

REPORT ON EXAMINATION

OF

RADIAN ASSET ASSURANCE INC.

AS OF

DECEMBER 31, 2008

DATE OF REPORT

FEBRUARY 1, 2010

EXAMINER

QILIN

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

February 1, 2010

Honorable James J. Wrynn
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30336 dated May 19, 2009, attached hereto, I have made an examination into the condition and affairs of Radian Asset Assurance Inc. as of December 31, 2008, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Radian Asset Assurance Inc.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company's administrative offices located at 335 Madison Avenue, New York, New York 10017.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2003. This examination covered the five-year period from January 1, 2004, through December 31, 2008. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment assessment. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Financial Condition Examiners Handbook of the NAIC:

- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Territory and plan of operation
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements
- Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of New York on December 30, 1985 as the Vesta American Insurance Company. On April 14, 1986, the Company absorbed by merger, the United States Branch of Gothaer Insurance Company of Cologne, Germany, to effect its domestication. The latter had entered the United States through New York on October 17, 1979. On July 1, 1988, the Company changed its name to Vesta American Reinsurance Corporation.

On December 30, 1992, all of the outstanding shares of the Company were purchased by Asset Guaranty Reinsurance Company, a New York insurer. On January 26, 1993, the Company merged with Asset Guaranty Reinsurance Company, with the Company as the surviving entity. Effective the same day, the Company changed its name to Asset Guaranty Insurance Company.

On November 13, 2000, the Company's then parent, Enhance Financial Services Group Inc. ("Enhance") and Radian Group Inc. ("Radian Group"), a Delaware corporation, entered into an agreement providing for the merger of Enhance and Gold Acquisition Corporation, a wholly-owned subsidiary of Radian Group, with Enhance being the surviving company. On December 1, 2000, Radian Group and Gold Acquisition Corporation filed an "application for approval of the acquisition of control of a domestic insurer" pursuant to Section 1506 of the New York Insurance Law and Department Regulation 52 for the acquisition and control of the Company. This acquisition was approved by the Department on February 21, 2001 and the merger was completed on February 28, 2001. Effective January 1, 2002, the Company changed its name to Radian Asset Assurance Inc.

Effective June 1, 2004, the Company merged with its affiliate, Radian Reinsurance Inc., with the Company as the surviving entity.

On September 18, 2008, all of the outstanding shares of the Company, which were directly owned and controlled by Enhance, were transferred by dividend, in their respective ownership percentage, to Enhance's shareholders: 89.51% to Radian Group and 10.49% to Radian Guaranty Inc., an affiliated insurance company domiciled in the State of Pennsylvania and 100% owned by

Radian Group. Radian Group then contributed its share of the Company to Radian Guaranty Inc. Accordingly, the Company became a wholly-owned subsidiary of Radian Guaranty Inc.

The Company's paid-in capital was \$15,000,000 consisting of 100,000 shares of common stock with a par value of \$150 per share. The Company has 4,000.08 shares of perpetual preferred stock authorized with a par value of \$1,000 per whole share. As of the examination date, these shares had not been issued.

As of December 31, 2008, the Company's gross paid-in and contributed surplus was \$702,722,452. Gross paid-in and contributed surplus increased by \$174,508,132 during the examination period, as follows:

| <u>Year</u> | <u>Description</u> | <u>Amount</u> | |
|-------------|---|------------------|----------------------|
| 2004 | Beginning gross paid in and contributed surplus | | \$528,214,320 |
| 2004 | Surplus contribution | \$ 65,000,000 | |
| 2006 | Surplus contribution | 7,885,989 | |
| 2007 | Surplus contribution | 101,937,853 | |
| 2008 | Surplus reduction | <u>(315,710)</u> | |
| | Total surplus contributions | | <u>174,508,132</u> |
| 2008 | Ending gross paid in and contributed surplus | | <u>\$702,722,452</u> |

In 2008, the Company reported a decrease in gross paid in and contributed surplus in the amount of \$315,710. The Notes to Financial Statements in the Company's 2008 annual statement included the following explanation for this decrease: "During 2008, capital was reduced by \$315,710 as the result of the lapsing of previously granted Radian restricted stock."

Paragraph 7 of Statement of Statutory Accounting Principals ("SSAP") No. 72 defines gross paid in and contributed surplus as:

The amount of capital received in excess of the par value of the stock issued. Changes in the par value of a reporting entity's capital stock shall be reflected as a reclassification between the capital stock account and gross paid-in and contributed surplus. Forgiveness of a reporting entity's obligations to its parent or other stockholders shall be accounted for as contributed surplus.

There is no statutory provision for reducing gross paid in and contributed surplus other than through a change in the par value of its capital stock, an approved stock redemption plan or through an approved quasi-reorganization pursuant to paragraph 15 of SSAP 72. Therefore, this transaction

should have been reported in the Company's income statement rather than as an adjustment to gross paid in and contributed surplus. There is no effect on surplus as regards policyholders as a result of this misclassification; however, it is recommended that the Company refrain from reducing its gross paid in and contributed surplus account for transactions other than those permitted by statute.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than twenty-one members. At December 31, 2008, the board of directors was comprised of the following fourteen members:

| <u>Name and Residence</u> | <u>Principal Business Affiliation</u> |
|--------------------------------------|---|
| Richard I. Altman Bala Cynwyd, PA | Executive Vice President, Chief Administrative Officer, Radian Group Inc. |
| David J. Beidler Woodstock, NY | Executive Vice President, Radian Asset Assurance Inc. |
| Derek V. Brummer Katonah, NY | Senior Vice President, General Counsel, Chief Risk Officer, Radian Asset Assurance Inc. |
| Teresa A. Bryce Philadelphia, PA | President, Radian Guaranty Inc. |
| Stephen D. Cooke Brooklyn, NY | President, Radian Asset Assurance Inc. |
| Edward A. Cubbin New York, NY | Chief Capital Officer, Radian Group Inc. |
| Bret S. Derman Brooklyn, NY | Senior Vice President, Deputy General Counsel, Corporate Secretary, Radian Asset Assurance Inc. |
| Ari B. Ginsburg New York, NY | Senior Vice President, Radian Asset Assurance Inc. |
| Edward J. Hoffman Wynnewood, PA | General Counsel, Radian Group Inc. |
| Terry L. Latimer West Chester, PA | Senior Vice President, Radian Group Inc. |

| <u>Name and Residence</u> | <u>Principal Business Affiliation</u> |
|--------------------------------------|---|
| Janet P. Moore Monroe, NY | Senior Vice President, Deputy General Counsel, Radian Asset Assurance Inc. |
| Carl R. Quint Rydal, PA | Executive Vice President, Chief Financial Officer, Radian Group Inc. |
| Patrick Rossi, Jr. Chatham, NJ | Senior Vice President, Radian Asset Assurance Inc. |
| William M. Russell Livingston, NJ | Senior Vice President, Radian Asset Assurance Inc. |

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance with the exception of Carl Quint who attended less than fifty percent of the meetings he was eligible to attend.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that the board may reach appropriate decisions. Individuals who fail to attend at least one-half of the regular meetings do not fulfill such criteria.

It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

As of December 31, 2008, the principal officers of the Company were as follows:

| <u>Name</u> | <u>Title</u> |
|-------------------|----------------------------------|
| Stephen D. Cooke | President |
| Bret S. Derman | Senior Vice President, Secretary |
| Terry L. Latimer | Senior Vice President, Treasurer |
| Patrick Rossi Jr. | Senior Vice President |

Conflict of Interest

A review of Company's conflict of interest policy noted that all board members and employees are required to sign an annual acknowledgement of Radian Group's "Code of Conduct."

The Code of Conduct includes a section concerning conflicts of interest. The Company was not able to provide the signed acknowledgements for all the years covered by this examination. A similar issue was noted in the prior report on examination. It is therefore again recommended that the Company exercise due care in obtaining and maintaining signed annual acknowledgements of its Code of Conduct as it relates to conflicts of interest of its directors and employees.

B. Territory and Plan of Operation

As of the examination date, the Company was licensed to write business in all fifty states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. The Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

| <u>Paragraph</u> | <u>Line of Business</u> |
|-------------------|-------------------------|
| 16(C) (D) (E) (F) | Surety |
| 17(A) | Credit |
| 25 | Financial Guaranty |

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

DIRECT PREMIUMS WRITTEN

| <u>Calendar Year</u> | <u>New York State</u> | <u>Total Premiums</u> | <u>Premiums Written in New York State as a Percentage of Total Premium</u> |
|----------------------|-----------------------|-----------------------|--|
| 2004 | \$101,625,683 | \$150,373,379 | 67.58% |
| 2005 | \$70,636,041 | \$139,500,056 | 50.64% |
| 2006 | \$70,542,741 | \$148,262,624 | 47.58% |
| 2007 | \$81,261,247 | \$135,584,533 | 59.93% |
| 2008 | \$50,582,509 | \$ 63,695,832 | 79.41% |

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13, 41 and 69 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$66,400,000.

The Company principally insures financial guaranty policies and reinsures financial guaranty companies, on both a treaty and facultative basis, for new and secondary market municipal bonds as well as structured corporate and real estate backed financing. Financial guaranty insurance typically provides an unconditional and irrevocable guaranty to the holder of a financial obligation for full and timely payment of principal and interest when due. In addition, the Company provided trade credit reinsurance and surety lines of business. During 2005, the Company announced it would place its trade credit line of business in run off.

In the third quarter of 2008, following downgrades of its insurance financial strength rating and facing difficult market conditions, the Company decided to discontinue, for the foreseeable future, writing any new financial guaranty insurance other than as may be necessary to commute, restructure, hedge or otherwise mitigate losses or reduce exposure in its existing insured portfolio.

C. Reinsurance

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles (“SSAP”) No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's chief executive officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62.

During the period covered by this examination, the Company commuted various reinsurance agreements where it was an assuming reinsurer. These commutations resulted in a gain in the Company's surplus position. Since the Company stopped writing any new business in the third quarter of 2008, the Company intended to run off or commute its reinsurance business.

The Company had several inter-company reinsurance agreements with its affiliates in effect during the examination period. Subsequent to the examination date, the Company has commuted most of its reinsurance business with its affiliates.

D. Holding Company System

The Company is a member of the Radian Group. The Company is 100% owned by Radian Guaranty Inc., a Pennsylvania domiciled insurance company, which is ultimately controlled by Radian Group Inc.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2008:

At December 31, 2008, the Company was a party to the following agreements with other members of its holding company system:

Expense Allocation and Service Agreements

On February 5, 1991, as amended effective March 14, 1991, the Company entered into an expense allocation agreement with Enhance Financial Service Group Inc. The types of costs allocated among participants to the agreement include, but are not limited to, depreciation of computer equipment, amortization of intangibles and the usage all furniture and other equipment, which were expensed upon purchase, salaries and related personnel expenses, general office expenses, general travel and entertainment expenditures, advertising, as it encompasses the companies of the group, and professional fees. The agreement states expenses are allocated among the companies on a monthly basis, pursuant to a method which equitably reflects the actual cost to each company. The agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law.

Effective May 17, 2003, the Company entered into an expense allocation and service agreement with Radian Group. Under the terms of the agreement, Radian Group provides such services as are reasonably required by the Company for the operation of its business, including, but not limited to, accounting, recording, tax, information services and data processing, treasury, investment and management services, internal auditing, and administrative services. The agreement states that these services shall be provided at a cost that is reasonable, equitable and equal to the cost incurred by Radian Group in providing such services. The agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law.

Effective August 6, 2003, Radian Reinsurance Inc. entered into an agreement relating to the provision of intra-group services with Radian Representatives Limited (“RRL”), an affiliate located in the United Kingdom. Under the service schedule of the agreement, Radian Reinsurance Inc. agreed to provide information technology services (“IT”) support to RRL. Due to the merger with Radian Reinsurance Inc., the Company assumed the responsibility to continue providing IT services to RRL. The agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law.

Effective October 1, 2005, the Company also entered a service agreement with its subsidiary, Van-American Insurance Agency Inc. (“VAIA”). Under the terms of the agreement, VAIA provides services such as claims settlement, insurance and reinsurance premiums processing, collateral management and billing related to the Company’s surety bond business. The agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law.

It is noted that Radian Guaranty Inc. provides the Company with services on a regular basis. Such services include accounting, record keeping, management services and administrative services; however, an agreement is not in place for the services provided.

Section 1505(d)(3) of the New York Insurance Law states that:

(d) The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period:

(3) rendering of services on a regular or systematic basis;

It is recommended that the Company comply with Section 1505(d)(3) of the New York Insurance Law and submit an agreement to the Department for the services rendered by Radian Guaranty, Inc.

Tax Allocation Agreement

Effective January 1, 2002, the Company was a party to a tax allocation agreement with the Radian Group. Under the terms of the agreement, the Company files a consolidated federal income tax return with its holding company, Radian Group and its affiliates. The agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law.

However, it is noted that subsequent addenda to the agreement were not filed with the Department during the examination period.

Circular Letter No. 33 (1979) states:

“. . . every domestic insurer is directed to notify this Department within 60 days of this circular letter if it participates in a consolidated tax return and to submit a copy of its tax allocation agreement with such notification. Any domestic insurer which

currently does not participate in a consolidated tax return shall file a copy of its tax allocation agreement with this Department within 30 days of electing to do so. Furthermore, notification to this Department should be given within 30 days of any amendment to or termination of a tax allocation agreement.”

It is recommended that the Company file any amendments to its tax allocation agreement within 30 days as required by Department Circular Letter No. 33 (1979).

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2008, based upon the results of this examination:

| | |
|--|-------|
| Net premiums written to surplus as regards policyholders | .08:1 |
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 62% |
| Premiums in course of collection to surplus as regards policyholders | 2% |

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five-year period covered by this examination:

| | <u>Amounts</u> | <u>Ratios</u> |
|--|----------------------|----------------|
| Losses and loss adjustment expenses incurred | \$387,807,333 | 42.18% |
| Other underwriting expenses incurred | 478,605,528 | 52.06 |
| Net underwriting gain | <u>52,902,709</u> | <u>5.76</u> |
| Premiums earned | <u>\$919,315,570</u> | <u>100.00%</u> |

F. Accounts and Records

(i) Impaired Investment

It is noted that the Company failed to write down an impaired bond to its fair value as of December 31, 2008. SSAP No. 26 Paragraph 9 requires that if any decline in the fair value of a bond is determined to be other than temporary, the cost basis of the bond shall be written down to

fair value as a new cost basis. The examiner's recalculation of the impaired bond at the new cost basis resulted in no material difference.

It is recommended that the Company properly account for impaired investments in accordance with SSAP No. 26.

(ii) Special Deposits

It was determined that the Company had certificates of deposit in the KeyBank National Association which were pledged for the Company's irrevocable letters of credits issued by the KeyBank National Association. However, the Company reported these certificates of deposits with special purpose as cash in Schedule E - Part 1. The annual statement instructions require special deposits to be reported in Schedule E - Part 3.

It is recommended that the Company correctly report and disclose its cash deposits as per the annual statement instructions.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2008 as determined by this examination and as reported by the Company:

| <u>Assets</u> | <u>Assets</u> | <u>Assets Not Admitted</u> | <u>Net Admitted Assets</u> |
|--|------------------------|--------------------------------|--------------------------------|
| Bonds | \$2,005,952,312 | \$ 0 | \$2,005,952,312 |
| Preferred stocks | 34,570,237 | | 34,570,237 |
| Common stocks | 102,174,874 | 318,800 | 101,856,074 |
| Cash, cash equivalents and short-term investments | 124,346,800 | | 124,346,800 |
| Other invested assets | 735,507 | | 735,507 |
| Investment income due and accrued | 25,250,177 | 15,380 | 25,234,797 |
| Uncollected premiums and agents' balances in the course of collection | 16,360,042 | 52,162 | 16,307,880 |
| Funds held by or deposited with reinsured companies | 26,547 | | 26,547 |
| Net deferred tax asset | 229,151,336 | 216,846,231 | 12,305,105 |
| Electronic data processing equipment and software | 3,043,631 | 2,017,504 | 1,026,127 |
| Furniture and equipment, including health care delivery assets | 50,823 | 50,823 | 0 |
| Equities and deposits in pool and associations | 1,949,231 | | 1,949,231 |
| Receivable – other | 333,951 | 32 | 333,919 |
| Prepaid expense | <u>1,105,820</u> | <u>1,105,820</u> | <u>0</u> |
| Total assets | <u>\$2,545,051,288</u> | <u>\$220,406,752</u> | <u>\$2,324,644,536</u> |

Liabilities, Surplus and Other FundsLiabilities

| | |
|---|--------------------|
| Losses | \$ 73,846,294 |
| Reinsurance payable on paid losses and loss adjustment expenses | 5,627,539 |
| Loss adjustment expenses | 1,694,282 |
| Commissions payable, contingent commissions and other similar charges | 172,081 |
| Other expenses (excluding taxes, licenses and fees) | 21,615,463 |
| Taxes, licenses and fees (excluding federal and foreign income taxes) | 993,027 |
| Current federal and foreign income taxes | 2,456,130 |
| Unearned premiums | 728,944,829 |
| Advance premium | 242,033 |
| Ceded reinsurance premiums payable (net of ceding commissions) | 86,764 |
| Funds held by company under reinsurance treaties | 262 |
| Provision for reinsurance | 1,084 |
| Payable to parent, subsidiaries and affiliates | 8,559,820 |
| Contingency reserve | <u>515,022,618</u> |
| Total liabilities | \$1,359,262,226 |

Surplus and Other Funds

| | |
|--|------------------------|
| Common capital stock | \$ 15,000,000 |
| Gross paid in and contributed surplus | 702,722,452 |
| Unassigned funds (surplus) | <u>247,659,858</u> |
| Surplus as regards policyholders | <u>965,382,310</u> |
| Total liabilities, surplus and other funds | <u>\$2,324,644,536</u> |

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 1999. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. Audits covering tax years 2000 through 2007 are currently under examination. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2008. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$142,308,137 during the five-year examination period January 1, 2004 through December 31, 2008, detailed as follows:

Underwriting Income

| | | |
|--------------------------------------|--------------------|--------------------|
| Premiums earned | | \$919,315,570 |
| Deductions: | | |
| Losses incurred | \$377,746,425 | |
| Loss adjustment expenses incurred | 10,060,908 | |
| Other underwriting expenses incurred | <u>478,605,528</u> | |
| Total underwriting deductions | | <u>866,412,861</u> |
| Net underwriting gain | | \$ 52,902,709 |

Investment Income

| | | |
|-------------------------------|------------------|-------------|
| Net investment income earned | \$463,793,290 | |
| Net realized capital gain | <u>6,879,287</u> | |
| Net investment gain or (loss) | | 470,672,577 |

Other Income

| | | |
|---|---------------------|----------------------|
| Net gain or (loss) from agents' or premium balances charged off | \$ 55,945 | |
| Aggregate write-ins for miscellaneous income | <u>(84,401,171)</u> | |
| Total other income | | <u>(84,345,226)</u> |
| Net income after dividends to policyholders but before federal and foreign income taxes | | \$439,230,060 |
| Federal and foreign income taxes incurred | | <u>97,690,672</u> |
| Net income | | <u>\$341,539,388</u> |

C. Capital and Surplus Account

| | | | |
|--|-------------------------|--------------------------|----------------------|
| Surplus as regards policyholders per report on examination as of December 31, 2003 | | | \$823,074,073 |
| | <u>Gains in Surplus</u> | <u>Losses in Surplus</u> | |
| Net income | \$341,539,388 | | |
| Net unrealized capital gains or (losses) | 23,014,463 | | |
| Change in net unrealized foreign exchange capital gain (loss) | | 2,294,239 | |
| Change in net deferred income tax | 111,157,133 | | |
| Change in nonadmitted assets | | 104,689,656 | |
| Change in provision for reinsurance | 283,411 | | |
| Surplus adjustments paid in | 174,508,132 | | |
| Dividends to stockholders | | 207,500,000 | |
| Aggregate write-ins for gains and losses in surplus | <u>0</u> | <u>193,710,395</u> | |
| Total gains and losses | <u>\$650,502,527</u> | <u>\$508,194,290</u> | |
| Net increase (decrease) in surplus | | | <u>142,308,137</u> |
| Surplus as regards policyholders per report on examination as of December 31, 2008 | | | <u>\$965,382,310</u> |

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

As of December 31, 2008, the Company reported a liability for the captioned items in the amount of \$75,540,576. During 2009, the Company reported additional incurred losses and loss adjustment expenses for accident years 2008 and prior totaling \$42.453 million. Through March 31, 2010, the additional development had increased to \$48.302 million.

The Company provides guarantees for Structured Finance (representing approximately 52% of the net par outstanding) and Public Finance (approximately 48% of the net par outstanding) instruments. The Company's primary areas of focus were: non-asset-backed security collateralized debt obligations ("non-ABS CDO's", representing approximately 50% of its business); General Obligation (21%); Healthcare (8.5%); Utilities (5.5%); and Transportation (4.5%).

A review of the Company's credit analysis and case reserve modeling and assumptions was performed by the Department's Capital Markets Bureau. The review included the following areas: Public Finance (specifically Jefferson County); corporate CDO's; commercial mortgage-backed security ("CMBS") CDO's; and trust-preferred ("TRUP") CDO's. The review did not indicate any

basis for rejecting or amending the Company's 2008 reserves. The increases reported by the Company were not deemed to be attributable to flaws in the Company's methodologies or models, but rather to unforeseeable factors; for example, the impact of the current financial crisis on small banks and insurance companies whose trust-preferred securities are part of the TRUP CDO's.

Case reserves for financial guaranty insurance companies differ from those of traditional property and casualty insurance companies. The primary difference is that traditional property and casualty case reserves include only claims that have been incurred and reported to the insurance company. Unlike traditional property and casualty claims, financial guaranty losses arise from the extension of credit protection and occur as the result of the credit deterioration of the issuer or underlying assets of the insured obligations over the lives of those insured obligations. A case reserve is determined using cash flow or similar models that represent the Company's estimate of the net present value of the anticipated shortfall between (a) schedule payments on the insured obligation plus anticipated loss adjustment expenses and (b) anticipated cash flow from and proceeds to be received from the issuer, sales of any collateral supporting the obligation and other anticipated recoveries. The Company uses assumptions, which represent current and forward looking perspectives of the underlying risks and market conditions. However, the Company is only able to forecast assumptions using data available at the time of the analysis.

The Company establishes a case basis loss reserve ("case reserve") for the estimated present value of a claim when reported by primary insurers or when, in the Company's opinion, the insured risk is in default on the balance sheet date. Pursuant to Section 6903(b) of the New York Insurance Law, a financial guaranty company is allowed to discount its loss reserves by application of a discount rate equal to the average rate of return on the admitted assets of the insurer as of the day of the computation of such reserves. As of the examination date, the Company discounted certain financial guaranty liabilities at an annual rate of 4.39%. The amount of discount reflected as a reduction in the Company's loss reserves was \$5,133,630.

Reserves for loss and loss adjustment expenses for the Company's other lines of business are based on reports and individual loss estimates received from ceding companies, net of salvage and subrogation. In addition, a liability is included for losses and loss adjustment expenses incurred but not reported.

In addition to case reserves, the Company is required to establish and maintain contingency reserves for the protection of insureds and claimants against the effect of excessive losses occurring

during adverse economic cycles. The amount required for these reserves depends on the type of bonds being insured and are established pursuant to the provisions of Section 6903(a) of the New York Insurance Law. Reinsurers are required to establish a contingency reserve equal to their proportionate share of the reserves established by the primary insurer. As of December 31, 2008, the Company reported contingency reserves in the amount of \$515,022,618.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained nine recommendations as follows (page numbers refer to the prior report):

| <u>ITEM</u> | <u>PAGE NO.</u> |
|--|-----------------|
| A. <u>Management</u> | |
| i. It is recommended that the board members who were unable or unwilling to attend meetings consistently should resign or be replaced. | 6 |
| The Company has not complied with this recommendation. A similar comment is made in this report. | |
| ii. It is recommended that the Company adhere to its by-laws as they relate to the number and frequency of meetings of its board of directors | 7 |
| The Company has complied with this recommendation. | |
| iii. It is recommended that the Company exercise due care in obtaining and maintaining annual signed acknowledgements of its "Code of Conduct" as it relates to conflicts of interest of its directors and employees. | 8 |
| The Company has not complied with this recommendation. A similar comment is made in this report. | |
| iv. It is therefore again recommended that the Company establish written procedures for enforcing a policy that would permit the board of directors to properly oversee and handle any known or potential conflicts of interest. | 8 |
| The Company has complied with this recommendation. | |
| v. It is further recommended that the board of directors maintain complete minutes of its procedures on this matter. | 8 |

ITEMPAGE NO.

The Company has complied with this recommendation.

B. Reinsurance

- i. It is recommended that the arbitration clause be amended to state that arbitration shall take place in New York State. 11

The Company has complied with this recommendation.

C. Accounts and Records

i. Custodial Agreement

It is also recommended that the Company take due care to correctly complete the General Interrogatories of its annual statement. 17

The Company has complied with this recommendation.

ii. CPA Engagement Letter

It is recommended that the Company incorporate the provisions of Part 89.2 of Department Regulation 118 into its audit engagement letter with its certified public accountant. 18

The Company has complied with this recommendation.

iii. Workpaper Retention

It is recommended that Company establish a records retention policy that complies with all applicable parts of Department Regulation 152. 18

The Company has complied with this recommendation.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| <u>ITEM</u> | <u>PAGE NO.</u> |
|--|-----------------|
| A. <u>Gross Paid In and Contributed Surplus</u> | |
| It is recommended that the Company refrain from reducing its gross paid in and contributed surplus account for transactions other than those permitted by statute. | 5 |
| B. <u>Management</u> | |
| i. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced. | 6 |
| ii. It is recommended that the Company exercise due care in obtaining and maintaining annual signed acknowledgements of its “Code of Conduct” as it relates to conflicts of interest of its directors and employees. | 7 |
| C. <u>Holding Company</u> | |
| i. It is recommended that the Company comply with Section 1505(d)(3) of the New York Insurance Law and submit an agreement to the Department for the services rendered by Radian Guaranty, Inc. | 12 |
| ii. It is recommended that the Company file any amendments to its tax allocation agreement within 30 days as required by Department Circular Letter No. 33 (1979). | 13 |
| D. <u>Accounts and Records</u> | |
| <u>Impaired Investment</u> | |
| (i.) It is recommended that the Company properly account for impaired investments in accordance with SSAP No. 26. | 14 |
| <u>Special Deposits</u> | |
| (ii.) It is recommended that the Company correctly report and disclose its cash deposits per the annual statement instructions. | 14 |

Respectfully submitted,

_____/S/
Qi Lin
Senior Insurance Examiner

STATE OF NEW YORK)
)ss:
COUNTY OF NEW YORK)

QI LIN, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

_____/S/
Qi Lin

Subscribed and sworn to before me

this _____ day of _____, 2010.

Appointment No. 30336

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, Eric R. Dinallo, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Qi Lin

as proper person to examine into the affairs of the

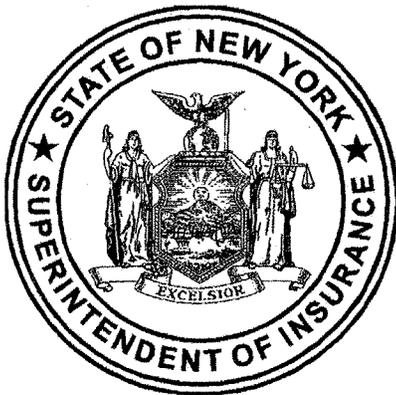
RADIAN ASSET ASSURANCE INC.

and to make a report to me in writing of the condition of the said

CORPORATION

with such other information as she shall deem requisite.

*In Witness Whereof, I have hereunto subscribed by the
name and affixed the official Seal of this Department, at
the City of New York,*



this 19th day of May, 2009

Eric Dinallo

ERIC R. DINALLO

Superintendent of Insurance