premium deficiency				
Policy acquisition costs	15,443	10,878	38,155	34,251
Other operating expenses	36,885	10,025	72,642	37,197
Interest expense	7,134	4,808	18,788	13,866
Total expenses	85,120	77,430	176,529	125,031
Equity in net income of affiliates				
Pretax income (loss)	127,903	(253,464)	801,887	(146,680)
Income tax provision (benefit)	53,550	(99,350)	279,537	(72,504)
Net income (loss)	$ 74,353	$ (154,114)	$ 522,350	$ (74,176)
Total assets	$ 2,934,032	$ 2,833,748		
Total investments	2,406,739	2,556,054		
Deferred policy acquisition costs	160,584	171,211		
Reserve for losses and loss adjustment expenses	183,969	209,719		
Derivative liabilities	122,933	199,568		
Unearned premiums	649,525	723,158		
Stockholders equity	1,349,016	1,409,168		

(1) With the exception of trade credit reinsurance products, net premiums written in our financial guaranty reinsurance business are recorded using actual information received from cedants on a one month lag basis. Accordingly, the net premiums written for any given period exclude those from the last month of that period and include those from the last month of the immediately preceding period. The use of information from cedants does not require us to make significant judgments or assumptions because historic collection rates and counterparty strength make collection of all assumed premiums highly likely. There were no material trade credit reinsurance premiums written for the nine months ended September 30, 2008 or 2007.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Financial Services (In thousands)	Three Months Ended September 30 2008	Three Months Ended September 30 2007	Nine Months Ended September 30 2008	Nine Months Ended September 30 2007
Net premiums written insurance	$	$	$	$
Net premiums earned insurance	$	$	$	$
Net investment income		119	14	162
Change in fair value of derivative instruments				
Net gains (losses) on other financial instruments	83	(32)	120	495
Gain on sale of affiliate		181,734		181,734
Other income	137	300	303	1,379
Total revenues	220	182,121	437	183,770
Provision for losses				
Provision for premium deficiency				
Policy acquisition costs				
Other operating expenses	125	(432)	485	5,072
Interest expense		1,822	249	4,985
Total expenses	125	1,390	734	10,057
Equity in net income (loss) of affiliates	15,798	(448,924)	44,028	(376,645)
Pretax income (loss)	15,893	(268,193)	43,731	(202,932)
Income tax provision (benefit)	6,583	(93,730)	18,665	(66,582)
Net income (loss)	$ 9,310	$ (174,463)	$ 25,066	$ (136,350)
Total assets	$ 183,970	$ 148,280		
Total investments				
Deferred policy acquisition costs				
Reserve for losses and loss adjustment expenses				
Derivative liabilities				
Unearned premiums				
Stockholders equity	144,836	143,365		

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

Consolidated (In thousands)	Three Months Ended September 30 2008	Three Months Ended September 30 2007	Nine Months Ended September 30 2008	Nine Months Ended September 30 2007
Net (loss) income:				
Mortgage Insurance	$ (46,964)	$ (375,287)	$ (707,603)	$ (358,788)
Financial Guaranty	74,353	(154,114)	522,350	(74,176)
Financial Services	9,310	(174,463)	25,066	(136,350)
Total	$ 36,699	$ (703,864)	$ (160,187)	$ (569,314)

For the quarters ended September 30, 2008 and 2007, our domestic premiums earned from all of our segments were $257.4 million and $269.0 million, respectively, and our premiums earned attributable to foreign countries were approximately $11.1 million and $4.4 million, respectively. For the nine months ended September 30, 2008 and 2007, our domestic premiums earned from all of our segments were $770.8 million and $753.8 million, respectively, and our premiums earned attributable to foreign countries were approximately $34.8 million and $23.6 million, respectively. In addition, long-lived assets located in foreign countries were immaterial for the periods presented.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

7. Investment in Affiliates

We have a 46.0% equity interest in C-BASS and a 28.7% equity interest in Sherman as of September 30, 2008. On August 13, 2008, our ownership interest in Sherman increased from 21.8% to 28.7% as a result of the sale by Mortgage Guaranty Insurance Corporation (MGIC) of their ownership interest back to Sherman and the subsequent retirement of those shares. As a result of the reduction in Sherman s equity at September 30, 2008, our investment in affiliates decreased by $25.8 million ($16.8 million after taxes) and is reflected as a reduction in our equity.

The following table shows the components that make up the investment in affiliates balance:

(In thousands)	September 30 2008	December 31 2007
Sherman	$ 87,217	$ 104,315
Other	39	39
Total	$ 87,256	$ 104,354

Sherman

2007 Sale of Partial Interest. On September 19, 2007, we sold to Sherman Capital, L.L.C. (Sherman Capital), an entity owned by the management of Sherman: (1) all of our preferred interests in Sherman and (2) 1,672,547 Class A Common Units in Sherman, representing approximately 43.4% of our total common interests in Sherman, for a cash purchase price of approximately $277.6 million, plus a future contingent payment. The amount of the contingent payment, if any, will depend on the extent that Sherman Capital s after-tax return on 1,425,335 of the Class A Common Units acquired in the transaction exceeds approximately 16% annually. The contingent payment is payable to us on December 31, 2013 or earlier upon the closing of a sale of Sherman. We recorded a gain of $181.7 million on the sale of our interest in Sherman in the third quarter of 2007.

2007 Option Granted to Sherman s Management. On September 19, 2007, in connection with the sale of a portion of our equity interests in Sherman, we entered into an Option Agreement with Meeting Street Investments LLC (MS LLC), an entity owned by Sherman s management. Under the Option Agreement, we granted to MS LLC an irrevocable option (the Call Option) to require us to sell to MS LLC all of our interests in Sherman at any time during the one year period ending September 19, 2007. The purchase price under the Call Option, if exercised, was equal to: (1) the product of (a) our ownership percentage in Sherman as of the date of sale under the Option Agreement and (b) $1.5 billion, minus (2) 50% of all future distributions made by Sherman with respect to our remaining interests in Sherman through the date of sale under the Option Agreement. The Option Agreement terminated unexercised on September 19, 2008.

C-BASS

Historically, C-BASS had been engaged as a mortgage investment and servicing company specializing in the credit risk of subprime single-family residential mortgages. As a result of the disruption in the subprime mortgage market during 2007, C-BASS ceased purchasing mortgages and mortgage securities and its securitization activities in the third quarter of 2007 and sold its loan servicing portfolio in the fourth quarter of 2007. On July 29, 2007, we concluded that there were indicators that a material charge for impairment of our investment in C-BASS was required under GAAP. In November 2007, we received financial statements from C-BASS as of September 30, 2007, at which point we made a final determination with respect to impairment.

We account for our investment in C-BASS under the equity method of accounting in accordance with Accounting Principles Board (APB) Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock (APB Opinion No. 18). During the third quarter of 2007, C-BASS incurred a loss of $935

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million and in accordance with APB Opinion No. 18, we recognized our portion of losses of approximately $441 million. This resulted in a reduction in our equity investment in C-BASS from $468 million to $27 million at September 30, 2007. In addition to the recognition of losses, we completed an impairment analysis which resulted in the charge-off of the remaining carrying value of $27 million in the equity investment in C-BASS at September 30, 2007.

Emerging Issues Task Force (EITF) No. 98-13, Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee (EITF No. 98-13), requires that when the recognition of equity losses reduces our equity investment to zero, we should continue to report our share of equity method losses in our income statement and should apply those equity method losses to our other investments in C-BASS. As a result of the additional losses at C-BASS, and continued application of APB Opinion No. 18 and EITF No. 98-13, we recorded a full write-off of our $50 million credit facility with C-BASS in the fourth quarter of 2007. We believe it is unlikely that we will collect on amounts drawn by C-BASS under this facility.

	Three Months Ended September 30		Nine Months Ended September 30	
(In thousands)	**2008**	**2007**	**2008**	**2007**
Investment in Affiliates-Selected Information:				
Sherman				
Balance, beginning of period	$ 112,644	$ 171,737	$ 104,315	$ 167,412
Share of net income for period	15,798	18,876	44,028	74,750
Dividends received	(15,961)		(35,460)	(51,512)
Other comprehensive income	522	(637)	120	(674)
Sale of ownership interest		(95,866)		(95,866)
Adjustment to investment related to Sherman buyback of MGIC equity interest	(25,786)		(25,786)	
Balance, end of period	$ 87,217	$ 94,110	$ 87,217	$ 94,110
Portfolio Information:				
Sherman				
Total assets	$ 2,433,666	$ 2,093,168		
Total liabilities	2,161,372	1,752,203		
Summary Income Statement:				
Sherman				
Income				
Revenues from receivable portfolios net of amortization	$ 380,863	$ 303,704	$ 1,163,550	$ 867,543
Other revenues	4,303	7,682	14,700	13,070
Derivative mark-to-market	(4,119)		764	
Total revenues	381,047	311,386	1,179,014	880,613
Expenses				
Operating and servicing expenses	155,118	155,984	525,490	443,661
Provision for loan losses	110,531	59,771	319,841	163,491
Interest	29,080	27,397	77,892	59,730
Other	22,757	8,060	50,530	705
Total expenses	317,486	251,212	973,753	667,587

Net income	$ 63,561	$ 60,174	$ 205,261	$ 213,026
C-BASS				
Balance, beginning of period	$	$ 467,800	$	$ 451,395
Share of net loss for period		(467,800)		(451,395)
Balance, end of period	$	$	$	$

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8. Losses and Loss Adjustment Expenses (LAE) Mortgage Insurance

The following table reconciles our mortgage insurance segment s beginning and ending reserves for losses and LAE for the three and nine months ended September 30, 2008 (in thousands):

Mortgage Insurance	Three Months Ended September 30 2008	Nine Months Ended September 30 2008
Balance at beginning of period	$ 2,120,577	$ 1,345,452
Less reinsurance recoverables	175,840	21,992
Balance at beginning of period, net	1,944,737	1,323,460
Add losses and LAE incurred in respect of default notices reported and unreported	519,257	1,539,561
Deduct losses and LAE paid	277,391	676,418
Foreign exchange adjustment	2	2
Balance at end of period, net	2,186,605	2,186,605
Add reinsurance recoverables	309,807	309,807
Balance at end of period	$ 2,496,412	$ 2,496,412

We have protected against some of the future 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 $69.4 million at September 30, 2008. In addition to Smart Home, we transfer a portion of our risk to captive reinsurance companies affiliated with our lender-customers. Ceded losses recoverable related to captive transactions were $240.4 million at September 30, 2008. The increase in reinsurance recoverables on Smart Home and captive transactions is reflected as a reduction of the provision for losses.

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9. Reserve for Premium Deficiency

The reserve for premium deficiency (PDR) in our mortgage insurance business consists of a $150.1 million reserve for first-lien insured loans and a $181.3 million reserve for second-lien insured loans.

The following tables reconcile our mortgage insurance segment s beginning and ending reserve for premium deficiency for the three and nine months ended September 30, 2008 (in thousands):

	Three Months Ended September 30 2008	Nine Months Ended September 30 2008
First Lien PDR:		
Balance at beginning of period	$ 421,825	$
Recognition of first-lien premium deficiency		421,825
Transfer of incurred losses to loss reserves	(497,536)	(497,536)
Transfer of premiums to earned premiums	182,676	182,676
Increase in expected losses due to changes in underlying assumptions	48,463	48,463
Increase in expected reinsurance recoverables	(23,624)	(23,624)
Other	18,262	18,262
Balance at end of period	$ 150,066	$ 150,066
Second Lien PDR:		
Balance at beginning of period	$ 161,718	$ 195,646
Transfer of incurred losses to loss reserves	(19,848)	(180,006)
Transfer of premiums to earned premiums	3,250	14,377
Increase in expected losses due to changes in underlying assumptions	30,264	139,577
Accretion of discount and other	5,923	11,713
Balance at end of period	$ 181,307	$ 181,307

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 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. Our first- and second-lien products are considered separate lines of business as each product is managed separately, priced differently and has a different customer base.

As of September 30, 2008, the net present value of expected losses and expenses on our first-lien business was $4.5 billion, offset by the present value of expected premiums of $2.3 billion and already established reserves (net of reinsurance recoverables) of $2.0 billion. We estimate that the first-lien business we originated during the third quarter of 2008 will be profitable, and therefore, we have not included this business in our premium deficiency reserve calculation. During the third quarter of 2008, we increased our expected losses on our first-lien portfolio as of June 30, 2008 by $48.5 million, primarily due to our revised expectation for unemployment rates to peak at 7%. In light of the current uncertainty regarding U.S. unemployment, we believe it is reasonably likely that unemployment rates could peak at 10%. If this were to occur, we project that our first lien premium deficiency reserve would increase by approximately $0.3 billion.

The rate of return used to arrive at the present values for our first-lien premium deficiency reserve was 4.03% at September 30, 2008, which is our expected portfolio yield over the average duration of our first-lien portfolio. Expected losses include an assumed claim rate of approximately 14% on our total first-lien risk in force, including 11% on prime and 23% on subprime and Alt-A.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Numerous factors affect our ultimate claim rates, including home price depreciation, unemployment, loan claim recission and interest rates. We believe a 3% change in the ultimate claim frequency of 14% indicated above for our first-lien portfolio is reasonably possible given the uncertainty inherent in present market conditions. If claim rates were to increase by 3% to a total of 17%, the premium deficiency reserve would increase by $0.5 billion. If claim rates were to decrease by a similar percentage to a total of 11%, no premium deficiency reserve would be required.

Our premium deficiency reserve for second-lien business decreased during the first nine months of 2008 by approximately $14.3 million, resulting in a total second-lien premium deficiency reserve of approximately $181.3 million at September 30, 2008. Our second-lien portfolio is relatively seasoned, and as a result we do not believe that changes in macro economic factors will result in significant changes to our current loss projections.

10. Long-Term Debt and Other Borrowings

The composition of our long-term debt and other borrowings at September 30, 2008 and December 31, 2007 was as follows:

(In thousands)	September 30 2008	December 31 2007
5.625% Senior Notes due 2013	$ 258,938	$ 254,292
7.75% Debentures due 2011	249,667	249,585
5.375% Senior Notes due 2015	249,677	249,647
Borrowings under unsecured revolving credit facility	150,000	200,000
	$ 908,282	$ 953,524

In February 2003, we issued $250 million of unsecured senior notes. These notes bear interest at the rate of 5.625% per annum, payable semi-annually on February 15 and August 15. These notes mature in February 2013. We have the option to redeem some or all of the notes at any time with not less than 30 days notice at a redemption price equal to the greater of the principal amount of the notes or the sum of the present values of the remaining scheduled payments of principal and interest on the notes to be redeemed. In April 2004, we entered into interest-rate swap contracts that effectively converted the interest rate on this fixed-rate debt to a variable rate based on a spread over the six-month LIBOR. We terminated these swaps in January 2008. The basis adjustment of $11.5 million that was recorded as an increase to the long-term debt carrying value is being amortized to interest expense.

We have a $150 million revolving credit facility that has been fully drawn. On September 18, 2008, we amended our credit facility to allow us to, among other things, contribute our equity interest in Radian Asset Assurance to Radian Guaranty. In exchange for this and certain other flexibility, we agreed to, among other things, (a) reduce the total outstanding principal amount and commitment size of the facility from $200 million to $150 million (with further reductions to a minimum of $100 million to take place if certain repayment events occur) and (b) pledge our equity interest in Sherman.

We had previously amended this credit facility on May 15, 2008. This amendment modified the credit agreement and related loan documents, among other things, by (a) reducing the commitment size from the original $400 million to $250 million (with further reductions to a minimum of $150 million to take place if certain repayment events occur), (b) increasing the pricing under the credit agreement, (c) eliminating the ratings covenant contained in Section 6.10 of the credit agreement, and (d) securing the credit agreement with a security interest in certain collateral. This security interest was affected primarily through a lien in favor of the lenders to the facility in (i) our ownership interests in certain of our first-tier subsidiaries and (ii) substantially all our other personal property. In addition, we granted a lien in our ownership interest in Radian Guaranty in favor of the lenders to the facility and the holders of the securities issued under our public indentures.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Under the amended credit agreement, we and our material subsidiaries are subject to a number of other business and financial covenants and events of default, including without limitation: (1) maintaining at all times a Consolidated Net Worth (as defined in the amended credit agreement) of not less than $1.75 billion, plus an amount equal to 75% of the net proceeds of any equity issuance following the effective date of the amendment, subject to certain limited qualifications and (2) maintaining a total debt to total capitalization ratio of 0.35 to 1 as of the end of any fiscal quarter. The credit agreement, as amended, also contains limitations on indebtedness, liens, mergers, consolidations, liquidations and sales, payment of dividends, investments, loans and advances and optional payments and modifications of subordinated and other debt instruments.

11. Income Taxes

We provide for income taxes in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes (SFAS No. 109). As required under SFAS No. 109, our deferred tax assets and liabilities are recognized under the liability method which recognizes the future tax effect of temporary differences between the amounts recorded in our condensed consolidated financial statements and the tax bases of these amounts. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the periods in which the deferred tax asset or liability is expected to be realized or settled.

Given the uncertainty of the impact of gains and losses on our financial instruments on our pre-tax loss projected for the full year, which directly affects our ability to project an effective tax rate for the full year, we book our income tax expense based on the actual results of operations as of September 30, 2008.

As of September 30, 2008, we have a net deferred tax assets (DTA) in the amount of $268.8 million recorded in tax recoverable. We believe that it is more likely than not that these assets will be realized. As such, no valuation allowance was established. The following factors were considered in reaching this conclusion:

- There is currently $300.6 million of taxable income available in tax return carryback years. This would yield a recovery of approximately $105.2 million of deferred tax assets.

- A significant source of future taxable income can be derived from our municipal and state securities investment portfolio. We believe that we have a viable tax planning strategy in which we would transfer investments from tax exempt to taxable investments and that such a plan will provide for higher yielding securities with fully taxable interest. This strategy would be implemented, if necessary, and could generate sufficient taxable income over the loss carryforward period allowed under the IRC.

The need for a valuation allowance will continue to be reviewed on a quarterly basis and no assurances can be made with regard to whether a valuation allowance will be needed in the future.

During the three month period ended September 30, 2008, we recorded provisions to filed tax return adjustments which reduced our total tax provision by $27.0 million.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

12. Recent Accounting Pronouncements

In October 2008, the FASB issued FSP FAS No. 157-3, Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active (FSP FAS No. 157-3). FSP FAS No. 157-3 clarifies the application of FAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS No. 157-3 is effective upon issuance, including prior periods for which financial statements have not been issued. We considered the guidance provided by FSP FAS No. 157-3 in determining the fair value of our financial assets for the quarter ended September 30, 2008 and determined that it did not have a significant impact to our condensed consolidated financial statements.

In September 2008, the FASB issued FSP No. 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161 . This FSP amends Statement No. 133, Accounting for Derivative Instruments and Hedging Activities , and FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others . It also clarifies the intent about the effective date of FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities discussed below. The FSP is intended to improve disclosures about credit derivatives by requiring more information about the potential adverse effects of changes in credit risk on the financial position, financial performance, and cash flows of the sellers of credit derivatives. The disclosures required by the new FSP are effective for reporting periods (annual or interim) ending after November 15, 2008.

In May 2008, the FASB issued SFAS No. 163, Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60 (SFAS No. 163). 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 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. SFAS No. 163 does not apply to financial guarantee insurance contracts accounted for as derivative contracts under SFAS No. 133. SFAS No. 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years, except for disclosures about the insurance enterprise s risk-management activities, which are effective for September 30, 2008 (see Note 13). Management is currently evaluating the impact of the adoption of SFAS No. 163, which could be material.

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 it is expected that the present claim loss will exceed the unearned premium revenue based on the probability-weighted present value of expected net cash outflows to be paid under the contract. 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. Currently, we establish unallocated non-specific reserves for our entire portfolio based on estimated statistical loss probabilities. Those credits that have defaulted are identified as Case Reserve credits (discussed below) are aggregated and tracked on a list (Watch List), and reserves are established. For those credits in the Intensified Surveillance category (discussed below) and where a default is considered to be likely, an allocated non-specific reserve is established. In each case, the most likely loss scenario becomes the amount reserved. Our unallocated non-specific reserve will be eliminated upon the full implementation of SFAS No. 163 in the first quarter of 2009. In addition, case reserves and allocated non-specific reserves may also change upon adoption.

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SFAS No. 163 requires the initial unearned premium revenue to be equal to the present value of the premiums due or expected to be collected over either the period of the financial guarantee insurance contract 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 at the inception of the contract. Premiums paid in full at inception are initially recorded as unearned premiums. Currently, premiums paid in advance of the coverage period are recorded as a liability for the amount received.

In March 2008, the FASB issued SFAS No.161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161). 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 instrument and hedged items under SFAS No. 133 and (c) how the instrument affects 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. SFAS No. 161 is effective for quarterly interim periods beginning after November 15, 2008, and fiscal years that include those quarterly interim periods. Management currently is considering the impact and disclosure requirements that may result from the adoption of SFAS No. 161.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of APB No. 51 (SFAS No. 160). The objective of SFAS No. 160 is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in consolidated financial statements by establishing accounting and reporting standards. These standards require that: (i) the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent s equity; (ii) the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of operations; (iii) changes in a parent s ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently; (iv) when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value; and (v) entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. Management currently is considering the impact and disclosure requirements that may result from the adoption of SFAS No. 160.

13. Financial Guaranty Insurance Contracts

The risk management function for 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. This discipline is applied at both the point of origination of a transaction and during the on-going monitoring and surveillance of each exposure in the portfolio. The risk management function is responsible for both credit and market risk and is structured by area of expertise. The department consists of: risk analytics; public finance; structured finance; and portfolio analytics/recovery management (each is more fully described below).

All directly insured transactions are subject to a thorough underwriting analysis, a comprehensive decision process, and ongoing surveillance for executed transactions**.** For our financial guaranty reinsurance portfolio, transactions assumed through a treaty with the ceding company are underwritten in accordance with the policies and the procedures of such ceding company. Transactions assumed on a facultative basis, however, are underwritten in accordance with our policies and procedures and the policies of the ceding company. We review the policies and procedures of the ceding company as more fully described below.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Our public finance and structured finance groups utilize several tools to monitor our direct insured portfolio. We require the regular delivery of periodic financial information and in most cases, covenant compliance reports, that are reviewed by the risk manager assigned to the particular credit. Each risk manager prepares regular periodic (usually annually or biennially depending on the continued credit quality of the transaction) written surveillance reports for each credit which contain in depth financial analysis of the credits together with the assignment of an internal rating supported by a clearly stated rationale. Observed deterioration in the performance of a credit may prompt additional and more frequent review. Upon continued performance deterioration, the risk manager, in consultation with senior management, may downgrade the internal credit scoring for a credit or if appropriate, move the credit to the financial guaranty Watch List. All amendments, consents and waivers related to a transaction are also the primary responsibility of the appropriate risk manager. In addition to individual credit analysis, these teams are responsible for following economic, environmental and regulatory trends and for determining their potential impact on the insured portfolio.

The portfolio analytics/recovery management group oversees all portfolio level analysis of our insured financial guaranty portfolio. This group is primarily responsible for the analysis of our assumed financial guaranty portfolio and the oversight of the credit risk relationship with our ceding companies. The head of the portfolio analytics/recovery management team directs the Watch and Reserve process (which is more fully described below), and chairs the quarterly Watch and Reserve meetings, at which reserve recommendations are made on the portfolio.

The risk analytics team is responsible for the analysis of market risk factors and their impact on economic capital. Key market risk factors, including interest rate risk and credit spreads, are assessed on an individual credit and insured portfolio basis. The risk analytics team has developed quantitative tools and models to measure these risks which incorporate the risk assessments and internal ratings assigned by each of the teams within risk management. We use an internal economic capital methodology to attribute economic capital to each individual credit exposure within our insured portfolio. This methodology relies heavily on our ability to quantify the individualized risks of default and prepayment underlying each transaction in our insured portfolio. Economic capital is also the basis for calculating risk-adjusted returns on our capital (RAROC), which allows us to establish criteria for weighing the credit risk relative to the premium received. An internal management committee considers this analysis in its evaluation of the related risk and other business factors for a proposed transaction in determining of the sufficiency of the premium.

Economic capital provides us with a uniform risk measure for analyzing and valuing risk that is consistent across all our insurance business lines. The ability to measure risk in substantially equivalent terms allows us to set Company-wide position limits for our portfolio along all our insurance business lines that take into account both differences in loss probabilities for each credit and also for the correlation in loss probabilities across a portfolio of credit exposures.

In our financial guaranty reinsurance business, the primary obligation for assessing and mitigating claims rests with the ceding company. To help align the ceding company s interests with ours, we generally require that the ceding company retain a portion of the exposure on any single risk that we reinsure. Our portfolio risk analytics/recovery management group is responsible for the periodic diligence and evaluation of the underwriting and surveillance capabilities of the ceding companies. This evaluation includes an in depth review of the following areas: business strategy; underwriting approach and risk appetite; sector specific surveillance strategies; watch and reserve processes and procedures and reinsurance strategies. Each of the ceding companies provides us with quarterly updates to their watch and reserve lists, including reserve information. In the event that we have identified a potential deficiency in the surveillance activities of a ceding company, appropriate personnel in our risk management department may conduct an independent analysis to the extent adequate

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information is available. We also may have an independent view on assumed credits where we also have direct exposure based on the information obtained through our independent credit view. As a result, we may assess credits and establish reserves based upon information in addition to that received from the ceding company.

Our board of directors has formed a Credit Committee of independent directors to assist the board in its oversight responsibilities for our credit risk management policies and procedures, including heightening board-level awareness of the impact of developing risk trends in our portfolio. Our risk management group updates this committee, no less frequently than on a quarterly basis, on all aspects of risk management, including portfolio/sector analysis, economic capital trends, risk management policy enhancements and Watch and Reserve Committee recommendations and decisions.

The financial guaranty business has a Watch and Reserve Committee that meets quarterly to review non-performing credits and establish reserves for transactions as recommended by the appropriate risk manager. The Committee is chaired by the head of the portfolio analytics/recovery management group and includes representatives of senior management, credit, legal and finance from both financial guaranty and the parent company. Our risk management processes and procedures address both performing and non-performing transactions. Performing transactions are assigned investment grade internal ratings, denoting nominal to moderate credit risk. 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 and Case Reserve. Assumed exposures in financial guaranty s

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

reinsurance portfolio are also placed in one of these categories if the primary insurer for such transaction downgrades it to an equivalent watch list classification or if our financial guaranty risk management group determines that such a downgrade is appropriate notwithstanding the risk rating assigned by the ceding company.

Special Mention. This category includes insured transactions that are internally rated no more than two rating levels below investment grade upon the observation and analysis of financial or asset performance deterioration by the appropriate risk manager. Although these insured transactions typically are not performing as expected, we have determined that such transactions are not expected to have severe, prolonged stress and we do not believe that claim payments are imminent. The credits in this category could have all or some of the following characteristics:

- Speculative grade obligations with increasing credit risk, but with the possibility of recovering and returning to investment grade levels;
- Slight probability of payment default due to current adverse economic and operating challenges;
- Limited capacity for absorbing volatility and uncertainty; vulnerability to further downward pressure which could lead to difficulty in covering future debt obligations; and
- Requires additional monitoring by risk manager to evaluate developing credit trends.

Once a risk manager detects some or all of these characteristics, the risk manager makes a recommendation to place the credit in this category to the portfolio analytics/recovery management group and the respective risk management group. Direct and assumed exposures in this category are typically reviewed annually or more frequently if there is a change to the credit profile.

Due to the additional efforts involved in monitoring Special Mention credits, consultants and/or counsel may be engaged to assist in claim prevention or loss mitigation strategies. As a result, LAE reserves are occasionally posted for exposures on this list should such third parties be engaged.

Intensified Surveillance. This category includes transactions in financial guaranty s insured portfolio that are internally rated below investment grade, indicating a severe and often permanent adverse change in the transaction s credit profile. Transactions in this category are still performing, meaning they have not yet defaulted on a payment, but our risk management department has determined that there is a substantial likelihood of default. Transactions that are placed in this category may have some or all of the following characteristics:

- Speculative grade transactions with high credit risk and low possibility of recovery back to performing levels;
- Impaired ability to satisfy future payments;
- Debtors or servicers with distressed operations that we believe have a questionable ability to continue operating in the future without external assistance from government and/or private third parties;

Requires frequent monitoring and risk management action to prevent and mitigate possible claims; and

Requires the allocation of claim liability reserves.

Insured transactions are generally elevated into this category from the Special Mention list as a result of continuing declining credit trends. Occasionally, however, transactions may enter this category due to an unexpected financial event that leads to rapid and severe deterioration. Direct and assumed exposures in this category are reviewed and reported on quarterly, except for immaterial credits based on par outstanding.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Consultants and/or counsel are regularly engaged in connection with these transactions to assist in claim prevention and loss mitigation strategies due to the remediation efforts necessary to prevent or minimize losses. As a result, LAE reserves are regularly posted for these exposures in addition to claim liability reserves.

Case Reserve. This category consists of insured transactions where a payment default on the insured obligation has occurred. LAE reserves are normally required as remediation efforts often continue for credits classified at this level to mitigate claims. Direct and assumed exposures in this category are reviewed and reported on quarterly. Case reserves are established for all non-derivative transactions on this list.

In our direct financial guaranty business, we establish loss and LAE reserves on our non-derivative financial guaranty contracts based upon the recommendation by the risk manager responsible for the transaction. Such recommendations are generally made for Intensified Surveillance and Case Reserve credits. For Intensified Surveillance credits, the risk manager may recommend a reserve if he or she has determined a default is likely and if the severity of loss upon default is quantifiable. Once a claim payment is made for a particular credit, a case reserve will be recommended that reflects claims made, together with anticipated future claims. The assumptions used to recommend reserves for direct credits are based upon the analysis performed by the risk manager as more fully described above. Except as described above, we recommend reserves for our assumed Watch List credits based upon information provided by the ceding company.

The following table includes additional information as of September 30, 2008 regarding our financial guaranty claim liabilities broken out by the surveillance categories described above:

Surveillance Categories

($ in millions)	Special Mention	Intensified Surveillance	Case Reserve	Total
Number of policies	101	73	44	218
Remaining weighted-average contract period (in years)	20	24	30	24
Insured contractual payments outstanding:				
Principal	$ 603.2	$ 686.3	$ 372.6	$ 1,662.1
Interest	266.1	382.3	243.6	892.0
Total	$ 869.3	$ 1,068.6	$ 616.2	$ 2,554.1
Gross claim liability	$ 0.2	$ 91.8	$ 54.6	$ 146.6
Less:				
Gross potential recoveries	0.1	7.0	2.6	9.7
Discount, net		13.3	3.4	16.7
Net claim liability	$ 0.1	$ 71.5	$ 48.6	$ 120.2
Unearned premium revenue	$ 8.4	$ 6.3	$ 3.1	$ 17.8
Claim liability reported in the balance sheet *	$ 0.1	$ 71.5	$ 48.6	$ 120.2
Reinsurance recoverables	$	$	$	$

* Includes case reserves and allocated non-specific reserves.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

14. Selected Financial Information of Registrant Radian Group

The following is selected financial information for the parent company:

(In thousands)	September 30 2008	December 31 2007
Investment in subsidiaries, at equity in net assets	$ 3,204,883	$ 3,496,089
Total assets	3,345,942	3,709,285
Long-term debt and other borrowings	908,282	953,524
Total liabilities	1,013,616	988,549
Total stockholders equity	2,332,326	2,720,736
Total liabilities and stockholders equity	3,345,942	3,709,285

15. Commitments and Contingencies

As previously disclosed, in August and September 2007, two purported stockholder class action lawsuits, *Cortese v. Radian Group Inc.* and *Maslar v. Radian Group Inc.*, were filed against Radian Group Inc. and individual defendants in the U.S. District Court for the Eastern District of Pennsylvania. The complaints, which are substantially similar, allege that we were aware of and failed to disclose the actual financial condition of C-BASS prior to our declaration of a material impairment to our investment in C-BASS. On January 30, 2008, the Court ordered that the cases be consolidated into *In re Radian Securities Litigation* and appointed the Institutional Investors Iron Workers Local No. 25 Pension Fund (Iron Workers) and the City of Ann Arbor Employees Retirement System (Ann Arbor) Lead Plaintiffs in the case. On April 16, 2008, a consolidated and amended complaint was filed, adding one additional defendant. On June 6, 2008, we filed a motion to dismiss this case, which has been fully briefed. While it is still very early in the pleadings stage, we do not believe that the allegations in the consolidated cases have any merit and we intend to defend against this action vigorously.

As previously disclosed, in April 2008, a purported class action lawsuit was filed against Radian Group, the Compensation and Human Resources Committee of our board of directors and individual defendants in the U.S. District Court for the Eastern District of Pennsylvania. The complaint alleges violations of the Employee Retirement Income Securities Act as it relates to our Savings Incentive Plan. The named plaintiff is a former employee of ours. On July 25, 2008, we filed a motion to dismiss this case. We believe that the allegations are without merit, and intend to defend against this action vigorously.

On June 26, 2008, we filed a complaint for declaratory judgment in the United States District Court for the Eastern District of Pennsylvania, naming IndyMac, Deutsche Bank National Trust Company, Financial Guaranty Insurance Company (FGIC), AMBAC Assurance Corporation and MBIA Insurance Corporation as defendants. The suit involves three Radian pool policies covering second-lien mortgages, entered into in late 2006 and early 2007 with respect to loans originated by IndyMac. We are in a second loss position behind IndyMac and in front of three defendant financial guaranty companies. We are alleging that the representations and warranties made to us to induce us to issue the policies were materially false, and that as a result, the policies should be void. The total amount of our claim liability is approximately $77 million. We have established loss reserves equal to the total amount of our exposure to these transactions. On June 27, 2008, IndyMac filed a suit against us in California State Court in Los Angeles on the same policies, alleging that we have wrongfully denied claims or rescinded coverage on the underlying loans. We are moving to have that suit dismissed or removed to federal court and stayed pending our suit in the Eastern District of Pennsylvania. IndyMac and the Federal Deposit Insurance Corporation, which now controls IndyMac, have obtained stays of the federal action and California action until November 26, 2008 and November 10, 2008, respectively. There are related suits between FGIC and IndyMac in California and the Southern District of New York which may also be consolidated with our suit at a later date.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

In addition to the above litigation, we are involved in litigation that has arisen in the normal course of our business. We are contesting the allegations in all pending actions and believe, based on current knowledge and after consultation with counsel, that the outcome of such litigation, individually or in the aggregate, will not have a material adverse effect on our condensed consolidated financial position, results of operations, or cash flows.

As previously disclosed, on October 3, 2007, we received a letter from the staff of the Chicago Regional Office of the Securities Exchange Commission stating that the staff is conducting an investigation involving Radian Group and requesting production of certain documents. The staff has also requested that certain Radian employees provide voluntary testimony in this matter. We believe that the investigation generally relates to the proposed merger with MGIC and our investment in C-BASS. We are cooperating with the requests of the SEC. The SEC staff has informed us that this investigation should not be construed as an indication by the Commission or its staff that any violation of the securities laws has occurred, or as a reflection upon any person, entity or security.

Securities regulations became effective in 2005 that impose enhanced disclosure requirements on issuers of asset-backed (including mortgage-backed) securities. To allow our customers to comply with these regulations, we typically are required, depending on the amount of credit enhancement we are providing, to provide (1) audited financial statements for the insurance subsidiary participating in the transaction or (2) a full and unconditional holding-company-level guarantee for our insurance subsidiaries obligations in such transactions. To date, Radian Group has guaranteed two structured transactions for Radian Guaranty involving approximately $363.3 million of remaining credit exposure.

Under our change of control agreements with our executive officers, upon a change of control of Radian Group or Radian Asset Assurance, as the case may be, we are required to fund an irrevocable rabbi trust to the extent of our obligations under these agreements. The total maximum amount that we would be required to place in trust is approximately $26.2 million as of September 30, 2008.

As part of the non-investment-grade allocation component of our investment portfolio, we have committed to invest $55.0 million in alternative investments ($22.1 million of unfunded commitments at September 30, 2008) that are primarily private equity securities. These commitments have capital calls over a period of at least six years, and certain fixed expiration dates or other termination clauses.

We also utilize letters of credit to back assumed reinsurance contracts, medical insurance policies and an excise tax-exemption certificate used for ceded premiums from our domestic operations to our international operations. These letters of credit are with various financial institutions, have terms of one-year and will automatically renew unless we specify otherwise. The letters of credit outstanding at September 30, 2008 and December 31, 2007 were $10.7 million and $10.8 million, respectively.

Our mortgage insurance business utilizes its underwriting skills to provide an outsourced underwriting service to its customers. We give recourse to our customers on loans we underwrite for compliance. Typically, we agree that if we make a material error in underwriting a loan, we will remedy, indemnify, make whole, repurchase, or place additional mortgage insurance coverage on the loan. Providing these remedies means we assume some credit risk and interest-rate risk if an error is found during the limited remedy period in the agreements governing these services. We paid losses for sales and remedies from reserves in the first nine months of 2008 of approximately $2.2 million, and our reserve for such expenses at September 30, 2008 was $11.0 million. We closely monitor this risk and negotiate our underwriting fee structure and recourse agreements on a client-by-client basis.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Our financial guaranty insurance business has entered into reinsurance agreements with several monoline financial guaranty primary insurers. These reinsurance agreements generally are subject to termination (i) upon written notice by either party (ranging from 90 to 120 days) before the specified deadline for renewal, (ii) at the option of the ceding company if we fail to maintain applicable ratings or certain financial, regulatory and rating agency criteria, or (iii) upon certain changes of control. Upon termination under the conditions set forth in (ii) and (iii) above, we may be required (under some of our reinsurance agreements) to return to the ceding company all unearned premiums, less ceding commissions, attributable to reinsurance ceded pursuant to such agreements. Upon the occurrence of the conditions set forth in (ii) above, regardless of whether or not an agreement is terminated, we may be required to obtain a letter of credit or alternative form of security to collateralize our obligation to perform under such agreement or we may be obligated to increase the level of ceding commission paid.

As a result of downgrades of our financial guaranty insurance subsidiaries financial strength ratings by Standard & Poor s Ratings Service (S&P) in June 2008 (the June 2008 downgrade), most of our primary insurance customers now have the right to take back or recapture business previously ceded to us under their reinsurance agreements with us, and in some cases, in lieu of recapture, the right to increase ceding commissions charged to us. As of September 30, 2008, up to $45.8 billion of our total net assumed par outstanding was subject to recapture. If all this business was recaptured as of September 30, 2008, we estimate that Radian Asset Assurance would have experienced a reduction in (1) written premiums of approximately $391.0 million, (2) earned premiums of approximately $75.8 million, and (3) the net present value of expected future installment premiums of $161.8 million. In addition, Radian Asset Assurance would have experienced a reduction in incurred losses of approximately $56.6 million under these circumstances. These recaptures would have required us to refund $315.2 million in unearned premiums, and would not have materially impacted pre-tax income.

In October and November 2008, as a consequence of the June 2008 downgrade, one reinsurance customer recaptured all of its business and we agreed to allow another reinsurance customer to take back a portion of its business. Due to these transactions, our net assumed par outstanding, written premiums, earned premiums and net present value of expected future installment premiums were reduced in the aggregate by $6.6 billion, $46.6 million, $15.4 million and $3.5 million, respectively.

Factors that may influence the ability or willingness of our other primary insurance customers to recapture business include, among other, current market conditions, recent ratings actions on certain of our primary insurance customers, and the limited availability of alternate reinsurance capacity. We cannot estimate what amount, if any, of our existing reinsurance business may be recaptured or the ultimate economic impact of any such recapture.

On August 26, 2008, S&P downgraded the financial strength ratings of our financial guaranty subsidiaries to BBB+ (the August 2008 downgrade). This rating action gave the counterparties in four of our synthetic credit default swap transactions the right to terminate the transaction with settlement on a mark-to-market basis, meaning that if, based on third-party bids received, a replacement counterparty would require amounts in addition to the payments we receive under the transaction in order to take over our position in the transaction, we would be required to pay such amounts to our counterparty, and if such third party would pay our counterparty to take over our position, our counterparty would pay such amount to us upon termination. In September 2008, we voluntarily terminated one of these transactions and novated a second transaction to an unaffiliated third party before the termination rights for our counterparty vested. We paid an aggregate of $3.8 million (our maximum termination payment for these transactions was $23.0 million) to terminate and novate these transactions, resulting in a reduction of our aggregate exposure by $224.0 million. The other two transactions currently subject to termination with settlement on a mark-to-market basis remain outstanding with an aggregate notional amount of $336.2 million. If our counterparty was to terminate these two transactions, the maximum amount that we

Radian Group Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

would be required to pay upon a termination is approximately $33.7 million in the aggregate. In addition, we insure one transaction with a $103.2 million notional amount that may be terminated on a mark-to-market basis, if S&P lowered Radian Asset Assurance s rating below investment grade (BBB-).

In addition, due to the August 2008 downgrade, counterparties to 148 of our 184 credit default swap transactions and four transactions where we issued a financial guaranty insurance policy, which includes three securities exchange clearinghouse and one structured finance transactions, currently have the right to terminate these transactions without any obligation on our part to settle the transaction at fair value. If all of these counterparties had terminated these transactions as of September 30, 2008, financial guaranty s outstanding net par exposure would have been reduced by $39.3 billion, with a corresponding decrease in unearned premium reserves and in the present value of expected future installment premiums of $254.3 million, $1.3 million of which would be required to be refunded to counterparties.

Following the June 2008 downgrades of our financial guaranty insurance subsidiaries, in July 2008, we initiated a plan to reduce our financial guaranty workforce commensurate with our expectations regarding our ability to originate new financial guaranty business. In order to maintain a portion of the workforce needed to effectively manage this business, we have put into place retention and severance agreements for all remaining personnel at an estimated cost of $29 million, which we expect will be paid by the end of 2009.

We are currently under examination by the Internal Revenue Service (IRS) for the 2000 through 2004 tax years. The IRS opposes the recognition of certain tax losses and deductions that were generated through our investment in a portfolio of residual interests in Real Estate Mortgage Investment Conduits (REMICs) and has proposed adjustments denying the associated tax benefits of these items. We are contesting all such proposed adjustments relating to the IRS s opposition of the tax benefits in question and are working with tax counsel in our defense efforts. We have received the IRS revenue agent report detailing the proposed increase to our tax liability of approximately $121 million and, in response to that report, have made a qualified deposit with the U.S. Department of the Treasury under IRC Section 6603 of approximately $85 million to avoid the accrual of the above-market-rate interest associated with our estimate of the potentially unsettled adjustment. Although we disagree with and will contest the adjustments proposed by the IRS, and believe that our income and loss from these investments was properly reported on our federal income tax returns in accordance with applicable tax laws and regulations in effect during the periods involved, there can be no assurance that we will prevail in opposing the additional tax liability, interest or penalties with respect to this investment.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following analysis should be read in conjunction with our condensed consolidated financial statements and the notes thereto included in this report and our audited financial statements, notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Form 10-K for the fiscal year ended December 31, 2007 for a more complete understanding of our financial position and results of operations. In addition, investors should review the Forward-Looking Statements-Safe Harbor Provisions above and the Risk Factors detailed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2007 as well as the material changes to these risks discussed in Item 1A of Part II of our quarterly reports on Form 10-Q (including the material changes set forth below in this report) for a discussion of those risks and uncertainties that have the potential to affect our business, financial condition, results of operations, cash flows or prospects in a material and adverse manner.

Business Summary

Our principal business segments are mortgage insurance, financial guaranty and financial services.

Mortgage Insurance

Our mortgage insurance segment provides credit-related insurance coverage, principally through private mortgage insurance, and risk management services to mortgage lending institutions located throughout the United States (U.S.) and in select countries outside the U.S. We provide these products and services mainly through our wholly-owned subsidiaries, Radian Guaranty Inc., Amerin Guaranty Corporation, and Radian Insurance Inc. (which we refer to as Radian Guaranty, Amerin Guaranty, and Radian Insurance, respectively). Private mortgage insurance protects mortgage lenders from all or a portion of default-related losses on residential mortgage loans made mostly to home buyers who make down-payments of less than 20% of the home s purchase price. Private mortgage insurance also facilitates the sale of these mortgage loans in the secondary mortgage market, most of which are sold to Freddie Mac and Federal National Mortgage Association (Fannie Mae). We refer to Freddie Mac and Fannie Mae as Government Sponsored Enterprises or GSEs.

Traditional Mortgage Insurance. Our mortgage insurance segment, through Radian Guaranty, offers primary and pool mortgage insurance coverage on residential first-lien mortgages. At September 30, 2008, primary insurance on domestic first-lien mortgages made up approximately 92.1% of our total domestic first-lien mortgage insurance risk in force, and pool insurance on domestic first-lien mortgages made up approximately 7.9% of our total domestic first-lien mortgage insurance risk in force. Currently, traditional primary mortgage insurance on residential first-lien mortgages is our primary business focus.

Non-Traditional Mortgage Credit Enhancement. In addition to traditional mortgage insurance, in the past we have used Radian Insurance to provide other forms of credit enhancement on residential mortgage assets. These products include second-lien mortgage insurance, credit enhancement on net interest margin securities (which we refer to as NIMS), credit default swaps (CDS) on domestic and international mortgages and traditional international mortgage insurance (collectively, we refer to the risk associated with these transactions as other risk). At one point, these products were a growing part of our total mortgage insurance business. However, in light of the housing and credit market turmoil, we stopped writing all non-traditional business other than a small amount of international mortgage insurance. Our prospects for writing international business are limited as discussed below.

International Mortgage Insurance. We wrote our existing international mortgage insurance business through Radian Insurance. The recent downgrades of Radian Insurance have significantly reduced our ability to continue to write international mortgage insurance business. In addition, as a result of these downgrades, the counterparties to each of our active international transactions have the right to terminate these transactions, which could require us to return unearned premiums or transfer unearned premiums to a replacement insurer. On March 4, 2008, Standard Chartered Bank in Hong Kong informed us that they wished to terminate their contract with Radian Insurance. There is a possibility that Radian Insurance could be required to return unearned premiums related to this transaction to Standard Chartered Bank, or to transfer such unearned premiums to

another insurer. In addition, we have used Radian Guaranty to assume or reinsure most of our Australian transactions, and we expect our two remaining Australian transactions to be reinsured by or novated to Radian Guaranty in the fourth quarter of 2008.

Financial Guaranty

Our financial guaranty business mainly insures and reinsures credit-based risks through our wholly-owned subsidiary, Radian Asset Assurance Inc. (Radian Asset Assurance), and through its wholly-owned subsidiary, Radian Asset Assurance Limited (RAAL), located in the United Kingdom. Financial guaranty insurance typically provides an unconditional and irrevocable guaranty to the holder of a financial obligation of full and timely payment of principal and interest when due.

We have traditionally offered the following financial guaranty products:

Public Finance. Insurance of public finance obligations, including tax-exempt and taxable indebtedness of states, counties, cities, special service districts, other political subdivisions and tribal finance and for enterprises such as airports, public and private higher education and health care facilities, project finance and private finance initiative assets in sectors such as schools, healthcare and infrastructure projects. The issuers of public finance obligations we insure typically are rated investment-grade at the time we issue our insurance policy, without the benefit of our insurance.

Structured Finance. Insurance of structured finance obligations, including collateralized debt obligations (CDOs) and asset-backed securities (ABS), consisting of funded and non-funded (synthetic) obligations that are payable from or tied to the performance of a specific pool of assets. Examples of the pools of assets that underlie structured finance obligations include corporate loans and bonds, residential and commercial mortgages, a variety of consumer loans, tax credits, equipment receivables and real and personal property leases. The structured finance obligations we insure generally are rated investment-grade at the time we issued our insurance policy, without the benefit of our insurance.

Financial Solutions. Financial solutions products (which we include as part of our structured finance business), including guaranties of securities exchange clearinghouses, excess-Securities Investor Protection Corporation (SIPC) insurance for customers of brokerage firms and excess-Federal Deposit Insurance Corporation (FDIC) insurance for customers of banks.

Reinsurance. Reinsurance of domestic and international public finance obligations, including those issued by sovereign and sub-sovereign entities, as well as reinsurance of structured finance and financial solutions obligations.

In October 2005, we exited the trade credit reinsurance line of business. Accordingly, this line of business was placed into run-off and we ceased initiating new trade credit reinsurance contracts.

In light of current market conditions, we have discontinued, for the foreseeable future, writing any new financial guaranty insurance other than as may be necessary to commute, restructure, hedge or otherwise mitigate losses or reduce exposure in our existing portfolio. In March 2008, we discontinued writing new insurance on synthetic CDOs and significantly reduced our structured products operations. This decision was based on the deterioration and uncertainties in the credit markets in which we and other financial guarantors participate, which significantly reduced the volume of CDOs and other structured products available for our insurance. In June 2008, the financial strength ratings of our financial guaranty insurance subsidiaries were downgraded by both Standard & Poor s Ratings Service (S&P) and Moody s Investor Service (Moody s), and in August 2008, S&P again lowered its financial strength rating on our financial guaranty insurance subsidiaries. See Ratings Recent Ratings Actions below. These downgrades, combined with the difficult market conditions for financial guaranty insurance, severely limited our ability to write new direct insurance and reinsurance both domestically and internationally. As a result, in the third quarter of 2008, we initiated plans to reduce our financial guaranty

operations, including a reduction of our workforce, commensurate with our current intention not to originate new business, and contributed the outstanding capital stock of Radian Asset Assurance to Radian Guaranty, significantly strengthening Radian Guaranty s statutory capital.

We continue to maintain a large insured portfolio, including a significant portfolio of CDOs as discussed below under Results of Operations Financial Guaranty Quarter and Nine Months Ended September 30, 2008 Compared to Quarter and Nine Months Ended September 30, 2007.

Financial Services

Our financial services segment mainly consists of our 28.7% equity interest in Sherman Financial Group LLC (Sherman), a consumer asset and servicing firm. In August 2008, our equity interest in Sherman increased to 28.7% from 21.8% as a result of the sale by Mortgage Guaranty Insurance Corporation (MGIC) of its remaining interest in Sherman back to Sherman. Our financial services segment also includes our 46% interest in Credit-Based Asset Servicing and Securitization LLC (C-BASS), a mortgage investment company whose operations are currently in run-off.

Sherman. Sherman specializes in charged-off and bankruptcy plan consumer assets, which are generally unsecured. Sherman typically purchases these assets at deep discounts from national financial institutions and major retail corporations and subsequently seeks to collect upon them. In addition, Sherman originates subprime credit card receivables through its subsidiary CreditOne and has a variety of other similar ventures related to consumer assets.

C-BASS. Historically, C-BASS had been engaged as a mortgage investment and servicing company specializing in the credit risk of subprime single-family residential mortgages. As a result of the disruption in the subprime mortgage market during 2007, C-BASS ceased purchasing mortgages and mortgage securities and its securitization activities in the third quarter of 2007 and sold its loan-servicing platform in the fourth quarter of 2007. The orderly run-off of C-BASS s business is dictated by an override agreement under which we and all of C-BASS s owners and creditors are parties. This agreement provides the basis for the collection and distribution of cash generated from C-BASS s whole loans and securities portfolio, as well as the sale of certain assets, including the loan-servicing platform. We recorded a full write-off of our equity interest in C-BASS in the third quarter of 2007 and wrote-off our $50 million credit facility with C-BASS in the fourth quarter of 2007. See Note 7 of Notes to Unaudited Condensed Consolidated Financial Statements.

Ratings

Our ratings are critical to our ability to market our products and to maintain our competitive position and customer confidence in our products.

Our holding company, Radian Group Inc. (Radian Group), currently has a senior debt rating of BB+ (Negative outlook) from S&P and Ba1 (Negative outlook; under review for possible downgrade) from Moody s. Our principal operating subsidiaries have been assigned the following ratings:

	MOODY S (1)	S&P (2)
Radian Guaranty	A2	BBB+
Radian Insurance	Baa1	BB+
Amerin Guaranty	A2	BBB+
Radian Asset Assurance	A3	BBB+
Radian Asset Assurance Limited	A3	BBB+

(1) Each Moody s rating for our mortgage insurance and financial guaranty subsidiaries is currently under review for possible downgrade.
(2) Each S&P rating for our mortgage insurance and financial guaranty subsidiaries is currently on Negative Outlook.

On May 2, 2008, Fitch Ratings (Fitch) withdrew its ratings for Radian Group and all of our insurance subsidiaries, citing a lack of adequate information regarding these entities. We had requested that Fitch withdraw these ratings in September 2007, following Fitch s downgrade of Radian Group and our financial guaranty subsidiaries.

Recent Ratings Actions. On June 25, 2008, Moody s lowered its senior debt rating on Radian Group to Ba1 from A2 and its insurance financial strength ratings on Radian Guaranty and Amerin Guaranty to A2 from Aa3. In downgrading our mortgage insurance subsidiaries, Moody s cited deterioration in our insured portfolio, including NIMS and second-liens. Moody s further stated that our ability to retain our status as a Tier 1 mortgage insurer with the GSEs will continue to be an important rating consideration for our mortgage insurance subsidiaries. Moody s lowered its insurance financial strength rating on Radian Insurance to Baa1 (two notches below Radian Guaranty) from Aa3 as a result of the higher-risk nature of its insurance portfolio of second-liens and NIMS and the fact that Radian Insurance is no longer strategically important to our overall mortgage insurance business.

Also on June 25, 2008, Moody s lowered its insurance financial strength rating on Radian Asset Assurance and RAAL to A3 from Aa3, citing the likelihood that Radian Asset Assurance will cease writing new business going-forward and the possible diversion of capital from Radian Asset Assurance to support our mortgage insurance business.

On August 26, 2008, S&P lowered its senior debt rating on Radian Group to BB+ from BBB and its insurance financial strength ratings on Radian Guaranty and Amerin Guaranty to BBB+ from A. In lowering its ratings for Radian Group and our mortgage insurance subsidiaries, S&P cited the significant operating losses incurred by our mortgage insurance business as well as S&P s reassessment of the mortgage insurance industry s long-term fundamentals. S&P also cited Radian Group s financial flexibility as a potential concern. S&P also lowered its insurance financial strength ratings for our financial guaranty subsidiaries to BBB+ from A. S&P stated that it had lowered the ratings for these entities based on the diminished business prospects for our financial guaranty business and our intention to use this business to provide capital support to our mortgage insurance business.

On October 10, 2008, Moody s placed its ratings for Radian Group and each of our mortgage insurance and financial guaranty subsidiaries on review for possible downgrade. In taking this ratings action, Moody s cited its expectation of further stress on the risk-adjusted capital position of our mortgage insurance business in light of continued deterioration in certain housing market fundamentals. Moody s expects to update its evaluation of our mortgage insurance capital adequacy in the near term. As part of this review, Moody s will consider the expected benefit of capital support from our financial guaranty business to our mortgage insurance business and various federal initiatives being pursued that may serve to mitigate the rising trend of mortgage insurance defaults.

Our current ratings and the threat of further ratings actions could have a significant impact on our business and results of operations. See Risk Factors We could lose our Top Tier status with the GSEs, causing Freddie Mac and Fannie Mae to decide not to purchase mortgages or mortgage-backed securities insured by us, which would significantly impair our mortgage insurance franchise for more information.

Overview of Business Results

As a seller of credit protection, our results are subject to macroeconomic conditions and specific events that impact the production environment and credit performance of our underlying insured assets. The current mortgage and credit cycle, characterized by a continuing decline in home prices in certain markets, deteriorating credit performance of mortgage assets and reduced liquidity for many participants in the mortgage and financial services industries, has had, and we believe will continue to have, a significant negative impact on the business environment and results of operations for each of our business segments. In addition, the potential for a prolonged recession in the U.S. may add further stress to the performance of our insured assets.

Mortgage Insurance

Traditional Mortgage Insurance

Defaults. Further deterioration in the U.S. housing and mortgage credit markets resulted in a 16.0% increase in first-lien primary defaults during the third quarter of 2008, compared to a 13.6% and 11.0% increase in first-lien defaults during the first and second quarters of 2008, respectively. We expect a significant increase in new first-lien primary defaults for the fourth quarter of 2008 as a result of seasonality and the on-going deterioration in the fundamentals of the economy and the domestic housing market. Overall, the underlying trend of higher defaults continues to be driven by poor performance of the late 2005 through early 2008 vintage books of business. While losses generally have increased across all mortgage insurance product lines, a significant percentage of our losses are attributable to Alternative-A (Alt-A) mortgages. Ongoing deterioration in markets in California and Florida, where housing values are expected to continue to decline and where Alt-A and adjustable-rate mortgage (ARM) products have been prevalent, continues to have a significant negative impact on our mortgage insurance business results.

Loss Provision/First-Lien Premium Deficiency. In addition to the increase in new defaults during 2008, our mortgage insurance loss provision at September 30, 2008 continued to be negatively impacted by higher loan balances on delinquent loans, higher rates of defaults moving into claim status, a decrease in the cure rate of defaults and an increase in claims paid. In the second quarter of 2008, we established a first-lien premium deficiency reserve of $421.8 million on our outstanding domestic first-lien mortgage insurance portfolio. A premium deficiency reserve was established because the projected net present value of expenses and losses for our first lien portfolio exceeded the net present value of future premiums and the loss reserve on this portfolio. This premium deficiency reserve was reduced to $150.1 million at September 30, 2008. Our new insurance written in the third quarter of 2008 is projected to be profitable, and therefore its projected profitability is not included in our first-lien premium deficiency reserve. Claims paid increased in the three months ended September 30, 2008 to $277.4 million, compared to $190.2 million and $208.8 million in the first and second quarters of 2008, respectively. We expect to pay total mortgage insurance claims (including second-liens) of approximately $275 million in the fourth quarter of 2008 and expect that claims paid in 2009 will significantly exceed those paid in 2008. Recent legislation and loan modification programs by certain of our lender customers aimed at mitigating the current turmoil in the housing market could have a positive impact on our business by potentially reducing the number of defaults going to claim. Many of these programs are in the early stages of implementation and we cannot be certain of their impact upon our business or the timing of any potential impact. Based on our current assumptions, we estimate that the net present value of expected losses and expenses on our first-lien portfolio is $4.5 billion. We expect these losses to be partially offset by the present value of expected future premiums of approximately $2.3 billion from our first-lien portfolio and significant recoveries from Smart Home and captive reinsurance arrangements as discussed below, and by our current loss reserve of $2 billion.

Smart Home/Captives. We have protected against some of the losses relating to riskier products by reinsuring our exposure through transactions (referred to as Smart Home) that effectively transfer risk to investors in the capital markets. Approximately 3.9% of our primary mortgage insurance risk in force was included in Smart Home transactions at September 30, 2008. Our mortgage insurance provision for losses for the nine months ended September 30, 2008 was reduced by $59.5 million due to recoverables from Smart Home. Ceded losses recoverable related to Smart Home were $69.4 million at September 30, 2008. In addition to Smart Home, we transfer a substantial portion of our risk to captive reinsurance companies affiliated with our lender-customers. We had approximately 54 active captive reinsurance agreements in place at September 30, 2008. Our mortgage insurance provision for losses for the nine months ended September 30, 2008 was reduced by $236.5 million due to recoverables from captive transactions. Ceded losses recoverable on captive transactions were $240.4 million at September 30, 2008. In light of the significant amount of ultimate losses we expect to incur in our mortgage insurance business, we estimate that we will receive total reinsurance recoveries, including

recoverable balances as of September 30, 2008, from Smart Home and captive reinsurance of approximately $761 million.

New Insurance Written. We experienced a decrease of 38.5% and 12.3% in traditional flow business written during the three and nine month periods ended September 30, 2008, respectively, compared to the same periods of 2007. Overall, primary new insurance written, which includes both structured and flow business, decreased by 44.0% and 36.9%, respectively, in the three and nine month periods ended September 30, 2008, compared to the same periods of 2007. This decrease is mainly the result of the market turmoil in 2007 and 2008, which has led to a decrease in the volume of mortgage originations, and a reduction in the volume of structured business written. In the fourth quarter of 2007 and throughout 2008, we have implemented a series of changes to our insurance guidelines aimed at improving the long-term risk profile and profitability of our business. As a result of these changes, we have experienced a positive shift in our overall business mix. In the three and nine month periods ended September 30, 2008, approximately 98.4% and 93.1%, respectively, of our new business production was considered prime business compared to 70.0% and 52.4%, respectively, for the comparable periods of 2007.

Persistency. The persistency rate, which is defined as the percentage of insurance in force that remains on our books after any twelve-month period, was 83.9% for the twelve months ended September 30, 2008, compared to 72.8% for the twelve months ended September 30, 2007. This increase was mainly due to a decline in refinancing activity from the high levels in 2005 and 2006, as a result of home price depreciation, tighter underwriting standards and an overall decrease in the lending capacity among mortgage originators. We expect that persistency rates will continue to remain at elevated levels as long as the current disruption in the housing and mortgage credit markets continues.

Discontinued Non-Traditional Products

NIMS. Our exposure to NIMS was reduced to $456 million at September 30, 2008, compared to $604 million at December 31, 2007, in part as a result of our purchase of certain of the NIMS that we insure. The performance of loans underlying the NIMS bonds that we insure continued to deteriorate during the first nine months of 2008. Of the $456 million in total exposure to NIMS, approximately $440 million represents our gross expected principal credit losses related to NIMS. The fair value of our total net liabilities related to NIMS as of September 30, 2008 was $248 million. Our carrying value includes the net present value of our total expected credit losses and incorporates the market s perception of our non-performance risk, in accordance with Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurement (SFAS No. 157). In the fourth quarter of 2007, as a risk mitigation initiative, we began purchasing NIMS that we insure at a discount to par. These efforts continued during the first nine months of 2008, resulting in an overall reduction of our risk in force related to NIMS of $71.3 million during 2008. We did not purchase any NIMS prior to the fourth quarter of 2007. The NIMS purchased are accounted for as derivative assets and are recorded at fair value in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), as amended and interpreted. Upon purchase, 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 positive impact to earnings. Since the fourth quarter of 2007, the overall impact to our financial statements as a result of these purchases has been immaterial.

Second-lien Mortgages. We experienced further deterioration in our second-lien insured portfolio during the first nine months of 2008, which resulted in a $41.1 million increase in second-lien loss reserves during this period to approximately $153.8 million. Our premium deficiency reserve for second-liens decreased during the first nine months of 2008 by $14.3 million (which partially offset the impact of the reserve increase), resulting in a total premium deficiency reserve for second-liens of approximately $181.3 million at September 30, 2008. As of September 30, 2008, our total exposure to second-liens was reduced to $696.0 million, compared to $924.7 million at December 31, 2007. As of

September 30, 2008, we held reserves, including our second-lien premium deficiency reserve, of $335.1 million against our total second-lien mortgage portfolio, representing approximately 48% of the total exposure.

Credit Default Swaps. As of September 30, 2008, our total risk in force exposure to domestic credit default swaps on residential mortgage-backed securities (RMBS) was approximately $162 million. The total fair value liability for these transactions at September 30, 2008, was $88.4 million, as compared to our estimate of future credit losses of $128 million, the difference being mainly attributable to the incorporation of the market s perception of our credit risk in computing fair value. In the fourth quarter of 2005, we wrote $7.3 billion in notional value of credit protection in international credit default swap form on two large AAA tranches of mortgage-backed securities, one containing German mortgages and one containing Danish mortgages. As of September 30, 2008, we had $6.9 million of cumulative unrealized mark-to-market losses on these transactions. Despite the large notional exposure to this business, which has increased to $7.6 billion at September 30, 2008 due to foreign currency rate changes, the remaining subordination for these transactions is substantial and performance to date has been good, and we do not currently foresee any reasonable scenario under which we would be liable for credit losses with respect to such exposures.

Financial Guaranty

New Business Production. A difficult business environment for financial guaranty existed during the first nine months of 2008. These conditions included the widening of credit spreads, a lack of price transparency and illiquidity in many of the structured products that we insure. In addition, there were losses by financial guarantors on RMBS, CDOs of ABS and other credit positions, ratings actions on financial guaranty industry participants, including us, and perceived instability in the franchise values and ratings of many of the financial guarantors, including us. These conditions have materially diminished the financial benefit that our credit protection provides to issuers in the current market of both public and structured finance transactions and to our primary insurer customers and have reduced the perceived benefit of our insurance to holders of insured debt. Many transactions that would normally have been marketed with some form of financial guaranty insurance are either not going to market or are being sold without the benefit of financial guaranty insurance. As a result, there has been a significant reduction in the volume of transactions for which financial guaranty insurance is a viable option, which has made it more difficult for us and many other financial guarantors to write new business. These conditions also resulted in fewer opportunities to obtain reinsurance business from our primary insurance customers. Consequently, new business production across all of our financial guaranty product lines has been significantly reduced in 2008, and in the third quarter of 2008, we decided to discontinue, for the foreseeable future, writing any new financial guaranty insurance business.

Credit Performance. Despite the deterioration in the credit markets during 2007 and 2008, we have not experienced material deterioration in our financial guaranty portfolio during the first nine months of 2008. See Results of Operations Financial Guaranty Quarter and Nine Months Ended September 30, 2008 Compared to Quarter and Nine Months Ended September 30, 2007 below for a discussion of our exposure to RMBS, commercial mortgage-backed securities (CMBS) and corporate CDOs.

Financial Services

Net income for Sherman for the nine months ended September 30, 2008 was $205.3 million compared to $213.0 million for the same period of 2007. Increased revenues from Sherman s credit card origination business and international operations were offset by higher loan loss provisions and an increase in operating expenses and interest expense. Our share of Sherman s income was $44.0 million for the nine months ended September 30, 2008 compared to $74.8 million in 2007. This reduction was primarily a result of our decreased ownership percentage in Sherman for most of 2008 compared to 2007. See Note 7 in Notes to Condensed Consolidated Financial Statements.

Our investment in C-BASS, including our $50 million credit facility with C-BASS, has been fully written off as of December 31, 2007.

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Results of Operations

Our financial results for the first nine months of 2008 were impacted by significant incurred losses in our mortgage insurance business, by gains and losses on our investments and by changes in fair values of derivatives. Credit spreads on underlying collateral, both corporate credit spreads and asset-backed spreads, widened significantly during the first nine months of 2008, which resulted in large unrealized losses on these positions. Offsetting these losses, however, is the impact of a change to our valuation methodology, effective January 1, 2008, that incorporates the market s perception of our non-performance risk. This change in methodology is required under the provisions of SFAS No. 157. Given the significant widening of our credit default swap spread since early 2007, the reduction in the valuation of our derivative liabilities related to our non-performance risk more than offset the credit spread widening on underlying collateral for the first nine months of 2008. These two drivers of our fair values can move in tandem as they have generally done during 2008 or in opposite directions, which could contribute to significant continued volatility of our operating results.

Results of Operations Consolidated

Quarter and Nine Months Ended September 30, 2008 Compared to Quarter and Nine Months Ended September 30, 2007

The following table summarizes our consolidated results of operations for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30		% Change	Nine Months Ended September 30		% Change
(In millions)	**2008**	**2007**	**2008 vs. 2007**	**2008**	**2007**	**2008 vs. 2007**
Net (loss) income	$ 36.7	$ (703.9)	n/m	$ (160.2)	$ (569.3)	(71.9)%
Net premiums written insurance	202.5	308.0	(34.3)%	669.4	798.9	(16.2)
Net premiums earned insurance	249.7	245.4	1.8	740.8	677.9	9.3
Net investment income	65.2	65.0	0.3	196.3	188.6	4.1
Change in fair value of derivative instruments	164.8	(615.9)	n/m	928.8	(633.8)	n/m
Net (losses) gains on other financial instruments	(63.7)	14.8	n/m	(126.9)	54.3	n/m
Gain on sale of affiliate		181.7	n/m		181.7	n/m
Other income	2.8	4.6	(39.1)	9.6	11.5	(16.5)
Provision for losses	544.9	330.5	64.9	1,586.5	611.5	159.4
Provision for premium deficiency	(252.2)	155.2	n/m	135.7	155.2	(12.6)
Policy acquisition costs	20.8	35.7	(41.7)	120.6	88.2	36.7
Other operating expenses	80.8	36.2	123.2	199.8	151.4	32.0
Interest expense	13.9	13.4	3.7	40.2	38.8	3.6
Equity in net income (loss) of affiliates	15.8	(448.9)	n/m	44.0	(376.7)	n/m
Income tax benefit	(10.3)	(420.4)	n/m	(130.0)	(372.2)	(65.1)

n/m = not meaningful

Net (Loss) Income. We had net income of $36.7 million and a net loss of $160.2 million, or $0.46 income per share and $2.01 loss per share (diluted), respectively, for the three and nine months ended September 30, 2008 compared to net losses of $703.9 million and $569.3 million, respectively, or $8.82 and $7.16 per share (diluted) for the corresponding periods of 2007. The on-going disruption in the housing and credit markets continued to negatively affect each of our operating segments during the first nine months of 2008. In particular, our results for 2008 have been negatively impacted by a significant increase in the provision for mortgage insurance losses, including the establishment of a premium deficiency reserve on our first-lien mortgage portfolio, the acceleration of policy acquisition cost amortization on our first-lien business, an increase in net unrealized losses on certain investments due to a continued widening of credit spreads, and losses on other-than-

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temporarily-impaired securities. These losses were partially offset by an increase in the change in fair value of derivative instruments as a result of the implementation of SFAS No. 157, which incorporates the market s perception of our non-performance risk in the calculation of fair value. The net loss for 2007 was primarily due to the impairment of our investment in C-BASS and a significant decrease in the change in fair value of derivative instruments. During the third quarter of 2007, we wrote-off our total investment in C-BASS of $468 million as a result of C-BASS s incurred loss of $935 million.

Net Premiums Written and Earned. Consolidated net premiums written for the three and nine months ended September 30, 2008 were $202.5 million and $669.4 million, respectively, compared to $308.0 million and $798.9 million, respectively, for the corresponding periods of 2007. Consolidated net premiums earned were $249.7 million and $740.8 million, respectively, for the three and nine months ended September 30, 2008 compared to $245.4 million and $677.9 million, respectively, for the corresponding periods of 2007. The decrease in premiums written was primarily due to the reduction in new financial guaranty business written in 2008 and a decrease in mortgage insurance net premiums written as a result of a decrease in mortgage loan origination volume. Earned premiums increased primarily as a result of the high volume of primary new mortgage insurance written in 2007, the higher persistency rates experienced in 2007 and 2008 and increased refundings in our financial guaranty business. Since we have decided to discontinue, for the foreseeable future, writing new financial guaranty business, written and earned premiums in that business are expected to decrease over time.

Net Investment Income. Net investment income was $65.2 million and $196.3 million, respectively, for the three and nine months ended September 30, 2008 compared to $65.0 million and $188.6 million, respectively, for the corresponding periods of 2007. These increases were mainly due to an increase in invested assets during the first nine months of 2008.

Change in Fair Value of Derivative Instruments. For the three and nine months ended September 30, 2008, the change in fair value of derivative instruments was a net gain of $164.8 million and $928.8 million, respectively, compared to net losses of $615.9 million and $633.8 million, respectively, for the corresponding periods of 2007. Change in fair value of derivative instruments for 2008 reflects the impact of the adoption of SFAS No. 157, which incorporates the market s perception of our non-performance risk in the computation of fair values. The change in fair value of derivative instruments for the three and nine months ended September 30, 2008 and 2007 are detailed as follows:

	Three Months Ended September 30		**Nine Months Ended September 30**	
	2008	**2007**	**2008**	**2007**
Net premiums earned derivatives	$ 18.7	$ 28.0	$ 64.8	$ 99.5
Financial Guaranty credit derivatives	156.9	(255.8)	724.7	(263.2)
NIMS	(35.9)	(366.7)	119.1	(426.3)
Mortgage Insurance domestic and international CDS	40.7	(21.4)	(30.5)	(43.8)
Put options on committed preferred securities (CPS)	(14.4)		57.6	
Other	(1.2)		(6.9)	
Change in fair value of derivative instruments	$ 164.8	$ (615.9)	$ 928.8	$ (633.8)

Net (Losses) Gains on Other Financial Instruments. Net losses on other financial instruments for the three and nine months ended September 30, 2008 were $63.7 million and $126.9 million, respectively, compared to net gains on other financial instruments of $14.8 million and $54.3 million, respectively, for the corresponding periods of 2007. Included in the nine months ended September 30, 2008 was: (1) $21.5 million of gains related to the change in fair value of the NIMS variable interest entities (VIE) debt that was required to be consolidated beginning March 31, 2008; (2) $20.3 million of net realized gains on the sales of hybrid securities in our investment portfolio; $118.0 million of net losses related to changes in the fair value of hybrid securities, primarily convertible bonds and trading securities in our investment portfolio; and (3) $52.2 million of net losses

related to the write-down of other-than-temporarily-impaired available for sale securities, which was partially offset by $16.2 million in realized gains on sales of available for sale securities. Included in the three and nine months ended September 30, 2007 were $10.4 million and $13.9 million of gains related to changes in the fair value of convertible securities and equity securities and a $30.7 million net gain related to the sale of hybrid securities.

Other Income. Other income, which mostly includes income related to contract underwriting services, was $2.8 million and $9.6 million, respectively, for the three and nine months ended September 30, 2008 compared to $4.6 million and $11.5 million, respectively, for the corresponding periods of 2007. The 2008 income reflects the decline in mortgage origination volume.

Provision for Losses. The provision for losses for the three and nine months ended September 30, 2008 was $544.9 million and $1,586.5 million, respectively, compared to $330.5 million and $611.5 million, respectively, for the corresponding periods of 2007. Our mortgage insurance segment experienced a significant increase in claim rates and claims paid in the first nine months of 2008 compared to the same period a year ago, as well as an increase in delinquent loan sizes and a general aging of defaults and pending claims, which require a higher reserve. See Results of Operations Mortgage Insurance Quarter and Nine Months Ended September 30, 2008 Compared to Quarter and Nine Months Ended September 30, 2007 Provision for Losses below. The provision for losses for our financial guaranty segment increased in the first nine months of 2008 to $46.9 million compared to $39.7 million in the first nine months of 2007 due primarily to a deterioration of assumed mortgage exposures and less favorable loss development with respect to our trade credit reinsurance and structured finance business. The 2008 provision for losses includes a higher provision as a result of assumed reinsurance RMBS exposures, while the 2007 provision for losses includes a $50 million reserve for one direct market value transaction that was fully paid in the first quarter of 2008, which was partially offset by a reduction of reserves on the trade credit reinsurance business.

Provision for Premium Deficiency. We reduced our reserve for premium deficiency for the three months ended September 30, 2008 by $252.2 million. For the nine months ended September 30, 2008, the provision for premium deficiency was $135.7 million, compared to $155.2 million for the nine months ended September 30, 2007. We reassess our expectations for premiums, losses and expenses for our businesses each quarter and record or adjust a premium deficiency reserve, if necessary. In the first nine months of 2008, the second-lien premium deficiency reserve decreased by approximately $14.3 million to $181.3 million as a result of the transfer of premium deficiency reserves to loss reserves and premiums earned, as actual losses were incurred and premiums were received, and assumptions of future premiums and losses were updated. In the first nine months of 2008, our first-lien premium deficiency reserve increased by $150.1 million, which resulted from the initial establishment of the reserve of $421.8 million at June 30, 2008, offset by a reduction of reserve primarily due to incurred losses and premiums earned in the third quarter of 2008.

Policy Acquisition Costs. Policy acquisition costs were $20.8 million and $120.6 million, respectively, for the three and nine months ended September 30, 2008 compared to $35.7 million and $88.2 million, respectively, for the corresponding periods of 2007. In our mortgage insurance segment, estimates of expected gross profit, which are driven in part by persistency and loss development for each underwriting year and product type, are used as a basis for amortization and are evaluated regularly. The total periodic amortization recorded to date is adjusted by a charge or credit to our condensed consolidated statements of operations if actual experience or other evidence suggests that earlier estimates should be revised. In the nine months ended September 30, 2008, we accelerated $50.8 million of deferred policy acquisition cost amortization in our mortgage insurance segment related to domestic business written prior to June 30, 2008, in connection with our first-lien premium deficiency reserve.

Other Operating Expenses. Other operating expenses were $80.8 million and $199.8 million, respectively, for the three and nine months ended September 30, 2008, compared to $36.2 million and $151.4 million, respectively, for the corresponding periods of 2007. The increase in other operating expenses in 2008 is mostly due to an increase in severance costs, pension plan termination charges, our reserves for contract underwriting, audit and legal fees, and other outside consulting services. Included in the three and nine month periods of 2007 were $1.3 million and $14.0 million, respectively, of merger related expenses.

Interest Expense. Interest expense was $13.9 million and $40.2 million, respectively, for the three and nine months ended September 30, 2008, compared to $13.4 million and $38.8 million, respectively, for the corresponding periods of 2007. Included in interest expense for the three and nine months ended September 30, 2008 was $2.6 million and $7.2 million, respectively, of interest related to the $200 million that we drew down from our revolving credit facility on August 15, 2007. On January 18, 2008, we terminated the interest rate swaps that we entered into in 2004, which converted the interest rate on our 5.625% Senior Notes due 2013 to a variable rate based on a spread over the London Interbank Offered Rate (LIBOR). The basis adjustment of $11.5 million that was recorded as an increase to the long-term debt carrying value is being amortized into interest expense.

Equity in Net Income (Loss) of Affiliates. Equity in net income of affiliates was $15.8 million and $44.0 million, respectively, for the three and nine months ended September 30, 2008, compared to equity in net loss of affiliates of $448.9 million and $376.7 million, respectively, in the corresponding periods of 2007. Sherman represents the only contribution to equity in net income of affiliates in 2008. Sherman contributed $18.9 million and $74.8 million, respectively, for the three and nine months ended September 30, 2007. Included in equity in net loss of affiliates for the three and nine months ended September 30, 2007 was $467.8 million and $451.4 million, respectively, in losses related to C-BASS. For more information, see Results of Operations Financial Services below.

Income Tax Benefit. We recorded an income tax benefit of $10.3 million and $130.0 million, respectively, for the three and nine months ended September 30, 2008, compared to an income tax benefit of $420.4 million and $372.2 million, respectively, for the corresponding periods of 2007. The tax benefit for the three months ended September 30, 2008, was primarily due to additional tax benefits realized upon completion and filing of our 2007 consolidated federal income tax return. The higher relative tax rate for the nine months ended September 30, 2008, reflects an increase in the percentage of income generated from the tax-advantaged securities compared to the loss generated from operations.

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Results of Operations Mortgage Insurance

Quarter and Nine Months Ended September 30, 2008 Compared to Quarter and Nine Months Ended September 30, 2007

The following table summarizes our mortgage insurance segment s results of operations for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30		**% Change**	**Nine Months Ended September 30**		**% Change**
(In millions)	**2008**	**2007**	**2008 vs. 2007**	**2008**	**2007**	**2008 vs. 2007**
Net loss	$ (47.0)	$ (375.3)	n/m	$ (707.6)	$ (358.8)	97.2%
Net premiums written insurance	188.6	249.5	(24.4)%	598.9	653.4	(8.3)
Net premiums earned insurance	196.2	213.0	(7.9)	605.6	578.8	4.6
Net investment income	38.0	37.4	1.6	115.8	109.3	5.9
Change in fair value of derivative instruments	8.6	(374.0)	n/m	105.5	(419.1)	n/m
Net (losses) gains on other financial instruments	(39.9)	9.3	n/m	(66.2)	39.8	n/m
Other income	2.6	3.8	(31.6)	9.1	9.4	(3.2)
Provision for losses	519.3	278.8	86.3	1,539.6	571.8	169.3
Provision for premium deficiency	(252.2)	155.2	n/m	135.7	155.2	(12.6)
Policy acquisition costs	5.3	24.9	(78.7)	82.5	53.9	53.1
Other operating expenses	43.8	26.6	64.7	126.6	109.2	15.9
Interest expense	6.7	6.8	(1.5)	21.1	20.0	5.5
Income tax benefit	(70.5)	(227.4)	(69.0)	(428.2)	(233.1)	83.7

n/m = not meaningful

Net Loss. Our mortgage insurance segment recorded net losses of $47.0 million and $707.6 million, respectively, for the three and nine months ended September 30, 2008, compared to net losses of $375.3 million and $358.8 million, respectively, for the corresponding periods of 2007. The net loss for the first nine months of 2008 was mainly due to the on-going deterioration in the U.S. housing and mortgage credit markets, which resulted in a significant increase in our provision for losses, a premium deficiency for our first lien domestic mortgage insurance portfolio, and the acceleration of policy acquisition cost amortization in connection with the premium deficiency reserve. Also affecting the net loss in the third quarter and first nine months of 2008 was an increase in net losses on other financial instruments due to the write-down of other-than-temporarily-impaired securities and unrealized losses on convertible securities in our investment portfolio, partially offset by a gain on consolidated VIE debt as a result of the implementation of SFAS No. 157, which incorporates the market s perception of our non-performance risk.

Net Premiums Written and Earned. Net premiums written were $188.6 million and $598.9 million, respectively, for the three and nine months ended September 30, 2008, compared to $249.5 million and $653.4 million, respectively, for the three and nine months ended September 30, 2007. Net premiums earned for the three and nine months ended September 30, 2008 were $196.2 million and $605.6 million, respectively, compared to $213.0 million and $578.8 million, respectively, in the corresponding periods of 2007. Primary new insurance written, which includes both structured and flow business, decreased in 2008 due to the significant decline in structured business written in 2008, as well as a decrease in mortgage loan originations. In addition, we ceased writing new second-lien business in the second half of 2007, which has decreased premiums written and earned related to this product. The increase in premiums earned for the nine months in 2008 compared to 2007 is largely the result of the higher volume of primary new insurance written during 2007 and the higher persistency rates experienced in both of these years.

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The following table provides additional information related to insurance premiums written and earned for the three and nine month periods indicated:

	Three Months Ended		Nine Months Ended	
	September 30 2008	September 30 2007	September 30 2008	September 30 2007
Premiums written (in thousands) (1)				
Primary and Pool Insurance	$ 186,524	$ 235,989	$ 578,770	$ 612,589
Seconds	2,044	4,711	8,430	22,340
International	15	8,821	11,664	18,510
Total premiums written insurance	$ 188,583	$ 249,521	$ 598,864	$ 653,439
Premiums earned (in thousands) (1)				
Primary and Pool Insurance	$ 187,596	$ 200,467	$ 575,017	$ 541,796
Seconds	3,250	7,270	14,378	25,165
International	5,361	5,261	16,173	11,868
Total premiums earned insurance	$ 196,207	$ 212,998	$ 605,568	$ 578,829

(1) Excludes premiums written and earned on credit derivatives. Premiums written on credit derivatives for the three and nine months ended September 30, 2008 were $2.4 million and $16.9 million, respectively, compared to $11.0 million and $46.4 million, respectively, for the corresponding periods of 2007. Premiums earned on credit derivatives for the three and nine months ended September 30, 2008 were $5.0 million and $23.9 million, respectively, compared to $14.1 million and $50.9 million, respectively, for the corresponding periods of 2007. These premiums are now reported within the change in fair value of derivative instruments. In previous periods, these were reported as premiums written and earned in the condensed consolidated statements of operations. This reclassification is the result of an effort by the financial guaranty industry in consultation with the Securities and Exchange Commission (SEC) to provide consistency in disclosure of credit derivative contracts.

Net Investment Income. Net investment income attributable to our mortgage insurance segment for the three and nine months ended September 30, 2008 was $38.0 million and $115.8 million, respectively, compared to $37.4 million and $109.3 million, respectively, for the corresponding periods of 2007. The increase in investment income reflects a slight increase in invested assets during the first nine months of 2008.

Change in Fair Value of Derivative Instruments. The change in the fair value of derivative instruments resulted in gains of $8.6 million and $105.5 million, respectively, for the three and nine months ended September 30, 2008, compared to losses of $374.0 million and $419.1 million, respectively, for the corresponding periods of 2007. The increase in the first nine months of 2008 compared to 2007 was mainly due to a $119.1 million cumulative unrealized gain on NIMS which was primarily attributable to the incorporation of the market s perception of our non-performance risk under SFAS No. 157, as compared to a $426.3 million cumulative unrealized loss on NIMS in 2007.

Net (Losses) Gains on Other Financial Instruments. Our mortgage insurance business had net losses on other financial instruments of $39.9 million and $66.2 million, respectively, for the three and nine months ended September 30, 2008, compared to $9.3 million and $39.8 million of net gains, respectively, for the corresponding periods of 2007. Included in the nine months ended September 30, 2008 were: (1) $21.5 million in gains related to the change in fair value of the NIMS VIE debt that was required to be consolidated beginning March 31, 2008, (2) losses related to changes in the fair value of hybrid securities and trading securities of $99.8 million, which was partially offset by net realized gains on the sale of hybrid securities of approximately $14.8 million, and (3) $18.2 million of losses on investment securities that were other-than-temporarily impaired. Included in the three months ended September 30, 2008 were: (1) losses related to changes in the fair value of hybrid securities and trading securities of $45.7 million, which was partially offset by net realized gains on the sales of hybrid

securities of approximately $0.1 million, and (2) $3.3 million of losses on investment securities that were other-than-temporarily impaired. Included in the three and nine months ended September 30, 2007 were gains related to changes in the fair value of convertible securities and equity securities of $6.3 million and $10.0 million, respectively. Also included in the first nine months of 2007 is a net realized gain of $21.8 million on the sale of hybrid securities.

Other Income. Other income for the three and nine months ended September 30, 2008 was $2.6 million and $9.1 million, respectively, compared to $3.8 million and $9.4 million for the corresponding periods of 2007. Other income mostly includes income related to contract underwriting services, which was slightly less in the first nine months of 2008 as a result of a decrease in contract underwriting volume.

Provision for Losses. The provision for losses for the three and nine month periods ended September 30, 2008 was $519.3 million and $1,539.6 million, respectively, compared to $278.8 million and $571.8 million, respectively, for the corresponding periods of 2007. The increase in 2008 was attributable to increases in defaults and claims paid, the aging of existing defaults, larger loan balances, a higher ratio at which defaults are moving to claim, and increased severity.

Provision for Premium Deficiency. We reduced our reserve for premium deficiency for the three months ended September 30, 2008 by $252.2 million. For the nine months ended September 30, 2008, the provision for premium deficiency was $135.7 million, compared to $155.2 million for the nine months ended September 30, 2007. We reassess our expectations for premiums, losses and expenses for our businesses each quarter and record a premium deficiency reserve, if necessary. In the first nine months of 2008, the second-lien premium deficiency reserve decreased by approximately $14.3 million to $181.3 million as a result of the transfer of premium deficiency reserves to loss reserves and premiums, as actual losses were incurred and premiums received, and assumptions of future premiums and losses were updated. For the nine months ended September 30, 2008, the provision for our first-lien premium deficiency on business originated prior to June 30, 2008, was $150.1 million, consisting of a $421.8 million provision in the second quarter, offset by a $271.7 million reduction in the third quarter as actual incurred losses were transferred to the provision for loss in our statement of operations, and premiums were transferred to earned premiums.

Policy Acquisition Costs. Policy acquisition costs were $5.3 million and $82.5 million, respectively, for the three and nine month periods ended September 30, 2008, compared to $24.9 million and $53.9 million, respectively, for the corresponding periods of 2007. In the nine months ended September 30, 2008, we accelerated $50.8 million of deferred policy acquisition cost amortization as a result of the establishment of a first-lien premium deficiency reserve on our domestic business originated prior to June 30, 2008. During the third quarter and first nine months of 2007, amortization expense was impacted by changes in persistency rates and updates to our loss ratios assumptions. In the third quarter of 2007, we updated our loss ratio assumptions which resulted in an acceleration of amortization expense of approximately $7.8 million.

Other Operating Expenses. Other operating expenses were $43.8 million and $126.6 million, respectively, for the three and nine months ended September 30, 2008, compared to $26.6 million and $109.2 million, respectively, for the corresponding periods of 2007. The increase in other operating expenses in 2008 was primarily due to a $9 million increase in our reserve for contract underwriting and an increase in outside consulting fees. Contract underwriting expenses for the three and nine months ended September 30, 2008, including the impact of reserves for remedies in other operating expenses, were $3.3 million and $24.6 million, respectively, compared to $5.5 million and $16.6 million, respectively, for the corresponding periods of 2007. During the first nine months of 2008, loans underwritten via contract underwriting for flow business accounted for 11.9% of applications, 11.2% of commitments for insurance and 10.1% of insurance certificates issued, compared to 12.4%, 11.6% and 10.1%, respectively, for the first nine months of 2007. Also included in operating expenses for the three and nine months ended September 30, 2007 were $1.1 million and $13.4 million, respectively, of merger related expenses.

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Interest Expense. Interest expense attributable to our mortgage insurance segment for the three and nine months ended September 30, 2008 was $6.7 million and $21.1 million, respectively, compared to $6.8 million and $20.0 million, respectively, for the corresponding periods of 2007. Both periods include interest on our long-term debt and other borrowings that was allocated to the mortgage insurance segment.

Income Tax Benefit. We recorded an income tax benefit for the three and nine months ended September 30, 2008 of $70.5 million and $428.2 million, respectively, compared to $227.4 million and $233.1 million, respectively, for the corresponding periods of 2007. The tax benefit for the three and nine months ended September 30, 2008, is attributable to our pre-tax losses as well as to additional tax benefits realized upon the completion and filing of our 2007 consolidated federal income tax return.

The following tables provide selected information as of and for the periods indicated for our mortgage insurance segment. Certain statistical information included in the following tables is recorded based on information received from lenders and other third parties.

	Three Months Ended					
	September 30 2008		June 30 2008		September 30 2007	
Primary new insurance written (NIW) ($ in millions)						
Flow	$ 7,524	99.8%	$ 9,432	97.9%	$ 12,225	90.8%
Structured	16	0.2%	205	2.1	1,234	9.2
Total Primary	$ 7,540	100.0%	$ 9,637	100.0%	$ 13,459	100.0%
Flow						
Prime	$ 7,405	98.4%	$ 8,743	92.7%	$ 8,448	69.1%
Alt-A	96	1.3%	475	5.0	2,588	21.2
A minus and below	23	0.3%	214	2.3	1,189	9.7
Total Flow	$ 7,524	100.0%	$ 9,432	100.0%	$ 12,225	100.0%
Structured						
Prime	$ 16	100.0%	$ 204	99.5%	$ 967	78.4%
Alt-A			1	0.5	32	2.6
A minus and below					235	19.0
Total Structured	$ 16	100.0%	$ 205	100.0%	$ 1,234	100.0%
Total						
Prime	$ 7,421	98.4%	$ 8,947	92.8%	$ 9,415	69.9%
Alt-A	96	1.3	476	5.0	2,620	19.5
A minus and below	23	0.3	214	2.2	1,424	10.6
Total Primary	$ 7,540	100.0%	$ 9,637	100.0%	$ 13,459	100.0%

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	Nine Months Ended			
	September 30 2008		September 30 2007	
Primary new insurance written (NIW) ($ in millions)				
Flow	$ 26,240	95.5%	$ 29,913	68.7%
Structured	1,234	4.5	13,623	31.3
Total Primary	$ 27,474	100.0%	$ 43,536	100.0%
Flow				
Prime	$ 24,356	92.8%	$ 21,171	70.8%
Alt-A	1,154	4.4	6,015	20.1
A minus and below	730	2.8	2,727	9.1
Total Flow	$ 26,240	100.0%	$ 29,913	100.0%
Structured				
Prime	$ 1,232	99.8%	$ 1,641	12.0%
Alt-A	2	0.2	11,137	81.8
A minus and below			845	6.2
Total Structured	$ 1,234	100.0%	$ 13,623	100.0%
Total				
Prime	$ 25,588	93.1%	$ 22,812	52.4%
Alt-A	1,156	4.2	17,152	39.4
A minus and below	730	2.7	3,572	8.2
Total Primary	$ 27,474	100.0%	$ 43,536	100.0%

	Three Months Ended					
	September 30 2008		June 30 2008		September 30 2007	
Total Primary New Insurance Written by FICO (a) Score ($ in millions)						
Flow						
<=619	$ 7	0.1%	$ 104	1.1%	$ 703	5.7%
620-679	773	10.3	1,512	16.0	3,506	28.7
680-739	2,662	35.4	3,452	36.6	4,644	38.0
>=740	4,082	54.2	4,364	46.3	3,372	27.6
Total Flow	$ 7,524	100.0%	$ 9,432	100.0%	$ 12,225	100.0%
Structured						
<=619	$		$		$ 129	10.5%
620-679			7	3.4%	296	24.0
680-739	4	25.0%	64	31.2	331	26.8
>=740	12	75.0	134	65.4	478	38.7
Total Structured	$ 16	100.0%	$ 205	100.0%	$ 1,234	100.0%
Total						
<=619	$ 7	0.1%	$ 104	1.1%	$ 832	6.2%

620-679	773	10.3	1,519	15.8	3,802	28.2
680-739	2,666	35.3	3,516	36.4	4,975	37.0
>=740	4,094	54.3	4,498	46.7	3,850	28.6
Total Primary	$ 7,540	100.0%	$ 9,637	100.0%	$ 13,459	100.0%

(a) Fair Isaac and Company (FICO) credit scoring model.

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	Three Months Ended					
	September 30 2008		June 30 2008		September 30 2007	
Primary New Insurance and Risk Written by Category						
Percentage of primary new insurance written						
Refinances		20%		35%		27%
95.01% LTV (b) and above		3%		12%		31%
ARMs						
Less than 5 years		1%				4%
5 years and longer		10%		10%		13%
Primary risk written ($ in millions)						
Flow	$ 1,770	99.9%	$ 2,231	97.9%	$ 3,196	91.7%
Structured	2	0.1	48	2.1	291	8.3
Total	$ 1,772	100.0%	$ 2,279	100.0%	$ 3,487	100.0%

(b) Loan-to-value ratios: The ratio of the original loan amount to the original value of the property.

	Three Months Ended		
	September 30 2008	June 30 2008	September 30 2007
Pool and other Risk Written			
Pool risk written (in millions)	$ 1	$ 28	$ 42
Other risk written (in millions)			
Seconds			
1st loss	$	$	$ 3
International			
1st loss-Hong Kong primary mortgage insurance			46
Reinsurance	2	23	15
Total other risk written	$ 2	$ 23	$ 64

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	Nine Months Ended			
	September 30 2008		September 30 2007	
Total Primary New Insurance Written by FICO Score				
Flow				
<=619	$ 376	1.4%	$ 1,830	6.1%
620-679	4,223	16.1	9,158	30.6
680-739	9,729	37.1	10,977	36.7
>=740	11,912	45.4	7,948	26.6
Total Flow	$ 26,240	100.0%	$ 29,913	100.0%
Structured				
<=619	$		$ 538	4.0%
620-679	17	1.4%	3,762	27.6
680-739	437	35.4	6,160	45.2
>=740	780	63.2	3,163	23.2
Total Structured	$ 1,234	100.0%	$ 13,623	100.0%
Total				
<=619	$ 376	1.4%	$ 2,368	5.4%
620-679	4,240	15.4	12,920	29.7
680-739	10,166	37.0	17,137	39.4
>=740	12,692	46.2	11,111	25.5
Total Primary	$ 27,474	100.0%	$ 43,536	100.0%
Percentage of primary new insurance written				
Refinances	33%		40%	
95.01% LTV and above	13%		22%	
ARMS				
Less than 5 years	1%		17%	
5 years and longer	9%		9%	
Primary risk written ($ in millions)				
Flow	$ 6,317	95.2%	$ 7,641	88.2%
Structured	316	4.8	1,022	11.8
Total	$ 6,633	100.0%	$ 8,663	100.0%

Most of the pool risk we have written in the last three years was written in a second-loss position. In these transactions, we will only pay claims if pool losses are greater than any applicable deductible.

	Nine Months Ended	
	September 30 2008	September 30 2007
Pool and Other Risk Written		
Pool risk written (in millions)	$ 60	$ 227
Other risk written (in millions)		
Seconds		
1st loss	$	$ 9
2nd loss		21
NIMS		377
International		

1st loss-Hong Kong primary mortgage insurance	51	96
Reinsurance	44	49
Total other risk written	$ 95	$ 552

	September 30 2008		June 30 2008		September 30 2007	
Primary insurance in force ($ in millions)						
Flow	$ 119,593	77.5%	$ 115,425	76.3%	$ 98,985	73.3%
Structured	34,699	22.5	35,754	23.7	36,030	26.7
Total Primary	$ 154,292	100.0%	$ 151,179	100.0%	$ 135,015	100.0%
Prime	$ 109,432	70.9%	$ 105,049	69.5%	$ 86,530	64.1%
Alt-A	33,404	21.7	34,239	22.6	36,266	26.9
A minus and below	11,456	7.4	11,891	7.9	12,219	9.0
Total Primary	$ 154,292	100.0%	$ 151,179	100.0%	$ 135,015	100.0%
Primary risk in force ($ in millions)						
Flow	$ 29,968	86.4%	$ 29,003	85.6%	$ 24,856	84.5%
Structured	4,701	13.6	4,879	14.4	4,545	15.5
Total Primary	$ 34,669	100.0%	$ 33,882	100.0%	$ 29,401	100.0%
Flow						
Prime	$ 24,242	80.9%	$ 23,125	79.7%	$ 19,117	76.9%
Alt-A	3,674	12.3	3,759	13.0	3,799	15.3
A minus and below	2,052	6.8	2,119	7.3	1,940	7.8
Total Flow	$ 29,968	100.0%	$ 29,003	100.0%	$ 24,856	100.0%
Structured						
Prime	$ 2,451	52.1%	$ 2,537	52.0%	$ 1,791	39.4%
Alt-A	1,451	30.9	1,499	30.7	1,668	36.7
A minus and below	799	17.0	843	17.3	1,086	23.9
Total Structured	$ 4,701	100.0%	$ 4,879	100.0%	$ 4,545	100.0%
Total						
Prime	$ 26,693	77.0%	$ 25,662	75.7%	$ 20,908	71.1%
Alt-A	5,125	14.8	5,258	15.5	5,467	18.6
A minus and below	2,851	8.2	2,962	8.8	3,026	10.3
Total Primary	$ 34,669	100.0%	$ 33,882	100.0%	$ 29,401	100.0%

Direct primary insurance in force was $154.3 billion at September 30, 2008, compared to $151.2 billion at June 30, 2008 and $135.0 billion at September 30, 2007. At September 30, 2008, non-prime insurance in force was $44.9 billion or 29.1% of total primary mortgage insurance in force, compared to $48.5 billion or 35.9% at September 30, 2007. Of the $44.9 billion of non-prime insurance in force at September 30, 2008, $33.4 billion or 74.5% was Alt-A.

	September 30 2008		June 30 2008		September 30 2007	
Total Primary Risk in Force by FICO Score ($ in millions)						
Flow						
<=619	$ 1,550	5.2%	$ 1,607	5.5%	$ 1,573	6.3%
620-679	8,318	27.8	8,365	28.9	7,632	30.7
680-739	11,101	37.0	10,744	37.0	9,122	36.7
>=740	8,999	30.0	8,287	28.6	6,529	26.3
Total Flow	$ 29,968	100.0%	$ 29,003	100.0%	$ 24,856	100.0%
Structured						
<=619	$ 740	15.7%	$ 784	16.1%	$ 1,025	22.6%
620-679	1,255	26.7	1,312	26.9	1,515	33.3
680-739	1,452	30.9	1,492	30.5	1,282	28.2
>=740	1,254	26.7	1,291	26.5	723	15.9
Total Structured	$ 4,701	100.0%	$ 4,879	100.0%	$ 4,545	100.0%
Total						
<=619	$ 2,290	6.6%	$ 2,391	7.0%	$ 2,598	8.8%
620-679	9,573	27.6	9,677	28.6	9,147	31.1
680-739	12,553	36.2	12,236	36.1	10,404	35.4
>=740	10,253	29.6	9,578	28.3	7,252	24.7
Total Primary	$ 34,669	100.0%	$ 33,882	100.0%	$ 29,401	100.0%
Percentage of primary risk in force						
Refinances	31%		31%		32%	
95.01% LTV and above	23%		24%		22%	
ARMs						
Less than 5 years	9%		10%		14%	
5 years and longer	9%		9%		9%	
Total primary risk in force by LTV ($ in millions)						
95.01% and above	$ 7,962	23.0%	$ 8,076	23.8%	$ 6,543	22.3%
90.01% to 95.00%	11,003	31.7	10,546	31.1	8,929	30.4
85.01% to 90.00%	12,045	34.7	11,576	34.2	10,040	34.1
85.00% and below	3,659	10.6	3,684	10.9	3,889	13.2
Total Primary	$ 34,669	100.0%	$ 33,882	100.0%	$ 29,401	100.0%
Total primary risk in force by policy year ($ in millions)						
2004 and prior	$ 7,598	22.0%	$ 7,960	23.5%	$ 9,399	31.9%
2005	4,385	12.6	4,575	13.5	5,364	18.3
2006	5,342	15.4	5,516	16.3	6,246	21.3
2007	10,896	31.4	11,069	32.7	8,392	28.5
2008	6,448	18.6	4,762	14.0		

Total Primary	$ 34,669	100.0%	$ 33,882	100.0%	$ 29,401	100.0%

	September 30 2008		June 30 2008		September 30 2007	
Pool risk in force ($ in millions)						
Prime	$ 2,096	70.7%	$ 2,119	70.8%	$ 2,088	69.9%
Alt-A	290	9.8	291	9.7	294	9.8
A minus and below	577	19.5	584	19.5	605	20.3
Total pool risk in force	$ 2,963	100.0%	$ 2,994	100.0%	$ 2,987	100.0%
Total pool risk in force by policy year ($ in millions)						
2004 and prior	$ 1,821	61.5%	$ 1,848	61.7%	$ 1,893	63.4%
2005	586	19.8	589	19.7	598	20.0
2006	255	8.6	258	8.6	269	9.0
2007	241	8.1	243	8.1	227	7.6
2008	60	2.0	56	1.9		
Total Pool	$ 2,963	100.0%	$ 2,994	100.0%	$ 2,987	100.0%

	September 30 2008	June 30 2008	September 30 2007
Other risk in force (in millions)			
Seconds			
1st loss	$ 289	$ 312	$ 436
2nd loss	407	460	571
NIMS	456	485	712
International			
1st loss-Hong Kong primary mortgage insurance	442	469	432
Reinsurance	139	151	85
Credit default swaps (1)	7,567	8,619	8,108
Other			
Domestic credit default swaps	162	206	212
Total other risk in force	$ 9,462	$ 10,702	$ 10,556

(1) Due to the foreign currency shifts between the dollar and the Euro, the current U.S. dollar-denominated risk on our international credit default swaps will fluctuate.

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	September 30 2008	June 30 2008	September 30 2007
Default Statistics			
Primary Insurance:			
Flow			
Prime			
Number of insured loans	619,035	602,571	542,819
Number of loans in default	33,330	26,604	16,908
Percentage of total loans in default	5.38%	4.42%	3.11%
Alt-A			
Number of insured loans	70,814	72,715	74,927
Number of loans in default	13,853	11,702	6,029
Percentage of total loans in default	19.56%	16.09%	8.05%
A minus and below			
Number of insured loans	60,946	62,874	60,826
Number of loans in default	13,436	11,637	8,638
Percentage of total loans in default	22.05%	18.51%	14.20%
Total Flow			
Number of insured loans	750,795	738,160	678,572
Number of loans in default	60,619	49,943	31,575
Percentage of total loans in default	8.07%	6.77%	4.65%
Structured			
Prime			
Number of insured loans	68,744	70,857	59,163
Number of loans in default	5,900	5,447	4,072
Percentage of total loans in default	8.58%	7.69%	