S&P Global
Market Intelligence

Assurant, Inc. NYSE:AIZ

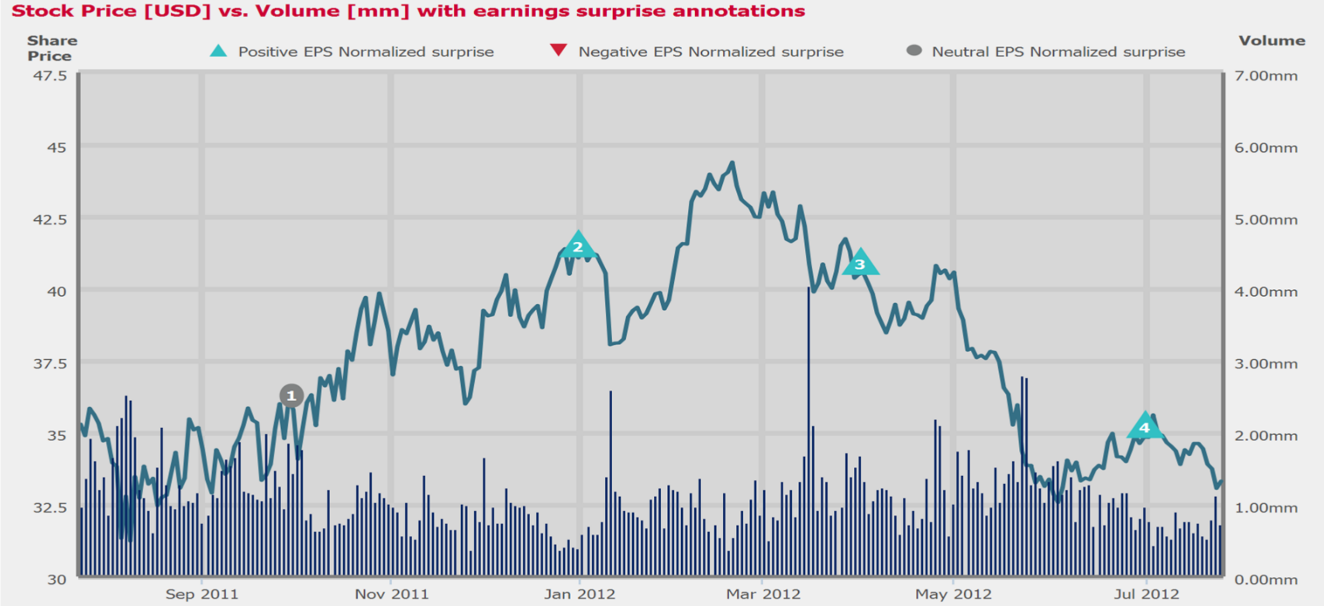
FQ3 2012 Earnings Call Transcripts

Thursday, October 25, 2012 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.43	1.55	8.39	1.51	6.51	5.74
Revenue (mm)	2102.38	2145.08	2.03	2129.76	8443.49	8375.63

Currency: USD
Consensus as of Oct-25-2012 8:05 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2011	0.79	0.78	0.00 %
FQ4 2011	1.36	1.65	21.32 %
FQ1 2012	1.43	1.76	23.08 %
FQ2 2012	1.38	1.81	31.16 %

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Call Participants

EXECUTIVES

Christopher John Pagano
Executive VP & Chief Risk Officer

Francesca Luthi
Executive VP and Chief Communication & Marketing Officer

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Robert Brian Pollock
Former Chief Executive Officer

ANALYSTS

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Mark Finkelstein

Sean Robert Dargan
Macquarie Research

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Presentation

Operator

Welcome to Assurant's Third Quarter, 2012 Earnings Conference Call and Webcast. [Operator Instructions]

It is now my pleasure to turn the floor over to Francesca Luthi, Senior Vice President of Investor Relations. You may begin.

Francesca Luthi
Executive VP and Chief Communication & Marketing Officer

Thank you, Quint, and good morning, everyone. We look forward to discussing our third quarter 2012 results with you today. Joining me for Assurant's conference call are Rob Pollock, our President and Chief Executive Officer; Mike Peninger, our Chief Financial Officer; and Chris Pagano, our Chief Investment Officer and Treasurer.

Yesterday afternoon we issued a news release announcing our third quarter results. Both the release and corresponding financial supplemental are available at Assurant.com. As a reminder, all prior period financial information presented in the release, financial supplement and on this call reflects the new accounting guidelines for deferred acquisition costs, which the company adopted as of January 1, 2012. We'll start today's call with brief remarks from Rob and Mike, with Chris participating in the Q&A session.

As a reminder, some of the statements we make on today's call may be forward-looking and actual results may differ materially from those projected in these statements. Additional information on factors that could cause actual results to differ materially from those projected can be found in yesterday's new release, as well as in our SEC reports, including our 2011 Form 10-K, second quarter 2012 Form 10-Q and the upcoming third quarter Form 10-Q available at Assurant.com.

Today's call will also contain non-GAAP financial measures, which we believe are meaningful in evaluating the company's performance. For more details on these measures, the most comparable GAAP measures and a reconciliation of the 2, please refer to the news release and financial supplement posted on Assurant.com.

And with that, I will turn the call over to Rob.

Robert Brian Pollock
Former Chief Executive Officer

Good morning, everyone, and thanks, Francesca. We are pleased to have you on the Assurant team and appreciate the seamless transitions you provided investors, because of the broad experience you bring to the job.

I also want to congratulate and thank Melissa Kivett as she moves to her new role as Senior Vice President, Business Development and Strategy. This is an excellent example of how we develop the leadership team at Assurant.

Our results for the third quarter of 2012 were strong and in line with our expectations. We are pleased with our continued progress in executing our strategy as we gain traction in the areas we have targeted for profitable growth. We are committed to creating long term value for shareholders and our capital management strategy is a key driver.

For the first 9 months of 2012, we've returned approximately $420 million to shareholders via dividends and share repurchases and we did this while maintaining a strong balance sheet.

Let me outline our performance against the 3 key operating metrics we used to track our progress. First, we reported an annualized operating return on equity, excluding accumulated other comprehensive income or AOCI of 11.8% for the quarter. Year-to-date, annualized operating return on equity is 13.6%. This includes $20 million of income from real estate joint ventures and $28 million from reportable catastrophe losses.

Second, book value per diluted share excluding AOCI grew by 4% in the quarter and by 13% year-to-date. Solid earnings and continued share repurchases drove the increase.

Third, revenue defined as net earned premiums and fee income grew by 4% to $2 billion compared to the third quarter of 2011, with solutions in specialty property leading the increase. Year-to-date revenue increased by about 3% compared to last year.

In 2012 our focus has been on achieving profitable growth and we are making solid progress, but the macro environment is challenging. Unemployment remains elevated, interest rates are at record lows and regulatory changes pervasive throughout the financial services sector in general and the insurance industry in particular.

Now let me comment on the businesses and the key trends influencing our results. In Assurant Solutions, both revenue and net operating income increased in the quarter compared to 2011. Improved performance in our domestic service contract business and across our Latin American operations, including mobile, were the primary contributors.

As sales have begun to rebound in the U.S. automotive sector, our vehicle service contract business is gaining renewed momentum. In addition, the continued growth and the use of mobile devices has expanded the market opportunity for our products worldwide.

Our pre-need business continues to perform well as we work closely with the industry leader SCI. As we look ahead, we are focused on achieving a 14% ROE in solutions in 2014. This will require a continued organizational focus on our strategic growth areas and reduced resources on non-growth areas.

Turning to Assurant Specialty Property. Our track record of great client service continues to generate success. We expanded our lender place business with new and existing clients. In the third quarter we signed a contract with a new client for a portfolio of 1 million loans, with expected placement rates around 1%. We expect to earn premiums on this business after the loans are on boarded in the first quarter of 2013.

Including this win, our total loans tracked are up more than 7% since 2010. We've benefited in recent years from loan movements towards the specialty services. We won portfolios and competitive bidding. Placement rates have remained at alleviated levels instead of declining. The timing of the housing recovery is difficult to predict, but we do believe that when the business normalizes, we will continue to have an attractive lender place specialty business, albeit with lower capital requirements and earnings.

We continue to grow our multi-family housing business, comprised mainly of renters insurance and resident bond products. Together they have grown to over $145 million of annualized revenue and we believe they have the potential to deliver double-digit revenue growth for the next several years.

After Mike reviews the financial highlights for the quarter, I'll offer an update on various actions underway in our lender place business, including the recent California rate reduction.

Assurant's Health's third quarter performance reflects continued success in 2012, in reducing expenses and tailoring our product offerings to consumer preferences for affordability and choice. We are encouraged by the growing interest in our Assurant health access and supplemental coverages products as Americans look for affordable alternatives.

Our network agreement with Aetna further improves the affordability of the individual major medical products and offers a broader choice of network providers. Health will face additional challenges as the implementation of the patient protection and affordable care act continues to unfold.

With the health exchanges beginning to take shape for 2014, we will need to further adapt our business model in what will be an evolving and likely quite different individual medical insurance marketplace than we have seen before. While we look to address these near term challenges, we remain confident in the long-term prospects of our business until the healthcare market opportunity expands.

Assurant's employee benefit continues to navigate through a challenging environment, characterized by low interest rates and continued economic uncertainty among small businesses. Voluntary products remain our growth engine in employee benefits and accounted for nearly half of new sales and more than a third of earned premiums in the quarter. These results demonstrate the success of our distribution approach that emphasizes key brokers, as well as our expanded voluntary offerings and capabilities. Overall I am pleased with our progress this year.

With that, I'll turn it to Mike for more detailed comments on the third quarter.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Thanks Rob. I'll discuss a few highlights from the quarter and key priorities for each of our businesses, starting with Assurant Solutions.

During the third quarter, Solutions delivered double digit growth in net earned premiums and fees, driven by our domestic service contract and Latin American business. Growth in Latin America was primarily generated from service contracts sold through mobile and retail clients.

As a reminder, net earned premiums in the fourth quarter will reflect the previously disclosed loss of a domestic mobile client effective October 1, which accounted for about $100 million of annual earned premiums.

Solutions also generated strong sales, particularly in our domestic service contracts from both retail and automotive clients. In the third quarter we assumed a block of automotive warranty business, which added about $40 million to gross written premiums. This block, along with improved auto sales over the past year, has led to strong growth in our vehicle service contract business.

Solutions new business pipeline remains strong, particularly in the mobile segment. Our previously announced wins, both domestically and abroad, demonstrate our ability to compete in the fast growing mobile market place.

The international combined ratio decreased to about 102%, excluding a charge related to our recent tax court decision, impacting certain products sold by insurance companies in Germany. The improvement was driven by more favorable results in Europe and Latin America. For the full year we expect the international combined ratio to be near our target of 102% excluding disclosed items.

Solutions remains focused on its goals of breaking even in the U.K. by mid 2013 and achieving an overall return on equity of 14% in 2014. While we expect growth across the business, we will need expense reductions to achieve these targets, particularly in areas experiencing market pressures such as Europe and the domestic credit business.

Specialty property posted strong results in the third quarter, reflecting revenue growth in lender placed homeowners' insurance and multi-family housing products. Catastrophe losses were lower compared to the same period last year. Placement rates remained elevated compared to historic averages, reflecting the continued impact of seriously delinquent loans.

We did however see a 10 basis point sequential decline in the third quarter. This was driven in part by the 2.1 million loans we added last quarter, which has about a 1% placement rate, but it may be further evidence of seriously delinquent loans moving to resolution. We anticipate that placement rates will continue to decline at a pace, which largely depends on the state of the economy, housing policy and client specific portfolio characteristics.

For 2013 we expect lender placed premiums and returns to be lower, primarily reflecting a continued reduction in placement rates and lower premiums, including the impact of the California rate reduction. This will be partially offset by the recent growth and the number of loans we track. We intend to mitigate the impact of lower premiums and higher combined ratios by managing expenses and freeing up capital as the business moves to a normalized steady state over the next few years.

At Health, net operating income increased due to continued expense management and favorable loss experience. The higher effective tax rate in the quarter reflects healthcare reform restrictions on deductible expenses.

Revenue declined due to ongoing product mix shifts and challenging economic conditions, particularly in our small group business. Our target market and group in the Health's group business is employers with less than 10 employees. We are seeing fewer business of that size adding employees or looking for coverage.

In the quarter, Health continued to tightly manage expenses. We will continue to look for additional expense savings opportunities over the course of the next year, but they are likely to come at a slower pace.

Looking forward we expect our loss ratio to increase as we continue to adjust our pricing to reflect minimum loss ratio targets. We also expect continued weak sales in our small group segment, as employers grapple with understanding and the full impact of healthcare reform. These trends combined with the expenditures required to prepare for 2014 requirements, will lead to a decline in Health's earnings next year.

Despite the near term hurdles, we are focused on generating sales, driving further expense savings and managing capital efficiently, as we position our Health business for long term success under healthcare reform.

At employee benefits, net operating income declined by about 3% compared to the third quarter of last year, reflecting slightly higher disability loss experience, which can often by volatile from quarter-to-quarter. Overall disability incidence rates remain stable and dental experience was excellent consistent with recent trends.

Looking ahead, persistent high unemployment, low payroll growth and lower interest rates continue to present challenges that we will have to navigate. However, our broad product suite and robust administrative and enrollment tools make our voluntary products attractive options for businesses with less than 500 employees.

Moving to corporate matters. Our capital position remains strong. We ended the quarter with approximately $370 million of deployable capital, in addition to our $250 million buffer. Share repurchases totaled $110 million in the quarter, compared to $76 million in the same period last year.

We anticipate that full year operating company dividends will at least equal operating earnings. We continue to believe our share price is attractive and expect to continue our repurchase activity during the remainder of the fourth quarter, subject as always to market conditions.

Despite persistently low interest rates, our investment portfolio continued to perform well. Our conservative investment philosophy and low asset turnover helped to moderate the pace of the yield decline in our portfolio.

In line with our accounting policy, we will perform our annual goodwill impairment testing during the fourth quarter. While we hold our goodwill in the corporate segment, testing is done at the business segment level. We will carefully consider the impact of the economic environment on each business and will report the results of our goodwill testing on our fourth quarter call.

Overall, we are pleased with our third quarter results and progress in creating long-term value for our shareholders.

And with that, I'll turn the call back to Rob.

Robert Brian Pollock
Former Chief Executive Officer

Thanks, Mike. Now I want to update you on what has transpired in our lender placed business since our last call. I'll start with California.

In 2012, we expect to record approximately $108 million of net earned premiums for policies subject to the rate reduction, compared to $124 million earned in 2011. The agreement we reached to reduce rates by about 30% reflects continued favorable loss experience since we first filed for a decrease nearly 2 years ago. It also uses different assumptions about future experience than we used in our previous filings.

These rates will be implemented on new policies beginning sometime in January and on policies that renew after that date as well. The estimated impact of the rate reduction on net earned premiums and net operating income will be about $33 million and $18 million respectively on an annual basis. Let me provide some background on these estimates.

They assume that our block of business and placement rates in California remain at current levels in the future. For context, California placement rates are down this year compared to 2011. The ultimate impact from the reduction will depend on future placement rates and many other factors such as lapse rates, when policies renew and average insured values of homes.

I should also point out we are pursuing operating improvements, which have not been considered in the net operating income impact provided. It's important to remember that the rate setting approval process varies in each State. Regulations and rating variables such as coastal and catastrophe exposure, loss experience, prospective claim cost trends and the availability of insurance coverage are State specific. That is why our state-by-state outreach is critical.

We regularly engage in discussions with the different insurance department. Right now these discussions are centered on how to best implement our next generation product. For example, in Florida we are in discussions with the insurance department and are preparing to file our new product in the fourth quarter.

Florida continues to be our largest state and also bears a large proportion of our catastrophe exposure. Therefore to fully understand our business there, it’s important to consider net earned premiums before the cost of catastrophe reinsurance. In the first 9 months of the year, this amount totaled about $270 million.

We’ve begun to implement our next generation lender priced product in 14 other states where it's been approved. We plan to follow a multi phased roll out that will continue throughout the next year.

In New York, we continue to be in dialogue with the department of financial services, but do not have any further updates at this time. At the federal level, the federal housing finance agency have stepped efforts to get input from the mortgage servicers and align the views of Fannie Mae and Freddie Mac. We supported our servicer clients with information, as they have provided input to this agency.

The consumer financial protection bureau proposed mortgage servicer guidelines issued in August. The guidelines largely reflect many of our current lender place practices. We expect them to announce their final rules in January 2013.
And with that, we can move into the Q&A portion of our call. Operator, first question please.

Question and Answer

Operator

[Operator Instructions] We'll take our first question from the site of Mark Finkelstein with Evercore Partners.

Mark Finkelstein

Actually, I just want to go back firstly to the last comment that you made Rob. I think you said Florida premium was $270 million before the CAT load. How much is it with kind of fully baked?

Robert Brian Pollock
Former Chief Executive Officer

So what we are trying to provide Mark is a way to think about the premium subject to our rating action, okay. And so what we did is outline the earned premium plus the reinsurance premiums related to CAT exposures in the state of Florida.

Mark Finkelstein

Okay. I just think that, just knowing how important Florida is, and most people having estimates that are I guess meaningful higher than that would imply, I'm just trying to get a feel for whether the book is 25% in total fully loaded, 30%, 35%, 40%.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

That's a 9-month number mark. So if you annualize it, that maybe helps.

Mark Finkelstein

Okay, moving on. I guess you talked a lot about capital release in specialty property and I'm trying to get a handle around how to think about that. On the one hand you have placement rates that are clearly going to go down over time and therefore your exposures go down. At the same you also have likely rate compression that arguably affects the ability to kind of cross fund losses. So how should we think about capital release as both of those factors work together?

Robert Brian Pollock
Former Chief Executive Officer

I mean, so let's start with our capitalization for the business, for all our businesses. Start with the BCAR models, okay and those models are what we use to maintain ratings, which are quite important to our clients. All of our ratings are at the A-minus or higher level. And so when you look at those formulas as they relate to the statutory entities where we write this business, the capital requirement is in the mid-40% of premium level. That's a simplification, because there's a lot of factors that work into that Mark, but that's just a way to think about things. Clearly we agree that as the business moves towards a steady state, we are going to earn a little bit less money, but the returns will be still be attractive and we are going to be in a position to still have and attractive specifically business when we return to more normal levels.

Mark Finkelstein

But I guess, maybe I'll ask it a little more simplistically, which is as placement rates go down, should we in just knowing that there are rate pressures, would we assume that the ability to leverage the business is actually not as favorable because of the rate actions or is it more in line with how placement rates should go down.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

If I'm understating the question, I think it's more in line. So again, you got to think about the process of capital requirements and what they are function of, okay. I don't know, a little bit less we'll get some, but not all the same kind of expense efficiencies, because some of the costs are related to that tracking system, which in the near term are pretty fixed.

Mark Finkelstein

Okay, and then just on expenses, when you talked about as the business declines cutting expenses etcetera, so I'm trying to get a sense for how to think about that as well. Because again, you have the total platform of specialty property declining fairly meaningfully, given where placement rates are, et cetera, and the question is, can you actually scale down the operating expenses, not the variable senses, but the fixed costs in line with how premium goes down or would you end up with negative leverage?

Robert Brian Pollock
Former Chief Executive Officer

Okay, so a couple of different points; number one, the reason we have been so successfully in this business is our customer service, which we are not going to cut back on that. In fact, I'd say many of our servicing clients are asking for more services from us and we are able to provide them. So we are not going to give up on anything that might impact the customer. We've had quite a bit of growth in the business. We've talked about placement rates going down for several years; they in fact have gone up. They are still at elevated levels. We don't know what that actual steady state level is, but we've compared back to 2006, okay, and we said that we believe that's probably where things will return when the mortgage market recovers. Now we've had a lot of growth. Gene and this team are always working on operational improvements. We will find ways to reduce expenses. In the near term there are some of the expenses that are more fixed. We can look at those too, but I'd keep that first point I made in mind here; the customer service is a big part of what delivers our value proposition to the servicer and we don't what to give up on those things. So we will work our way to finding out how we can get to lower expense. Right now remember, we are still acquiring loans. Our loan portfolio is growing and placement rates are at higher levels. So we've got to deal with the business as it exists today.

Operator

We'll go next to the site of Chris Giovanni with Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

A follow up for Mark's question on the expense side and Rob you mentioned kind of '06 and if we go back to that timeframe, the administrative expenses were running around $550 million. Today we are close to on an annual basis of $825 million. So if we think about that as a steady state for our revenue side, should we be thinking about the same level kind of expenses or is some of the customer service initiatives you guys are implementing going to maybe drive up that number a bit higher.

Robert Brian Pollock
Former Chief Executive Officer

First, that's an interesting way to look at it. I can't speak to all the numbers right away, but I will tell you, a couple of things that are important to think about Chris are we have a mix of business shift going on. We mentioned our renters business and multifamily housing product businesses growing. That has a different expense structure associated with it than the lender-placed business does. When you look at premiums, premiums that are generated have some variable components. Those expenses will go away as premiums do and we are working efficiencies in the business and we hope to re-close as well. So again, I think what we need to do is allow a number of things to settle out there. We'll be in a position to provide you an update on our belief on where things will be, we just don't have that right now, because again, we are adding new business and the market is growing for us right now.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay, understood. And then you would mention the 14 States that you've seeped and got an approval for kind of on the next gen product. So can you maybe talk about the differences in price and maybe the terms and conditions of the new policy versus the previous policy. And then roughly if you do have, what percentage of maybe premiums these 14 sates represent.

Robert Brian Pollock
Former Chief Executive Officer

Yes, well, there's a couple of different things. So again, as we talked about this next generation product, the features that go along with that, they are not rocket scientist type variables. We are going to do a little more expansion of geo rating. We are going to have more options on deductibles, we can deal with different blocks of loans differently, that's not where the work is. The work is being in a position to service programs for each of the mortgage servicers differently. That's where we've spent quite a bit of time and effort in our system area to make sure our systems can accommodate that, and so that's why we are very focused on the implementation, because that's the most important things. Now in terms of trying to figure out how any of this is going to work, it's way too early. We just are starting this process in a few states and it's going to be dependent on who the particular policyholders are and their characteristics. But we have our line of sight on that; we'll provide the information.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Yes, I think Chris, just in the initial rollout or something that's reasonably different, we would naturally I think start with our smaller states and so the 14 that we are working on now tend to be on the smaller side, plus it's going to take some time to actually roll out and go through the letter cycle and all the other things that go along with the policies. So that's another reason it's difficult to give you an estimate of the premium impact now. I'd also say, Rob mentioned the flexibility. I think that is a pretty important point, because our servicers then can have more choices in how they administer their own programs, which means the impact on us will be somewhat dependant on our client decisions too.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay, and then with the implementation of that, I mean I guess based on the loss time that the answer would be no. But will the implementation will be similar to California where all new and existing business will go in this next gen product or would people still be staying in the existing LPI products?

Robert Brian Pollock
Former Chief Executive Officer

So they will go to the new for all new business and as business renews, it will move to the new product as well.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay, very helpful and just lastly, on capital, I mean obviously you mentioned you are going to continue to be in the market, but obviously there are some headwinds for some of the business as you go forward. So I guess as you think about acquisitions, especially business lines, along with kind of incremental debt capacity here, how are you balancing buybacks versus M&A.

Robert Brian Pollock
Former Chief Executive Officer

Yes, well I think first I'm going to take one step back and say I think we've identified targeted areas and each of the business for growth and whether that's multifamily housing in the property business, the voluntary business in benefits, affordable choice medical products in Health, the mobile and international business and solutions, particularly in Latin America, those are places that we are more likely to look for organic growth, as well things that could help us on the M&A side, okay, so we are looking at those. I'm going to switch over and let Chris talk a little about it. Okay, so we are looking at all that, how do we evaluate M&A opportunities versus buyback? I think the methodology is still quite consistent and Chris you want to just elaborate on that a little.

Christopher John Pagano
Executive VP & Chief Risk Officer

Sure, hi Chris. I don't think anything is changed in the way we are looking at profitable growth opportunities. I think our capital priorities are the same, capitalize the operating companies and then look to deploy capital either organically or through M&A using what is a significant amount of deployable capital currently at the holding company. And then to the extent that there are opportunities in the near term, we have been very disciplined about returning the capital to shareholders. Most of the return of capital in the last 3 years has been via share repurchase, and we continue to think that will play a role, given where we think, how attractive we think the share price is right now. But ultimately it's about maintaining flexibility and that's where your comment around debt capacity comes in. We do think that give that our debt to total cap is just over 18%, we do have the ability to go to the market for probably $300 million to$350 million of opportunistic debt. We also have the 2014 issue that matures in February, which we realistically need to address sometime between now and the end of 2013. But again the main source of capital is going to be what we have at the holding company now, which is about $370 million and then being able to access operating earnings in the form of dividend gives us a lot of options with regards both M&A and share repurchase.

Operator

We'll go next to the site of Jeff Schuman with KBW.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

I was just wondering, first of call very basic question about the lender placed. How does it renew it? Does it typically renew it annually or how is it renew?

Robert Brian Pollock
Former Chief Executive Officer

Yes, it's typically annual.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then in California as you talked to them about the rate decrease, I mean did you also talk to them about any aspects of the next gen product. Is there going to be more geographic rating or any other changes?

Robert Brian Pollock
Former Chief Executive Officer

I think our hope is to now sit down and talk to them. We've certainly mentioned the issue. So I think we are now positioned to move toward that product and we hope to do that as quickly as we can make that happen.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

And also as part of those discussions, were there any agreements about captive reinsurance or commission practices.

Robert Brian Pollock
Former Chief Executive Officer

Not that.

Michael John Peninger

Former Chief Financial Officer and Executive Vice President

I don't think so, Jeff. I think these are primarily around the pricing of the product.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

Okay and then lastly, I think coming out of the NAIC hearings I think it's a kind of thing that there's some other state might be more actively looking at rates. Did you talk about the fact that you do have ongoing discussions, but are there any other particular states outside of California, Florida and New York that are maybe a little more active than they have been in pursuing the rate issues?

Robert Brian Pollock
Former Chief Executive Officer

None that come to mind. Again, the process on this is we have a dialog regularly that process on how the state goes through and reviews things as different. I will say that we are engaged in dialog with all of them, because we are focused on getting this next generation product up and activated in all the states.

Operator

We'll go next to the site of John Nadel with Sterne Agee.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

I was hoping we might be able to take a slightly different approach to thinking about steady states for the lender place business. About 18 months ago at your Investor Day you laid out a view of how this business might be impacted as the housing market yields and placement rates drop and I think that essentially suggested that the specialty property segment would see revenues down to $1.5 billion, combined ratios would rise, placement rates would fall and it seems to suggest doing all the math, about $180 million to $200 million of earnings from this segment, once you got to that steady state, whenever that was. So my question for you is this, as we think about it 18 months later, with a lot of the things that are changing, rate pressure, CFPB, proposed changes that might take placement rates lower, all that sort of stuff, growth in the business maybe as a slight offset, can you give us some help in just understanding order of magnitude; how some of those assumptions that you've previous laid out for us might change?

Robert Brian Pollock
Former Chief Executive Officer

Well, first we thought that placement rates were going to start coming down. They actually went the other way John. So again, I think that's a function of the broader housing market. Pretty difficult for us to predict giving all the variables going on, right. A lot of that has evolved, a lot of it has led to the development of this new product that can be more flexible and more responsive to today's housing market and we embarked on that process starting in late '10 and as I mentioned, it's not that the product filing per say is so complicated; it's all about do we have the administrative system set up to deal with things on a servicer by servicer basis, dealing with all the different things that have been raised by the GSCs, different things that servicers might want and we are really proud that we have a system that can actually deal with all these things, okay. So we are going to provide and the market is clearly evolved in a way we couldn't have imagined. But when we get through a few more of these things, because I think we are getting the resolution, close to resolution on the number of them, we will put together an update re-forecast of what we now see the steady state being moving forward, but we just don't have it right now, because a number of the variables I think…

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

It evolves in motion.

Robert Brian Pollock
Former Chief Executive Officer

They are just all in motion, exactly.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

All right. I mean listen, I understand there is a lot going on. I think that commitment to sort of update everybody I think is really important, because this is clearly just a very important issue for the shareholders to think about. I just have a question for you on the capital in specialty property and maybe it's a bit along the lines of Mark's question and I understand how the BCAR, the best capital ratio or model works. But should we expect, if premiums drop because of a rate reduction, versus premiums dropping because of placement rate falls, should we expect the same sort of level of capital release from the business under either of those scenarios. In the first case your exposures don't change, but in the second they clearly do.

Robert Brian Pollock
Former Chief Executive Officer

Yes, you are on an interesting point. But I guess I'd say 2 things John, right. The formulas themselves are somewhat mechanical, that did apply and of course then they look at an applied judgment to a broader set of issues. So could it conceivably be different, it could. When I look at all this stuff though, if you look at our business placement rate change, which we said for a long time is going to be the biggest driver on what happens to the business we believe.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Yes, I agree too, yes.

Robert Brian Pollock
Former Chief Executive Officer

And so, that's where we are focused and we are very focused on having a product that can meet what is clearly a different market place today than when we had 3 or 4 years ago.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

And I'd also just say, we have very regular dialogue with A. M. Best and they have a very thorough understanding of our business John and also they make their own decisions, but it's not and I'm sure we'll be talking with them as things go forward.

Christopher John Pagano
Executive VP & Chief Risk Officer

Yes, John, it's Chris. Maybe one other comment, and I think Mark was touching on this earlier. Capital is going to be going forward about risk and the smaller the block, the lower the placement rate, which is our expectation, the lower the risk. Now the rules of thumb that we've given you in the past may change and that's what we'll address with regard to our discussions with the rating agencies. Keep in mind it also has to do with the amount of catastrophe reinsurance that we buy, which is a critical piece of our risk management. But untimely and I think our updated view around steady state and can also include an updated view around capital and what the lender placed product's going to represent going forward.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Okay, I just have a couple of more quick ones, I'm sorry. Is there a way to help us understand, I think you mentioned that you're going to be filing your next generation products in Florida next month and I don't know if this is going to be easy or not, but is there a way to help us understand sort of on an apples-to-apples basis what the premium rate will look like on the next gen product versus what you've already got in place.

Robert Brian Pollock
Former Chief Executive Officer

Well, I think it's just a couple of things to think about there John. I think the most important things is we will provide an update when we know we've reached the resolution with the state, that's kind of number one. Number two is, I look at that next generation product and if you think about all the things that product is looking to address, I can't think of a state that has all of them operating, more than Florida does, okay. So it is going to be the perfect test case for how all these flexible variables could be put in to play. But they are going to be put in play by the servicer, okay. So that again, the complexity of trying to estimate what is going to happen I think is really difficult, but when we know something we will report it out.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Okay, and then the last 2 quick ones. Are you seeing seated premiums to your lenders or servicer partners decline yet?

Robert Brian Pollock
Former Chief Executive Officer

Each of the services that have reinsurance sort of make their own decisions. We did have a client this quarter that made a change in their program John, you probably saw that in our numbers but that's something that's sort of client specific issue.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Okay and then are commissions being cut yet?

Robert Brian Pollock
Former Chief Executive Officer

Again, if you think about the way we talked about this, this will be a servicer specific issue on how they want things to work. So I don't know that I can say that John, but when we know we'll -- this is another one that each client -- each client makers their own decisions, yes.

Operator

We'll go next to the site of Sean Dargan with Macquarie.

Sean Robert Dargan
Macquarie Research

I was just wondering if you can maybe tell us about the experience you are seeing in placement rates in different states. There are different foreclosure processes and different hoops that one will just have to jump through. Would it be safe to say that you see placement rates coming down more in California than say Florida?

Robert Brian Pollock
Former Chief Executive Officer

I haven't looked at the Florida experience, so I can't really make a statement on that. But I think the issue you outlined is an important one. If you think about issues like the economy in the area, like how does the process work to move a property foreclosure, these are all things that will have impact on the placement rates. In addition how many loans are seriously delinquent is going to be a driver there too. So every State really is different depending on those factors and they will untimely play out based on all those different conditions.

Sean Robert Dargan
Macquarie Research

If I can just shift to Assurant Health, I think you mentioned that you expect premiums and earnings to come down in 2013. Can you give us any sensitivity or the degree to which it will come down?

Robert Brian Pollock
Former Chief Executive Officer

Well, in the MLR requirement, there's the big thing that we have to sort of adjust our pricing to over time Sean. If you look at our loss ratios, they are in the low 70s. I think we have said before that you can't compare an MLR loss ratio calculation and a gap loss ratio directly, because there's different rules for the MLR calculation. And then you've got to think about the mix of our products that are subject to the MLR and some aren't, so you've got a variety of factors going. But I think it's fair to say that our loss ratios will be rising as we adjust the pricing and it takes time for our rate changes, just like when you need to increase prices, it takes tame to roll increases through your block when you're changing in the other direction; it takes time for that roll through. So over time that's going to start impacting our loss ratio, so you will see those rising. Then you've got the other sort loss study factory is that we've got a lot of growth going on in our health access and supplemental products. We've also got our Aetna arrangement that is helping with the sales of our more traditional individual major medical products. So you've got a lot of different things and then as I mentioned in our prepared remarks, you've got this sort of freeze in the small group markets. So you've got a lot of different factors there, but I think the primary thing that leads us to say earnings will go down is that loss ratios will go higher.

Operator

We'll go next to the site of Steven Schwartz with Raymond James.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

I have a few, I apologize ahead of time. Mark mentioned the 270 in Florida. I guess that annualizes to 360 or whatever it is. Is the importance of that number that any rate cut that occurs, the reinsurers aren't going to take it, the CAT re-guys aren't going to take back their exposure. It doesn't matter what happens to your rates. Is that…

Robert Brian Pollock
Former Chief Executive Officer

That's why we try to present it that way.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Yes, exactly.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay, good, just making sure. Sticking with that, you've got this new client 1 million loans, just so I'm clear here, once that's on your books, you will get the policies currently in force right. This isn't one of these deals where it rolls over time.

Robert Brian Pollock
Former Chief Executive Officer

So in essence we are going to get the new business that is written, but we will not get the end; it's not a flat cancel called.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

It's not a not a flat cancel, that was the term I was looking for. Okay, not a flat cancel, quite an asset. And then going back on to the discussion of the next gen product, I guess the choppiness is what we are all dealing with here. I'm going to make up a number. Let's say you have a 75-combined ratio in a State and the regulators for political reasons or whatever are saying that's too low, all right. Introducing the next gen product, is it going to make a 75 combined okay, right?

Robert Brian Pollock
Former Chief Executive Officer

Again, I think we are talking about apples-and-oranges here a little bit, Steven. Lets first talk about what that next generation product does; it allows lots of flexibility. For instance let's take an example. You could vary the deductible offered based on the value of the home. Right now, decisions tend to be made uniformly for a portfolio. Wow, that's a big difference and has the ability to change rates if you are at a, let's say a $2000 deductible versus a $200 deductible, so those kinds of things could make a big difference. Second, if we look at just -- we are going to put in some difference in geographic rating. So that's says to me if you are closer to coast line, those rates maybe going up a little bit but the other side of that is people away are going to pay less. So we don't do any underwriting that has to be recognized and presented. The historical look is obviously one place they look, but the more interesting I think the thing that we have to talk about is what is our exposure and what do we think costs are going to be prospectively. So lot of this really relates to -- and you've seeing it just looking at the reinsurer models. People think the cost of catastrophes are going up. That's difficult when in the last year for instance we didn't have many and that's where a lot of the dialogue needs to take place in my mind with actuary to actuary, looking at the reasonability of assumptions.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

All right, and then just to get off this, this question might be one for an Investor Day, but while we are at it, the access product in the health area that are doing so well for you, how do you see those products working in 2013 and then in particular in 2014, once ACA is implemented.

Robert Brian Pollock
Former Chief Executive Officer

Yes, so I'll start and then I think Mike has some things he can add in, but the first things I'd say is these products are resonating around affordability and choice. So everyone would like to have a Cadillac planned, but they don't all have a Cadillac budget, and the way we can put these products together allows them to say, this is what I really need and can afford and that combination has proven to be widely successfully as we talk to consumers.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

And I think you are raising a great question and probably would be worth a more in-depth conversation at some point, but there is a lot of question about who exactly will be buying on an exchange starting in 2014 and given that the rules around exchanges really haven't been to find out exactly how the subsidies will work, etcetera, etcetera, etcetera, that there is a school of thought that says, most of the buyers on the exchanges will be heavily subsidies, but that remains to be seen, so that's another things that will impact, but I think overall our belief is that healthcare costs are going to keep going up. As Rob said we got products that help people that don't have the Cadillac budgets deal with that reality and we don't think that's likely to change even as the new world unfolds.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay, let me ask this. These products, if my understanding is correct, if somebody post 2014 wants to buy these products, that person will be subject to the penalty/tax, is that correct?

Robert Brian Pollock
Former Chief Executive Officer

They are theoretically, but already at least what I've read is there are signals that it's not going to be strongly enforced.

Operator

And we have time for one more question. Lastly, we'll go to the side of Mark Hughes with SunTrust Robinson Humphrey.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Are you seeing much progress on the health exchanges? Are they communicating with the industry? Are you getting some insight as to how they are going to work? What's going on there?

Robert Brian Pollock
Former Chief Executive Officer

Yes, there is all kinds of different working groups on this. I'd say that the federal exchange is furthest ahead. We have our own committee within Assurant Health looking at all these things, but state by state they've got make decisions around, do I want to build my own exchange or be part of the federal exchange and they are trying to make those decisions. At the federal level it's a complicated process. They want to be able to, if you will, tap into tax returns and figure our subsidies that Mike was talking about earlier for the population. You can imagine there is a fair amount of complexity, but I think there is a lot of resource being put to being this to fruition.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

I think it is another one though as Rob said Mark. Every state is really different and is going through their own calculus about do they want to build, do they want to tap into the federal, something certainly there is philosophical differences about the exchanges etcetera. So a lot of discussion, but the reality is we don't have clear rules or definitions yet. But saying all that, we are prepared to get ready to play on the exchanges that we deemed that's the place to be and as rules are clarified and make that decision.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Am I right in assuming that the products are going to be uniform across the state?

Robert Brian Pollock
Former Chief Executive Officer

No, I don't think so. I mean again, open question right. All that's really been outlined is a certain actuarial value of what's offered on the, we call it the metallic plant, gold, silver, bronze. So they have to have a certain level of value, benefit value. My guess is lots of different ways to put those benefit values together, with the constraints of how some of the regulation is written.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Right, in California, I think you touched on some of this, but where you took those rate decreases, how did the economic, how are they impacted for, the services or other than the value chain let's say. You've obviously laid down or laid out the impact that you are feeling. What's happening with others, not to name names, but generally speaking in those markets?

Robert Brian Pollock
Former Chief Executive Officer

Sorry, if you talk about the servicers, I can't speak to other insurers. For instance, if there is a commission being paid to the servicer, they are going to get a commission on smaller premium. If they are participating on a reinsurance basis, it's going to operate a little bit differently. So it's going to be very client specific in terms of how those issues operate.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Right, and of the decline in premium, what proportion of that are you bearing the brunt of it?

Robert Brian Pollock
Former Chief Executive Officer

Well, we tried to outline in our estimates the impact on net NOI mark in a fully implemented state with a number of caveats. Obviously we put an estimate together based on the size of assumptions. I tried to outline those assumptions in my prepared remarks that might be worth taking a look at rather than going through them, but we also said we are working on operating improvements so that we minimize that number.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

But again as Rob said Mark, the policy or the premium goes down, then a client who is reinsuring will get the pro-rata reduction in their seated premium too.

Robert Brian Pollock
Former Chief Executive Officer

Thanks for joining us this morning. We encourage you to reach out to Francesca and Suzanne with additional questions. We look forward on updating you on our progress in the months ahead.

Operator
This does conclude today's teleconference. Please disconnect your lines at this time and have a wonderful day.