RADIAN GROUP INC
Form 10-K
March 10, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 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 **(State or other jurisdiction of** **incorporation or organization)**	**23-2691170** **(I.R.S. Employer** **Identification No.)**
1601 Market Street, Philadelphia, PA **(Address of principal executive offices)**	**19103** **(Zip Code)**

(215) 231-1000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.001 par value per share	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

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

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates, computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter. As of June 30, 2008, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $116,587,797 based on the closing sale price as reported on the New York Stock Exchange. Excluded from this amount is the value of all shares beneficially owned by executive officers and directors of the registrant. These exclusions should not be deemed to constitute a representation or acknowledgement that any such individual is, in fact, an affiliate of the registrant or that there are not other persons or entities who may be deemed to be affiliates of the registrant.

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date: 81,420,871 shares of common stock, $.001 par value per share, outstanding on March 4, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1980).

	Form 10-K Reference Document
Definitive Proxy Statement for the Registrant s 2009 Annual Meeting of Stockholders	Part III (Items 10 through 14)

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Forward Looking Statements Safe Harbor Provisions

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

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

further 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 internally sourced capital plan, (which depends, in part, on the performance of our financial guaranty portfolio) and if necessary, to obtain additional capital to support new business writings in our mortgage insurance business and our long-term liquidity needs and to protect our credit ratings and the financial strength ratings of Radian Guaranty Inc., our principal mortgage insurance subsidiary, from further downgrades;

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

our ability to maintain adequate risk-to-capital ratios and surplus requirements in our mortgage insurance business in light of 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 of 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 continue to decline;

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changes in persistency rates of our mortgage insurance policies;

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

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

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

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

the application of existing federal or state consumer, lending, insurance, securities and other applicable laws and regulations, or changes in these laws and regulations or the way they are interpreted; including, without limitation: (i) the outcome of existing investigations or the possibility of private lawsuits or other formal investigations by state insurance departments and state attorneys general alleging that services offered by the mortgage insurance industry, such as captive reinsurance, pool insurance and contract underwriting, are violative of the Real Estate Settlement Procedures Act and/or similar state regulations, (ii) legislative and regulatory changes affecting demand for private mortgage 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 our tax- and expense-sharing arrangements with our subsidiaries; and

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 this report. 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

Item 1. Business.

I. General

We are a credit enhancement company with a primary strategic focus on domestic, first-lien residential mortgage insurance.

We have three business segments mortgage insurance, financial guaranty and financial services:

- Our mortgage insurance business provides credit protection for mortgage lenders and other financial services companies on residential mortgage assets.

- Our financial guaranty business, which is not currently writing any new business, has provided insurance and reinsurance of municipal bonds, structured finance transactions and other credit-based risks, and has provided credit protection on various asset classes through financial guarantees and credit default swaps (CDS).

- Our financial services business consists mainly of our ownership interest in Sherman Financial Group LLC (Sherman) a consumer asset and servicing firm specializing in credit card and bankruptcy-plan consumer assets.

A summary of financial information for each of our business segments and a discussion of net premiums earned attributable to our domestic and international operations for each of the last three fiscal years is included in Segment Reporting in Note 3 of Notes to Consolidated Financial Statements.

Background. We began conducting business as CMAC Investment Corporation, a Delaware corporation, following our spin-off from Commonwealth Land Title Insurance Company through an initial public offering on November 6, 1992. On June 9, 1999, we merged with Amerin Corporation, an Illinois based mortgage insurance company, and were renamed Radian Group Inc. (Radian Group). On February 28, 2001, we entered the financial guaranty insurance and financial services businesses through our acquisition of Enhance Financial Services Group Inc. (EFSG), a New York-based holding company that owned our principal financial guaranty subsidiaries, Radian Asset Assurance Inc. (Radian Asset Assurance) and Radian Asset Assurance Limited (RAAL) and our interests in two financial services companies Sherman and Credit-Based Asset Servicing and Securitization LLC (C-BASS), a mortgage investment and servicing company that specialized in the credit risk of subprime, single-family residential mortgages. In the third quarter of 2008, we decided to discontinue, for the foreseeable future, writing any new financial guaranty business, including accepting new financial guaranty reinsurance, other than as may be necessary to commute, restructure, hedge or otherwise mitigate losses or reduce exposure in our existing financial guaranty portfolio. Our principal executive offices are located at 1601 Market Street, Philadelphia, Pennsylvania 19103, and our telephone number is (215) 231-1000.

Additional Information. We maintain a website with the address www.radian.biz. We are not including or incorporating by reference the information contained on our website into this report. We make available on our website, free of charge and as soon as reasonably practicable after we file with, or furnish to, the Securities and Exchange Commission (SEC), copies of our most recently filed Annual Report on Form 10-K, all Quarterly Reports on Form 10-Q and all Current Reports on Form 8-K, including all amendments to those reports. In addition, copies of our guidelines of corporate governance, code of business conduct and ethics (which includes the code of ethics applicable to our chief executive officer, principal financial officer and principal accounting officer) and the governing charters for each committee of our board of directors are available free of charge on our website, as well as in print to any stockholder upon request.

A. Mortgage Insurance Business (*General*)

Our mortgage insurance business 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 limited countries outside the U.S. We provide these products and services mainly

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through our wholly-owned subsidiaries, Radian Guaranty Inc. (Radian Guaranty), Radian Insurance Inc. (Radian Insurance) and Amerin Guaranty Corporation (Amerin Guaranty). Of these subsidiaries, only Radian Guaranty is currently originating a significant amount of new business.

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 together as Government Sponsored Enterprises or GSEs.

Our mortgage insurance segment, through Radian Guaranty, offers private mortgage insurance coverage on first-lien residential mortgages (first-lien). We have used Radian Insurance to provide credit enhancement for mortgage-related capital market transactions and to write credit insurance on mortgage-related assets such as international insurance transactions. We also insured net interest margin securities (NIMS) and second-lien mortgages (second-lien) through Radian Insurance and second-lien in Amerin Guaranty, although we have discontinued writing new insurance for these and other products written in the capital markets. We refer to the risk associated with products other than first-lien as non-traditional or other risk in force. In 2008, we wrote $113 million of other risk in force, compared to $604 million in 2007. At December 31, 2008, our other risk in force was 11.9% of our total mortgage insurance risk in force.

Premiums written and earned by our mortgage insurance segment for the last three fiscal years were as follows:

	Year Ended December 31		
	2008	2007	2006
		(In thousands)	
Net premiums written insurance (1)			
Primary and Pool Insurance	$ 759,943	$ 835,961	$ 723,213
Second-lien	11,458	27,236	57,935
International	15,831	35,306	20,375
Net premiums written insurance	$ 787,232	$ 898,503	$ 801,523
Net premiums earned insurance (1)			
Primary and Pool Insurance	$ 768,723	$ 730,966	$ 715,136
Second-lien	18,727	32,744	52,588
International	21,331	15,549	7,028
Net premiums earned insurance	$ 808,781	$ 779,259	$ 774,752

(1) Excludes premiums written and earned on credit derivatives. These premiums are reported within the change in fair value of derivative instruments. Premiums written on credit derivatives for the year ended December 31, 2008 were $18.7 million, compared to $56.6 million and $47.6 million, for 2007 and 2006, respectively. Premiums earned on credit derivatives for the year ended December 31, 2008 were $26.1 million, compared to $64.3 million and $37.3 million, for 2007 and 2006, respectively.

1. Traditional Types of Coverage (General Mortgage Insurance)

Primary Mortgage Insurance. Primary mortgage insurance provides protection against mortgage defaults on prime and non-prime mortgages (non-prime mortgages include Alternative-A (Alt-A), A minus and B/C mortgages, each of which are discussed below under Risk in Force/Net Par Outstanding Mortgage Insurance Lender and Mortgage Characteristics) at a specified coverage percentage. When there is a claim, the coverage percentage is applied to the claim amount which consists of the unpaid loan principal, plus past due interest and certain expenses associated with the default to determine our maximum liability. We provide primary mortgage insurance on a flow basis (which is loan-by-loan) and we have also provided primary mortgage insurance on a structured basis (in which we insure a group of individual loans).

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Some of our structured business has been written in a second-to-pay or second-loss position, meaning that we are not required to make a payment until a certain amount of losses have already been recognized. See Types of Transactions below.

In 2008, we wrote $32.5 billion of primary mortgage insurance, of which 96.2% was originated on a flow basis and 3.8% was originated on a structured basis, compared to $57.1 billion of primary mortgage insurance written in 2007, of which 70.6% was originated on a flow basis and 29.4% was originated on a structured basis. Primary insurance on first-lien mortgages made up 92.2% of our total first-lien mortgage insurance risk in force at December 31, 2008.

Pool Insurance. We offer pool insurance on a limited basis. Pool insurance differs from primary insurance in that our maximum liability is not limited to a specific coverage percentage on each individual mortgage. Instead, an aggregate exposure limit, or stop loss, generally between 1% and 10%, is applied to the initial aggregate loan balance on a group or pool of mortgages. In addition to a stop loss, many pool policies are written in a second-loss position. We believe the stop loss and second-loss features are important in limiting our exposure on a specified pool.

We write most of our pool insurance in the form of credit enhancement on residential mortgage loans underlying residential mortgage-backed securities, whole loan sales and other structured transactions. An insured pool of mortgages may contain mortgages that are already covered by primary mortgage insurance, and, as such, the pool insurance is secondary to any primary mortgage insurance that exists on mortgages within the pool. Generally, the mortgages we insure with pool insurance are similar to primary insured mortgages.

In 2008, we wrote $60 million of pool insurance risk, compared to $261 million of pool insurance risk written in 2007. Pool insurance on first-lien mortgages made up approximately 7.8% of our total first-lien mortgage insurance risk in force at December 31, 2008.

Modified Pool Insurance. We also write modified pool insurance, which differs from standard pool insurance in that it includes an exposure limit on each individual loan as well as a stop loss feature for the entire pool of loans. Modified pool insurance and the related risk in force is included in our primary mortgage insurance.

2. Types of Transactions (General Mortgage Insurance)

Our mortgage insurance business has provided credit enhancement mainly through two forms of transactions. We write mortgage insurance on an individual loan basis, which is commonly referred to as flow business, and insure multiple mortgages in a single transaction, which is commonly referred to as structured business. In flow transactions, mortgages typically are insured as they are originated, while in structured deals, we typically provide insurance on mortgages after they have been originated and closed. For 2008, our mortgage insurance business wrote $31.3 billion of flow business and $1.2 billion in structured transactions, compared to $40.3 billion of flow business and $16.8 billion in structured transactions in 2007.

In structured mortgage insurance transactions, we typically insure the individual mortgages included in a structured portfolio up to specified levels of coverage. Most of our structured mortgage insurance transactions involve non-prime mortgages and mortgages with higher than average balances. A single structured mortgage insurance transaction may include primary insurance or pool insurance, and many structured transactions have both primary and pool insured mortgages.

In the past, we also have written insurance on mortgage-related assets, such as residential mortgage-backed securities (RMBS), in structured transactions. In these transactions, similar to our financial guaranty insurance business, we insured the timely payment of principal and interest to the holders of debt securities, the payment of which is backed by a pool of residential mortgages. Unlike our traditional flow and structured transactions, in our residential mortgage-backed securities transactions, we do not insure the payment of the individual loans in the

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pool, but insure that aggregate payments on the pool of loans will be sufficient to meet the principal and interest payment obligations to the holders of the debt securities. Some structured transactions include a risk-sharing component under which the insured or a third-party assumes a first-loss position or shares in losses in some other manner. Given market conditions, we stopped originating this type of business in 2007.

3. Non-Traditional Forms of Credit Enhancement (General Mortgage Insurance)

In addition to traditional mortgage insurance, in the past, we provided other forms of credit enhancement on residential mortgage assets. Although we do not anticipate writing this type of business again in the future (other than possibly international mortgage insurance as discussed below), we maintain a sizeable insured portfolio involving these products.

Second-Lien Mortgages. In addition to insuring first-lien mortgages, we also provided primary or modified pool insurance on second-lien mortgages. Beginning in 2004, we began limiting our participation in these transactions to situations (1) where there was a loss deductible or other first-loss protection that preceded our loss exposure or (2) where a lender otherwise was required to share in a significant portion of any losses. Despite these measures, our second-lien business was largely susceptible to the disruption in the housing market and the subprime mortgage market that began in 2007, and we significantly reduced the amount of our new second-lien business written in 2007. We did not write any new second-lien business in 2008. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview of Business Results Mortgage Insurance Discontinued Non-Traditional Products Second-Lien Mortgages below for information regarding our recent loss experience and total loss expectations with respect to second-lien mortgages.

Credit Enhancement on Net Interest Margin Securities. In the past, we provided credit enhancement on NIMS bonds. A NIMS bond represents the securitization of a portion of the excess cash flow and prepayment penalties from a mortgage-backed security comprised mostly of subprime mortgages. The majority of this excess cash flow consists of the spread between the interest rate on the mortgage-backed security and the interest generated from the underlying mortgage collateral. Historically, issuers of mortgage-backed securities would have earned this excess interest over time as the collateral aged, but market efficiencies enabled these issuers to sell a portion of their residual interests to investors in the form of NIMS bonds. Typically, the issuer retained a significant portion of the residual interests, which was subordinated to the NIMS bond in a first-loss position, so that the issuer would suffer losses associated with any shortfalls in residual cash flows before the NIMS bond experienced any losses.

On the NIMS bonds for which we have provided credit protection, our policy covers any principal and interest shortfalls on the insured bonds. For certain deals, we only insured a portion of the NIMS bond that was issued. The NIMS transactions that we have insured were typically rated BBB or BB at inception based on the amount of subordination and other factors, although the poor performance of the bonds has led to significant downgrades. As of December 31, 2008, we had $438 million of risk in force associated with NIMS in 34 deals. The average remaining term of our existing NIMS transactions is approximately three years.

At December 31, 2008, our risk in force related to NIMS had decreased by approximately $166 million from December 31, 2007, reflecting both normal paydowns as well as our purchase of some of the NIMS bonds that we insure. Beginning in the fourth quarter of 2007, as a risk mitigation initiative, we began purchasing, at a discount to par, some of our insured NIMS bonds, thereby contributing to the reduction in our overall risk on NIMS. The NIMS purchased are accounted for as derivative assets and are recorded at fair value in accordance with Statement of Financial Accounting Standards (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 on the guarantee associated with the purchased NIMS is eliminated. The difference between the amount we pay for the NIMS and the sum of the fair value of the NIMS and the eliminated liability represents the net impact to earnings. The overall net impact to our financial statements as a result of these purchases has been immaterial.

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NIMS are a relatively unproven product with volatile performance history, particularly in the current declining housing market. Like second-liens, NIMS bonds have largely been susceptible to the disruption in the housing market and the subprime mortgage market during 2007 and 2008. We stopped writing insurance on NIMS bonds during the second quarter of 2007. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview of Business Results Mortgage Insurance Discontinued Non-Traditional Products NIMS below for information regarding our total loss expectations with respect to NIMS.

Domestic CDSs. In our mortgage insurance business, we sold protection on residential mortgage-backed securities through CDSs. A CDS is an agreement to pay our counterparty should an underlying security or the issuer of such security suffer a specified credit event, such as nonpayment, downgrade or a reduction of the principal of the security as a result of defaults in the underlying collateral. A CDS operates much like a financial guaranty insurance policy in that our obligation to pay is absolute. Unlike with most of our non-derivative mortgage insurance and financial guaranty products, however, our ability to engage in loss mitigation is generally limited. Further, in a CDS structure, there is no requirement that our counterparty hold the security for which credit protection is provided. We stopped writing this type of protection in our mortgage insurance business in 2006. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview of Business Results Mortgage Insurance Discontinued Non-Traditional Products Credit Default Swaps below for information regarding our loss expectations with respect to credit default swaps.

International Mortgage Insurance Operations. Through Radian Insurance, we wrote (i) credit protection in the form of CDSs, (ii) traditional mortgage insurance with Standard Chartered Bank in Hong Kong, and (iii) several mortgage reinsurance transactions in Australia. We terminated one large CDS transaction (representing approximately $4.0 billion of notional value) in the fourth quarter of 2008. Our exposure to international mortgage insurance CDS at December 31, 2008 consists of two CDSs referencing RMBS bonds related to mortgage loans in Germany and the Netherlands. The first CDS contains prime, low loan to value or LTV mortgages originated in Germany. Our exposure to this transaction, which is rated AAA, was $3.3 billion as of December 31, 2008 with remaining subordination of approximately $247 million. The second transaction contains prime, low LTV mortgages originated in the Netherlands. Our exposure to this transaction was $125 million as of December 31, 2008 with remaining subordination of $16 million. We have insured several tranches in the Netherlands transaction which are rated between BBB and AAA, with over half of our exposure in the AAA category. Both of these transactions are performing well and we currently do not expect to pay claims on either of these transactions.

Ratings downgrades of Radian Insurance have significantly reduced our ability 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 for new business 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.

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4. Premium Rates (General Mortgage Insurance)

We cannot change our premium rates after we issue coverage. Accordingly, we determine premium rates in our mortgage insurance business on a risk-adjusted basis that includes borrower, loan and property characteristics. We use proprietary default and prepayment models to project the premiums we should charge, the losses and expenses we should expect to incur and the capital we need to hold in support of our risk. We establish pricing in an amount that we expect will allow a reasonable return on allocated capital.

Premiums for our mortgage insurance may be paid by the lender, which will in turn charge a higher interest rate to the borrower, or directly by the borrower. We price our borrower-paid flow business based on rates that we have filed with the various state insurance departments. We generally price our structured business and some lender-paid business based on the specific characteristics of the insured portfolio, which can vary significantly from portfolio to portfolio depending on a variety of factors, including the quality of the underlying loans, the credit history of the borrowers, the amount of coverage required and the amount, if any, of credit protection or subordination in front of our risk exposure.

Premium rates for our pool insurance business are generally lower than primary mortgage insurance rates due to the aggregate stop loss. As a result of these lower premium rates, the lack of exposure limits on individual loans, and the greater concentration of risk in force associated with much of our pool insurance, the rating agency capital requirements per dollar of risk for this product are generally more restrictive than for primary insurance.

5. Underwriting (General Mortgage Insurance)

Delegated Underwriting. We have a delegated underwriting program with a number of our customers. Our delegated underwriting program enables us to meet lenders demands for immediate insurance coverage by having us commit to insure loans that meet agreed-upon underwriting guidelines. Our delegated underwriting program currently involves only lenders that are approved by our risk management group, and we routinely audit loans submitted under this program. Once we accept a lender into our delegated underwriting program, however, we generally insure all loans submitted to us by that lender even if the lender has, without our knowledge, not followed our specified underwriting guidelines. A lender could commit us to insure a number of loans with unacceptable risk profiles before we discover the problem and terminate that lender s delegated underwriting authority. We mitigate this risk by screening for compliance with our underwriting guidelines and through periodic, on-site reviews of selected delegated lenders. As of December 31, 2008, approximately 49% of our total first-lien mortgage insurance in force had been originated on a delegated basis, compared to 43% as of December 31, 2007.

Contract Underwriting. In our mortgage insurance business, we also utilize our underwriting skills to provide an outsourced underwriting service to its customers known as contract underwriting. For a fee, we underwrite our customers loan files for secondary market compliance (*i.e.*, for sale to GSEs), while concurrently assessing the file for mortgage insurance, if applicable. Contract underwriting continues to be a popular service to our mortgage insurance customers. During 2008, loans underwritten via contract underwriting accounted for 12.4% of applications, 11.5% of commitments for insurance and 10.7% of insurance certificates issued for our flow business.

We give recourse to our customers on loans that we underwrite for compliance. Typically, we agree that if we make a material error in underwriting a loan, we will provide a remedy to the customer by purchasing or placing additional mortgage insurance on the loan, or by indemnifying the customer against loss. Providing these remedies means we assume some credit risk and interest-rate risk if an error is found during the limited remedy period, which may be up to seven years, but typically is only two years. Rising mortgage interest rates or an economic downturn may expose our mortgage insurance business to an increase in such costs. During 2008, we processed requests for remedies on less than 1% of the loans underwritten and sold a number of loans previously acquired as part of the remedy process. We expect the request for remedies may increase in 2009 due to the increase in delinquent loans and mortgage foreclosures throughout the mortgage industry. We closely monitor this risk and negotiate our underwriting fee structure and recourse agreements on a client-by-client basis. We also routinely audit the performance of our contract underwriters to ensure that customers receive quality underwriting services.

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B. Financial Guaranty Business (*General*)

Our financial guaranty business has mainly provided direct insurance and reinsurance on credit-based risks through Radian Asset Assurance, a wholly-owned subsidiary of Radian Guaranty, and through Radian Asset Assurance s wholly-owned subsidiary, 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. Financial guaranty insurance may be issued at the inception of an insured obligation or may be issued for the benefit of a holder of an obligation in the secondary market. Historically, financial guaranty insurance has been used to lower an issuer s cost of borrowing when the insurance premium is less than the value of the spread (commonly referred to as the credit spread) between the market yield required to be paid on the insured obligation (carrying the credit rating of the insurer) and the market yield required to be paid on the obligation if sold on the basis of its uninsured credit rating. Financial guaranty insurance also has been used to increase the marketability of obligations issued by infrequent or unknown issuers and/or obligations with complex structures. Until recently, investors generally have benefited from financial guaranty insurance through increased liquidity in the secondary market, reduced exposure to price volatility caused by changes in the credit quality of the underlying insured issue, and added protection against loss in the event of default on the insured obligation. Recent market developments, including ratings downgrades of most financial guaranty insurance companies (including our own), have significantly reduced the perceived benefits of financial guaranty insurance.

We provide financial guaranty credit protection either through the issuance of a financial guaranty insurance policy or through CDSs. Either form of credit enhancement can provide the purchaser of such credit protection with a guaranty of the timely payment of interest and scheduled principal when due on a covered financial obligation. By providing credit default swaps, we have been able to participate in transactions with superior collateral quality involving asset classes (such as corporate collateralized debt obligations (CDOs)) that may not have been available to us through the issuance of a traditional financial guaranty insurance policy. Either form of credit enhancement requires substantially identical underwriting and surveillance skills.

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, for enterprises such as airports, public and private higher education and health care facilities, and for project finance and private finance initiative assets in sectors such as schools, healthcare and infrastructure projects. The issuers of our insured public finance obligations were generally rated investment-grade at the time we issued our insurance policy, without the benefit of our insurance;

Structured Finance Insurance of structured finance obligations, including CDOs and asset-backed securities (ABS), consisting of funded and non-funded (referred to herein as synthetic) executions that are payable from or tied to the performance of a specific pool of assets or covered reference entities. Examples of the pools of assets that underlie structured finance obligations include corporate loans, bonds or other borrowed money, residential and commercial mortgages, diversified payment rights, a variety of consumer loans, equipment receivables, real and personal property leases or a combination of asset classes or securities backed by one or more of these pools of assets. We have also guaranteed excess clearing losses of securities exchange clearinghouses. The structured finance obligations we insure were generally rated investment-grade at the time we issued our insurance policy, without the benefit of our insurance; and

Reinsurance Reinsurance of domestic and international public finance obligations, including those issued by sovereign and sub-sovereign entities, and structured finance obligations.

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In October 2005, we exited the trade credit reinsurance line of business which insured the collectibility of cross border payable obligations. Accordingly, this line of business was placed into run-off and we have ceased initiating new trade credit reinsurance contracts. We have also been novating or cancelling several of the trade credit agreements that were in place.

In March 2008, we discontinued writing new insurance on synthetic CDOs and reduced significantly our structured products operations. This action 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. Subsequent to this action, in June 2008, both Standard & Poor s Ratings Service (S&P) and Moody s Investor Service (Moody s) downgraded the financial strength ratings of our financial guaranty insurance subsidiaries and in August 2008, S&P again downgraded the financial strength ratings 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 profitable new direct financial guaranty insurance and reinsurance both domestically and internationally. Accordingly, in the third quarter of 2008, we decided to discontinue, for the foreseeable future, writing any new financial guaranty business, including accepting new financial guaranty reinsurance, other than as may be necessary to commute, restructure, hedge or otherwise mitigate losses or reduce exposure in our existing portfolio. We initiated plans to reduce our financial guaranty operations, including a reduction of our workforce, commensurate with this decision. We also contributed the outstanding capital stock of Radian Asset Assurance to Radian Guaranty, strengthening Radian Guaranty s statutory capital. We continue to maintain a large insured financial guaranty portfolio, including a portfolio of insured CDOs.

As a result of the downgrade of our financial guaranty subsidiaries by S&P in June 2008, four reinsurance customers took back or recaptured all of their business ceded to us and we agreed to allow another reinsurance customer to take back a portion of its business (the 2008 FG Recaptures).

As a result of a further downgrade of the financial strength ratings of our financial guaranty insurance subsidiaries by S&P in August 2008, counterparties in four of our synthetic credit default swap transactions obtained the right to terminate these transactions 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 are entitled to 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. In September 2008, we voluntarily terminated one of these credit default swap transactions and novated a second transaction to an unaffiliated third party before our counterparty s right to terminate on a mark-to-market basis vested. This termination and novation did not have a material impact on our consolidated financial statements.

In addition, an additional $75.6 billion of our financial guaranty net par outstanding remains subject to recapture or termination due to these downgrades. See Risk in Force/Net For Outstanding Financial Guaranty Exposure Currently Subject to Recapture or Termination below for additional information regarding the rights of our primary insurance customers, CDS counterparties and other insured parties to recapture risks assumed by us or to terminate credit protection provided by us, and the potential impact of such recaptures or terminations on us.

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The following table summarizes the net premiums written and earned by our financial guaranty business s various products for the last three fiscal years:

	Year Ended December 31 2008	2007 (In thousands)	2006
Net premiums written (1):			
Public finance direct	$ 15,558	$ 60,117	$ 79,655
Public finance reinsurance	34,066	86,821	81,065
Structured finance direct	12,151	16,594	18,772
Structured finance reinsurance	18,735	21,933	18,676
Trade credit reinsurance	177	1,264	4,599
	80,687	186,729	202,767
Impact of 2008 FG recaptures	(51,050)		
Total net premiums written insurance	$ 29,637	$ 186,729	$ 202,767
Net premiums earned (1):			
Public finance direct	$ 56,191	$ 45,770	$ 32,517
Public finance reinsurance	89,227	44,667	37,765
Structured finance direct	14,418	17,325	19,446
Structured finance reinsurance	19,690	22,957	21,086
Trade credit reinsurance	657	2,303	21,476
	180,183	133,022	132,290
Impact of 2008 FG recaptures	(17,144)		
Total net premiums earned insurance	$ 163,039	$ 133,022	$ 132,290

(1) Excludes premiums written and earned on credit derivatives. These premiums are reported within the change in fair value of derivative instruments. Premiums written on credit derivatives for the year ended December 31, 2008 were $50.1 million, compared to $43.0 million and $60.1 million, for 2007 and 2006, respectively. Premiums earned on credit derivatives for the year ended December 31, 2008 were $54.1 million, compared to $62.1 million and $71.5 million, for 2007 and 2006, respectively.

In our financial guaranty business, the issuer of an insured obligation generally pays the premiums for our insurance either, in the case of most public finance transactions, in full at the inception of the policy or, in the case of most non-synthetic structured finance transactions, in regular monthly, quarterly, semi-annual or annual installments from the cash flows of the related collateral. Premiums for synthetic CDSs are generally paid in periodic installments (*i.e.* monthly, quarterly, semi-annually or annually) directly from our counterparty, and not from the cash flows of the insured obligation or the collateral supporting the obligation. On occasion, all or a portion of the premium for structured products transactions is paid at the inception of the protection. Since we depend on the corporate creditworthiness of our counterparty rather than the cash flows from the insured collateral for payment, we generally have a right to terminate our synthetic transactions without penalty if our counterparty fails to pay us, or is financially unable to make timely payments to us under the terms of the CDS transaction.

For public finance transactions, premium rates typically have been stated as a percentage of debt service, which includes total principal and interest. For structured finance obligations, premium rates are typically stated as a percentage of the total par outstanding. Premiums are generally non-refundable. Premiums paid in full at inception are recorded initially as unearned premiums and earned over the life of the insured obligation (or the coverage period for such obligation, if shorter). Premiums paid in installments are generally recorded as revenue in the accounting period in which coverage is provided. The long and relatively predictable premium earnings pattern from our public finance and structured products transactions provides us with a relatively predictable source of future earned revenues.

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The premium rate we establish for a transaction may reflect some or all of the following factors:

- issuer-related factors, such as the issuer s credit strength and sources of income;
- servicer-related factors, such as the ability of our counterparty or third-party servicer to manage the underlying collateral, the servicer s credit strength and sources of income and the availability of one or more replacement servicers should the need arise;
- obligation-related factors, such as the type of issue, the type and amount of collateral pledged, the revenue sources and amounts, the existence of structural features designed to provide additional credit enhancement should collateral performance not meet original expectations, the nature of any restrictive covenants, the length of time until the obligation s stated maturity, and our ability to mitigate potential losses; and
- insurer and market-related factors, such as the credit spreads in the market available to pay premiums, rating agency capital charges, competition, if any, from other insurers, alternate credit support providers or alternate transaction structures.

1. Public Finance (General Financial Guaranty)

Our public finance business provides credit enhancement of bonds, notes and other evidences of indebtedness issued by states and their political subdivisions (*e.g*. counties, cities or towns), school districts, utility districts, public and private non-profit universities and hospitals, public housing and transportation authorities, and authorities and other public and quasi-public entities such as airports, public and private higher education and healthcare facilities. Public finance transactions may also include project finance and public finance initiatives, which are transactions in which public or quasi-public infrastructure projects are financed through the issuance of bonds which are to be repaid from the expected revenues from the projects being built. These bonds may or may not be backed by governmental guarantees or other support.

Municipal bonds can be categorized generally into tax-backed bonds and revenue bonds. Tax-backed bonds, which include general obligation bonds, are backed by the taxing power of the governmental agency that issues them, while revenue bonds are backed by the revenues generated by a specific project such as bridge or highway tolls, or by rents or hospital revenues. Credit enhancement of public finance obligations can also take the form of CDSs, where we provide credit protection on a pool of public finance obligations or credit protection on the timely payment of principal and interest on a specified public finance or project finance obligation.

2. Structured Finance (General Financial Guaranty)

The structured finance market traditionally has included asset-backed securities and other asset-backed or mortgage-backed obligations, including funded and synthetic CDOs. Each asset in a CDO pool typically is of a different credit quality or possesses different characteristics with respect to interest rates, amortization and level of subordination.

Funded asset-backed obligations usually take the form of a secured interest in a pool of assets, often of uniform credit quality, such as credit card or auto loan receivables, commercial or residential mortgages or life insurance policies. Funded asset-backed securities also may be secured by a few specific assets such as utility mortgage bonds and multi-family housing bonds. In addition, we have insured future flow diversified payment rights transactions, where our insured obligations are backed by electronic payment orders intended for third-party beneficiaries (*e.g*. trade-related payments, individual remittances, and foreign direct investment).

The performance of synthetic transactions is tied to the performance of pools of assets, but is not secured by those assets. Most of the synthetic transactions we insure are CDOs. In many of these transactions, including our corporate CDOs and CDOs of trust preferred securities, we generally are required to make payments to our counterparty upon the occurrence of credit-related events related to the borrowings or bankruptcy of obligors contained within pools of investment-grade corporate obligations or, in the case of pools of mortgage or other asset-backed obligations, upon the occurrence of credit-related events related to the specific obligations in the pool. When we provide synthetic credit protection on a specific credit, our payment obligations to our

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counterparties are generally the same as those we have when we insure credits through a financial guaranty insurance policy. However, unlike most of our financial guaranty insurance policy obligations, where we have subrogation and other rights and remedies, we generally do not have recourse or other rights and remedies against the issuer and/or any related collateral for amounts we may be obligated to pay under these transactions. Even in those cases where we have such rights and remedies, they are generally much more limited than the rights and remedies we generally have in our more traditional financial guaranty transactions, and oftentimes need to be exercised indirectly, through our counterparty.

We primarily have provided credit protection in our synthetic CDO portfolio with respect to the following types of collateral: corporate debt obligations, trust preferred securities (TruPs), commercial mortgage-backed securities (CMBS), ABS (which includes RMBS), collateralized loan obligations (CLOs) and a combination of collateral types. In our corporate CDO transactions, we provide credit protection for certain specified credit-related events related to the borrowings or bankruptcy of obligors contained within pools of corporate obligations that were predominantly rated investment-grade at inception. TruPs are subordinated debt obligations or preferred equity issued by banks, insurance companies, Real Estate Investment Trusts and other financial institutions to supplement their capital needs. TruPs are subordinated to substantially all of such institutions debt obligations, but are senior to payments on equity securities of such issuer. In our CDO of CMBS transactions, we insure the timely payment of current interest and the ultimate payment of principal on securities whose payment obligations are secured by pools of CMBS securities. In our CDO of ABS transactions, we insure the timely payment of current interest and the ultimate payment of principal on a senior class of notes whose payment obligations are secured by pools of ABS, predominantly highly-rated (at inception) mezzanine-tranches of RMBS securities. CDOs of CLOs are similar to our corporate CDOs except that the obligations for which we are providing credit protection are backed by loans rather than other corporate debt securities.

In some circumstances, we have provided credit protection for second-to-pay corporate CDOs, TruPs and CLOs in which we are not required to pay a claim unless another financial guarantor defaults on its primary insurance obligation to pay such claim. Other structured finance transactions include diversified payment rights, clearinghouse soft capital, collateralized guaranteed investment contracts or letters of credit, foreign commercial assets and life insurance securitizations.

The following table shows the gross par amounts (principal) of structured finance obligations originated in each of the years presented:

Type	2008	2007	2006
		(In millions)	
Collateralized debt obligations	$ 141	$ 13,470	$ 22,362
Asset-backed obligations	221	2,025	1,305
Other structured	274	198	1,436
Total structured finance	$ 636	$ 15,693	$ 25,103

The following table shows the gross par outstanding on structured finance obligations at the end of each of the years presented:

Type	2008	2007
	(In millions)	
Collateralized debt obligations	$ 45,649	$ 46,961
Asset-backed obligations	3,554	5,275
Other structured	2,108	2,656
Total structured finance	$ 51,311	$ 54,892

The net par originated and outstanding on our structured finance obligations is not materially different from the gross par originated and outstanding for each period because we do not cede a material amount of business to reinsurers.

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3. Reinsurance (General Financial Guaranty)

We reinsure direct financial guarantees written by other primary insurers or ceding companies. Reinsurance allows a ceding company to write larger single risks and larger aggregate risks while remaining in compliance with the risk limits and capital requirements of applicable state insurance laws, rating agency guidelines and internal limits. State insurance regulators allow ceding companies to reduce the liabilities appearing on their balance sheet to the extent of reinsurance coverage obtained from licensed reinsurers or from unlicensed reinsurers meeting certain solvency and other financial criteria. Similarly, the rating agencies may permit a reduction in both exposures and liabilities ceded under reinsurance agreements, with the amount of credit permitted dependent on the financial strength rating of the insurer and reinsurer.

Our financial guaranty insurance business has entered into reinsurance agreements with various ceding companies. 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 S&P s downgrades of our financial guaranty insurance subsidiaries in June 2008, all of our financial guaranty reinsurance treaties have been terminated on a run-off basis, which means that none of our reinsurance customers may cede additional business to us under our reinsurance agreements with them. The business they previously ceded to us under these agreements currently remains outstanding (and a part of our risk in force) unless the applicable primary insurer has exercised its right to recapture business previously ceded to us under the applicable reinsurance agreement. See Risk in Force/Net Par Outstanding Financial Guaranty Exposure Currently Subject to Recapture or Termination below for information regarding the ability of our reinsurance customers to recapture business previously ceded to us.

Treaty and Facultative Agreements. The principal forms of reinsurance agreements are treaty and facultative. Under a treaty agreement, the ceding company is obligated to cede to us, and we are obligated to assume, a specified portion of all risks, within ranges, of transactions deemed eligible for reinsurance by the terms of a negotiated treaty. Limitations on transactions deemed eligible for reinsurance typically focus on the size, security and ratings of the insured obligation. Each treaty is entered into for a defined term, generally one year, with renewals upon mutual consent and rights to early termination (subject to the existing reinsured risk extending upon termination of the treaty for the life of the respective underlying obligations) under certain circumstances. The termination rights described above under Reinsurance also are typical provisions for the termination of a treaty reinsurance agreement.

In treaty reinsurance, there is a risk that the ceding company may select weaker credits or proportionally larger amounts to cede to us. We mitigated this risk by requiring the ceding company to retain a sizable minimum portion of each ceded risk, and we included limitations on individual transactions and on aggregate amounts within each type of transaction.

Under a facultative agreement, the ceding company has the option to offer to us, and we have the option to accept, a portion of specific risks, usually in connection with particular obligations. Unlike under a treaty agreement, where we generally rely on the ceding company s credit analysis, under a facultative agreement, we often perform our own underwriting and credit analysis to supplement the primary insurer s analysis in order to determine whether to accept the particular risk. The majority of our financial guaranty reinsurance was provided under treaty arrangements.

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Proportional or Non-Proportional Reinsurance. We typically have accepted our reinsurance risk on either a proportional or non-proportional basis. Proportional relationships are those in which we and the ceding company share a proportionate amount of the premiums and the losses of the risk subject to reinsurance. In addition, we generally pay the ceding company a commission, which typically is related to the ceding company s underwriting and other expenses in connection with obtaining the business being reinsured. Non-proportional relationships are those in which the losses, and consequently the premiums paid, are not shared by the ceding company and us on a proportional basis. Non-proportional reinsurance can be based on an excess-of-loss or first-loss basis. Under excess-of-loss reinsurance agreements, we provide coverage to a ceding company up to a specified dollar limit for losses, if any, incurred by the ceding company in excess of a specified threshold amount. A first-loss reinsurance agreement provides coverage to the ceding company on the first dollar of loss up to a specified dollar limit of losses. Generally, we do not pay a commission for non-proportional reinsurance. However, the same factors that affect the payment of a ceding commission in proportional agreements also may be taken into account with respect to non-proportional reinsurance to determine the proportion of the aggregate premium paid to us. The majority of our financial guaranty reinsurance business was originated on a proportional basis.

4. European Operations (General Financial Guaranty)

Through RAAL, we have written financial guaranty insurance in the United Kingdom, France, the Netherlands and the Republic of Ireland. RAAL primarily has insured synthetic CDSs which have been substantially reinsured (at least 90% of the risk) by Radian Asset Assurance.

C. Financial Services Business (*General*)

Our financial services segment mainly consists of our 28.7% equity interest in Sherman, a consumer asset and servicing firm. Our financial services segment also includes our 46% interest in C-BASS, a mortgage investment company which we have written off completely and whose operations are currently in run-off.

1. Sherman (General Financial Services)

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

In August 2008, our equity interest in Sherman increased to 28.7% from 21.8% as a result of a reallocation of the equity ownership of Sherman following a sale by Mortgage Guaranty Insurance Corporation (MGIC) of its remaining interest in Sherman back to Sherman. As a result of Sherman s repurchase of MGIC s interests, which reduced Sherman s equity, our investment in affiliates decreased by $25.8 million ($16.8 million after taxes) and is reflected as a reduction in our equity.

2. C-BASS (General Financial Services)

C-BASS is an unconsolidated, less than 50%-owned investment that is not controlled by us. Historically, C-BASS was 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 run-off of C-BASS s business is dictated by an override agreement to which we and all of C-BASS s other owners and creditors are parties. This non-bankruptcy restructuring agreement provides the basis for the orderly run-off of C-BASS s business through 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 8 of Notes to Consolidated Financial Statements.

As a consequence of the complete write-off of our investment in C-BASS in 2007, we have no continuing interest of value in C-BASS. The effect of C-BASS on our financial position and results of operations as of and for the year ended December 31, 2008, was negligible. We have no contractual obligations to C-BASS or its creditors to fund C-BASS s shareholders deficit as of December 31, 2007 or continuing losses in 2008 or thereafter. All of C-BASS s business is currently in run-off and we anticipate that all future cash flows of C-BASS will be used to service the outstanding debt. Given its approximate $1 billion shareholders deficit as of December 31, 2007, the likelihood that we will recoup any of our investment is extremely remote. Accordingly, we believe that the chance that our investments in C-BASS will have anything more than a negligible impact on our financial position, results of operation or cash flows at any time in the future is extremely remote.

II. Risk in Force/Net Par Outstanding

Our business has traditionally involved taking credit risk in various forms across various asset classes, products and geographies. Credit risk is measured in our mortgage insurance business as risk in force, which represents the maximum exposure that we have at any point in time, and as net par outstanding in our financial guaranty business, which represents our proportionate share of the aggregate outstanding principal exposure on insured obligations. We are also responsible for the timely payment of interest on insured financial guaranty obligations. Our total mortgage insurance risk in force and financial guaranty net par outstanding was $143.7 billion as of December 31, 2008, compared to $161.2 billion as of December 31, 2007. Of the $143.7 billion of total risk in force/net par outstanding as of December 31, 2008, approximately 70.1% consists of financial guaranty risk and 29.9% consists of mortgage insurance risk.

A. Mortgage Insurance ***(Risk in Force/Net Par Outstanding)***

The following table shows the risk in force outstanding associated with our mortgage insurance segment as of December 31, 2008 and 2007:

	December 31 2008	December 31 2007
	(In millions)	
Primary	$ 34,951	$ 31,622
Pool	2,950	3,004
Seconds	622	925
NIMS	438	604
International and domestic CDS	3,493	8,414
Other International	566	568
Total Mortgage Insurance Risk in Force	$ 43,020	$ 45,137

The following discussion mainly focuses on our primary risk in force. For additional information regarding our pool and non-traditional mortgage insurance risk in force, see General Mortgage Insurance above.

Our primary mortgage insurance risk in force was $35.0 billion as of December 31, 2008, compared to $31.6 billion as of December 31, 2007. We analyze our portfolio in a number of ways to identify any concentrations or imbalances in risk dispersion. We believe the performance of our mortgage insurance portfolio is affected significantly by:

- general economic conditions (in particular interest rates and unemployment);
- the age of the loans insured;

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- the geographic dispersion of the properties securing the insured loans;

- the quality of loan originations; and

- the characteristics of the loans insured (including LTV, purpose of the loan, type of loan instrument and type of underlying property securing the loan).

The persistency rate, defined as the percentage of insurance in force that remains on our books after any 12-month period, is a key indicator for the mortgage insurance industry. Because most of our insurance premiums are earned over time, higher persistency rates enable us to recover more of our policy acquisition costs and generally result in increased profitability. At December 31, 2008, the persistency rate of our primary mortgage insurance was 85.8%, compared to 75.4% at December 31, 2007.

1. Primary Risk in Force by Policy Year (Risk in Force/Net Par Outstanding Mortgage Insurance)

The following table shows the amount and percentage of our primary mortgage insurance risk in force by policy origination year as of December 31, 2008:

	December 31, 2008 ($ in millions)	
2003 and prior	$ 4,530	13.0%
2004	2,767	7.9
2005	4,229	12.1
2006	5,196	14.9
2007	10,711	30.6
2008	7,518	21.5
Total	$ 34,951	100.0%

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2. Geographic Dispersion (Risk in Force/Net Par Outstanding Mortgage Insurance)

The following tables show the percentage of our direct primary mortgage insurance risk in force by location of property for the top 10 states and top 15 metropolitan statistical areas (MSAs) in the U.S. as of December 31, 2008 and 2007:

	December 31	
Top Ten States	**2008**	**2007**
California	10.8%	8.8%
Florida	8.8	9.0
Texas	6.5	6.5
Georgia	4.6	4.8
Illinois	4.5	4.4
Ohio	4.4	4.7
New York	4.1	4.4
New Jersey	3.5	3.4
Michigan	3.4	3.6
Arizona	3.2	3.1
Total	53.8%	52.7%

	December 31	
Top Fifteen MSAs	**2008**	**2007**
Chicago, IL	3.4%	3.3%
Atlanta, GA	3.4	3.4
Phoenix/Mesa, AZ	2.4	2.3
New York, NY	2.2	2.2
Houston, TX	2.1	2.0
Los Angeles Long Beach, CA	2.0	1.5
Riverside San Bernardino, CA	1.8	1.6
Washington, DC MD VA	1.7	1.6
Minneapolis St. Paul, MN WI	1.5	1.6
Dallas, TX	1.4	1.4
Tampa St. Petersburg Clearwater, FL	1.3	1.4
Las Vegas, NV	1.3	1.3
Denver, CO	1.3	1.2
Orlando, FL	1.2	1.2
Philadelphia, PA	1.2	1.2
Total	28.2%	27.2%

The following table shows the amount and percentage of our international mortgage insurance risk in force by location of property as of December 31, 2008 and 2007:

	December 31			
International	**2008**		**2007**	
	($ in millions)			
Germany	$ 3,237	82.4%	$ 3,870	44.1%
Hong Kong	413	10.5	465	5.3
Australia	153	3.9	103	1.2
Netherlands	124	3.2	130	1.5

Denmark			4,202	47.9
Total	$ 3,927	100.0%	$ 8,770	100.0%

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3. Lender and Mortgage Characteristics (Risk in Force/Net Par Outstanding Mortgage Insurance)

Although geographic dispersion is an important component of our overall risk diversification, the quality of the risk in force should be considered in conjunction with other elements of risk diversification such as product distribution and our risk management and underwriting practices. In the recent past, we faced increased competition for traditional prime mortgage credit enhancement. As a result, non-prime mortgages and products such as adjustable rate mortgages (ARMs), negative amortizing loans and interest-only loans grew to represent a greater percentage of our total risk profile. Given current market conditions in which traditional prime mortgages are the predominant mortgage product being originated, we expect that non-prime and other non-traditional products will represent a negligible percentage of our overall mortgage insurance risk written in 2009.

In response to current market conditions, we implemented changes to our underwriting criteria in the fourth quarter of 2007 and throughout 2008, and have increased our pricing.

Loan to Value. One of the most important indicators of claim incidence is the relative amount of a borrower s equity or down payment that exists in a home. Generally, loans with higher LTVs are more likely to result in a claim than lower LTV loans. For example, claim incidence on mortgages with LTVs between 90.01% and 95% (95s) is significantly higher than the expected claim incidence on mortgages with LTVs between 85.01% and 90% (90s). We, along with the rest of the industry, had been insuring loans with LTVs between 95.01% and 97% (97s) since 1995 and loans with an LTV of between 97.01% and 100% (100s) since 2000. These loans are expected to have a higher claim incidence than 95s. We have also insured a small amount of loans having an LTV over 100%. We charge a premium for higher LTV loans commensurate with the additional risk and the higher expected frequency and severity of claims. We are no longer writing business on loans with LTV ratios in excess of 95%.

Loan Grade. The risk of claim on non-prime loans is significantly higher than that on prime loans. We generally define prime loans as loans where the borrower s Fair Isaac and Company (FICO) score is 620 or higher and the loan file meets fully documented standards of our credit guidelines and/or the GSE s guidelines for fully documented loans. Prime loans made up 94.1% of our primary new insurance written in 2008, compared to 58.2% of primary new insurance written in 2007. Prime loans comprised 77.8% of our primary risk in force at December 31, 2008 compared to 71.9% at December 31, 2007. We expect that prime loans will constitute all but a negligible part of our primary new insurance written in 2009.

Within our non-prime mortgage insurance program, we have three defined categories of loans that we insure: Alt-A, A minus and B/C loans. During 2008, non-prime business accounted for 5.9% of our primary new insurance written in our mortgage insurance business (61.4% of which was Alt-A), compared to 41.8% in 2007 (81.0% of which was Alt-A). Non-prime loans comprised 22.2% of our primary risk in force at December 31, 2008 compared to 28.1% at December 31, 2007. We expect that non-prime loans will represent a negligible part of our primary new insurance written in 2009.

We define Alt-A loans as loans where the borrower s FICO score is 620 or higher and where the loan documentation has been reduced or eliminated. Because of the reduced documentation, we consider Alt-A business to be more risky than prime business, particularly Alt-A loans to borrowers with FICO scores below 660. We insure Alt-A loans with FICO scores ranging from 620 to 660 and we charge a significantly higher premium for the increased default risk associated with these loans. Alt-A loans tend to have higher balances than other loans that we insure because they are often more heavily concentrated in high-cost areas. Alt-A loans made up 3.6% of our primary new insurance written in 2008, compared to 33.9% of primary new insurance written in 2007.

We generally define A minus loans as loans where the borrower s FICO score ranges from 575 to 619. We also classify loans with certain characteristics originated within the GSE s automated underwriting system as A minus loans, regardless of the FICO score. Our pricing of A minus loans is tiered into levels based on the FICO score, with increased premiums at each descending tier of FICO score. We receive a significantly higher premium for insuring this product commensurate with the increased default risk. A minus loans made up 2.3% of our primary new insurance written in 2008, compared to 7.9% of primary new insurance written in 2007.

We define B/C loans as loans where the borrower s FICO score is below 575. Certain structured transactions that we insure contain a small percentage of B/C loans. We price these structured transactions to reflect a higher premium on B/C loans due to the increased default risk associated with these types of loans. B/C loans made up a negligible amount of total primary new insurance written during 2008 and 2007.

Adjustable-Rate Mortgages (ARMs). Our claim frequency on insured ARMs has been higher than on fixed-rate loans due to monthly payment increases that occur when interest rates rise. We consider a loan an ARM if the interest rate for that loan will reset at any point during the life of the loan. It has been our experience that loans subject to reset five years or later from origination are less likely to result in a claim than shorter term ARMs, and our premium rates for these longer term reset loans are lower to reflect the lower risk profile of such loans.

We have also insured Option ARMs, a product that, until recently, was popular in the mortgage market. Option ARMs offer a number of different monthly payment options to the borrower. One of these options is a minimum payment that is below the full amortizing payment, which results in interest being capitalized and added to the loan balance and the loan balance continually increasing. This process is referred to as negative amortization. As a result, additional premiums are charged for these Option ARMs. As of December 31, 2008, Option ARMs represented approximately 4.1% of our primary mortgage insurance risk in force compared to 4.9% at December 31, 2007. We are no longer writing insurance on this product. As of December 31, 2008, approximately 6% of the ARMs and approximately 2% of the Option ARMs and interest-only loans we insure are scheduled to reset during 2009. Within our existing Option ARMs and interest-only insurance portfolio, approximately 43% of these loans have first time resets in 2010 or later.

We have also insured an ARM type product called interest-only mortgages, where the borrower pays only the interest charge on a mortgage for a specified period of time, usually five to ten years, after which the loan payment increases to include principal payments. These loans may have a heightened propensity to default because of possible payment shocks after the initial low-payment period expires and because the borrower does not automatically build equity as payments are made. At December 31, 2008, interest-only mortgages represented approximately 10.2% of our primary mortgage insurance risk in force compared to 10.5% at December 31, 2007. We are no longer insuring interest-only mortgages.

Loan Size. The average size of loans that we insure has been increasing as a result of our having insured in the recent past a larger percentage of non-prime loans, in particular Alt-A loans, which tend to have larger loan balances relative to our other loans, and as a result of a general increase in the size of borrowings during the recent past. The increase in average loan size has resulted in a corresponding increase in the average size of loans in default, primarily and most significantly, with respect to Alt-A loans. At December 31, 2008, the average size of loans subject to our primary mortgage insurance was $168,175, compared to $159,844 at December 31, 2007.

Amortization Periods. We believe that 15-year mortgages are less risky than 30-year mortgages, mainly as a result of the faster amortization and the more rapid accumulation of borrower equity in the property. Premium rates for 15-year mortgages are lower to reflect the lower risk. Mortgages with amortization periods beyond 30 years recently have grown in the mortgage market. Our current exposure to these loans is minimal.

Property Type. The risk of claim also is affected by the type of property securing the insured loan. Loans on single-family detached housing are less likely to result in a claim than loans on other types of properties.

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Conversely, we generally consider loans on attached housing types, particularly condominiums and cooperatives, to be a higher risk due to the higher density of these properties. Our more stringent underwriting guidelines on condominiums and cooperatives reflect this higher expected risk.

We believe that loans on non-owner-occupied homes purchased for investment purposes are more likely to result in a claim and are subject to greater value declines than loans on either primary or second homes. Accordingly, we have underwritten loans on non-owner-occupied investment homes more stringently, and we charge a significantly higher premium rate than the rate charged for insuring loans on owner-occupied homes. We are no longer writing insurance on non-owner occupied homes.

It has been our experience that higher-priced properties experience wider fluctuations in value than moderately priced residences and that the high incomes of many people who buy higher-priced homes are less stable than those of people with moderate incomes. Underwriting guidelines for these higher-priced properties reflect these factors.

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The following table shows the percentage of our direct primary mortgage insurance risk in force (as determined on the basis of information available on the date of mortgage origination) by the categories indicated as of December 31, 2008 and 2007:

	December 31	
	2008	**2007**
Direct Primary Risk in Force ($ in millions)	$ 34,951	$ 31,622
Product Type:		
Primary	92.2%	91.3%
Pool	7.8	8.7
Total	100.0%	100.0%
Lender Concentration:		
Top 10 lenders (by original applicant)	50.2%	47.9%
Top 20 lenders (by original applicant)	63.1	61.9
LTV:		
95.01% and above	22.3%	23.8%
90.01% to 95.00%	32.1	30.6
85.01% to 90.00%	35.3	33.5
85.00% and below	10.3	12.1
Total	100.0%	100.0%
Loan Grade:		
Prime	77.8%	71.9%
Alt-A	14.3	18.3
A minus and below	7.9	9.8
Total	100.0%	100.0%
Loan Type:		
Fixed	82.2%	78.4%
ARM (fully indexed) (1)		
Less than five years	5.0	7.6
Five years and longer	8.8	9.2
ARM (potential negative amortization) (2)		
Less than five years	3.6	4.3
Five years and longer	0.4	0.5
Total	100.0%	100.0%
FICO Score:		
>=740	30.5%	26.1%
680-739	36.3	35.6
620-679	26.9	30.2
<=619	6.3	8.1
Total	100.0%	100.0%
Mortgage Term:		
15 years and under	1.2%	1.4%
Over 15 years	98.8	98.6

Total	100.0%	100.0%
Property Type:		
Non-condominium (principally single-family detached)	91.0%	91.8%
Condominium or cooperative	9.0	8.2
Total	100.0%	100.0%

	December 31 2008	2007
Occupancy Status:		
Primary residence	93.0%	92.6%
Second home	3.7	3.7
Non-owner-occupied	3.3	3.7
Total	100.0%	100.0%
Mortgage Amount:		
Less than $400,000	91.2%	92.1%
$400,000 and over	8.8	7.9
Total	100.0%	100.0%
Loan Purpose:		
Purchase	70.0%	68.9%
Rate and term refinance	15.4	14.9
Cash-out refinance	14.6	16.2
Total	100.0%	100.0%

(1) Fully Indexed refers to loans where payment adjustments are the same as mortgage interest-rate adjustments.

(2) Loans with potential negative amortization will not have increasing principal balances unless interest rates increase as contrasted with scheduled negative amortization where an increase in loan balance will occur even if interest rates do not change.

B. Financial Guaranty *(Risk in Force/Net Par Outstanding)*

Our financial guaranty net par outstanding was $100.7 billion as of December 31, 2008, compared to $116.0 billion as of December 31, 2007. The decline in net par outstanding in 2008 was primarily due to the 2008 FG Recaptures, the amortization of principal, the prepayment or refundings of public finance obligations and the termination or novation of certain transactions. The following table shows the distribution of our financial guaranty net par outstanding by type of issue and as a percentage of our financial guaranty net par outstanding as of December 31, 2008 and 2007:

	Net Par Outstanding (1)			
	2008		2007	
Type of Obligation	Amount	Percent	Amount	Percent
	($ in billions)			
Public finance:				
General obligation and other tax-supported	$ 21.6	21.4%	$ 25.6	22.1%
Healthcare and long-term care	9.5	9.4	12.4	10.7
Water/sewer/electric/gas and other investor-owned utilities	7.7	7.6	10.4	9.0
Airports/transportation	4.9	4.9	6.9	6.0
Education	3.6	3.6	4.2	3.6
Housing revenue	0.5	0.5	0.6	0.5
Other municipal (2)	1.6	1.6	1.8	1.5
Total public finance	49.4	49.0	61.9	53.4
Structured finance:				
Collateralized debt obligations	45.6	45.3	47.0	40.5
Asset-backed obligations	3.6	3.6	4.4	3.8

Other structured (3)	2.1	2.1	2.7	2.3
Total structured finance	51.3	51.0	54.1	46.6
Total	$ 100.7	100.0%	$ 116.0	100.0%

(1) Represents our exposure to the aggregate outstanding principal on insured obligations.

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(2) Represents other types of municipal obligations, none of which individually constitutes a material amount of our financial guaranty net par outstanding.

(3) Represents other types of structured finance obligations, including diversified payment rights, clearinghouse soft capital, collateralized guaranteed investment contracts or letters of credit and foreign commercial assets and life insurance securitizations, none of which individually constitutes a material amount of our financial guaranty net par outstanding.

1. Credit Quality of Insured Portfolio (Risk in Force/Net Par Outstanding Financial Guaranty)

The following table identifies the internal credit ratings we have assigned to our net par outstanding as of December 31, 2008 and 2007:

	December 31			
	2008		2007	
Credit Rating (1)	**Net Par Outstanding**	**Percent**	**Net Par Outstanding**	**Percent**
	($ in billions)			
AAA	$ 41.4	41.1%	$ 49.1	42.3%
AA	17.3	17.2	17.5	15.1
A	17.7	17.6	24.6	21.2
BBB	20.8	20.7	23.4	20.2
BIG (2)	3.5	3.4	1.4	1.2
Total	$ 100.7	100.0%	$ 116.0	100.0%

(1) Represents our internal ratings estimates assigned to these credits utilizing our internal rating system. See Risk Management Financial Guaranty below. Each rating within a letter category includes all rating grades within that letter category (*e.g.*, A includes A+, A and A-

(2) Below investment grade.

2. Geographic Distribution of Insured Portfolio (Risk in Force/Net Par Outstanding Financial Guaranty)

The following table shows the geographic distribution of our financial guaranty net par outstanding as of December 31, 2008 and 2007:

	December 31	
State	**2008**	**2007**
Domestic Public Finance by State:		
California	5.7%	6.2%
Texas	4.0	3.8
New York	3.6	5.1
Pennsylvania	2.8	2.8
Florida	2.5	3.0
Illinois	2.4	2.7
New Jersey	2.3	2.3
Washington	1.7	1.8
Massachusetts	1.7	2.1
Colorado	1.6	1.6
Other domestic public finance	15.5	17.3
Total Domestic Public Finance	43.8%	48.7%
Domestic Structured Finance	34.6	31.9
International Public and Structured Finance	21.6	19.4
Total Public and Structured Finance	100.0%	100.0%

For each of the years ended December 31, 2008, 2007 and 2006, financial guaranty premiums written attributable to foreign countries were approximately 30.6% (20.8% excluding the 2008 FG Recaptures), 9.8% and 9.0%, respectively, of total financial guaranty premiums written.

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3. Largest Single Insured Risks (Risk in Force/Net Par Outstanding Financial Guaranty)

The following table represents our 10 largest public finance single risks by net par outstanding (together representing 4.1% of financial guaranty s total net par outstanding) as of December 31, 2008, along with the credit rating assigned as of that date to each credit:

Credit	**Credit Rating (1)**	**Obligation Type**	**Aggregate Net Par Outstanding as of December 31, 2008 (In millions)**	
State of California	A-	General Obligation	$	605
State of Washington (2)	AA	General Obligation		435
City of Chicago, IL	A+	General Obligation		433
Los Angeles Unified School District, CA (2)	AA-	General Obligation		421
New Jersey Transportation Trust Fund Authority	AA-	General Obligation		419
City of New York, NY	AA-	General Obligation		408
Metropolitan Transportation Authority, NY (2)	A	Revenue Obligation		370
Massachusetts School Building Authority	AA	Tax-Backed		359
New Jersey Economic Development Authority School FAC	AA-	General Obligation		344
Thames Water Utilities Finance PLC, U.K. (2)	A-	Revenue Obligation		320
			$	4,114

(1) Represents our internal ratings estimates for each issuer.

(2) We have additional exposure to several credits in the amounts indicated below on a second-to-pay basis, meaning that our obligation to pay timely principal and interest on insured bonds is secondary to another insurer. Therefore, we will not be required to pay claims on all or any portion of the additional exposure referenced below unless both the issuer and the other insurer fail to meet their payment obligations with respect to the insured bonds.

State of Washington: $0.7 million
Los Angeles Unified School District: $1.4 million
Metropolitan Transportation Authority: $0.3 million
Thames Water Utilities Finance PLC: $29.8 million

Our 10 largest structured finance single risks by net par outstanding represented $5.8 billion, or 5.8% of financial guaranty s net par outstanding as of December 31, 2008. We have entered into each of these transactions through the issuance of a CDS. These risks include the following exposures:

The seven largest structured finance risks are synthetic corporate CDO transactions with non-managed, fixed or static portfolios, which means that the reference entities or obligations in the collateral pool cannot be substituted or otherwise replaced. Each of these seven transactions has a net par outstanding of $600.0 million as of December 31, 2008. These transactions are scheduled to mature in 2011 (one transaction), 2014 (one transaction) and 2017 (five transactions);

The eighth largest structured finance risk is a synthetic, static CDO of CMBS transaction, with a net par outstanding of $598.5 million, which is scheduled to mature in 2049;

The ninth largest structured finance risk is a synthetic, static corporate CDO transaction with a net par outstanding of $562.5 million, which is scheduled to mature in 2017; and

The tenth largest structured finance risk is a synthetic, static CDO of ABS transaction (with predominantly RMBS collateral) with a net par outstanding of $479.7 million, which is scheduled to mature in 2046.

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The nine largest structured finance single risks are each internally rated AAA, while the tenth largest structured finance single risk is internally rated CCC-, B+ by S&P and Ba2 by Moody s. For additional information regarding the CDO of CMBS transaction and the CDO of ABS transaction included above, see Structured Finance Insured CDO Portfolio below.

4. Structured Finance Insured CDO Portfolio (Risk in Force/Net Par Outstanding Financial Guaranty)

The following table shows the distribution of our CDO net par outstanding as of December 31, 2008:

Asset Class	Total Exposure (Net Par) (In billions)	% of CDO Net Par Outstanding	% of Total Net Par Outstanding
Corporate CDOs (1)	$ 38.0	83.3%	37.7%
TruPs	2.2	4.8	2.2
CDO of CMBS (2)	1.8	4.0	1.8
CDO of ABS (3)	0.6	1.3	0.6
Other (4)	1.3	2.9	1.3
Subtotal	$ 43.9	96.3%	43.6%
Assumed CDOs (5)	1.7	3.7	1.7
Total CDOs	$ 45.6	100.0%	45.3%

(1) Includes one CDO squared transaction (a transaction of a master CDO with four sub-pools of corporate CDOs) scheduled to terminate in June 2009, in which we have $0.2 million in exposure through the four sub-pools. Also includes one second-to-pay corporate CDO transaction with a net par outstanding of $0.1 billion.
(2) For more information regarding this exposure, see Directly Insured CDOs of Commercial Mortgage-Backed Securities and Asset-Backed Securities below.
(3) Includes transactions that are predominantly CDOs of RMBS.
(4) Includes CLOs, second-to-pay trust preferred CDOs and one direct multisector CDO.
(5) Includes four transactions with net par outstanding of $0.2 billion that are not accounted for as derivatives.

The following table sets forth the ratings assigned to our CDO exposures as of December 31, 2008:

Ratings (1)	# of CDO Contracts/Policies	Net Par Outstanding (In billions)	% of CDO Net Par Outstanding
AAA	443	$ 38.8	85.0%
AA	46	4.4	9.7
A	17	0.7	1.6
BBB	13	1.1	2.4
BIG (2)	19	0.6	1.3
Total	538	$ 45.6	100.0%

(1) Represents our internal ratings estimates. Each rating within a letter category includes all rating grades within that letter category (*e.g.*, A includes A+, A and A-).

(2) Below investment grade.

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Directly Insured Corporate CDO Portfolio (Risk in Force/Net Par Outstanding Financial Guaranty Structured Finance Insured CDO Portfolio)

Our aggregate net par outstanding in our directly insured corporate CDO portfolio is $38.0 billion. We have $37.7 billion in aggregate net par outstanding through 102 directly insured corporate CDO transactions, with exposure to an aggregate of 929 corporate names. In addition, we directly insure one CDO squared transaction, with a net par outstanding of $0.2 billion, in which we have exposure to 296 corporate names. We also directly insure one second-to-pay corporate CDO, with a net par outstanding of $0.1 billion. All of our outstanding corporate CDOs are static pools, which means the covered reference entities generally cannot be changed without our consent.

The same corporate obligor may exist in a number of our corporate CDO transactions and may exist in our other structured finance obligations. However, the pool of corporate names in our directly insured corporate CDO portfolio is well diversified with no individual exposure to any corporate name exceeding 0.7% of our notional exposure to corporate entities in our directly insured corporate CDO portfolio as of December 31, 2008. As of December 31, 2008, our exposure to the five largest corporate names represented (measured by notional exposure) approximately 3.3% of our total aggregate notional exposure to corporate entities in our directly insured corporate CDO portfolio, compared to 3.1% as of December 31, 2007.

Because each transaction has a distinct level of subordination, credit events would typically have to occur with respect to numerous entities in a collateral pool before we would have an obligation to pay in respect of any particular transaction, meaning that our risk adjusted exposure to each corporate entity in a CDO pool is significantly less than our notional exposure. In the unlikely event that all of our five largest corporate obligors were to have defaulted at December 31, 2008, absent any other defaults in the CDOs in which these obligors were included, we would not have incurred any losses due to the significant subordination remaining in each transaction in which these entities were included.

The number of corporate entities in our directly insured corporate CDO transactions range between 79 and 151 per transaction, with the concentrations of each corporate entity averaging 1.3% per transaction. No corporate entity represented more than 2.1% of any one transaction. Our exposure to any single corporate name in any one transaction ranges from $2.5 million to $80.0 million, with an average of $26.4 million per transaction.

The following table summarizes the five largest industry concentrations in our financial guaranty directly insured corporate CDO portfolio as of December 31, 2008:

Industry Classification (1)	% of Total Notional
Telecommunications	8.1%
Insurance	6.8
Retailers (Excluding food and drug)	6.1
Financial Intermediaries	5.9
Utilities	5.8
Total of five largest industry concentrations	32.7%

(1) No industry represents more than 18.0% in any one transaction.

Our directly insured corporate CDO portfolio is highly rated with 98.0% of the transactions (representing 98.4% of the aggregate net par exposure of such portfolio), having subordination at or above the level of subordination necessary to warrant a AAA rating from S&P. Approximately one-third of our directly insured corporate CDO transactions (representing 37.5% of the aggregate net par exposure of our directly insured corporate CDO portfolio), has at least two times the subordination necessary to warrant a AAA rating from S&P.

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The amount of remaining subordination necessary to warrant a specific rating is determined using the most recent version of the CDO Evaluator tool published by S&P (as of December 31, 2008) to assist in the risk assessment of the CDO transactions. Ratings derived through this tool do not necessarily reflect our internal ratings for transactions or any of the ratings assigned to our insured tranches.

The number of sustainable credit events, which is the number of credit events on different corporate entities that would have to occur before we are obligated to pay a claim (i.e. the remaining subordination in our transaction measured in credit events), is another measure that is helpful in evaluating the credit strength of a transaction. The following table provides this information for our directly insured corporate CDO portfolio as of December 31, 2008, by year of scheduled maturity. In order to determine the number of different corporate entities that would be required to experience a credit event before we pay a claim, we calculate the weighted average net par exposure per corporate entity, then reduce such amount by an assumed recovery value of 30% (except with respect to transactions where we have agreed to a set fixed recovery, in which case we assume such fixed recovery), which then determines the estimated reduction of subordination that would occur for each applicable credit event. We then divide the aggregate subordination for the applicable transaction by the related reduction of subordination per credit to determine the applicable number of corporate entities that need to experience credit events before subordination in the transactions below our position would be reduced to zero.

Year of Scheduled Maturity (1)	Number of CDO Contracts/ Policies (2)	Aggregate Net Par Exposure (2) (In billions)	Initial Average # of Sustainable Credit Events (3)	Current Average # of Sustainable Credit Events (4)	Minimum # of Sustainable Credit Events (5)	Avg. # of Current Remaining Entities in Transaction (2)(6)
2009	7	$ 1.0	12.1	11.0	4.4	123
2010	7	1.3	14.8	12.3	5.9	124
2011	3	1.5	39.1	36.8	28.7	100
2012	16	5.9	25.5	23.5	10.9	105
2013	36	15.2	31.9	29.8	13.9	100
2014	16	6.5	29.6	27.6	11.3	99
2017	17	6.3	26.0	24.0	13.0	100
Total	102	$ 37.7				

(1) No directly insured corporate CDO transactions are scheduled to mature in 2015 or 2016. All of our directly insured corporate CDO transactions are scheduled to mature in or before December 2017.

(2) Excludes (a) one CDO squared transaction (a transaction of a master CDO with four sub-pools of corporate CDOs), scheduled to terminate in June 2009, with a net par outstanding of $0.2 billion and (b) a second-to-pay corporate CDO transaction, with a net par outstanding of $0.1 billion.

(3) The average number of sustainable credit events at the inception of each transaction. Average amounts presented are simple averages.

(4) The average number of sustainable credit events determined as of December 31, 2008. Average amounts presented are simple averages.

(5) The number of sustainable credit events for the one transaction with the fewest remaining sustainable credit events scheduled to mature in the year of scheduled maturity indicated. For example, for the 7 directly insured corporate CDO transactions scheduled to mature in 2009, our subordination level for one of those transactions would be eroded after 4.4 credit events in that transaction.

(6) The current average number of different corporate entities in each of the transactions.

In 2008, we experienced a decrease in the Current Average Number of Sustainable Credit Events, Minimum Number of Sustainable Credit Events and the Average Number of Current Remaining Entities in Transaction, in each case as described in the table above, primarily due to credit events in the financial services sector. Several notable financial and corporate institutions experienced credit events in the third and fourth quarters of 2008, including Fannie Mae, Freddie Mac, Lehman Brothers Holdings Inc., Washington Mutual,

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Glitnir Banki, hf, Kaupthing Bank hf, Landsbanki Island hf and Tribune Company. Despite these credit events, as of December 31, 2008, the Current Average Number of Sustainable Credit Events has declined only slightly. On average, this decline was only 1.9 sustainable credit events, meaning that for all of our outstanding directly insured corporate CDOs as of December 31, 2008, on average, we are only 1.9 credit events closer to paying a claim than we would be had these events not occurred in the third and fourth quarter of 2008. As of December 31, 2008, for any year of scheduled maturity, there remains at least 83.1% of the sustainable credit events existing at the inception of our policies. In light of the significant deterioration in economic conditions during the second half of 2008, we believe this is an indication of the resiliency of our directly insured corporate CDO portfolio.

Our directly insured corporate CDOs are carried at market value, and the credit spreads used in those valuations imply that further credit deterioration should occur. Deterioration beyond those anticipated market levels may decrease the estimated fair value of our directly insured corporate CDO portfolio, which could have a further negative impact on our results of operations. However, given the remaining subordination in our directly insured corporate CDO transactions and the remaining term of those transactions that have experienced the greatest deterioration of subordination, we do not currently expect any material claims with respect to our directly insured corporate CDO portfolio.

Directly Insured Primary Obligation Trust Preferred CDO Portfolio (Risk in Force/Net Par Outstanding Financial Guaranty Structured Finance Insured CDO Portfolio)

We provide credit protection on 13 directly insured TruPs CDOs in a first-to-pay position (Direct TruPs CDOs) representing an aggregate net par outstanding of $2.2 billion as of December 31, 2008. TruPs are deeply subordinated securities issued by banks and insurance companies, as well as Real Estate Investment Trusts and other financial institutions, to supplement their regulatory capital needs. Generally, the TruPs issued are subordinated to substantially all of an issuers debt obligations, but rank senior to the equity securities of such issuer. Our insurance, however, is generally issued on the senior classes of TruPs, and all of our Direct TruPs CDOs are currently rated investment grade by both S&P and Moody s, with our weighted average internal rating for these transactions being A-.

Our Direct TruPs CDOs include 709 separate issuers, including 580 banking institutions (comprising 73.8% of the collateral in our Direct TruPs CDOs), 92 insurance companies (comprising 24.2% of the collateral in our Direct TruPs CDOs), and 37 other financial institutions, Real Estate Investment Trusts and CDO tranches (comprising the remaining 2.0% of the collateral in our Direct TruPs CDOs). The banking institutions in our collateral pool are well diversified geographically and are located in 49 states. Our Direct TruPs CDOs include between 59 and 125 issuers per transaction, with the concentrations of each issuer averaging 1.3% per transaction. No issuer concentration in our Direct TruPs CDOs is more than 1.7% in any one transaction. Our exposure to any issuer in any one Direct TruPs CDO transaction ranges from $0.1 million to $42.0 million, with an average per transaction of $13.1 million.

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The issuer of a TruPs often has the right to defer interest or dividend payments for up to five years before a failure to pay the expected interest or dividend will result in a default of the underlying bond. Since we believe there is a significant likelihood that TruPs that are currently in deferral status will ultimately result in a default, we closely monitor deferrals as well as defaults. The following table provides additional detail regarding the scheduled maturity, net par outstanding and subordination in each of our Direct TruPs CDOs as of December 31, 2008.

Direct TruPs CDOs	Maturity Date	Net Par Outstanding (In millions)	Current Subordination after Defaults (1)	Current Subordination after Defaults and Deferrals (2)
1	07/15/2011	$ 213.3	43.0%	40.2%
2	09/21/2011	98.4	39.8	38.2
3	10/12/2011	288.0	41.6	38.8
4	11/30/2011	215.1	46.3	39.5
5	03/15/2012	317.9	47.0	44.8
6	08/04/2017	76.6	44.2	40.7
7	12/15/2017	189.1	44.6	40.8
8	09/26/2034	48.9	46.3	42.5
9	09/23/2035	89.2	45.5	42.6
10	12/23/2036	144.3	46.8	43.2
11	03/22/2037	139.4	44.6	42.6
12	12/23/2037	209.2	43.9	39.9
13	10/10/2040	164.0	47.1	45.2
Total		$ 2,193.4		

(1) Reflects the amount of remaining subordination expressed as a percentage of the collateral pool as of December 31, 2008, after giving effect to paydowns or redemptions (amortization) of the collateral and actual defaults assuming a loss for the full par amount of the underlying TruPs in the collateral pool.

(2) Reflects the amount of remaining subordination expressed as a percentage of the collateral pool as of December 31, 2008, after including the effect of amortization and actual defaults on the underlying bonds in the collateral pool and the effect of deferrals of payment on the underlying bonds in the collateral pool, assuming that any such deferral will ultimately result in a loss of the full par amount of the TruPs.

Directly Insured CDOs of Commercial Mortgage-Backed Securities and Asset-Backed Securities (Risk in Force/Net Par Outstanding Financial Guaranty Structured Finance Insured CDO Portfolio)

We have directly insured four CDOs of CMBS transactions, containing 127 CMBS tranches that were issued as part of securitizations. Of the 127 CMBS tranches in the collateral for our CDO of CMBS transactions, 22 of them were downgraded by Moody s in February 2009 from Aaa to between Aa3 and A2. All of the downgraded collateral is contained in one transaction, which is currently rated A+ internally.

The following table provides information regarding our directly insured CDOs of CMBS exposure as of December 31, 2008:

Total Size Of CDO Collateral Pool (In billions)	Radian Outstanding Exposure (In millions)	Internal Rating	Number of Obligations In CDO (1)	Average Size of Obligation In CDO (In millions)	Average Subordination of Obligation (2)	Total Delinquencies (Average of Securitizations) (3)	Radian Attachment Point (4)	Radian Detachment Point (4)
$2.4	$ 598.5	AAA	30	$ 80.0	21%	0.9%	5.1%	30.0%
1.9	450.0	AAA	27	72.0	31	1.1	6.8	30.0
1.5	352.5	AAA	30	50.0	14	1.0	6.5	30.0

1.0	430.0	A+	40	25.0	13	1.2	7.0	50.0
$6.8	$ 1,831.0		127					

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(1) Represents the number of CMBS tranches that comprise the collateral pool for the applicable CDO of CMBS transaction.
(2) The average subordination incorporates principal paydowns and defaults.
(3) Delinquencies reflect the average percentage (of total notional) of CMBS which are delinquent. Even if all current delinquencies resulted in defaults, substantial subordination would remain.
(4) The Attachment Point is the percentage of losses in the collateral pool that must occur before we are obligated to pay a claim. The Detachment Point is the point where the percentage of losses reach a level where we cease to have an obligation to pay claims on additional losses. For example, a 7.0% attachment point on a $1.0 billion collateral pool means that we are not obligated to pay claims until there are $70.0 million of losses, and a 50% detachment point on the same obligation means that our obligation to pay claims for losses ceases when the transaction reaches an aggregate of $500 million of losses.

The total balance of the reference obligations in these collateral pools equals $6.8 billion. The loan collateral pool supporting our $1.8 billion of outstanding exposure to the CDOs of CMBS consists of approximately 15,000 loans with a balance of approximately $198 billion. The underlying loan collateral is well diversified both geographically and by property type. While there is some risk in CMBS securitizations that the underlying loan collateral cannot be refinanced when due (particularly in the current economic downturn), we believe that such risk in our portfolio, particularly given our current subordination levels, is limited given that only approximately 21% of the underlying loans will become due before 2014.

We have exposure to RMBS, including exposure to subprime RMBS, through two directly-insured CDOs of ABS as summarized in the following table.

Net Par Outstanding ($ in millions)	Collateral						Subordination		
	RMBS (1)	CMBS	CDO of ABS (2)	CDO of CDO	Other	Total	Amount ($ in millions)	% of Collateral (Attachment Point)	% of Collateral (Detachment Point)
$150.0	64.8%	0.0%	0.0%	0.0%	35.2%(3)	100%	$ 78.0	13.0%	38.0%
$479.7	63.5%	14.4%	13.5%	3.5%	5.1%	100%	(4)	(4)	100%

(1) Approximately 15.8% of the collateral in the $150 million transaction and 41.6% of the collateral in the $479.7 million transaction represents subprime RMBS.
(2) Includes CDOs which contain RMBS and CMBS.
(3) Includes 25.2% of ABS collateral other than RMBS and CMBS.
(4) Although the current attachment point equals $110.5 million (18.7%), we currently expect to pay claims on this transaction as discussed below.

We provide $479.7 million net par outstanding of credit protection on the senior-most tranche of a CDO of ABS transaction, where the underlying collateral consists of mezzanine tranches of predominately mortgage-backed securities. As of December 31, 2008, 54 RMBS credits and 20 CDOs of ABS credits (collectively representing $342.3 million (or 58.3%) of the $586.9 million collateral pool) had been downgraded by S&P or Moody s and 30 of these credits, with a notional value of $136.2 million, have defaulted. The transaction, which is accounted for as a derivative, is currently internally rated CCC-, B+ by S&P and Ba2 by Moody s. Due to substantial deterioration of the underlying collateral, which has accelerated over the past few quarters, and based on available projections, we currently expect that losses from the remaining collateral will exceed the remaining subordination. Based on current anticipated cash flows, we expect to begin paying unreimbursed claims related to interest shortfalls on this transaction in 2017 or later. Due to the structure of this transaction, we do not expect to begin paying claims related to the principal shortfall until sometime between 2036 and the legal final maturity date for the transaction in 2046. We currently believe that the ultimate principal payment with respect to this transaction will be less than the current outstanding par amount, but due to the long remaining life and nature of the collateral in this transaction, losses are difficult to estimate. Deterioration in economic conditions over the remaining life of the transaction beyond our current projections could have a material impact on the timing and amount of cash available to make interest and principal payments on our insured tranche, and therefore, our ultimate losses on this transaction could be greater than expected.

The $150.0 million CDO of ABS transaction is rated AAA internally as well as by S&P and Moody s. While there has been some deterioration in the collateral pool for this transaction, 70% of the collateral pool remains rated in one of the two highest ratings categories by S&P and Moody s and no credits in this transaction had defaulted. This transaction is scheduled to terminate in March 2010.

In addition, we have RMBS exposure in our directly insured CDO portfolio through one multi-sector CDO described below in *Other Directly Insured CDO Exposure.*

Other Directly Insured CDO Exposure (Risk in Force/Net Par Outstanding Financial Guaranty Structured Finance Insured CDO Portfolio)

We also have $1.3 billion in exposure related to other directly insured CDOs, including second-to-pay CLOs, second-to-pay TruPs CDOs and one multi-sector CDO. In a second-to-pay transaction, another financial guaranty insurer has insured the same risk for which we have provided credit protection, and we will not be obligated to pay a claim unless this insurer defaults on its insured obligation. The following table provides information regarding our other directly insured CDOs as of December 31, 2008:

Type of CDO	Number of Transactions	Net Par Outstanding Amount (In billions)	Percentage of CDO Net Par Outstanding	Weighted Average Rating
CLO (Direct) (1)	1	$	%	AAA
CLO (Second-to-Pay) (2)	4	0.8	1.8	AA+
CLO Total	5	0.8	1.8	
Multisector CDO (3)	1	0.3	0.8	AAA
Second-to-Pay TruPs (4)	3	0.2	0.4	A+
Total CDO Other	9	$ 1.3	3.0%	

(1) Our directly insured CDO transaction has less than $0.1 billion in net par outstanding and represents less than 0.1% of our CDO net par outstanding.

(2) Our internal ratings for these transactions range between AAA and AA-.

(3) This transaction is currently rated AAA internally. The collateral for this transaction consists of 45.1% of CDOs of investment-grade corporate obligations, 32.9% of RMBS (none of which is subprime), 17.0% of non-mortgage related ABS and 5.0% of CDOs of high-yield corporate obligations. None of the ABS in this transaction, including mortgage-backed obligations, have been downgraded or placed on negative watch by S&P or Moody s as of December 31, 2008, and all of the RMBS collateral is rated at least A3 by Moody s (or if not rated by Moody s, A- by S&P). This transaction is scheduled to terminate in June 2009.

(4) Each of these transactions is scheduled to mature in 2033. Two of these transactions are rated AA internally and the third is rated A- internally.

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5. Non-CDO ABS Risk (Risk in Force/Net Par Outstanding Financial Guaranty)

The following table shows the distribution of our $3.6 billion of net par outstanding related to ABS obligations outside of our insured CDO portfolio.

Type of Non-CDO Asset-Backed Security	Net Par Outstanding Amount (In billions)	Percentage of ABS Net Par Outstanding	Percentage of Total Net Par Outstanding
Consumer Assets	$ 1.2	34.3%	1.2%
Commercial and other	1.1	31.4	1.1
RMBS Domestic	1.0	28.6	1.0
RMBS International	0.3	5.7	0.3
RMBS Total	1.3	34.3	1.3
Total ABS	$ 3.6	100.0%	3.6%

At December 31, 2008, our ABS portfolio, both directly insured and assumed as reinsurance, included approximately $1.0 billion of net par outstanding related to non CDO domestic RMBS exposure, which consists of 272 transactions. Approximately 33.9% of this exposure is subprime RMBS, as indicated in the table below. We have not directly insured any non-CDO RMBS since 2004. We do not have any financial guaranty exposure to CMBS outside of CDOs that we insure.

The following table provides additional information regarding our exposure to domestic RMBS in our non-CDO portfolio as of December 31, 2008.

Types of RMBS	Net Par Outstanding			% of U.S. Domestic Non-CDO RMBS Portfolio		% of Net Par Outstanding by Rating				
Exposure By Product	Total Net Par Outstanding	Direct	Assumed (1)		2006/2007 Vintage %	AAA *	AA *	A *	BBB *	BIG (2)*
	($ in millions)									
Subprime	$ 352.2	$ 122.2	$ 230.0	33.9%	10.5/33.1	16.9	0.3	3.1	0.1	79.6
Prime	267.6	122.5	145.1	25.8	6.2/33.2	59.3	9.1	7.6	12.9	11.1
Alt-A	369.6	72.6	297.0	35.6	26.2/33.2	46.6	6.1	3.6	8.3	35.4
Second-to-Pay	48.5		48.5	4.7	4.3/95.7	21.0	5.2	0.0	6.1	67.7
Total RMBS	$ 1,037.9	$ 317.3	$ 720.6	100.0%	14.8/35.7	38.6	4.9	4.3	6.6	45.6

* Ratings are based on our internal ratings estimate for these transactions.

(1) As of December 31, 2008, we had approximately $180 million of exposure to home equity lines of credit (including $40 million to subprime and $60 million to Alt-A), all of which was assumed from our primary financial guaranty reinsurance customers.

(2) Below investment grade. All below investment grade exposure is on our Watch List and reserves have been established for these transactions as necessary.

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6. Reinsurance Exposure (Risk in Force/Net Par Outstanding Financial Guaranty)

As of December 31, 2008, we had assumed approximately $36.9 billion in exposure from our primary reinsurance customers, compared to $49.9 billion as of December 31, 2007. The decline in assumed net par outstanding in 2008 was primarily due to the 2008 FG Recaptures. See the section immediately above for a discussion of assumed ABS exposure. The following table summarizes the distribution of our assumed net par outstanding by type of issue and as a percentage of our assumed net par outstanding as of December 31, 2008:

Types of Reinsurance Obligations	**2008**	
	Amount (In millions)	**Percent**
Public Finance:		
General obligation and other tax-supported	$ 14.8	40.1%
Water/sewer/electric/gas and other investor-owned utilities	6.8	18.4
Airports/transportation	4.3	11.6
Healthcare and long-term care	3.6	9.8
Education	0.8	2.2
Housing revenue	0.5	1.4
Other municipal (1)	0.9	2.4
Total public finance	31.7	85.9
Structured Finance:		
Asset-backed obligations (2)	2.8	7.6
Collateralized debt obligations	1.7	4.6
Other structured (3)	0.7	1.9
Total structured finance	5.2	14.1
Total	$ 36.9	100.0%

(1) Includes other types of municipal obligations, none of which individually constitutes a material amount of our assumed net par outstanding.
(2) Includes mortgages and mortgage-backed securities, consumer and commercial and other asset-backed securities.
(3) Includes other types of structured finance obligations, none of which individually constitutes a material amount of our assumed net par outstanding.

7. Financial Guaranty Exposure Currently Subject to Recapture or Termination (Risk in Force/Net Par Outstanding Financial Guaranty)

As a result of S&P s downgrades of our financial guaranty insurance subsidiaries in June and August 2008, $75.6 billion of our net par outstanding as of December 31, 2008 remains subject to recapture or termination at the option of our primary reinsurance customers, our credit derivative counterparties or other insured parties.

All but one of our reinsurance customers has 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 December 31, 2008, up to $36.7 billion of our total net assumed par outstanding was subject to recapture. If all of this business was recaptured as of December 31, 2008, we estimate that we would have experienced a reduction in (1) written premiums of approximately $312.8 million, (2) earned premiums of approximately $52.2 million, and (3) the net present value of expected future installment premiums of $142.3 million. In addition, we would have experienced a reduction in incurred losses of up to $94.9 million if this business were recaptured. We would be required to return written premiums (less commissions) and possibly a portion of our reserves, if this business were recaptured.

The counterparty in two of our synthetic CDO transactions, with an aggregate net par outstanding of $293.3 million ($243.0 million of which is scheduled to terminate in June 2009), has the right to terminate these

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transactions with settlement on a mark-to-market basis, subject to a maximum payment amount as of December 31, 2008 of approximately $34.1 million in the aggregate. In addition, we also have $103.2 million in exposure to another synthetic CDO transaction which is scheduled to terminate in June 2009. This transaction may be terminated on a mark-to-market basis if S&P lowers Radian Asset Assurance s financial strength rating below investment grade (BBB-).

As of December 31, 2008, the counterparties to 147 of financial guaranty s transactions currently have the right to terminate these transactions without our having an obligation to settle the transaction on a mark-to-market basis. If all of these counterparties had terminated these transactions as of December 31, 2008, our net par outstanding would have been reduced by $38.6 billion, with a corresponding decrease in unearned premium reserves of $12.0 million (of which only $0.4 million would be required to be refunded to counterparties) and the present value of expected future installment premiums of $168.0 million. If all these transactions were terminated, we do not believe it would have a material impact on our financial condition or results of operations.

III. Defaults and Claims

We establish reserves to provide for losses and the estimated costs of settling claims in both our mortgage insurance and financial guaranty businesses. Setting loss reserves in both businesses involves significant use of estimates with regard to the likelihood, magnitude and timing of a loss. We have determined that the establishment of loss reserves in our businesses constitutes a critical accounting policy. Accordingly, a detailed description of our policies is contained in Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Reserve for Losses included in Item 7 below and in Notes 2 and 10 of Notes to Consolidated Financial Statements.

A. Mortgage Insurance (*Defaults and Claims*)

The default and claim cycle in our mortgage insurance business begins with our receipt of a default notice from the insured lender. A default is defined under our master policy as a borrower s failure to make a payment equal to or greater than one monthly regular payment under a loan. Generally, our master policy of insurance requires the insured to notify us of a default within 15 days of (1) the loan s having been in default for three months, or (2) the occurrence of an early default in which the borrower fails to make any one of the initial 12 monthly payments under a loan so that an amount equal to two monthly payments has not been paid.

Defaults, whether voluntary or involuntary, can occur due to a variety of factors, including death or illness, divorce or other family problems, unemployment, inability to manage credit, overall changes in economic conditions, housing value changes that cause the outstanding mortgage amount to exceed the value of the home or other events. Depending on the type of loan, defaults also may be caused by rising interest rates or an accumulation of negative amortization. Involuntary defaults are those that occur due to factors generally outside the control of the borrower (*e.g.*, job loss, unexpected interest rate changes or in the event of death). Voluntary defaults are those where the borrower willingly walks away from his or her mortgage obligation despite the ability to continue to pay. These types of defaults often are caused by significant negative changes in property values where the borrower makes an investment decision not to continue with a mortgage that exceeds the value of the home. This problem is exacerbated by the fact that many borrowers in the recent past were not required to pay closing costs or make a significant down payment on their homes, leaving these borrowers with little incentive to remain in their homes when values have depreciated. In addition, we believe that some borrowers may be voluntarily defaulting on their mortgages to take advantage of many of the loan modification programs that recently have been announced or implemented to help stem the rising number of defaults and foreclosures. Although it is difficult to track and confirm, we believe that voluntary defaults, which are commonly referred to as moral hazard defaults, could represent a portion of new defaults in our mortgage insurance business.

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The following table shows the number of primary and pool loans that we have insured, the related loans in default and the percentage of loans in default as of the dates indicated:

	December 31		
	2008	2007	2006
Primary Insurance:			
Prime			
Number of insured loans in force	692,135	630,352	563,144
Number of loans in default (1)	51,267	25,339	18,441
Percentage of loans in default	7.4%	4.0%	3.3%
Alt-A			
Number of insured loans in force	149,439	172,085	133,633
Number of loans in default (1)	35,706	16,763	7,995
Percentage of loans in default	23.9%	9.7%	6.0%
A Minus and below			
Number of insured loans in force	81,504	92,600	89,037
Number of loans in default (1)	23,580	18,746	16,264
Percentage of loans in default	28.9%	20.2%	18.3%
Total Primary Insurance			
Number of insured loans in force	923,078	895,037	785,814
Number of loans in default (1)	110,553(2)	60,848(2)	42,700(2)
Percentage of loans in default	12.0%	6.8%	5.4%
Pool Insurance:			
Number of loans in default (1)	32,677(3)	26,526(3)	18,681(3)

(1) For reporting and internal tracking purposes, we do not consider a loan to be in default until the loan has been in default for 60 days. Accordingly, the amounts represented in this table exclude loans that are 60 or fewer days past due, in each case as of December 31 of each year.

(2) Includes 539, 2,595 and 1,161 defaults at December 31, 2008, December 31, 2007 and December 31, 2006, respectively, where reserves have not been established because no claim payment is currently anticipated on such loans.

(3) Includes 21,719, 20,193 and 13,309 defaults at December 31, 2008, 2007 and 2006, respectively, where reserves have not been established because no claim payment is currently anticipated on such loans.

We generally do not establish reserves for loans that are in default if we do not believe we will be liable for the payment of a claim with respect to that default. For example, for those defaults in which we are in a second-loss position, we calculate what the reserve would have been if there had been no deductible. If the existing deductible is greater than the reserve amount for any given default, we do not establish a reserve for the default.

The default rate in our mortgage insurance business is subject to seasonality. Historically, our mortgage insurance business experiences a fourth quarter seasonal increase in defaults.

Regions of the U.S. may experience different default rates due to varying economic conditions. The following table shows the primary mortgage insurance default rates by our defined regions as of the dates indicated, including prime and non-prime loans:

	December 31		
	2008	2007	2006
South Atlantic	15.38%	7.44%	5.11%
Pacific	14.02	5.95	2.81
New England	12.74	8.16	6.65
East North Central	12.07	8.50	7.72
Mountain	11.44	4.79	3.27
Mid-Atlantic	10.80	6.80	5.75

West North Central	9.40	6.29	5.53
East South Central	9.02	6.37	5.82
West South Central	7.81	5.58	5.68

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As of December 31, 2008, the two states with the highest primary mortgage insurance default rates were Florida and Nevada, at 23.4% and 19.5%, respectively. We believe that the higher default rates in both of these states are attributable to declining home values which are significantly higher than the national average. These states continue to be challenged by a large inventory of new housing as a result of significant investor speculation during recent periods of home price appreciation in these states.

Mortgage insurance claim volume is influenced by the circumstances surrounding the default. The rate at which defaults cure, and therefore do not go to claim, depends in large part on a borrower s financial resources and circumstances, local housing prices and housing supply (i.e., whether borrowers may cure defaults by selling the property in full satisfaction of all amounts due under the mortgage), interest rates and regional economic conditions. In our first-lien mortgage insurance business, the insured lender is required to complete foreclosure proceedings and obtain title to the property before submitting a claim. It can take anywhere from three months to five years for a lender to acquire title to a property through foreclosure, depending on the state. On average, we do not receive a request for claim payment until 12 to 18 months following a default on a first-lien mortgage. In our second-lien business, we typically are required to pay a claim much earlier, within approximately 150 days of a borrower s missed payment.

Claim volume in our mortgage insurance business is not evenly spread throughout the coverage period of our insurance in force. Historically, most claims under mortgage insurance policies on prime loans occurred during the third through fifth year after issuance of the policies, and on non-prime loans during the second through fourth year after issuance of the policies. After those peak years, the number of claims that we receive historically has declined at a gradual rate, although the rate of decline can be affected by macroeconomic factors. Approximately 62.5% of our primary risk in force, including most of our risk in force on non-prime products, and approximately 18.6% of our pool risk in force at December 31, 2008 had not yet reached its historical highest claim frequency years. At December 31, 2007, the comparable amounts were 67.2% and 37.1%, respectively. The business we originated in 2008 and 2007 has experienced claim activity much sooner than has been the case for prior years. Because it is difficult to predict both the timing of originating new business and the run-off rate of existing business, it also is difficult to predict, at any given time, the percentage of risk in force that will reach its highest claim frequency years on any future date.

The following table shows cumulative claims paid by us on our primary insured book of business at the end of each successive year after the year of original policy issuance, referred to as a year of origination, expressed as a percentage of the cumulative premiums written by us in each year of origination:

Claims Paid vs. Premiums Written Primary Insurance

Year of Origination	**End of 1st year**	**End of 2nd year**	**End of 3rd year**	**End of 4th year**	**End of 5th year**	**End of 6th year**	**End of 7th year**	**End of 8th year**
2001	0.4%	10.7%	29.5%	46.9%	54.2%	57.8%	60.0%	61.5%
2002	0.5%	8.5%	23.4%	32.3%	37.0%	40.7%	42.8%	
2003	0.4%	7.3%	17.1%	23.0%	28.0%	31.1%		
2004	0.6%	6.6%	15.8%	28.0%	38.9%			
2005	0.3%	6.0%	24.7%	58.9%				
2006	0.9%	13.1%	45.4%					
2007	0.5%	9.8%						
2008	0.2%							

Policy year 2001 was negatively impacted by poor credit performance on our structured business, primarily related to one subprime mortgage lending customer. Policy years 2003 and 2004 have developed better than anticipated due to significant home price appreciation and a liquid refinance market during the years following issuance of these policies. Business written in the latter half of 2005 contains a significant amount of poorly underwritten business generated by subprime and Alt-A customers due to the strong demand for mortgage product to populate mortgage-backed securities. The 2006 and 2007 business continued that trend, and also

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contains higher LTV loans. The 2005 through 2007 policy years are expected to contain substantially higher ultimate loss ratios than in previous policy years. In light of underwriting guideline changes we made late in 2007 and throughout 2008, we expect policy year 2008 to outperform the previous policy years, despite the uncertainty around future home price appreciation and mortgage credit markets. The 2008 policy year contains predominantly prime borrowers with higher FICO scores and lower LTV ratios than any of the previous policy years.

In addition to claim volume, another significant factor affecting losses is claim severity. The severity of a claim is determined by dividing the claim paid by the original loan amount. The main determinants of the severity of a claim are the size of the loan, the amount of mortgage insurance coverage placed on the loan, and the impact of our loss management activities with respect to the loan. Pre-foreclosure sales, acquisitions and other early workout efforts help to reduce overall claim severity. The average claim severity for loans covered by our primary insurance was 27.6% for 2008, compared to 27.5% in 2007 and 26.4% in 2006.

The following table shows claims paid information for primary mortgage insurance for the periods indicated:

	Year Ended December 31	
	2008	2007
	(In thousands)	
Direct claims paid:		
Prime	$ 310,965	$ 166,967
Alt-A	210,700	107,672
A minus and below	211,612	152,670
Second-lien	182,872	90,799
Total	$ 916,149	$ 518,108
Average claim paid:		
Prime	$ 40.9	$ 31.8
Alt-A	54.8	45.4
A minus and below	39.0	33.8
Second-lien	35.5	32.4
Average claim paid on all products	41.6	34.7
States with highest claims paid (1st lien):		
California	$ 115,947	$ 21,158
Michigan	68,761	49,806
Florida	45,649	14,724
Ohio	44,469	40,689
Georgia	44,313	30,364

Claims paid in California and Florida have increased significantly as home price depreciation in those states has been at a much higher level than the national average. We believe that claims in the Midwest and Southeast have been rising (and will continue to rise) due to the weak industrial sector of the economy in those areas. A much higher level of claims exist in Michigan, as problems with the domestic auto industry and related industries have depressed economic growth, employment and housing prices in that state.

B. Financial Guaranty ***(Defaults and Claims)***

The patterns of claim payments in our financial guaranty business tend to fluctuate and may be low in frequency and high in severity. In the event of default, payments under a typical financial guaranty insurance policy that we provide or reinsure may not be accelerated without our or the primary insurer s approval. Without such approval, the policyholder is entitled to receive payments of principal and interest from us or the primary insurer on their regularly scheduled dates as if no default had occurred. We or the primary insurer often have remedies against other parties to the transaction, which may be exercised both before and after making any necessary payment.

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In our direct financial guaranty business, and with respect to some of the mortgage-backed securities insured by our mortgage insurance business, we typically are obligated to pay claims in an amount equal to defaulted payments on insured obligations on their respective due dates. Normally, these defaulted payments consist of current interest and principal upon the legal maturity of the obligation. However, in certain of the mortgage-backed securities we insure, we may become obligated to pay principal on scheduled principal due dates or to the extent the outstanding principal balance of the insured obligation exceeds the value of the collateral insuring such obligations for a specified number of reporting periods.

In our synthetic corporate CDO transactions, losses arise upon the occurrence of a credit event (i.e., bankruptcy, a failure to pay or certain restructuring of debt) set forth in our agreement with respect to a covered corporate entity or money borrowed by such defaulting entity. Once a loss arises, we typically are obligated to pay a claim in an amount equal to the decrease in market value below par (100% of the outstanding principal amount we have agreed to insure) of a senior unsecured corporate bond selected by our counterparty in accordance with specific criteria set forth in our agreement, but only to the extent that the aggregate of all such loss amounts exceeds an agreed upon amount of subordination.

In our financial guaranty reinsurance business, claim payments due to the ceding companies are typically settled net of premiums payable to us.

The following table shows financial guaranty s incurred losses and claims paid by category for each period indicated:

	Year Ended December 31	
	2008	2007
	(In thousands)	
Incurred losses:		
Public finance direct	$ 10,619	$ 4,577
Public finance reinsurance	8,907	4,467
Structured finance direct	(3,426)	111,634
Structured finance reinsurance	108,203	(6,177)
Trade credit reinsurance	(9,808)	(16,511)
Total	$ 114,495	$ 97,990
Claims Paid:		
Public finance direct	$ 690	$ 2,127
Public finance reinsurance	7,667	212
Structured finance direct	100,036	9,733
Structured finance reinsurance	20,579	12,191
Trade credit reinsurance	3,440	8,579
Total	$ 132,412	$ 32,842

IV. Loss Management

A. Mortgage Insurance *(Loss Management)*

In 2008, we continued to add significant resources to our mortgage insurance loss management department in order to better manage losses in the uncertain housing market and rising claim environment. Our loss management function consists of approximately 92 full-time employees dedicated to minimizing claim payment, representing a 46% increase in the number of full time loss management employees from 2007. Loss management pursues opportunities to mitigate losses both before and after claims are received.

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In our traditional mortgage insurance business, upon receipt of a valid claim, we generally have the following three settlement options:

(1) Pay the maximum liability determined by multiplying the claim amount (which consists of the unpaid loan principal, plus past due interest and certain expenses associated with the default) by the applicable coverage percentage and allow the insured lender to keep title to the property;

(2) Pay the amount of the claim required to make the lender whole, commonly referred to as the deficiency amount (not to exceed our maximum liability) following an approved sale; or

(3) Pay the full claim amount and acquire title to the property.

In general, we base our selection of a settlement option on the value of the property. In 2008, we settled 92% of claims by paying the maximum liability (compared to 86% of claims in 2007), 7% by paying the deficiency amount following an approved sale (compared to 13% of claims in 2007) and less than 1% by paying the full claim amount and acquiring title to the property (also less than 1% in 2007). Declining property values in many regions of the U.S. during 2007 and 2008 have made our loss management efforts more challenging. If property values continue to further decline, our ability to mitigate losses could be adversely affected, which could have an adverse effect on our business, financial condition and operating results.

For pre-claim default situations, our loss management specialists focus on the following activities to reduce losses:

- Communication with the insured or the insured s servicer to ensure the timely and accurate reporting of default information;
- Prompt and appropriate responses to all loss mitigation opportunities presented by the mortgage servicer (including short sale requests); and
- Proactive communication with the borrower, realtor or other individuals involved in the loss mitigation process to maximize results and to increase the likelihood of a completed loss mitigation transaction.

After a claim is received and/or paid, our loss management specialists focus on:

- A review to ensure that program compliance and our master policy requirements have been met;
- Analysis and prompt processing to ensure that valid claims are paid in an accurate and timely manner;
- Responses to real estate owned (REO) loss mitigation opportunities presented by the insured;
- Aggressive management and disposal of acquired real estate; and
- Post-claim payment activities to maximize recoveries on various products including, when appropriate, the pursuit of deficiencies through subrogation and/or acquired rights.

In addition, in response to market conditions, we have recently launched a strategy where we advance to the servicer 15% of our claim responsibility, up to $15,000, to use as necessary, in order to cure a defaulted loan. We expect to expand this program in 2009.

Another strategy we recently implemented involves utilizing a third party, Consumer Credit Counseling of the Delaware Valley, to provide credit counseling and other services to our defaulted borrowers. We also built and deployed a borrower education website during 2008 and recently expanded it to allow for the collection of borrower financial information in order to allow us to facilitate modifications with servicers on our insured loans.

We are also participating in large scale modification programs being led by Federal Housing Finance Agency (FHFA), several top 10 mortgage servicers and numerous borrower outreach campaigns being conducted by HOPE NOW, of which we are a member. See Regulation Federal Regulation Indirect Regulation below for information regarding recent modification programs.

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Other units within our loss management department contribute additional risk management services. One unit is responsible for identifying and investigating insured loans involving non-compliance with the terms of our master policy of insurance (or commitment letter for structured transactions) to ensure that claims are ultimately paid, as agreed, only upon valid and insurable risks. Much of our effort involves the identification, investigation and reporting of mortgage fraud schemes that impact our losses. We coordinate our activities with legal counsel, law enforcement and fraud prevention organizations, and work to promote mortgage fraud awareness, detection and prevention among our personnel and client lenders. If a claim fails to comply with our master policy, fails to comply with our underwriting guidelines or contains misrepresentations (mortgage fraud), we may rescind the insurance policy or deny the claim. During 2008, the number of claims that we rescinded increased significantly.

Another unit manages counterparty risk by examining operational risk, completing underwriting reviews, and performing ongoing surveillance of our lender clients. During 2008, we began placing experienced loss mitigation personnel on-site with our servicing partners to improve communication and workflow, allowing us to act more quickly to reduce loss exposure. We also created a Servicer Advocacy Group which includes field- based representatives of loss management who make regular visits to our servicing partners to improve communication and better implement our programs that could mitigate losses.

B. Financial Guaranty (*Loss Management*)

The risk management function in our financial guaranty business is responsible for the identification, analysis, measurement and surveillance of credit, market, legal and operational risk associated with our financial guaranty insurance contracts. Risk management is also responsible for claims prevention and loss mitigation strategies. 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 structured by area of expertise and includes the following areas: risk analytics; public finance; structured finance; and portfolio management (each is more fully described below).

Our public finance and structured finance groups utilize several tools to monitor our directly insured portfolio. For each transaction, 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 manager s internal rating for the transaction. 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 rating 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.

We monitor not only the nominal exposure for each obligor for which we provide protection in our corporate CDO transactions, but also risk-adjusted measures, taking into account, among other factors, our assessment of the relative risk that would be represented by direct exposure to the particular obligor and the remaining subordination in the transactions in which we are exposed to a particular obligor. We have $12.5 million of exposure to our affiliate, C-BASS, as collateral under one TruPs CDO, which constitutes an insignificant portion of such collateral pool.

The portfolio management group oversees all portfolio level analysis and reporting of our insured financial guaranty portfolio. This group is also primarily responsible for the analysis of our assumed financial guaranty portfolio and the oversight of the credit risk relationship with our reinsurance customers. The head of the portfolio 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 individual 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.

In our financial guaranty reinsurance business, the primary obligation for assessing and mitigating claims rests with our ceding reinsurance customers. To help align the ceding company s interests with ours, we generally have required that the ceding company retain a portion of the exposure on any single risk that we reinsure. Our portfolio 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 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 review. 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 under-performing credits and establish reserves for transactions as recommended by the appropriate risk manager. The Committee is chaired by the head of the portfolio management group and includes senior management, credit, legal and finance personnel from both the financial guaranty business and Radian Group. Our risk management processes and procedures address both performing and under-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 or Case Reserve. Assumed exposures in financial guaranty s reinsurance portfolio are generally placed in one of these categories if the primary insurer for such transaction downgrades it to an equivalent watch list classification. However, if our financial guaranty risk management group disagrees with the risk rating assigned by the ceding company, we may assign our own risk rating rather than using the risk rating assigned by the ceding company.

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;

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Slight probability of payment default due to current adverse economic conditions 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 the risk manager to evaluate developing, potentially adverse 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 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 legal counsel may be engaged to assist in claim prevention or loss mitigation strategies. As a result, loss adjustment expense (LAE) reserves are occasionally posted for exposures on this list where such third parties are engaged.

Intensified Surveillance. This category includes transactions in financial guaranty s insured portfolio that are internally rated below investment grade and indicates 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 generally reviewed and reported on quarterly.

Consultants and/or legal 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 generally reviewed and reported on quarterly. Case reserves are established for all non-derivative transactions on this list.

In our directly insured 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 default occurs, a case reserve is

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established that reflects anticipated future claims. The assumptions used to recommend reserves for directly insured credits are based upon the analysis performed by the risk manager as more fully described above. In our financial guaranty reinsurance business, the primary obligation for assessing and mitigating claims rests with the ceding company. We establish reserves for our assumed Watch List credits based upon information provided by the ceding company. Expected losses on derivative financial guaranty contracts are recorded in change in fair value of derivative instruments.

As discussed in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies, the reserving policies used by the financial guaranty industry will be impacted by the adoption of SFAS No. 163, Accounting for Financial Guarantee Insurance Contracts, an interpretation of Financial Accounting Standards Board (FASB) Statement No. 60 (SFAS No. 163).

As soon as our risk management department detects a problem, it works with the appropriate parties in an attempt to avoid a default or to minimize the claims that we may be obligated to pay on our policy. Loss mitigation can consist of:

- restructuring the obligation;
- enforcing available security arrangements;
- working with the issuer to work through or to find alternatives mitigating the impact of management or potential political problems;
- when appropriate, exercising applicable rights to replace problem parties; and
- when appropriate, purchasing the insured obligation.

Issuers typically are under no obligation to restructure insured transactions to prevent losses, but often will cooperate to avoid being associated with an obligation that experiences losses. When appropriate, we discuss potential settlement options, either at our request or that of our counterparties, regarding particular obligations with appropriate parties. On occasion, loss mitigation may include an early termination of our obligations, which could result in payments to or from us. To determine the appropriate loss mitigation approach, we generally consider various factors relevant to such insured transaction, whi