S&P Global
Market Intelligence

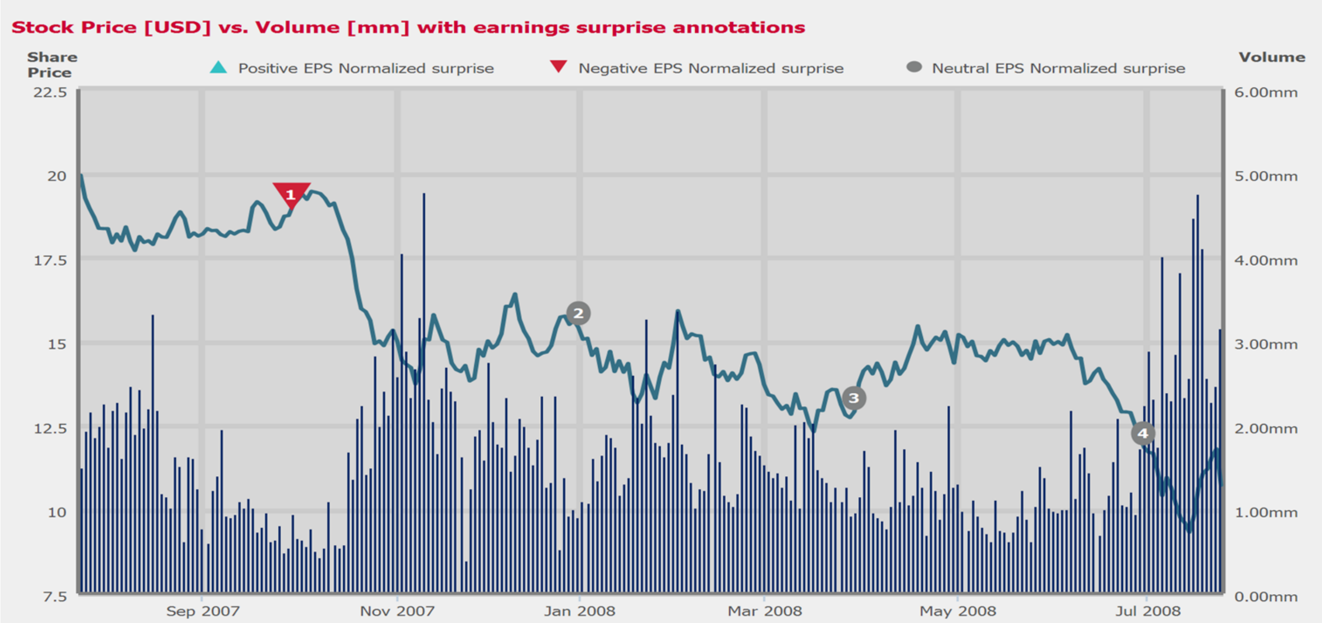
Old Republic International Corporation
NYSE:ORI
FQ3 2008 Earnings Call Transcripts

Thursday, October 23, 2008 7:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.16)	(0.20)	NM	(0.16)	(0.63)	(0.13)
Revenue	-	-	(6.22 %)	-	-	-
Revenue (mm)	998.35	936.30	-	987.85	3873.70	3937.30

Currency: USD
Consensus as of Oct-23-2008 7:38 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	0.39	0.11	1 (71.79 %)
FQ4 2007	0.09	0.09	2 0.00 %
FQ1 2008	(0.02)	(0.08)	NM
FQ2 2008	(0.16)	(0.22)	NM

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Call Participants

EXECUTIVES

Aldo C. Zucaro

Christopher S. Nard

Leslie Loyet

ANALYSTS

David Lewis
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Elizabeth C. Malone
KeyBanc Capital Markets

Mark Alford
Centurion Investments

Tedd O'Connor
Cooken NBR

Unidentified Analyst

Presentation

Operator

Good afternoon ladies and gentlemen. Welcome to the Old Republic International Third Quarter 2008 Earnings Conference Call. Today's call is being recorded. At this time all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for your questions. I would like to remind everyone that this conference is being recorded.

I would now like to turn the conference over to Leslie Loyet of the Financial Relations Board. Please go ahead ma'am.

Leslie Loyet

Thank you. Good afternoon everyone and thank you for joining us today for Old Republic's conference call to discuss third quarter 2008 results. This morning we distributed a copy of the press release and hopefully you've all had a chance to review the results. If there is any one online who did not receive a copy, you may access it at Old Republic's website at oldrepublic.com or you may call Liz Dolezal at 312-640-6771 and she'll send you a copy immediately.

Please be advised that this call may involve forward-looking statements as discussed in the press release dated October 23, 2008. Risks associated with these statements can be found in the company's latest SEC filings. With us today from management we have

Al Zucaro Chairman and Chief Executive Officer, and Chris Nard, President of Old Republic Mortgage Guarantee Company.

At this time I would like to turn the call over to Al for his opening remarks. Please go ahead.

Aldo C. Zucaro

Thank you, Leslie. And thank you to every one to for joining this regular quarterly gathering of Old. As you can readily see in this morning's release the news that we published was not much different in terms of either trends or bottom-line operating results. And we've posted for the most recent quarters. The third quarter 2008 bottom-line wise now makes it five unfortunate quarters of negative performance. And as we've said, however, for more than a year now, we're likely to experience a continuation of this less than stellar performance for another four or five quarters before more positive earnings trends emerge down the road as we expect.

For us this means of course that we need to continue to manage our business in anticipation of spilling a moderate amount of red ink well into 2009. In this latest quarter, as you see operating results continue to benefit from pretty good underwriting. I should say very good underwriting results in the context of the long history of the property and liability business in particular. As well as some investment income contributions from our general insurance business.

On the other hand again the performance in our mortgage guarantee line wasn't somewhat and our title segment once again posted moderately negative operating results. As we've noted in the release we did have some slippage in general insurance underwriting profits year-to-date. This was again as stated driven mostly by our loss experienced in several coverages but most of the damage was done by the consumer credit indemnity or CCI for short as we say consumer credit indemnity line. This line incidentally represents about 9% - 10% of our general insurance are in the premium base. And it is currently producing some of the worst underwriting results we've experienced in the 50 plus years that we've offered the product.

For the first nine months of this year the CCI line added about 500 basis points or 5 percentage points to our general insurance composite ratios. Where as it's affect on the same ratio for all of the 2007 was I would say rather negligible. So it gives you an idea of again what's driving the upward tilt in our combined ratio for the general insurance business and it also says therefore that, that business axe the CCI coverage is performing well. As the name implies the CCI coverage incidentally is basically tied to consumer borrowings for purchases such as home improvements as well and more importantly now a days expenditures have been financed with the second lease loan home ownership.

The coverage is therefore as you might well suspect being impacted by the abundance of credit issues that are highly visible all over the media. Our expectation right now is that the underwriting pressure that this line is creating on the overall general insurance performance is probably going to dissipate sometimes in 2009 in line with hopefully the consumer credit field gradually regenerating itself into a greater level of normalcy.

So to say however, that the majority of general insurance coverage is delivered pretty flattish to moderately better underwriting results which together overcame as I say most of the consumer credit indemnity claim costs in particular.

In the beginning of this year, those of you who follow we publicly suggested that the general insurance segment would likely produce underwriting results within a composite underwriting ratio ranging between 95% and 98%. So that now a nine months down the road we've posted 97%. So, it seems probable to us that the entire year will come in at the higher end of that range.

From an investment income perspective in the general insurance area, it slipped a bit in 2008 so far. And this is mostly the result of lower dividend income on equity holdings and a somewhat reduced yield on the combination of long and short term fixed income securities. And all this in the light I might add of a moderately lower mark-to-market invested asset base.

Let's see; turning to mortgage guarantee. I would say that the news here again falls in the category of same old same, same old in both the narrative and the numerical tables that we included in this morning's press release. We listed the main elements which we think drives the down trend in mortgage guarantee performance in the past four, five quarters. So given the fact that we have got those numbers in front of you in the release there is no need for me to rehash, take the time to rehash, and recite the printed data.

We'll leave it to the question-and-answer portion of this call later on, for you to address any matters that need further explanation or clarification. But in this timeframe, I'd like to simply note that very little has changed, relative to our expectations for this part of our business. We still believe that it's going to take several quarters and probably through year-end 2009 before, we see any clear daylight at the end of the tunnel.

We think that the combination of all the initiatives taken so far, primarily at the U.S. Treasury and Federal Reserve levels are bound to have their intended effect of ultimately suppressing the fall in home values, fixing some of the mortgages that are out there, both individual loans as well as the securitized feature of home loans.

And of course, to detoxify the financial system, generally. What is worth our best guess at the moment is that the benefits of all this financial reengineering, and rigid domain, that's taking place, is probably going to emerge very gradually in 2009, bearing in mind that the government, semi-government institutions that are involved in this fix up are huge institutions, which take quite a bit of time to find their sea life so to speak.

With all of this in mind, however, we still to continue to manage this part of our business with the expectation that new insurance written and risk in force growth are going to take taper off to some degree just as they already have in this year's third quarter. And this of course says its implications for the capital needs and the intensity of capital of this business. In this regard, we still believe that the best, most economically efficient course of action for us is to stress the statutory mortgage guarantee balance sheet toward a 20:1 risk to capital ratio which as some of you may know keeps it well within the regulatory constraints of 25:1.

So that, we've adopted a very gradualistic disciplined approach to mortgage guarantee capital additions which to how we're thinking has to reflect the combination of actual quarter-to-quarter bottom-line results. And the evolution of important capital benchmarks such as the one I just mentioned of risk to capital ratios. And of course always a rational and disciplined balancing of the long term interests of policyholders as well as shareholders.

In all these regards we're also continued to be very mindful of the important lessons of history which in a specific case of the mortgage guarantee industry shows that it weathered very well. The significant housing and mortgage lending dislocations in the mid 1980s to early 1990s and that was done in the context of risk to capital ratios that exceeded 20:1 for a period of time.

The cumulative mortgage guarantee underwriting results we expect through year-end 2009. In our view still contemplate about a 150% loss ratio that we pegged early or since summer of 2007 I should say. And between July '07 and current date the end of September, the actual cumulative loss ratio we posted penciled out at about 184%. So, I feel for these numbers at this time is that the ratio is still likely to continue to reach up for the next two quarters or so, and then start to pay off by mid-year of 2009 or there above.

As we said repeatedly, there are many, many variables that can affect these expectations, but the type of scenario I have adjust outlined seems realistic to us at this point. And it is the best educated guess we are making at the moment.

Might add that operating cash flow and the mortgage guarantee segment is still very positive, and continues to be additive to a growing invested asset base, to a larger degree. Of course, that's due to the lag between the incurrence of claims costs, which are affected obviously, by the amount of reserves that we put up, and the actual payment of losses.

Even though as you can see in the statistics we published that paid loss ratio is inclining as you might suspect it would right now on the other much greater asset base than we did about the year ago. And, it is in fact responsible for producing the amount of investment income growth that you see in the income tables of the press release.

Let's see for reasons we have already cited not much needs to be said additionally, to what's been recorded for our title business. From an earning standpoint, this segment is likely to... I guess, the best way to put it is likely to idle in the bottom-line ranges of the last three quarters.

And if our assumptions are reasonably correct housing activity should pickup sometimes in 2009 say by late spring. And in that case, title insurance results will likely be first out of the gate of that business, as you know is rather transaction intensive and oriented. And it turns... it typically turns on the dime when the level of transactions, starts to rise measurably.

Consolidated wise, we've included the usual shareholders equity per share reconciliation at the tail-end of the release. And of course, this type of reconciliation brings together all the elements of our business activities into pretty good focus.

As you can see, more than half of the equity loss per share for the first nine months has come from paper losses resulting from mark-to-market impairment adjustments.

So far, as we can see, we've kept the quarterly cash dividend payout at the higher rate we announced back in February of this year. As we say repeatedly we look at this rate every quarter in conjunction or at the same time as we hold our quarterly board meetings. And so far we've felt and continue to feel comfortable in letting the higher rate ride given our long term capital management plans. And the expectations for earnings that are built into our play book for the next couple of years or so.

Look at my notes here that's about the extent of the additional comments I thought we should make. So, now, Chris Nard and I will take whatever questions you have.

Question And Answer

Question and Answer

Operator

[Operator Instructions]. And we'll go first to David Lewis with Raymond James.

David Lewis
Raymond James & Associates

How are you Aldo?

Aldo C. Zucaro

Good, how are you?

David Lewis
Raymond James & Associates

Doing fine, thank you. Couple of questions start with mortgaging trends over the past year or so. We've all been talking about the sub-prime side. Are you seeing this, the prime side of your book start to see higher delinquency rates here and do you anticipate that current developing were some of the predictions will occur with unemployment?

Aldo C. Zucaro

Higher delinquency rates with respect to any particular vintage or what?

David Lewis
Raymond James & Associates

Well. And I am just trying and get more of the prime side of the business versus the sub-prime side?

Aldo C. Zucaro

Okay, Chris do you want to --

Christopher S. Nard

Yes sure, David how are you?

David Lewis
Raymond James & Associates

Good.

Christopher S. Nard

One thing I'll differentiate is we were never a huge player in the sub-prime space. So, it's not like through this period that all the stress in the mortgage guarantees has been caused by the sub-prime book, and prime books have been fine and then all of a sudden now the prime book is under pressure. I think it's safe to say that through this whole period most of the insurance books either sub prime or other high risk attributes like reduced stock and the prime book have been under pressure for a while.

So I wouldn't think that, the increasing pressure on the economy employment in particular is all of a sudden going to take the prime book from a dead stop meaning everything is fine. But also now it's going to take a huge jump because of stress in the economy. It's been under stress for a while. With that said I would also say there's not, we've never found there to be a linear relationship between losses and stress in the employment side, it takes long time for kind of normal job losses to work their way through to mortgage guarantee claims. And by as to work through any severance you may have, unemployment whatever savings and by that time you are generally 12 months or so into the cycle. Not to say that delinquency is down for pressure on us, but again we don't see it is a direct unemployment, we don't see it as a kind of direct one to one.

David Lewis
Raymond James & Associates

That helpful. Chris, if I recall earlier in the year, you kind of posted your result per delinquent loan from something maybe 12.5 to 14.5 or some $1000, you know what those figures are running today?

Christopher S. Nard

They have continued to go up from that rate, I don't have them right in front of me but again I think there are up would you say 14.5?

David Lewis
Raymond James & Associates

Yes, I think the last time we talked about this, this was somewhere around 14,500 per delinquent loan.

Christopher S. Nard

Yes, that continues to rise and I think we'll be probably up to the 17 to 18.

Aldo C. Zucaro

17 to 18 now I think Chris.

David Lewis
Raymond James & Associates

Okay and Al given kind of the demise of the financial stocks in general obviously your investments in PMI and MTG continue under pressure probably just as much related to concerns from investors there it maybe reality. But any change in your thoughts there about the entire industry been able to continue to provide services for the government sponsored agencies given the rating actions were like?

Aldo C. Zucaro

No, we still feel comfortable that those companies are going to survive one way the other as I indicated before in my brief remarks. Again if you... if history is any indicator of what is likely going to happen, I think the industry is going to be allowed to continue, perhaps at a higher risk to capital ratio as I say. In order to enable it to rectify the balance and the mix of it's business, so that the better product, the more diligently underwritten product, the better priced product that is being put on the books, that can start to have a beneficial effect on the rest of the business.

It's a long-term guaranteed renewable product as you know. And those types of insurance coverages, just need to have time on their side, in order to as I say rectify issues that have taken a while to develop.

With respect to those two specific investments, we still like them. Although I have to say I wish we had bought them to day instead of a year ago.

David Lewis
Raymond James & Associates

I understand. Thank you very much.

Operator

And we'll go next to Beth Malone with KeyBanc.

Elizabeth C. Malone
KeyBanc Capital Markets

Thank you, good afternoon. Can I ask a question about the trucking business, the general insurance business, I mean. Are you seeing much evidence of companies coming into compete in that market that may not have been experienced in that industry before. Are you seeing new entrants at all trying to price their way into your market?

Aldo C. Zucaro

We're seeing some Beth. But it's not particularly large, large involvement by others that we're not that are not our usual competitors. I think this time around in this cycle this seems to be a lot more disciplined on the underwriting side.

And also, with interest yields what they are companies can't bank on investment income to save the day. So they are having to be a lot more careful. Or then they would otherwise be. Having said that though, there is no question that there is more pressure, including from our regular participating peer companies. So that it is difficult to get any new business on the books.

Elizabeth C. Malone
KeyBanc Capital Markets

And are you seeing any opportunities to gain market share in the mortgage insurance market?

Aldo C. Zucaro

Yes. Chris why not share and explain what we are seeing there, and what we think.

Christopher S. Nard

Yes. The obvious trends have been in the last quarter or so, some increases. But we have been... those have been somewhat moderated by the fact that we have been first out of the blocks, to take some conservative underwriting measures. We eliminated first to eliminate captive reinsurance transactions.

We were the first to eliminate some dock waiver programs. And then, we were the first to make some pricing changes. So I think, while certainly we've been thought of positively given the counterparty strength. We have done some things to get the business on the right footing that may moderate our share growth trends. But we are certainly not first and foremost looking at share growth at the moment. We are looking at fixing the terms of trade for later periods.

Elizabeth C. Malone
KeyBanc Capital Markets

And can you... is it possible to trying to quantify what the price increases you put in place say in the last year on your new business?

Christopher S. Nard

Yes, I think if you have to adjust for mix obviously but I would think on a mix like we're riding today you might see it 25% to 30% increased again can move around based on types of products, that's probably a good range.

Elizabeth C. Malone
KeyBanc Capital Markets

And at that rate increase you are comfortable you can get the margin that you priced for on the mortgage insurance side?

Christopher S. Nard

Yes. We feel good about that rate in the underwriting guideline.

Elizabeth C. Malone
KeyBanc Capital Markets

I guess this might be a question more for Mr. Zucaro, how does that rate increase compared to other past pricing experiences what you know were their spend a real issues in mortgage insurance market that you had rectify through pricing?

Aldo C. Zucaro

For the last time and correct me if I am wrong Chris. Because we did, we have been looking back to our history, and the history of the industry. The last time, again that we had anything similar to what we're experiencing now was in the... from the, period from the '85, '86 to the early 1990s. And in that late 80s period, I mean to say, '86, '87, we had about a 25% increase in pricing. Not admittedly you did not have then the variety of products that we have today which is what Chris is intimating. But I would say that that was about where we were and it seems to us that that's where we are today. Am I right Chris?

Christopher S. Nard

Yes. So, if you look where we are today our underwriting guidelines are similar today to what they were in the early 90s. And yet we'll have about 25% to 30% more rate than we did in that period. So we feel pretty good about the rating guideline relationship going forward.

Elizabeth C. Malone
KeyBanc Capital Markets

Okay. And then just lastly on the outlook for the housing market recovery, and you kind of articulated it over a year ago when things first started to look week was that it looked like it was 2010 kind of recovery target for the aero stabilization in the housing market. It sounds like your staying that continues and I was just curious as to what factors are you seeing that may give you the confidence that the time frame of late 2009 or late 2010 still makes sense?

Aldo C. Zucaro

Well, first of all, when we first start to talk about those expectations that in late summer, early fall last year. We did not have the benefits of all the... as I refer to with the financial reengineering that's taken place in last couple of months in particular. And that alone is going to ultimately be very beneficial.

And secondly, the one thing we are looking at is at what level and when can you expect housing prices to bottom out. And, so far we are probably using case shriller as a proxy for that. We are probably looking at a 20% maybe by the end of September, a cumulative drop from the peak at the end of 2006. And we said based on our crystal ball, looking at what's happened nationally to housing prices, we think that 30% is necessary.

So what we are effectively saying is that between September and early spring of there about of next year, you are probably going to get another 10% before in bottoms out. So the combination of those factors is what leaves us to still feel comfortable, that we should start beginning to see something official effects in our study around in late '09 or spring of 2010.

Elizabeth C. Malone
KeyBanc Capital Markets

Okay, an then one last thing on the government can take over of the Freddie and Fannie from your perspective, is that going to be with that the move that was necessary and is that going to be sufficient to stabilize, to help stabilize the housing market?

Aldo C. Zucaro

Well. I think the move was probably necessary because I don't think the congress was had that much of an appetite to throw potentially $700 billion of tax payer money against the problem. As to whether its going to have a beneficial effect, or what we think the combination of those agencies being now fully supported by the government. And therefore, having not just the implied, but the actual support of the tax payer is important to stabilize the market.

We think that the introduction of the FHA as a means of taking care of some of the particularly bad loans that are out there, is bound to have a positive effect on extending foreclosures, and that of itself is good. That it's obviously, eliminates a large number potentially of homes being dumped on the market and further depressing price, and creating the kind of spiral that we are, and that we've been witnessing now for the better... for about a year or so.

So all those things we think are good for the long-term health of the housing and mortgage lending industry.

Chris, can you think of anything else?

Christopher S. Nard

No, I would concur those things particularly, the Fannie Freddie moves will add stability to the residential mortgage markets that we need to get housing prices to recover.

Elizabeth C. Malone
KeyBanc Capital Markets

Okay, thank you.

Operator

And we'll go next Mike Randel with Key Colony Fund [ph].

Unidentified Analyst

Thanks for taking my questions guys. Just a couple on the mortgage insurance business. With your risk to capital now at 16:1, where would you project that it would be at 20:1, and kind of what are your plans when you get there?

Aldo C. Zucaro

Well as Chris intimated before, our main focus is on one riding quality business. And we have the ability to do that. A second and just as important focus is retaining a world-class ability to meet our obligations to existing assureds, and policy holders, and those that we add by virtue of riding new businesses. Having said that therefore, our focus is more on retention of capital, and putting it to maximum efficient use.

And thirdly, again as Chris indicated, we think that the combination of the much more stringent underwriting standards we've adopted, and the more... the higher pricing structure we've adopted, the high pricing structure incidentally of the GSCs. And the contra effect of the FHA's greater involvement in lending on homes that that is going to in fact reduce the speed by which risk in force is going to accumulate.

So, right now, contrary to what we saw at the beginning of the year, we're not going to see think a speedy increase in risk in force. And therefore, that's going to alleviate some pressure on the capital side of the equation.

Unidentified Analyst

Okay. So what you're saying is the market, or you guys are slowing down more than what you originally thought. So you're not going to get there as quick. Do you still anticipate being there at 20 to 1 in early '09, or when would you think you get to about that level.

Aldo C. Zucaro

Well, it's an educated guess. But right now, I personally think and Chris certainly can speak from himself, that there is a good chance we may not even reach 20 to 1 by year end this year.

And then, of course time will tell as to what happens next year when the system gets unclogged ever so gradually as to how much of opportunity then we have. How much will of the products will have been covered by FHA, and how much of the product at that time, let's say around spring time, or early summer of next year finds it's way back to a GSE conforming product. Chris?

Christopher S. Nard

Yes, I would say that when we did the original forecasts in the ... getting arms around this in the third and fourth quarter of '07, we were seeing dramatic increases in the MI penetration right in the market. As you guys know, we've gone very low rates in these piggy bag structures or essentially the predominant credit enhancement. Two, I think in the third quarter of '07, we had reached something like 16% or 17% MI penetration rate. That had run on new insurance written off before everybody.

Well, that has come down dramatically as all of us has tightened guidelines and increased prices as well as the Fannie and Freddie the GSEs, instituting a loan level price adjustments. So, you now have a dramatic change with the MI penetration rates have fallen significantly and the FHA rate has grown I would guess somewhere up to... close to 20% in this market. So, that has greatly reduced the growth in the risk and force outlook that we had which will moderate the need for capital in these next few quarters.

Unidentified Analyst

Okay. And Al, another question. What do you think the MI industry is going to look like in a couple of years? Are there going to still be seven or so players or what do you think it looks like?

Aldo C. Zucaro

Well, again, I will ask Chris to participate in answering this question. But I think we're together in feeling that in thinking that maybe one or two companies in the business may get derailed or at least go into some quiet time for a period of time before being resurrected again.

But we think, I mean, it's hard to tell. You got a company out there that maybe spun off by its current owner. You have another one where the owner got all sorts of difficulties and just talking about getting rid of some assets. So, its hard to figure right now as to whether you're going to get new entrance in the business either picking up those active companies or creating a new one. My gut for its worth is that we'll be looking at about the same industry. You may have some changes in market share. Some picking up, some market share and others more or less stable. But I think you'd look the same three, four years from now. Chris, please do comment.

Christopher S. Nard

Yes. What I'd I think add to that is if you look at the outlook as we work through the format for the GSCs and what residential lending looks like. I don't think we have any situation that would, any solution that would say we need less private credit enhancements in the market.

So, I think is it being an attractive market for people to be in, I think any solution that we look at going forward says and if anything we need more private credit enhancement and more eyes. In that sense looking at these loan transactions. So, I think that's a positive for the industry. I would opine on how many of us sight. I think there are. I do think though that's its, its not really relevant whether there is 7,6,5. Its simply is their capital available to meet the needs of the high LTV markets in the country. And you can do that with any number of players.

Unidentified Analyst

Okay. And then last question guys. You mentioned in the press release that you were resending more claims due to the fraud. Do you have like a percent of claims that you are resending and how that's gone up year-over-year. Any feel for the number of claims you're resending on a percentage or actual basis?

Christopher S. Nard

All I'd say to that is when you see fraud crop up in mortgage loans, you see it frequently with early payment defaults, loans that have gone bad within the first 12 months and if you look at the way delinquencies have developed with the '06 and even to some extent the earlier '08 book, you can see that you couldn't develop those delinquency rates that quickly unless big portions of those books in the market as a whole went to default early in their lives.

When we see loans in our insured book go to fall early in the first 12 to 15 months, generally have a high proportion of misrepresentation and other issues. So we don't have a percentage I would give you. I would simply say our procedures for enforcing the master policy which does not pay in those events. It's been unchanged.

Historically, we have always handled these things in the same way and continue to. The increases again not a change in our procedures or policies but just watching that '06, '07 book begin to age through the pipeline, it's generating much higher rescission.

Unidentified Analyst

Would you say your rescissions are continuing to grow? Would you expect them to be higher on an absolute basis fourth quarter and early '09?

Christopher S. Nard

Yes. I think everybody in the market would have to assume that they will continue to increase as that not to use the rat and the snake method or but is that '06, '07 book ages through the pipeline, you'll see that occur.

Unidentified Analyst

Okay. Thank you guys.

Operator

[Operator Instructions]. We will go next to Mark Alford with Centurion Investments.

Mark Alford
Centurion Investments

To as best you can to hear, if there is some type of program to provide relief to distressed home mortgage holders either through... well, I guess worse case would be some type of a cram down where $100,000 mortgage perhaps becomes $80,000. As a mortgage insurer, are you responsible for the first lets say 20%?

Christopher S. Nard

No. the policy does not account for a cram down to be a cause of the loss. So, we would not... there would not be a situation where $100,000 was cramped down. The loan was current obviously because of that there would be no claim to be filed on that $100,000.

Mark Alford
Centurion Investments

So, won't any type of program be... I mean I assume that if its a reduction of interest rate it won't affect you because you are guaranteeing principle on that interest. And if there is a principle reduction that if anything this would reduce the frequency it seems to me a foreclosure. So is it 1% beneficial to mortgage insurers?

Christopher S. Nard

Absolutely. Anything that... well, generally, I won't say. Generally anything that's done to get the home buyer borrower in a position of being able to handle the payments over the long-haul is a good outcome for the service or lender and us.

Mark Alford
Centurion Investments

Okay. Thank you.

Operator

And we'll go next to Tedd O'Connor with Cooken NBR.

Tedd O'Connor
Cooken NBR

Hi thanks. You guys have answered a lot of my questions. On that cram down that issue, would that apply also that we are just voluntarily if the government encourage the bank to modify loan?

Christopher S. Nard

Yes. Now there is a couple of ways to look at it. There is one obviously the policy language in the master policy, which in that cram down situation is similar to what have been in essentially a waiver of the UPB. When we look at each one of these modifications on a case by case basis and determine how the best participate with the lender to get the borrower into a position where he can continue to make his payments.

Tedd O'Connor
Cooken NBR

So, in those cases it'd be sort of a negotiation with the lender to come up with the solution.

Christopher S. Nard

Yes. We'll look at them on a case by case basis.

Mark Alford
Centurion Investments

And then to take things in sort of a darker vein, all these government intervention sound very positive. But there is certainly lot of skepticism in the market about the long-term viability and more reinsurance business. IF something changed and it proved not to be a viable business, is there any recourse outside of mortgage insurance to the parent company or is... as I think about your book value and shareholders exposure side, I just look at the surplus in the mortgage insurance business write that off and then look at what's left.

Christopher S. Nard

Let me address the first part of the question and Al can address the second part. Again, I think I said this earlier, if you look through everything that's going on in the mortgage markets, the way they kind of got to where they are today, the levels of defaults and losses that are being taken kind of the negative outcome of the piggy bank market where our product was super seeded by different structures.

Again, you can't really... it's hard to reach any conclusion that would say in anyway that you would reshape the mortgage markets going forward, you would want less private credit enhancements on loans. We've always said that one of the values that mortgage insurance provides in the market is that friction between the individual who takes the first dollar loss, the investor and the originator. And we being the guy that takes the first dollar loss, generally is active and working with the originator, and the ultimate investor. Three to set the guidelines that works for everybody. One of the things we got away from when this market got a little bit overheated, that's an understatement, overheated in '06 and '07 was that that friction kind of disappeared from the market.

And I think that in turn contributed to things getting out of balance. So I don't... for a group of policy makers was sitting around putting together a map for the MI business or the mortgage business for the future. I don't think you would want to eliminate private parties taking first dollar risk on high LTV loans.

So, while certainly there is a lot of grey area around how the mortgage markets look in the future, you got to think that private credits enhancements play a pretty good role in anyway you would restructure this market.

Aldo C. Zucaro

That's right. And then, relative to second part of the question, whether these companies, what is the structure corporately of these companies under the same umbrella of ORI. Each of our companies stands on its own, and is responsible solely for the obligations it incurs to its assureds.

As a matter of enterprise risk management, we do not believe in using the assets of or the capital of one insurance company to support the assets and obligations of another insurance company but buy the same token. The fact that all of these companies are joined under the Old Republic umbrella as I say does give comfort to the policy holders of each of the companies that there is greater flexibility, greater ability to use all of the assets of the holding company to access the capital markets. And thereby, come up with capital to some degree anyway, for each of the companies that maybe in need at any point of time.

Mark Alford
Centurion Investments

Fair enough. Thanks guys.

Operator

[Operator Instructions]. We'll go next to Kevin Korlager [ph] with Perkinsville.

Unidentified Analyst

Hi Al and Chris.

Aldo C. Zucaro

Hi Kevin.

Christopher S. Nard

Hi Kevin.

Unidentified Analyst

Hi. Quick question to Al. going back to trucking, when gas prices go down do you see a change there in accident trends and such?

Aldo C. Zucaro

I think most of the change that occurs in trucking accidents or any other accidents really for that matter, in any manufacturing or any company of that service provider, what have you, is related to how much activity takes place.

So therefore, it's really driven by the economy, the harder the economy, the more miles are put on by the trucks and the furthermore they are exposed to traffic accidents and whatever.

With respect to the price, the effect of gasoline or diesel price on accidents in the trucking industry, it does appear that the truckers do slowdown a bit. They get more miles per gallon that way. And therefore, by slowing down a bit that tends to somewhat reduce the propensity to get into accident situations.

Unidentified Analyst

Okay. And then secondly, what are your thoughts on, if you could, both for the industry and as it relates Old Republic, just with what's going on in AIG. Is that an opportunity for you? And how do you see this playing out for the industrial overall?

Aldo C. Zucaro

Well, as you know, the AIG, it's a matter of public record is apparently in the process of selling some of its assets. And there are going to be assets that are, from what we understand, mostly in the non-general insurance area. They are assets in its life insurance business, certainly and the same probably in there financial products area in their aviation leasing business. None of which of course, have any bearing competitively on our relationship with AIG in the marketplace.

With respect to the property and casualty business in North America, which is the only place where we do compete with AIG, I think you have a natural effect of problems at AIG, whereby some of its people are maybe more difficult to retain. And therefore, those people may find a home elsewhere. But when you shake it all together, I think the opportunity arises from customers perhaps taking a long second look at their relationship in this case with AIG or any other company that maybe... that may appear to have some sort of difficulty attached to it. That customers may want to look for a second opinion so to speak, a type of thing. And therefore you may have as a result more opportunities to bid on business than you might otherwise have.

Unidentified Analyst

Okay. Thanks.

Operator

And we'll go next to Rick Lane with Broadview [ph].

Unidentified Analyst

Afternoon guys.

Aldo C. Zucaro

Hi.

Unidentified Analyst

Could you have the delinquency number for your prime book by chance.

Christopher S. Nard

Well, the traditional primarily delinquency rate is 8.36%. I don't have that broken out from the by-prime and others. Its safe to say that the bulk of our book is in the prime segment. But there's some percentage of reduced stock and some lower FICOs that would have come through those agency automated underwriting systems there. So, it's safe to say that the non-prime delinquency rate would be higher, the prime rate level.

Unidentified Analyst

Chris. Might you guess that the prime book could be 150 basis points lower than the 836?

Christopher S. Nard

It's lower, but I just don't have that in front of me right now.

Unidentified Analyst

All right. Is that something I could get?

Christopher S. Nard

I don't we released that. I think you can look though at the and see what the percentages are in the different risk categories. I think we released risk in four spy arm doc type and some other characteristics.

Unidentified Analyst

Okay. So, I'll have to wait for the Q1 then, isn't it?

Christopher S. Nard

Yes. I'll be in there. There would be... I could tell you second quarter to third quarter, there would obviously be no increase in new insurance written in those high risk buckets.

Unidentified Analyst

Yes. And Al, when you originally talked about envisioning the '05 through '07 book. I think originally you were talking about 150%.

Aldo C. Zucaro

Yes. Just for the entire...

Unidentified Analyst

Cost ratio?

Aldo C. Zucaro

Just for the entire book of business, Rick, which would be 2007 and prior and all prior years together with 2008 and then of course next year 2009.

Unidentified Analyst

Yes.

Aldo C. Zucaro

Compliance of business.

Unidentified Analyst

And when you'd originally envisioned that, did you also equate it to where you thought at that level your risk to capital ratio with would bottom out.

Aldo C. Zucaro

No. We assumed a... we looked or we determine that guess as to the loss ratio, purely on what we expected the books of business for let's say '07 and prior to ultimately come out to and what we expected the books for '08 and '09 to look like and commingled the whole thing and that's how we came up with that 150. That one thing.

The other thing we did was to mimic loss emergence patterns that were deductible in that 85 to 92 or so period that we keep talking about which was the last period of similarly harsh dislocation in housing and mortgage lending and mimicked that starting with the loss ratio trends for that period. Starting with the 2006 year end and running it through 2009.

So, it was a combination of expected quality of the business for '08 and '09 and what the likely loss ratios would be on that, together with the loss ratios for '07 and prior and modeling superimposing on that a module in terms of what we refer to as link ratios that we took from that earlier period and more years ago.

Unidentified Analyst

And just follow-up on that question. And talking with some of your competitors, it now seems like there is a thought process that maybe more like a 25 to 1 level might not only be acceptable in and off itself but perhaps you'd have to breach that level before at this stage of the game given all the water under the bridge that used you'd go to that point and maybe you'd have to breach before you'd have to.

You'd feel you would have to raise capital again. In other words, maybe we are thinking 20 to 1 prior to let's say the last month and now. I mean, let's face it, it came out to like in 91 and 92 and the bank regulators kind of looked the other way. And a lot of capital ratios below what would otherwise been the case.

If I understand where you're going with that and I try to answer that question in the comments we made earlier, and that is that again harking back to where we and the rest of the industry were back in the 80s and 90s, we were in fact allowed to operate certainly above 20 to 1. Don't have the exact number, but I'm going to guess maybe you have the numbers there. It's between 22 to 23 or something like that.

Christopher S. Nard

Yes. If you look through that cycle, it was I think about 20 to 23, maybe a little bit higher in the worst year.

Aldo C. Zucaro

All right. And then, the other thing, Rick that is present in our current situation is that we think that the GSCs in particular are much more sophisticated today than they were in those days and do require us annualize an industry to provide them with modeled expectations, or where we think we're going to be. And therefore, they're approaching the approval of mortgage guarantee insurers to do business with them with a great deal more understanding of the status of these companies, and for that reason again we believe that they are more likely than not to see it in their best interest to work together to make sure that the business is approached on a long-term value standpoint rather than the shorter term orientation that seems to prevail today.

Unidentified Analyst

Yes. That's well. But my response to that would be of course. Unusual times. And then I'd just follow-up and finish by asking, have you seen with all the mitigation efforts that are going on from all of the various different avenues, and I can think of one in particular, the Bank of America countrywide settlement. One, I take it that it's probably slowing down the payment of claims in the third quarter than otherwise might have been the case. And two, I would guess its exaggerated delinquencies, because if you are home owner on fence why not consider going delinquent and just saying if your institution contacts you for a mitigation effort. And so, my personal guess is that delinquency rate have been somewhat exaggerated by that. But I'd ask how you feel about that?

Aldo C. Zucaro

I would agree with it. You're unable to guess at how much of the delinquent population is people who are seeing friends or [indiscernible] being offered mitigation opportunities because their delinquent and it's they're current, they are not offer that opportunity. I'm absolutely worried about that but I have no way to estimate.

Unidentified Analyst

Of course.

Aldo C. Zucaro

But it absolutely could be true.

Unidentified Analyst

And how about retarding the pays of flares [ph]. Don't you think Chris that that's a front function of all the assets we're taking in the areas of frauds and so forth

Christopher S. Nard

Yes, I mean you could pay down more.

Unidentified Analyst

Turning down more claims because of those issues, correct?

Christopher S. Nard

Yes. Absolutely

Unidentified Analyst

Okay. Well, thanks, guys. Hang in there.

Christopher S. Nard

Thank you Rick.

Operator

We'll go next to Bill Emil [ph] with Devine Capital Markets

Unidentified Analyst

Hello.

Aldo C. Zucaro

Hello, Bill. How are you?

Unidentified Analyst

Pretty good. Now we are in the recession now and usually during recessions pricing gets better for profit, you catch the insurance company. Do you see any evidence of that?

Aldo C. Zucaro

Well, I think there was a question raised earlier Bill, about what's happening to pricing generally and so forth. And I believe we said that... as I recall I said that really what's driving it in our view is the fact that investment income is not particularly additive to the bottom-line of property and casualty insurers or any other insurers for that matter. And that whenever that happens, there is a lot more pressure obviously to generate a return on capital by the underwriting side of the equation.

So, we think right now that that's the main driver in this economic, likely economic downturn that this is going to be first of all probably less business from this standpoint, that if you have less sales, less employment etcetera that of itself, those factors of themselves drive down the amount of premiums that can be charged. But on the other hand the premium rate that is charged on the lower sales, lower employment etcetera is more likely than not to inch up and than to go down. So, the underwriting results should be better from the standpoint of the deposit ratio, but not necessarily from the standpoint of the dollars involved because investment income, as I say, is not likely going to grow significantly, not for the foreseeable future.

Unidentified Analyst

Okay. Thank you. And then we were cruising along 18%, 19%, 20%, in net premiums earned in the mortgage guarantee area. Then all of a sudden, we came up with 10% this quarter. Is that due to re-pricing or --

Christopher S. Nard

Yes. The slow in growth is obviously the slower growth and new production, again attributed largely to timing the guidelines in the growth in the FHA.

Unidentified Analyst

Thank you.

Operator

And that does conclude our question-and-answer session. I'd now like to turn the call back over to Mr. Zucaro for any additional or closing remarks.

Aldo C. Zucaro

Well thank you, everyone. As always, we appreciate very much everybody's interest in joining us on these quarterly calls and look forward to visiting with you in a couple or three months. Having said that, now you all have a good afternoon. Bye.

Operator

And again, that does conclude today's call. We do appreciate your participation. You may disconnect at this time. .