Acquisition of United Guaranty Corp & AIG United Guaranty Insurance (Asia) Ltd from American Interna

Company Participants

- Constantine P. Iordanou
- Marc Grandisson
- Mark Donald Lyons

Other Participants

- Albert S. Copersino
- Amit Kumar
- Charles Joseph Sebaski
- Ian J. Gutterman
- Jay Gelb
- Josh D. Shanker
- Kai Pan
- Quentin McMillan
- Ryan Byrnes

MANAGEMENT DISCUSSION SECTION

Operator

Good day, ladies and gentlemen, and welcome to the Arch Capital Group Limited Investor Call on the Acquisition of United Guaranty Corporation. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. And as a reminder, this conference call is being recorded.

Before the company get started with its update, management wants to first remind everyone that certain statements in today's press release and discussed on this call may constitute forward-looking statements under the federal securities laws. These statements are based upon management's current assessments and assumptions and are subject to a number of risks and uncertainties. Consequently, actual results may differ materially from those expressed or implied. For more information on the risks and other factors that may affect future performance, investors should review periodic reports that are filed by the company with the SEC from time to time.

Additionally, certain statements contained in the call that are not based on historical facts are forward-looking statements within the meaning of the Private Securities Litigation

Reform Act of 1995. The company intends the forward-looking statements in this call to be subject to the Safe Harbor created thereby.

Management also will reference some non-GAAP measures of final (sic) [financial] (00:58) performance. The reconciliation of these measures to GAAP and definition of operating income can be found in the company's filings within the SEC and they're also available on the company's website.

I would now like to introduce your host for today's conference Mr. Dinos Iordanou. Sir, you may began.

Constantine P. Iordanou {BIO 2397727 <GO>}

Thank you, Emily. Good morning everyone, and welcome to our call. We're very pleased that we have reached an agreement to purchase United Guaranty from AIG. When this transaction closes, it will make us the largest private mortgage insurance company and it will allow us to deploy our excess capital into a high return business. On a pro forma basis and with just a simple combination of our company's mortgage insurance will absorb approximately one-third of our capital and contribute approximately 50% of our earnings.

At this time in the cycle, we like the mortgage sector because we believe that the mortgage insurance earnings are more stable and predictable than P&C earnings. This might change over time as the primary insurance and P&C re-insurance cycle changes, but at this point in time, we view the MI space as more attractive on a risk reward basis that many of the business lines in our core insurance and re-insurance business.

The mortgage insurance industry's history has not been stellar and some of the problems can be linked to the mono-line structure of the industry, which has proven vulnerable to their own version of cat risk. In our view most of the past problems are attributed to very lose underwriting standards practiced by the entire industry for quite a bit of time. We believe that these PML can be effectively managed through prudent reselection and conservative capital management. United Guaranty under the AIG umbrella has been a strong component of risk based pricing and data analytics, which we strongly agree with and religiously practice ourselves by coupling the talents and capabilities of both companies.

We believe it will give us a competitive advantage in managing the PML risk in the mortgage insurance business. From a risk management point of view, as we have done since our formation, we will maintain risk aggregation limit in accordance with prudent capital management, balance across our three business segments.

Both organizations have developed capital market mechanisms and reinsurance purchases to manage PMLs and we will expect these market leadership to continue.

I'm going to turn now the call over to Mark Lyons, who will give you the key transaction metrics, and after Mark, we will ask Marc Grandisson who is also here on the call with us to give you a bit more on the strategic rationale, and then we will come back and answer your questions.

With that, here it is Mark.

Mark Donald Lyons {BIO 6494178 <GO>}

Great, great. Good morning all. I'd like to address a few topics to help clarify things a bit. First, well, what did we purchase, exactly. Well, we purchased the United Guaranty U.S. primary mortgage operation along with UGC Asia. Additionally and to clarify, Arch will assume that 50% quota shares that has been provided by AIG United Guaranty. AIG will terminate that quota share contract on a run-off basis and keep the cash flows and exposures on a 50% basis, emanating from policies that incepted during 2014 through 2016.

Arch beginning at closing will assume 100% of the UGC policy exposures written as a result. This is value not immediately evident by examining the UGC S-1/A filed with the SEC earlier this year.

So, what is the consideration? The consideration is $3.42 billion. This amount consists of approximately $622 million of cash from internal resources, $200 million from our revolver facility, $925 million of debt, up to $700 million of preferred and $975 million of ACGL common stock. I'll come back and clarify the comments backs in a moment.

This translates to a cash payment to AIG of up to $3.45 billion. There are some wrinkles though that make it a bit less straightforward, and I'll discuss those now. First, there is a possibility that UGC will dividend to AIG, pre-closing up to $250 million. This will have the effect of lowering the consideration paid by Arch to $3.172 billion, but AIG would continue to receive the $3.42 billion I alluded to you before. It's just that $250 million would come from a dividend from UGC, and of course that dividend would commensurately lower UGC's book value as well.

Therefore, assuming a $250 million dividend for a moment, the price paid by Arch would be $3.172 billion, the preferred issuance would commensurately drop to $450 million from $700 million, and the cash component would be approximately $2.2 billion.

Furthermore, there was a collar structure involving $975 million of common stock. Within a plus or minus 7.5% band, the number of shares will adjust in order to keep the dollar value fixed. Outside of the collar, the number of shares remain constant, but the value per share can fluctuate up or down. The common is actually a common equivalent form of preferred, which has no coupon and no voting rights. It will convert to common in a 10:1 ratio upon being sold.

There is also a lock-up provision that permits AIG to begin selling the common-equivalent preferred beginning six months after closing with a lock-up expiring at 18 months. Lastly, AIG at closing is expected to be an approximate 10% to 11% shareholder of ACGL. So what's our view of some of the financial benefits? Well, the classical measures are all positive. We expect significant EPS accretion and ROE expansion by the end of the first year.

Additionally, the transaction is expected to be accretive to book value per share by the first year and it is expected to recover on a tangible book value per share basis by two years post closing. There is a no financing condition within our agreement, so we've put in place a facility to secure the expected capital markets execution coming from acquisition debt and preferred stock financing.

Lastly, we are extremely pleased with the defensive risk management that has been put in place and will be put in place by UGC and AIG prior to closing. As you may be aware, UGC has executed already two capital market transactions known as Bellemeade I and Bellemeade II that help to roll off (09:13) the potential downside risk of pre-crisis exposures. Bellemeade I provides cover for performing loans effective between 1/1/2009 and 3/31/2013. Bellemeade II provides cover for performing loans on policies effective prior to 1/1/2009.

Additionally, aggregate excess of loss protection will be put in place pre-closing, that provides extreme tail risk (09:38) protection for performing loans effective between 1/1/2009 and 12/31/2015, inclusive. These then provide a portfolio more akin to any new company in the U.S. mortgage insurance space.

With that being said, I'd like to now turn it over to Marc Grandisson.

Marc Grandisson {BIO 4369887 <GO>}

Thank you, Mark. Good morning.

From a strategic and operational standpoint, we are fortunate to be combining two operations that have similar culture of innovation, strong risk management processes and diversified client base and a focus on providing values to its customers. We will be building from much common ground and this will allow us to dedicate our efforts to enhance to get the benefits from the enhanced scale of the joint operations.

Both Arch and UGC have well developed data analytics and a history of innovation that will allow the companies to be market leaders in risk management in the future. We are attaining scale at an opportune time with the acquisition of a significant book of business from the post 2008 quality origination years.

In addition, as Mark mentioned the pre-2009 book is well protected by an innovative risk sharing structure, Bellemeade II. We've said many times and you heard Dinos said it as well today that we believe the economics of the U.S. MI insurance industry have been very favorable since 2009. With United Guaranty, we are acquiring not only a market leader, but a company that shares our core principles of price, cycle and risk management.

Our values are aligned and the combined companies will enhance Arch's global footprint and breadth in the U.S. MI industry. With this Dinos, I'll turn it back over to you.

Constantine P. Iordanou {BIO 2397727 <GO>}

Hey, Emily, we're ready for questions.

Q&A

Operator

Thank you. Your first question comes from Amit Kumar. Your line is open.

Q - Amit Kumar {BIO 19777341 <GO>}

Thanks and good morning and congrats on the deal. Just maybe a couple of questions, the first question I was getting last night was – maybe a discussion on the legacy reserves for UGC. I'm sure you did a deep dive and you talked about some projection, maybe just talk about it a bit more so that we can have comfort around those numbers.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, the UGC has managed their book effectively. We were impressed by their thought process, and also, we were impressed by the innovation with their Bellemeade I and Bellemeade II transactions that in essence ruled off (12:41) any adverse development that it will emanate from the prior year. So, we got very, very comfortable with the old book, which is only approximately 18% of the outstanding liability. So when you look at the United Guaranty's book, 82% is post-crisis exposures, 18% is pre-crisis exposures and the pre-crisis exposures have been well booked (13:20) by these two transactions.

Marc, you want to add something to it.

A - Marc Grandisson {BIO 4369887 <GO>}

Two things to add to this. First and foremost, one of the key elements of the due diligence was to sit down with their claims and understand the claims processes, and we're very, very impressed by it. They have a very active and very solid operation, as you would expect.

So, I think that, in addition, we have also insight into our own book of business. We were competing with them as a result of the PMI. We have the data for the PMI one-off that we are effecting on behalf of the liquidator over there. So we had a good sense for where the pre-2009 roll rates or claims are developing, and they're actually developing favorably as you've heard on many calls and it's the same as you would expect for our friends at UGC. So, we're very, very comfortable there.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

And, Amit, I'll just throw one other thing back to the Bellemeade transaction, because it doesn't attach the (14:18) statement reserves. It's higher. But I think the important thing to keep in mind is that there's a future economic problem. The issue isn't known (14:27) claims, in my opinion. The issue is currently performing loans that become non-performing loans. And this is what this cover provides. As you know the statutory accounting model does not permit that kind of estimation on the balance sheet and this provides thoughtful cover for that.

Q - Amit Kumar {BIO 19777341 <GO>}

Got it. That's helpful. The second question and I would re-queue after this; Dinos, I think in the past you had talked about, maybe somewhat of a self-imposed limit of 25% capital to any risk. And MI is now sort of one-third, and I'm just trying to figure that out in terms of looking at the broader, new Arch and the various pieces, what other areas probably get pulled back in terms of trying to meet that requirement. Maybe just help us (15:17) if you were to fast-forward, how should we think about capital allocation for MI versus reinsurance versus insurance?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Yeah. Very, very good question, and you're absolutely correct. Our original goal was to have balance within all of our operations with approximately 25% of our capital being allocated to the MI space. Having said that, it's not very often that you will find something to merge with of the quality that we have found in United Guaranty and get you exactly to 25%.

So, the fact that we're at 35% today is still a very comfortable level for us based on where we think the mortgage insurance marketplace is and the returns that we expect from that. And as I said in my prepared remarks, we're going to maintain these balance over the year. So we're not going to allow the MI to dominate Arch. At the end of the day, Arch will always be a major reinsurer, a major insurer and a major mortgage insurer, and we will use all tools available, capital market tools, reinsurance availability in the marketplace and potentially investors that they want to partner with us to manage the risk to the tolerances that we will – us (17:03) and our board is comfortable with.

So there is no change in philosophy, so to speak and – but for this transaction and for the next few years, we'll probably be committing a bit more to the MI space but that's where the highest returns exist. But I want to assure you that we're not going to lose sight of aggregations and PMLs and be comfortable with how much of that we have on the balance sheet.

Mark and Marc anything to add or...

A - Marc Grandisson {BIO 4369887 <GO>}

No. You hit all the point.

A - Mark Donald Lyons {BIO 6494178 <GO>}

Well said.

Q - Amit Kumar {BIO 19777341 <GO>}

Well said indeed. That's all I have for now. I will re-queue. I'm sure there are lots of other questions. Thank you for all the answers.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

You're quite welcome.

Operator

Your next question comes from Ryan Byrnes. Your line is open.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Great. Thanks for taking the call. Just had a question on – so AIG may take a pre-dividend out. Will you guys need to add capital to the more insurance underwriter, again, if I'm looking – UGC has a lower ratings than Arch MI? I just want to get your thoughts there.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Not at this point in time. But we're cognizant to maintaining a very strong capital position. And as the business evolves and emerges in 2017 and 2018, we will always re-examine our capital position based on our ratings, and then if there is a requirement at that point in time for us to add capital, we will do so.

We will always try to maintain a bit of excess capital in all of our operations for two reasons. One, it's a good safety margin to have, even though it might hurt you a little bit on the return on equity. But second, if there is market opportunities that emerge, you won't be able to take advantage of that and you don't want to stretch your balance sheet to the point that it doesn't give you that flexibility to maneuver.

And third, it's also important, we have a lot of constituents, the rating agencies, they are very big constituent that we need to have very good relationships with them. And usually we have open dialog with the rating agencies on capital needs and capital management, and it's all in the mix. But for closing this transaction, what we have presented to you, it give us comfort, that we don't need to put significant capital into UG.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Okay, great. And then, were you guys...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Marc, do you want to (20:00)...

A - Marc Grandisson {BIO 4369887 <GO>}

(20:01), Ryan, just to let you know, I mean, the key driver for capital level in the U.S., the mortgage basis with the PMIER complaint (20:10), which we are currently and UC is also currently at this point PMIER compliant, I think what we have in addition to the PMIER compliance to deal with or to – as a benefit to being part of a group like Arch, there are abilities to leverage other parts of the company perhaps through reinsurance to leverage some of the excess capital that some units (20:30) may have within us. So, at this point out, we don't believe that we need to do anything in terms of influx of capital in UGC.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Okay, great. And then just quickly, do you guys plan on merging the – I guess, the statutory entities and then I'm just trying to figure out from, I know, cost efficiencies, UGC is running at about a 27% expense ratio legacy, I guess, Arch's MI book is around 50%. I guess, how quickly can the combined MI piece be in that sub-30% range?

A - Mark Donald Lyons {BIO 6494178 <GO>}

Well, it will take a bit of time, that transaction wasn't done, based just on synergies, I mean, we're buying a very good business. I think at a reasonable price, it's good for AIG and it's good for us. They have significant talent. We were impressed with the people that we have met. We haven't met everybody with the two independent companies, but for the people that we have come in touch with, we were positively impressed with the quality of that personnel.

And if you're going to do a transaction purely on the basis that one plus one makes two, and you're going to get significant number of synergies and that's what drives the deal, in my view that's a bad deal. At the end of day, this deal works very well for us on the basis that, yes, we're going to get some synergies, this is obvious, but it's going to be done in a thoughtful way. We have created a team of senior executives from one side with senior executives from our side that they will deal with all the transition issues and what it would look like after closing once we close, plus we don't expect one plus one to be two. At the end of the day, I think the economics work very well on one plus one makes 1.7 or whatever. Yeah.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Okay, thanks. I will re-queue.

Operator

Your next question comes from Al Copersino. Your line is open.

Q - Albert S. Copersino {BIO 4366978 <GO>}

Thank you very much. I appreciate it. I have a couple of questions. The first one is just following up on that last question, on costs and synergies, are you – as you purchase UGC, are you in fact just saying – say the back office operations of UGC?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, there is a team that is going to deal with all those issues. We have some projections in our numbers. Yes, they might be in many different areas. It's not just...

A - Marc Grandisson {BIO 4369887 <GO>}

Back office.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

...back office. It's also – there is projects on both companies on innovation of improving underwriting efficiency by using analytics, et cetera, and at the end of the day, it's not going to happen overnight. It might be gradual, over time. But we both have goals, for example to improve through analytics our ability to underwrite maybe seven, eight, nine mortgages per day, per underwriter where actually United Guaranty is better than us right now, we are in the four – four or five files per underwriter there a little higher than that.

So, at the end of the day, there is going to be a lot of consolidation we got to deal with. But arise to create efficiency not only immediately after the transaction, but going out two years or three years, four years from today, how can we be the most efficient company on the space with the highest customer service possible.

Q - Albert S. Copersino {BIO 4366978 <GO>}

Great, thank you. One other if I could, just a follow-up. And this might be more of a qualitative question, I guess. But the industry – the MI industry appears to have reached intra-industry pricing stability that has not always been the case. I'm curious if your thought is that the – if the benefits of a deal such as yours, Arch is not known for giving away business. You guys price business very responsibly. Will the benefits of a deal like this accrue mainly to your shareholders? Do you think you will share some of the benefits with the banks and the end customers? What impact do you think this deal may have on pricing?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, don't forget. One of the reasons we did the transaction, in the space – in the primary MI space, there were only two companies who believe that re-space pricing is an important ingredient to incorporate into your operations. So you can access risk property and you priced it properly (25:45). And that was United Guaranty and us. As a matter of fact, they were ahead of us, they introduced risk based pricing way back in, I believe, in 2009 and 2010. We introduced risk based pricing only about a year and half ago.

So from that perspective is, it fits very well with our culture that this is another specialty line of business in our view with long-tail, and our attitude in pricing long-tail business, you better get your underwriting right up-front and not wait until your actuaries and your claims people tell you, you didn't get the pricing right up-front. So we do put a lot of emphasis on that. The benefits of all that, they will go to our shareholders.

Now, there is a few differences in approach. I give you an example, I think on singles, we will probably accompany that, it has the lowest percentage of their book in singles. I don't know what the future will bring. I think United Guaranty had a bigger percentage of their singles of their book in singles. I think you're going to probably see that coming down closer to what our numbers are. But we'd both focus and culturally are aligned to appropriately price risk, use all the tools in the tool kit including in-depth analytics and then I think we had a very good United Guaranty and hopefully that will rub off on us, not that we're not that very good, but sometimes we got to accept the – on the marketing side and on the customer satisfaction side, that we're probably a little better than we're. And I think we're going to incorporate that into our future operations. The very customer centric, they have a 1,800 relationships in the marketplace, which is very, very important.

Q - Albert S. Copersino {BIO 4366978 <GO>}

Marc, you've spent a lot of time in the due diligence with the people, so what is your view?

A - Marc Grandisson {BIO 4369887 <GO>}

Culturally, I think that's one thing that is very common to us and I said that in my remarks is the pricing in risk – in cycle management. I mean, they have showed and we've seen it in the numbers, the willingness and ability to react to market pricing, the market share will go up and down, if you don't think – you don't think the returns are appropriate in the business. And I think they had a very ROE of the economic value-added calculation that came to ROE calculation, whereby they react almost immediately to pricing reaction. The market wishes, again testament to not being a top-line focused operation and being bottom-line focused, which I think is also a factor in being part of a bigger multiline outfit, which speaks to the viability over the long-term, we believe of an MI being part of the multiline having multiple sources of income and earnings.

A - Mark Donald Lyons {BIO 6494178 <GO>}

Hey, Al – Mark Lyons, one of the thing I would add is that with risk based pricing, as Dinos, alluded to being the only two companies doing it, there is that real trade-off of real exposure to price and what's critical and both companies have it are indices that measure the quality of the portfolio over time and that will be reflected by are we having better credit related policies on the books and you can – and both companies have that and it's going be critical and they – each company manages by it. And it's a critically important tool.

Q - Albert S. Copersino {BIO 4366978 <GO>}

That's very thorough. Thanks so much guys. I appreciate it. The Dinos' comments on the singles business was also quite helpful, so thank you.

Operator

Your next questions comes from Charles Sebaski. Your line is open.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

Good morning.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Good morning, hi.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

First question, is there any – given you guys just said you and UGC is the only companies out there doing risk-based pricing, does that create any regulatory hurdle for this combination. I mean, is there – you guys...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

We don't believe so, we had – we file our plans with the regulators, we get approval, we'd file in almost every single state and we have approval in most, there is only exception of a couple. And United Guaranty does exactly the same, it's a highly regulated business, and we don't believe that is a problem in the marketplace. As a matter of fact, on the P&C side, in the Auto business or in the property and casualty in a lot of segments, it's been happening for many, many, many years. The only industry that had a very simple pricing tool it was the mortgage insurance business by using just purely credit score and LTV to price their business, which we believe it's the inappropriate way to assess price to the risk.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

Okay. And then, I guess on the growth prospects, obviously this is a growth piece for your guys business due to the scale of UGC. But if I look at UGC over the last few years, profitability has been getting better, but top line premium writings kind of flat. And I guess, what I'm wondering is this – did you kind of buying annuity here? Does the combined mortgage business that Arch, going to be...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

It's not a – we're not just buying on annuity; we're buying a company who believes in the same way we believe as to how you make money in the risk business. You probably price the risk, you don't focus on just top line, you focus on bottom line. And at the end of the day, you continue to find growth opportunities by navigating the company into different sectors, and I don't care these sectors might be on the reinsurance side, on the insurance side, or on the mortgage side.

So, the fact that United Guaranty was disciplined in their pricing and in their approach of assessing risk. And I attribute that to their leadership; I mean, Donna has been a phenomenal leader for United Guaranty; I view that extremely positive. It tells you something about the fabric of the company, their DNA, and it has a lot of similarities to what we do at Arch.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

Okay. That's...

A - Marc Grandisson {BIO 4369887 <GO>}

Let me add to all of this, it's Marc Grandisson here. The two things I wanted you to, I said in my comments, but sometimes the comments get overlooked and not really listened, attentive to, but it's really an innovation and disruptor. The ability for UG to have done what they've done at risk-based pricing in our discussions with them, there is a willingness and ability to be innovative in delivering the credit risk to the markets, the way we are thinking about this.

So, clearly in the future that technology and data analytics and innovation capabilities is something that, we'll be - we've just enhanced dramatically. The second thing is that which is not be overlooked and we have a very, very healthy book of business that they've written and they've attached to their book of business in 2009 and that is going to come to a significant extent to our shareholders for the foreseeable future. So...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

So, the industry, I mean - the industry in the past and they've fought the old war - market share, market share, market share it was what drove a lot of their senior management decisions. And at the end, they ignored underwriting, and when you ignore underwriting, you go and pay dearly. And hopefully, the last war was fought and lost and the new war is going to be fought and won because people are going to pay attention to properly price their business.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

No, I'm not - and I wasn't trying nitpick on my reference to an annuity, I was just curious if the market share of UGC given its size, just that mortgage insurance has been such a growth driver to Arch over the last three years or four years, and I just wondered does that pricing discipline and the current market position allow that business to expand from its pro forma Arch UGC, that's what I was trying to understand and that's why maybe annuity...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, it has potential to grow, but you got to bring it back within the boundaries of risk management. As I said, I'm not going to expose the balance sheet to undo PML risk. We do not roll the dices here; we're very cognizant of our responsibilities to our shareholders and the capital that they provide. However, if we find the opportunities to do more, and we've done it in our history through Flatiron or with Watford Re or other mechanisms; we might bring additional third-party capital into the mix.

The thing that makes it important for us, those who have the underwriting capabilities, and the technology, and the systems, they're going to be in the driver seats in looking at how much profit they can provide. And now you couple that with different capital structures, maybe I can't get the full load (36:02) because that will be un-prudent from a risk management point of view. But I can continue to manufacture and sell the product and offload it, and get paid fees and profit commission through other structures and all of that is going to be in the mix.

So at the end of the day, that innovation exists within Arch today, and we've seen a lot of evidence of that innovation existing within United Guaranty. So, I think the combination is going to be fantastic.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

Thank you. And then, one final - on DTA, could you give any color or commentary on what the value of that DTA is to Arch given your tax structure?

A - Mark Donald Lyons {BIO 6494178 <GO>}

Yeah. Well, Chuck, I think I can see very quick related and say to Arch it's of no value. We're doing a 338(h)(10) election, and the DTA stays with AIG.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

Excellent. Thanks a lot for the answers, guys.

A - Mark Donald Lyons {BIO 6494178 <GO>}

Thanks, Chuck.

Operator

Your next question comes from Jay Gelb. Your line is open.

Q - Jay Gelb {BIO 21247396 <GO>}

Thanks. Good morning. Just to start off with a couple numbers questions. What's the tangible book value of the business being acquired?

A - Mark Donald Lyons {BIO 6494178 <GO>}

They have no goodwill or intangibles on the book, so their book and tangible is the same.

Q - Jay Gelb {BIO 21247396 <GO>}

That's what I thought, and I was just trying to square that what you comment that the deal will be recoverable to Arch's tangible book in the two years.

A - Mark Donald Lyons {BIO 6494178 <GO>}

Okay. Two different things. There's two different things, what's the balance sheet of the company we're acquiring, and then what is the purchase price paid on Arch's balance sheet on goodwill versus intangibles, two different things. I answered the question at best, why we're acquiring UGC, and it has no goodwill. Does that...

Q - Jay Gelb {BIO 21247396 <GO>}

Yes.

A - Mark Donald Lyons {BIO 6494178 <GO>}

...answer that?

Q - Jay Gelb {BIO 21247396 <GO>}

Could you go through the second part, Mark, in terms of how we think about what goodwill and intangibles goes on Arch's balance sheet?

A - Mark Donald Lyons {BIO 6494178 <GO>}

Well, I'm not going to go through the whole amount, and I can tell you, we're still working through the purchase GAAP accounting aspects as we speak, but there is going to be a fair amount of excess purchase prices subject to being intangible being amortized as opposed to sitting on the balance sheet as goodwill.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay.

A - Mark Donald Lyons {BIO 6494178 <GO>}

But that's in the process of being finalized.

Q - Jay Gelb {BIO 21247396 <GO>}

I see. So, there will be amortization expense from this deal...

A - Mark Donald Lyons {BIO 6494178 <GO>}

Correct.

Q - Jay Gelb {BIO 21247396 <GO>}

...in Arch's earnings? Okay.

A - Mark Donald Lyons {BIO 6494178 <GO>}

Correct.

Q - Jay Gelb {BIO 21247396 <GO>}

But we don't have that yet?

A - Mark Donald Lyons {BIO 6494178 <GO>}

Right. We have a range of views of it, but we got to sit down and arm-wrestle with our accounts.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. The 35% accretion to run rate EPS, is that based on if the deal – if the two companies were put together today on a pro-forma basis, or is that looking out some point in the future?

A - Mark Donald Lyons {BIO 6494178 <GO>}

It's a kind of a longer-term average from 2017 forward. We just try to...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

It's a high growth.

A - Mark Donald Lyons {BIO 6494178 <GO>}

...straight-line it for the average. It'll fluctuate. It'll actually increase, but it's a good way to think about it.

Q - Jay Gelb {BIO 21247396 <GO>}

Did that assume steady-state legacy Arch MI earnings or essentially that growing over time, which is what I would have...

A - Mark Donald Lyons {BIO 6494178 <GO>}

I think one question I'll kick it off to probably to Marc. It would assume some view towards what Dinos alluded to, which is the mixed of monthlies and singles likely to be altered.

A - Marc Grandisson {BIO 4369887 <GO>}

As well as accounting for some overlapping some client, which is not tremendously the case, but there's some overlapping, some clients recognizing fully that we may not be able to be 100% of the delivery. We'd like to be or make the case to our clients, but it may not happen, they may want to diversify away at least from this combined entity. So there some of the assumptions are in our numbers that you see.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Yeah. We have assumed, we're going to lose some volume because of company overlap, Arch and United Guaranty might be too big market share for a specific customer, and then, a reduction in the singles.

Q - Jay Gelb {BIO 21247396 <GO>}

Right.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

So, in the usual Arch way, we are not going to try to overpromise and under deliver. We'll try to be conservative in our projections.

Q - Jay Gelb {BIO 21247396 <GO>}

I appreciate that, the conservative outlook. Cost synergies on page nine of the presentation, I believe it does say significant cost synergies. So, I just want to circle back on that.

A - Mark Donald Lyons {BIO 6494178 <GO>}

Well, we anticipate some, and we would expect them to be realized partially in 2017, a little more in 2018, and then probably run rating out of that point. Admittedly, a bit of a swag at this point until the integration team really goes through the detail as Dinos alluded to, but I don't want to go into the specifics, Jay, but let me tell you, it's not an (41:17).

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. And then last one, I promise. Tax saving opportunity, on the current United Guaranty businesses carries an effective tax rate in the 30%s, Arch overall is in the mid single-digit range. So, I'm wondering, if there is an opportunity there as well that's taken into account for your accretion expectation?

A - Mark Donald Lyons {BIO 6494178 <GO>}

Just keep in mind that we'll use the same tools that we use in our property casualty space and have done in our mortgage operation to date, which is utilizing our internal quota share capabilities to aid in capital management and in the topic you asked about.

Q - Jay Gelb {BIO 21247396 <GO>}

Makes lot of sense. Thanks.

A - Mark Donald Lyons {BIO 6494178 <GO>}

Thank you.

Operator

Your next question comes from Ian Gutterman. Your line is open.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

All right. Dinos, it's early in the days and my question is what was for breakfast?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, listen I was the best short order cook in a Greek Diner. I could have done one case of eggs, we just – 36 dozen in about an hour, so...

A - Mark Donald Lyons {BIO 6494178 <GO>}

Ian, you are suppose to be the last questioner on the call.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

I thought, I would be actually, but, so before my serious questions, I did some research on Greek Diner, Dinos, I watched a show on Sophia Foods (42:36) so we can talk about that some time, but...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, listen, you can be my partner, you know...

Q - Ian J. Gutterman {BIO 18249218 <GO>}

I know. We'll be the fourth leg of the stool, so...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

I don't think my Board is interested in Greek Diner, and maybe I'm, but not them.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

So, my first question is, I was just wondering, if I'm sure this isn't something out, the tip of your finger as maybe after the deal closes on a go forward basis just how to think about risk in the MI business? Right. We're so used to on the P&C business talking about PMLs, and how to think about the zones and occurrence versus a prevent and things like that, and now that MI is also going to be such a big part of the business, I think it will be helpful even given you mentioned the cap bonds within reinsurance, just some framework down the road to help us think about how you manage the tail and how much capital you have to put in the tail and something equivalent to 1-in-250 year as a percentage of your our capital, I think it would be helpful to invest just trying to understand the risk?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Right. We haven't settled to the exact characteristic 1-in-250 year, 1-in-500 year et cetera, but let me give you the flavor around it. S&P, for example, set their capital at the A level in the MI space on the basis that home prices declined by 37% and defaults on all mortgages are at 14%. So, 14% of every single mortgage defaults, and at the same time, you have a 37% price reduction in home values.

Now, we are having similar models that we look at where unemployment rate might go, where price reductions might go, what the claim ratio might be. And basically, we're managing through those kind of extreme events in the 1-in-250 year PML. Now we haven't decided yet because, I haven't - I haven't had that discussion with my board. We'll make that information publicly available or not, but I can assure you internally, every quarter, we make those calculations and François Morin which is our Chief Risk Officer and our board is aware of the numbers, and that's what guide us in - not only in our capital structure, but also how much risk we want to take on the balance sheet of Arch. And if it's still good business, but we don't want to take aggregation that is above what is prudent, then I said we might create other vehicles for us to continue to be a service and get this out of that activity.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

(45:59)

A - Mark Donald Lyons {BIO 6494178 <GO>}

Hey, Ian, let me approach that a little differently, give you a P&C announcement (46:04).

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay.

A - Mark Donald Lyons {BIO 6494178 <GO>}

In the P&C space, when you get a soft market to a hard market, on a policy year basis, you could pretty much get a good sense of how it's going to run, and because you see pricing, it has to point change (46:19) so forth and so on. In the mortgage space, it was more of a macroeconomic event hit, it cuts across policy years. So I think on average, you should say if there's a macroeconomic event hitting in year X, it's going to go back two years X-4X minus 5X in a decreasing way.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Sure.

A - Mark Donald Lyons {BIO 6494178 <GO>}

So, if it has a 30% once you show (46:43) impact on the current year, it might be 20% on the prior year before that and 15% and then 10%, because it's simply fewer policy still outstanding to impact it. But so, current minus 4 or current minus 5, I think it's the way to, if you're thinking in a modeling sense, how to think about it.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Okay.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

And, Ian, important for you to, talking about the last four versus the new (47:12). If the industry did not make that - what I would think classic mistakes of not focusing on underwriting upfront. The stress scenario I described which is for S&P is an A level tabular (47:34) of capital requirement, the 14% claim ratio. We will never have been reached even in the last crisis, if no verification and all day loans were not underwritten by the MI company.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Of course.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

And the data will show you – to you. If you take the old data and we have the run-off of PMI and we have all that information, or if you go to Bloomberg and you see on the – on the historical default rates by type of loan, you find out that the big problems they were with no verification and all day, I'm not saying they're the only problems. There were other things that they were problematic, over-inflated appraisals, some fraud, et cetera. But even with that in all in, just eliminating all days and no verification loans, you will never get to double-digit claim ratios. And that tells you that this industry today is in a much better shape than it was – ever was, not because of where the economic cycle is and where housing prices are, but I think hopefully, too many people put their hands on the stove, when they get burned, then hopefully those tuition bills, they will be put to good use going forward.

I will assure you that as long as I run this company or my colleagues here they're running this company; we're not going to make those tragic mistakes of the past. We're not volume driven, we're profitability, underwriting driven and bottom-line driven, and that's what we believe is being in the last – at least what we've seen in the last four years, five years, the thesis and not only the thesis, but the performance of United Guaranty, they were focusing on the same things we're focusing.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Exactly, exactly. And then just to move on to the accretion math I just – Mark, I just want to understand that the – is the reason we get to 35% down the road but not day one, I assume is a little bit like what you were saying a few minutes ago, right it's just because you don't capture 50% of the 2014 to 2016, I'm going to make up a number maybe you're getting two-thirds of UGC's earnings day one and it's a 100% by year five, is that sort of conceptually the right way to think about and it just still...

A - Mark Donald Lyons {BIO 6494178 <GO>}

Yeah. That is the right way to think about it. Because as you know, the quarter show risk attaching and a lot of it is monthly business at the same time it's coming over. So, yeah, that eats its way in, but its growth and impact in 2017, 2018, and 2019 is material....

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Yeah. That's what I was trying to understand.

A - Mark Donald Lyons {BIO 6494178 <GO>}

... (50:24)

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Right. So, can you give us a sense of how much of their earnings, by just looking at AIG's reported financials, how much of their earnings you get in 2017 and then, is it five years till you get to a 100%, six years, seven years like, what's the right way to think about that?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

When you mean, say 100% you mean when do you...

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Meaning that...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

... (50:44) value?

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Right. When that's completely run-off and you have sort of everything?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

I think it's closer to four years to five years to be 90% plus.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Four years to five years. Okay, great.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Don't forget its 2014, 2015 and 2016, right.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Right.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

That's the data. 2014, it would be almost gone five years from today, 2016 you will have. You know, so - but that's a good rough number, right.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay. Got it. And then related to that, I assume, the accretion assumes no change in - or essentially no buyback, where if you're going to a deal that probably would have been buyback down the road, can you give us a sense given how much excess capital is deploying into this? How many - how long does it take to sort of rebuild to a normal cushion? Is that two years, three years, maybe less?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

It would be - it's not going to be three, it's going to be probably like two years. So I don't think we'll have buybacks in 2017, 2018 is up in the air. But at the end of the day I told you, I'm also very cognizant that when I make commitments independent, if it's to regulators, rating agencies and all that, I live up to my commitments. And at the end of the day, we're going to maintain those commitments.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. And then just one final text book question. The convert – the shares that we'll convert, when do those become eligible to invert, is the expectation that AIG will convert this upon closing or that it takes a year or two, how does that work?

A - Mark Donald Lyons {BIO 6494178 <GO>}

Well, I can't speak for AIG behavior...

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay.

A - Mark Donald Lyons {BIO 6494178 <GO>}

What I can speak to is what the lockup provision is in the contract.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

All right.

A - Mark Donald Lyons {BIO 6494178 <GO>}

And there is a lockup until six months...

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay.

A - Mark Donald Lyons {BIO 6494178 <GO>}

And then there is points along the way, where that expands, but it's cumulative and it expires at18 months. What AIG chooses to do with that is completely up to them.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

And while they're making up their mind or until the lockup hits, will those be in your fully equivalent shares or do they not become fully equivalent shares until they exercise?

A - Mark Donald Lyons {BIO 6494178 <GO>}

They are in.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

They are in. Okay so, we don't have to really worry about their time and we should just put M&A shares for you guys?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Yeah.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay, great. Thanks.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

You got to think about as the equivalent shares, et cetera. And you know, this AIG is a small company there, that's a value to them and I'm sure within the lock-up provision they're going to exercise good care in the way they're going to maximize their income, right.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Right now I'm just thinking like sometimes when companies issue converts like those old ESUs or whatever, you can keep them out of share count for a few years. I wanted to make sure it wasn't one of those, so.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

No, no.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay, great. Thank you.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Thanks, Ian.

Operator

Your next question comes from Justin Maurer (53:28). Your line is open.

Good morning, guys.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Hi, (53:33).

Q - Operator

Just quick with the rating agencies, did you - I'm assuming you've talked to them in terms of expectations of ratings?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Yeah. We have - I'd say we have indications as opposed to set determinations, but our expectation is we retain our S&P A+ that is still in the process of discussion, such we expect to maintain our A+ FSR, I think the debt rating is being examined and Moody's is likely to move us to an A2 from an A1.

Q - Operator

Got it, okay. And then just in terms of timing closure just given that CMG and PMI kind of got dragged out, how do you think about that in terms?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

This is a different scenario. We got to go to form A, processed through the States, this is mostly North Carolina and Wisconsin and then the GSEs Fannie and Freddie. The timeframe we said by year-end maybe early part of 2017 is reasonable place to be for closing and is different than the PMI. We was in receivership and there was a bankruptcy procedure, et cetera. It's much – these are to help the well-performing companies and at the end of the day, it should be a shorter process.

Q - Operator

Got it. Thanks, guys. Congrats.

Your next question comes from Ryan Byrnes. Your line is open.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Sorry. Thanks, guys. Just one quick clarification, one, just want to make sure I understand that the – what the UGC quota share economics. So, if I look at the AIG sub, I want to say that the operating income was $644 million versus the S1, which I want to say was $550 million (55:45) or so. Does that explain what the quota share is taking out?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

There is one my understanding of it our S1 (55:55) is it reflects the UGC book as well as the assumption of AIG on the consolidated way on the 50% quota share. So it's a blend and their mix is going to be a little bit different because they've been on the quota share a longer since 2014.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Got it. Okay. Thanks, guys.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Thank you.

Operator

Your next question comes from Quentin McMillan. Your line is open.

Q - Quentin McMillan {BIO 19411547 <GO>}

Hi, good morning. Thanks very much, guys. I just wanted to quickly ask about the sort of the markets share gain or loss, what do you guys think the insurance in force for your book is going to be as a percentage of the overall market on a pro forma basis if you can take a stab at that. And is there sort of a comfortable...?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

When, yes, when?

Q - Quentin McMillan {BIO 19411547 <GO>}

...as of the closing of the transactions. So, whether that's the end of this year or the beginning of next year, when the book sort of turns over before the full amount of AIG's shares over the next four years to five years are even earned in (56:59), where do you sort of think you will stand at at that point?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, when we close, all you got to do is just take our market share in there (57:09) and put it together and that's what it is. The actions are going to happen in 2017, 2018 and beyond, and we don't know. As a combined entity, we're probably at 28%, 29% market share. We view that, that is going to come down to maybe in the low 20%s, over three-year period of time. But I don't – like I said, all things being equal, the only thing I'm trying to emphasize is that other than the comments I made on the singles, we want to maintain a customer relationships. We want to be – but at the end, the customers have things to say, too, so there might be (57:51) some of them – and it would've been unprudent for us to assume that all customers are going to love us and they're going to say, they love United Guaranty and they love Arch and then they're going to maintain all the relationships.

Some relationships, we might lose or readjust, and at the end, we're going to try to do the best we can to maintain good relationships with a very, very broad and expansive customer base that United Guaranty has over 1,800 customers.

A - Mark Donald Lyons {BIO 6494178 <GO>}

And then, Quentin, let me just clarify because there is a difference between the IIF, the insurance in-force mix and the NIW mix. The NIW, which is the standard market share view is, I like to call it the onion skin layer of new business coming in. So that's your incremental to the IIF, I suppose to the in-force business. So our rule of thumb basis Arch's IIF is a smaller percentage than its NIW because of the growth. It's the reverse, I would think, for UGC that their market share has been dropping, so their in-force should be relatively larger on a relative basis.

Q - Quentin McMillan {BIO 19411547 <GO>}

Okay, that's very helpful. And then I just wanted to sort of tie that thought together and I know a few different people have asked about sort of the growth prospects going forward. But in terms of RateStar, it seems like you're obviously targeting better more profitable business – oh, I'm sorry, the same ROE, but kind of faster growth business. And if the IIF is sort of coming from high-20%s down to low-20%s, which is the prevailing sentiment, as you announced this, how do we think about sort of the growth of RateStar?

Are we going to sort of meaningfully tail off, or do you look to continue to grow RateStar at a very fast clip and maybe more singles as the portfolio sort of churns away from some of the business that you maybe don't want?

A - Marc Grandisson {BIO 4369887 <GO>}

I think, RateStar is not a growth engine, RateStar is a pricing engine. And it just so happens that it's able to select and better select risk within the risk spectrum. And for that reason we're able to take, we believe, the best risk part of any grid that will be crudely done on a rate card basis.

So in terms of what happens one quarter or two quarters after the innovation is – the closing is done, they have a risk-based pricing. We have a risk-based pricing. Our expectation is we'll have the best of both worlds and it just allows us to be better risk selectors in the marketplace. So again, RateStar or their risk-based pricing model is – were (01:00:25) not growth engine, they're really meant to slice and dice the data more refinely and get better risk-adjusted returns.

Q - Quentin McMillan {BIO 19411547 <GO>}

Great. Thank you very much, guys.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Josh.

Operator

Your next question comes from Josh Shanker. Your line is open.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Yeah, thank you for my question, everyone. Everyone, hear me okay? Unfortunately, I'm on a cell phone.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Yeah, that's fine Josh Ian Shanker (01:00:50).

Q - Josh D. Shanker {BIO 5292022 <GO>}

Yeah, (01:00:53). So anyways, I think for the past two years, the question you've gotten most often is, are you going to buy UGC. This is not a new story in anyways and then you've always been very complementary about business and whatnot, but yesterday the deal got announced. If we think about the last couple of years, is the deal more attractive now given where P&C markets are or to put in another way, has your outlook for P&C diminished so much that the best thing you can do with your $3 billion put into MI, how does the rest of the market affect your incentives to do this transaction right now?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, the - what you said it was absolutely correct. Our interest in United Guaranty, it wasn't a recent interest - we. But we were disciplined with that - are there reasonable price. This is a company that we will like to have, because of the lot of other ingredient, like we said you heard me many times talk about culture, pricing culture, underwriting culture, and we found that, as a matter of fact I'm more - I'm happier today with a transaction that when I actually made my first call to Peter, because when we got in and they allowed us to fix their tires and all that (01:02:23), we have confirmed what we suspected, and it was all true.

Having said that, you rather common (01:02:31), it's almost correct tools. The P&C world, especially, the reinsurance world is on, I don't know, 12, 13 consecutive quarters of giving upgrade (01:02:42). I think, there is price correction that needs to happen on the P&C side, and it hasn't happened yet, and I hope it will, but we're not going to wait - you never fight Mr. Market. Mr. Market, it will be whatever it is, and then you got to navigate within that marketplace. We view the MI space a better place to be right now.

Again, within risk management tolerance, I can't keep emphasizing that. But we're not abandoning a P&C and our reinsurance. Our P&C, and reinsurance business is very, very core. It's our engine, it got us the ability to do this transaction, and we will continue to be a big participant in that in a prudent way. When the pricing improves, we'll do a lot more on that side too. And, if it doesn't, we're going to be defensive. And, that's a real implication Josh, that overtime depending upon the opportunities and the cycles and pretty much non-correlated cycles between them. There could be massive insurance and reinsurance margins, and the questions you're asking is why it's mortgage insurance only 60% to 70% of your capital. So, it's going to fluctuate depending upon relative market conditions.

Q - Josh D. Shanker {BIO 5292022 <GO>}

And given that you're now the market share leader, do you find the GSEs, first thing, when it comes to Stafford (01:04 05) transactions, whatnot, your left invariable (01:04:08) counterparty because you are already giving a lot of flow through the standard (01:04:11) channel?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, at the end of the day, I think we have very good relationships with the GSEs. The GSEs, especially when they look at the bulk transactions, they look also the balance sheets of the providers, and it's not just us, there's other reinsurance companies et cetera, and very high quality from a capital point of view, Arch will have in excess of $10 billion of total capital between common, preferred and long-term debt, and I think is a good place for the GSEs to be to have the entire balance sheet large (01:04:57) behind those transactions.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Okay. So, I'm going to think there is no change.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Yeah.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Just, good luck and congratulations.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Yeah.

A - Mark Donald Lyons {BIO 6494178 <GO>}

Thanks Josh.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Thank you, Josh.

Operator

Your next question comes from Kai Pan. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning. First question...

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Hi, Kai.

Q - Kai Pan {BIO 18669701 <GO>}

Hi. First question on debt. So what's your debt-to-capital ratio post merger? What are your comparable rates? And how much of the debt is going to be issued on shore, which you probably had some tech divisibility?

A - Mark Donald Lyons {BIO 6494178 <GO>}

Well. Let me give you from a perspective of Moody's, because there are certain equity credits like when you issue preferreds and so forth. It's in the 24%.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

24%.

A - Mark Donald Lyons {BIO 6494178 <GO>}

24%. And we anticipate, the longer tenured debt to be issued onshore.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. All right that's great. Then the second question, I want to push a little harder on the reinsurance deal, is that out of the $360 million net earnings in 2015 (01:06:18) on UGC's X1? How much of that you would just like – you expect to retain on day one?

A - Mark Donald Lyons {BIO 6494178 <GO>}

You said a reinsurance question, because the $360 million you're referencing, which I think it was 2015's number...

Q - Kai Pan {BIO 18669701 <GO>}

Yeah.

A - Mark Donald Lyons {BIO 6494178 <GO>}

...is net of the quota share.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. So that's the amount if everything else is constant (01:06:47).

A - Mark Donald Lyons {BIO 6494178 <GO>}

That's right. So Kai when there is valuation metrics out there on price-to-book or price-to-earnings and so forth and a supply to a $360 million, it just implicitly assumes that the 50% quota share is always in effect, always 50% retained by UGC, and this is the valuation associated with the reinsurance that we're assuming.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. So over time, the earnings, ever since (01:07:17) earnings will grow because you will retain more on your own balance sheet.

A - Mark Donald Lyons {BIO 6494178 <GO>}

That's correct.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Everything else being equal.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Great. My last question is on the imaginary retention, what's your plan for imaginary retention for post UGC as well as your own MI business? And also Dinos, I don't know if this deal impacted your retirement planning?

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, that's a mouthful. I'll address the retirement. I mean, March of 18th, the CEO job will go to Marc Grandisson. That's our plan. We plan for everything in this company including succession. I'm not going away. I mean, I have an agreement with our board and with Marc et cetera. As Vollaro retired in 2009, and you see him all the time and he is an advisor to the company and he has been doing a phenomenal job for us for now, another seven years since his retirement. I'm going to be in that mode. I'll be around, I'll be the Chairman of the company. I will continue to advise Marc on a lot of issues I've been involved, more over a part time basis with whatever assignments I get from Marc. But at the end of the day, that's what you get with Arch. You get continuity, you get - we don't make abrupt decisions and we move on. And it's the model that is being working very well for us. We prepare our people for succession in every job that we have within the organization. So no change in the plans, but I've been a little more expensive as to be truthfully honest with everybody on the call as to what we were always internally been planning now for four years or five years.

Marc?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. Thanks for that Dinos. I think in terms of the executives from UG and then the Arch, no matter we have very capable collective leaders and deep management throughout. And as Dinos mentioned already there is an executive integration group that's been formed, three from UGC, three from Arch Capital Group. And we'll go through that and make sure we have the best people in the best place, and we'll retain talent in the appropriate places (01:09:47) run even faster after closing.

Q - Kai Pan {BIO 18669701 <GO>}

That's great. Thank you so much and good luck.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Thank you.

Operator

I'm not showing any further questions. I would now like to turn the conference over to Mr. Dinos Iordanou for closing remarks.

A - Constantine P. Iordanou {BIO 2397727 <GO>}

Well, thank you, Emily. Thank you, everybody. I know we took a lot of your time, but we appreciate the support, and we're looking forward to integrating two great companies as soon as we get approval to close. Thank you and have a wonderful day.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may all disconnect.