S&P Global
Market Intelligence

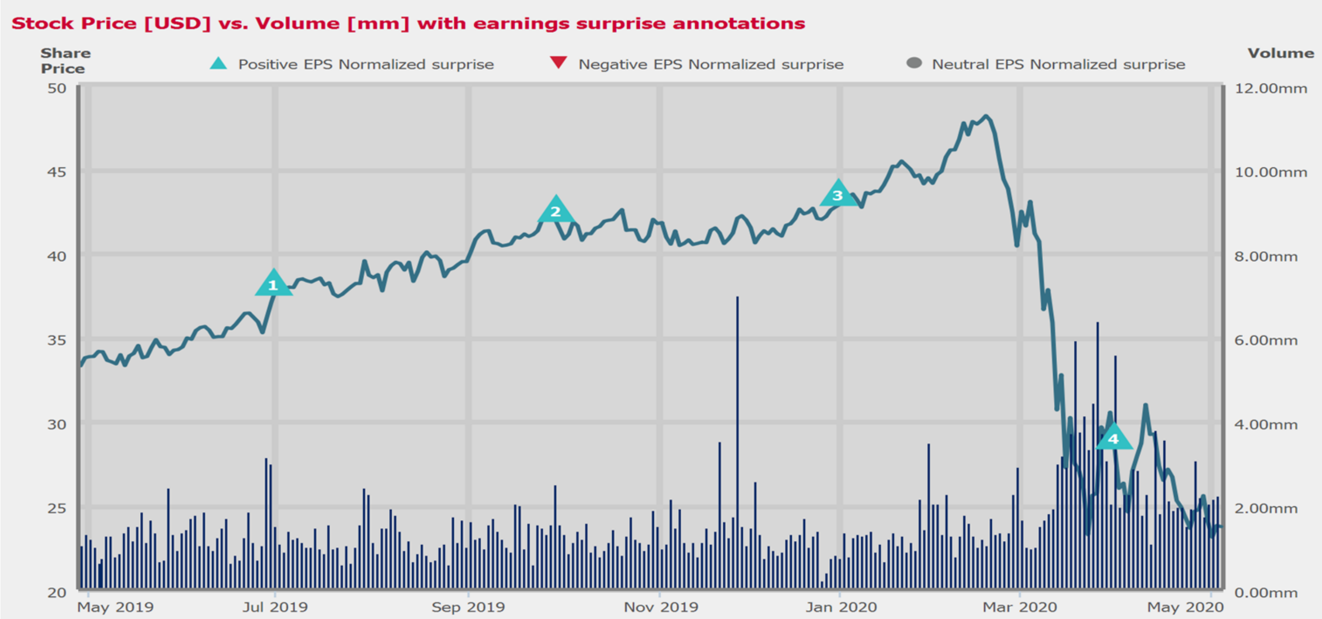
# Arch Capital Group Ltd. NasdaqGS:ACGL
# FQ1 2020 Earnings Call Transcripts

## Tuesday, May 05, 2020 3:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ1 2020- | | | -FQ2 2020- | -FY 2020- | -FY 2021- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.41 | 0.46 | ▲12.20 | 0.45 | 2.05 | 2.60 |
| **Revenue (mm)** | 1551.25 | 1950.55 | ▲25.74 | 1400.91 | 5940.55 | 6148.65 |

Currency: USD
Consensus as of May-05-2020 10:40 AM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ2 2019** | 0.67 | 0.77 | ▲1 14.93 % |
| **FQ3 2019** | 0.62 | 0.63 | ▲2 1.61 % |
| **FQ4 2019** | 0.68 | 0.74 | ▲3 8.82 % |
| **FQ1 2020** | 0.41 | 0.46 | ▲4 12.20 % |

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# Call Participants

## EXECUTIVES

François Morin
*Executive VP, CFO & Treasurer*

**Marc Grandisson**
*President & CEO*

## ANALYSTS

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# Presentation

**Operator**

Good day, ladies and gentlemen, and welcome to the Arch Capital Group First Quarter 2020 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

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

Additionally, certain statements contained in the call that are not based on historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the safe harbor created thereby.

Management also will make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP and definition of operating income can be found in the company's current report on Form 8-K furnished to the SEC yesterday, which contains the company's earnings press release and is available on the company's website.

I would now like to introduce your host for today's conference, Mr. Marc Grandisson and Mr. François Morin. Sirs, you may begin.

**Marc Grandisson**
*President & CEO*

Thank you, Shannon, and good morning to you. It would not be an understatement to say that the coronavirus has changed the world since our last call with you just 3 months ago. Fortunately, at Arch, we are entering this period with the investments we have made in our P&C business beginning to pay off, while our mortgage group navigates through the current turbulence. If you work long enough in the insurance business, like I have, you are bound to experience the industry cycle, its highs and its lows. As management, we have to keep our eye on the goal, which for Arch is generating sustainable growth in book value per share.

The current stress in the financial and insurance markets reminds us of changes that can occur to which we need to adapt. While we are still early in the assessment of our direct and indirect claims exposure to the coronavirus, it is clear that this event will be a significant industry loss and will result in profound changes. However, dislocation often leads to opportunity. As you know, one of Arch's strategic principles from inception has been cycle management. We are embarking in this new market environment with both a strong financial foundation and the creative ability of our more than 4,200 employees that position us for the opportunities that will emerge.

Turning to the quarter. We saw improving conditions in our P&C businesses, while our mortgage operations continued to produce good results. Strengthening P&C market conditions remain evident, even as the economy contracts. We have seen a rise in our submission activity along with accelerating rate increases across multiple lines of business in Q1, and it is continuing here in Q2.

Our belief in the continuing hardening of the P&C market is due to the need our industry has to address the accumulation of risk factors over the last 5 years of soft market conditions. These risk elements are: one, future claims and covered litigation related to COVID-19; two, a heightened perception of risk in general; three, economic uncertainty; four, a continuation of low interest rates and their dampening effect on investment returns; five, a potential for shortfalls in casualty reserves; and six, reduced availability of retro and alternative capital in general.

These risk elements are all in play today and are likely to lead insurance companies to be more cautious in allocating capital to risk.

In our insurance group, our strategy remains to be selective and pick our spots in this improving market. The rising rates environment and dislocation in the markets have allowed us to grow profitably in the past 2 years in many sectors, such as E&S property, D&O and E&S casualty. On a reported basis, we saw our margins improve this current quarter as our accident combined ratio, ex-cat of COVID and PYD, improved to 97%.

In our reinsurance business, pricing is also improving, and we continue to observe tightening of terms and conditions in many lines. The value of reinsurance as a capital protection tool has been enhanced by the recent events. The hallmark of our reinsurance group remains the dynamic allocation of capital to contracts that will provide appropriate risk-adjusted returns while helping clients with solutions that are tailored to their needs and was a large factor in our growth this quarter.

Switching now to our mortgage insurance segment. The industry is facing its first significant test since the fundamental reforms and product improvements that were adopted following the global financial crisis, or GFC. As you know, Arch MI is a data and analytics-driven company, and our investment in the sector was predicated on a new and better MI operating model than the industry employed prior to 2008. Now pricing is more precise, products and documentation are better, and the MI industry buys protection against downside.

In addition, another change in the industry can be seen in the aggressive government actions taken in the early stages of the pandemic directed at helping borrowers stay in their homes. The GSE's forbearance program and the unemployment benefits programs provide unprecedented support that should enable borrowers to cure delinquent -- delinquencies as the economy improves and will result in fewer losses.

As noted in our quarterly HaMMR report, the MI industry is far better positioned for a recession than they were in 2008. At that time, mortgage insurance portfolios were facing a housing market that was significantly overbuilt, risky mortgage products and less creditworthy borrowers. More than 2/3 of mortgage insurance written in 2007 would have been uninsurable during the last 10 years. And finally, there was a speculative bubble in home prices.

Mortgages filed under the FHFA's forbearance programs were estimated at 5.85% of the GSE mortgages as of April 26. This program allows homeowners to suspend mortgage payment for 6 months which can then be extended for up to another 6 months. While initially recorded as delinquencies under GAAP, our data on forbearance programs utilized in recent natural catastrophes indicates that almost all of these loans cure by providing borrowers time to return to work.

Over the next few quarters, rising delinquency rates under GAAP should lead to elevated loss ratios in the MI segment. Furthermore, once the forbearance programs expire, the GSEs have instituted a sturdy list of remedial solutions that, once again, will enable loans to be back-performing.

We realize that this pandemic-led recession will be different than a GFC. But based on what we can see today, our view is this is an earnings, not a capital event for Arch. It is worth noting again that even if this recession is worse than we currently expect, we hold significant reinsurance protection on our risk in force that would moderate our net losses even in a more severe recession.

While some of our reinsurance quota share attaches at first-dollar loss, that would provide up to an additional $3 billion of excess and loss protection if this becomes a recession worse than what the industry experienced in a GFC.

Lastly, turning to our investment operations. We believe that interest rates are likely to stay at historically low levels for the foreseeable future, and that will, over time, require insurers to improve their underwriting margins through price increases. In our investment strategy, as in our underwriting approach, we have maintained our focus on risk-adjusted total return, while enabled us -- which enabled us to avoid much of the negative impact of the pandemic on our investments this quarter.

As perception of risk increases, so does the cost of capital and underwriting discipline becomes important. Again, recent world events reminds us that risk is always present, that insurance premiums must include an adequate margin of safety, and that reinsurance plays an important role in protecting capital and returns.

In summary, through to Arch's cycle and risk management principles and fortified by our conservative balance sheet, Arch is prepared for this crisis and is well positioned to continue to build on its track record of book value growth.

In closing, I want to thank all of our employees around the world as they are responsible for the success of Arch and are working tirelessly throughout the world to meet the needs of our insureds.

Thank you. With that, I'll turn the call over to François.

François Morin

*Executive VP, CFO & Treasurer*

Thank you, Marc, and good morning to all. We at Arch hope that you are in good health in these difficult and uncertain times. This quarter, in anticipation of some of the questions you may have, I will try to elaborate in more detail on some notable items in addition to the regular discussion of financial items. I recognize this may take a bit longer than usual, so please bear with me.

Now on to the first quarter results. As a reminder, and consistent with prior practice, the following comments are on a core basis, which corresponds to Arch's financial results, excluding the other segment, i.e. the operations of Watford Holdings Ltd. In our filings, the term consolidated includes Watford.

After-tax operating income for the quarter was $189.8 million, which translates to an annualized 7.1% operating return on average common equity and $0.46 per share. Book value per share decreased to $26.10 at March 31, a slight reduction of 1.2% from last quarter and a 12.9% increase from 1 year ago. The defensive posture of our investment portfolio ahead of the COVID-19 crisis served us extremely well in preserving our capital base relatively intact during the stressed economic environment of recent months. I will elaborate on this in more detail later on.

Outside of the losses related to the COVID-19 pandemic, which impacted on our first quarter results, our underwriting groups fared very well this quarter with strong growth and generally improving underwriting results through our property casualty insurance and reinsurance operations. Given the unusual circumstances and breadth of the pandemic, we have classified COVID-19 losses as a catastrophe. However, as you saw in the financial supplement, we have also provided the segment level detail of our current estimates to assist with the analysis of the underlying performance of our book of business. We expect to follow this approach until the end of 2020 at a minimum.

Losses from 2020 catastrophic events in the quarter, not including COVID-19, net of reinsurance recoverables and reinstatement premiums, stood at $31.8 million or 2.0 combined ratio points compared to 0.6 combined ratio points in the first quarter of 2019. The losses impacted both our insurance and reinsurance segments and were primarily due to various U.S. severe convective storms, U.K. storms and floods and Australian bushfires.

We recorded approximately $87 million of COVID-19 losses across our P&C operations, split 41% to insurance and 59% to reinsurance. While it is still very early and we have extremely limited information to accurately quantify our potential exposure to the pandemic, we believe that was prudent to establish a certain level of IBNR reserves for occurrences through March 31 based on policy terms and conditions, including limits, sublimits and deductibles. These reserves were recorded across a limited number of lines of business, such as property, where we have a very small number of policies that do not contain a specific pandemic exclusion and/or explicitly afford business interruption coverage under a pandemic, and trade credit.

As regards the potential impact of COVID-19 on our mortgage segment and our estimation process at this time, we believe it's important to make a distinction between our U.S. primary mortgage insurance unit, which we refer to as USMI, and the rest of this segment, which includes our international book and our portfolio of GSE credit risk transfer policies.

For USMI, pursuant to GAAP, our estimates are based only on reported delinquencies as of March 31, 2020. However, given the potential effect of the pandemic, we elected to book reserves at a higher level of confidence within our range of reserve estimates for such known delinquencies. The financial impact of this increased level of conservatism was approximately 5.2 loss ratio points across the segment.

For the rest of this segment, the loss-reserving approach we use is more consistent with traditional property casualty techniques, where loss ratio picks are set at the policy level and are able to consider future delinquencies on business already earned. This quarter, in response to the potential impact from the pandemic across our portfolio, we adjusted our loss-ratio picks for some policies, which resulted in an increase of 6.8 loss-ratio points to the overall segment results. Based on the information known to date and economic forecast, we believe the adjustment across the non-USMI book is prudent and consistent with a moderately severe stress level.

As we look towards the remainder of 2020 for our USMI unit, we are expecting the delinquency rate to increase progressively from the current level as more borrowers request forbearance on their mortgage loans under the CARES Act. As mandated by GAAP, we expect to record loss reserves on these delinquencies, which will most likely translate into an increase in our levels of incurred losses over the coming quarters. Over time, we would expect many of these delinquencies to cure and revert back to performing loans as the economy returns to a more normal state.

At this time, we do not have enough visibility to predictably forecast the rate at which forbearance delinquencies will be reported to us, cure or ultimately turn into claims on an annual, let alone a quarterly basis. That said, based on our current analysis, which tells us that the pandemic will represent an earnings event for our mortgage segment and not a capital event, our current expectation is that our pretax underwriting income for the entire mortgage segment will be minimal for the remainder of 2020, i.e., from the second through the fourth quarter of 2020. However, there is likely to be variability in underwriting income between quarters based on the timing of receipt of notice of defaults.

Turning to prior period net loss reserve development. We recognized $17.8 million of favorable development in the first quarter, net of related adjustments, for 1.1 combined ratio points compared to 3 combined ratio points in the first quarter of 2019. All 3 of our segments experienced favorable development at $0.8 million, $11 million and $6.1 million for the insurance, reinsurance and mortgage segments, respectively.

We had excellent net written premium growth in the insurance segment of 33.4% over the same quarter 1 year ago. The insurance segment's accident quarter combined ratio, excluding cats, which as a reminder include COVID-19 losses, was 97.1%, lower by 310 basis points from the same period 1 year ago. Approximately 190 basis points of the difference is due to a lower expense ratio, primarily from the growth in the premium base over 1 year ago. The lower ex-cat accident quarter and loss ratio primarily reflects the benefits of rate increases achieved throughout most of 2019 and the first quarter of 2020.

As for our reinsurance operations, we had a significant transaction in the quarter, which affected the comparability of our underwriting results, an $88 million loss portfolio transfer written and fully earned in the period in the other specialty line of business. Absent this transaction, net premiums written would have been 57.2% higher than the same quarter 1 year ago. This net written premium growth was observed around -- sorry, across most of our lines and includes a combination of new business opportunities, rate increases and the integration of the Barbican reinsurance business.

While the loss portfolio transfer had a minimal impact on the overall combined ratio for this segment, a decrease of approximately 50 basis points, its impact on each of the loss and expense ratio components was more observable with a resulting increase of 400 basis points to the loss ratio and a decrease of 450 basis points to the expense ratio. Overall, the growth and underlying performance of our reinsurance segment was very good this quarter.

The mortgage segment's combined ratio was at 44.1% including the 12-point loss ratio -- loss ratio impact resulting from the increased level of conservatism in our overall segment reserve estimates discussed earlier. The expense ratio was higher by 240 basis points over the same quarter 1 year ago, reflecting reductions in profit commissions on ceded business and higher compensation costs and employee benefits. Total investment return for the quarter was negative 80 basis points on a U.S. dollar basis as the defensive positioning of our portfolio served us extremely well in this difficult period. Given some of our fund investments are reported on a lag, typically 3 months, their first quarter performance will be included in our second quarter financials.

The duration of our investment portfolio was slightly lower than last quarter at 3.19 years compared to 3.40 years at December 31, but remain overweight relative to our target allocation by approximately 0.35 years. Most financial markets had a positive return in April, which should help reverse some of the results we're -- we observed in the first quarter.

The effective tax rate in the quarter on pretax operating income was 10.5% and reflects the geographic mix of our pretax income and a 110-basis-point benefit from discrete tax items in the quarter. As always, the effective tax rate could vary, depending on the level and location of income or loss and varying tax rates in each jurisdiction.

Turning briefly to risk management. Our natural cat PML on a net basis increased to $680 million as of April 1, which at approximately 7% of tangible common equity remains well below our internal limits at the single event, 1-in-250-year return level.

With respect to capital management, we remain committed to maintaining a strong and liquid balance sheet. During the quarter, we repurchased approximately 2.6 million shares at an aggregate cost of $75.5 million. While we have a meaningful remaining share authorization under our current program, we do not expect to repurchase shares for the remainder of 2020.

At USMI, our capital position remained strong with our PMIER sufficiency ratio at 165% at the end of March 31, 2020, which reflects the coverage afforded by a Bellemeade mortgage insurance link notes. These structures provide approximately $3.1 billion of aggregate reinsurance coverage as of March 31, 2020.

Finally, to echo Marc's comments, I'd like to give a special shout-out to our more than 4,000 colleagues around the world that have demonstrated a tremendous amount of creativity, patience, resilience and compassion with clients and business partners, the communities they live in, their families and loved ones and each other over the last 7-plus weeks. They are the essence of what Arch is all about, and I couldn't be prouder to be part of such a great team of individuals. Thank you. With these introductory comments, we are now prepared to take your questions.

# Question and Answer

**Operator**

[Operator Instructions] Our first question comes from Elyse Greenspan with Wells Fargo.

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

My first question is on the mortgage segment. So I heard you guys say that kind of still difficulty -- difficult to put your hands around what the total loss could be within MI. But you did say that you expect no underwriting income for the next 3 quarters. So if I look at what you guys might have been expecting, it seems like -- and look at what you generated right in the back few quarters of 2019, that triangulates maybe into about an $800 million or vicinity loss. Now the reason why I go there is your RDS that you guys disclosed at the end of last year for that business was around 8% of your tangible equity.

So the numbers seem within the same ballpark of each other. So am I triangulating correct, that you're assuming that this loss could be equivalent to your RDS? Or am I missing something in putting those thoughts together?

**Marc Grandisson**
*President & CEO*

Yes. I think -- thanks, Elyse, for the question. I think that the 2 numbers appear to be the same level, but are actually coming from a different source. The $800 million that you referred to that could be, let's say, it's a great number for the next 3 quarters, will be incurred losses. And against that, you have to put premium.

And if you look at our RDS scenario, we actually look at the rollout of all the claims paid in the future and we offset it by all the premiums that we would receive, and this is what constitutes the PML. So they're very different. One is a net P&L impact. The other one is incurred loss of the $800 million you mentioned, the first time around.

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

So the $800 million is the losses that you expect over the balance of the next 3 quarters, not the -- I thought you had said it wouldn't generate any underwriting income?

François Morin
*Executive VP, CFO & Treasurer*

Yes. I mean just to clarify, I think, it's really a difference between the next 9 months versus the full runoff of the in-force portfolio. As we think of the remainder of 2020, what -- the comment I made was really underwriting income, meaning premiums minus losses, minus expenses. And we're saying we don't expect a whole lot of underwriting income for the remainder of 2020.

When we think about the RDS, fundamentally, to get to a similar, let's say, an $800 million number that you quote of RDS, what that would mean was really -- would be a much larger incurred loss because we expect to have material premium flows or premium income coming to us in future calendar years, which may be 5, 7, 10 years. So it's just -- the RDS is really a full comprehensive premium and gain/loss underwriting income across the full runoff of the in-force portfolio.

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

Okay. And then within the RDS, can you remind us what are the assumptions for delinquency rates as well as like housing price depreciation and how we think about you guys coming to that 8% loss figure?

**Marc Grandisson**
*President & CEO*

Yes. There are many assumptions, but at a high level, decrease in house price, 25% below fundamental, so 25% from now going down and staying there for 2 to 3 years. Interest rates shooting up 7% or 8%, that these are major -- the 2 major ones that -- and unemployment, of course, lasting longer. The length of time that RDS is stressing our portfolio, when we go through it, is a much longer period than even the 2007 crisis would have generated.

To the delinquency equivalent, it's something more like 9% ultimate claims rate. It's hard for me to parse out what is delinquency versus conversion to claims. So at a high level, we prefer to think in terms of claims rate. So the portfolio, as it stands right now, if you run it off and 9% of it were to default, that will be equivalent to the RDS number that we have, which is significantly above what we expect right now, just to -- just for your benefit, which is significantly above what we expect to happen for the next 12 months.

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

And then one last one on the guide for the lack of underwriting income for the year-end mortgage. Does -- and you -- do you guys -- are you guys assuming that you're going to have to use some of your ILS, the Bellemeade securities? Or at this point, you do not think you might attach into any of those covers?

François Morin
*Executive VP, CFO & Treasurer*

Well, 2 things that just for -- I think good points of clarification for you guys. First of all, the Bellemeade protections, as you probably do know, amortize over time. But there's a trigger on them that, basically, once you exceed a certain level of delinquencies, they stop amortizing. And that, we think, we expect will happen most likely sometime in 2020 and maybe in the second quarter, maybe in the third quarter, maybe later. And that will basically freeze, at least for some period, the amount of coverage that is available to us and would remain most likely for the duration of each of those structures.

But to answer, I think, more directly to your question, we do not expect under most scenarios that we would trigger the coverage of the -- provided by the Bellemeade protection. So the $3 billion of excess of loss cover that we talk about, we know is available, we know it's there. But at this time, under most scenarios, we don't expect to pierce the attachment that we would -- where we would actually fully -- well, we'd start to receive coverage or cede some of our exposures.

**Operator**

Our next question comes from Jimmy Bhullar with JPMorgan.

**Jamminder Singh Bhullar**
*JP Morgan Chase & Co, Research Division*

So just first a question on the MI business. Your assumption of no underwriting income for the rest of the year, does that reflect primarily you having to reserve at the level that reflects sort of delinquencies given GAAP rules? Or does it also -- and not -- and you -- from your comments, it seems like you think ultimate defaults will be lower than that, given that people are taking advantage of forbearance and stuff and then the cure rates will be higher.

But it's more because of just you having to reserve at a higher -- at a level that reflects delinquencies? Or is it also a reflection of your views on ultimate defaults?

François Morin
*Executive VP, CFO & Treasurer*

Yes. I -- it's certainly more of the former. So, right, we do expect the reality, given the forbearance programs that have been in place, we expect a higher-than-normal flow of delinquencies to be reported to us. Some people are just taking advantage of the programs just to be safe, and they'd rather just play it safe and not take the risk of falling behind on their mortgage payments. So what we expect will happen, we haven't seen much of it yet, but we do expect -- I mean that will pick up in Q2 and Q3 is that we will have to -- we will receive these delinquencies.

When we come to the end of Q2, we'll have to assess what kind of reserves we'll set on those delinquencies. We'll make determinations on the probability that those will actually cure based on the information we'll have in front of us at that time. It's too early today to tell you what that will look like. But certainly, based on the fact that we expect just an elevated number of delinquencies to be reported to us, that will just, by nature, trigger us. We will reserve for those delinquencies, and we'll incur some losses.

Whether those will translate into claims paid, ultimately, we don't know. Time will tell, but that's really just how we think that the accounting will work, at least in the year -- I mean the -- certainly, for the next few quarters.

**Jamminder Singh Bhullar**
*JP Morgan Chase & Co, Research Division*

And then on business interruption, you mentioned provisions in most of your contracts that actually exclude losses because of pandemics or viruses. I'm assuming you're talking about primary contracts. On the reinsurance side, should we assume that if your clients are paying either because there wasn't a provision or because they lose a case and then -- and a lawsuit, then you would have to be on the hook to the extent you provided coverage as well?

**Marc Grandisson**
*President & CEO*

Yes. I think -- yes, the comment had to do with insurance, which, as you can appreciate, the vast majority, or more than the vast majority of what we do has an exclusion for viral -- it is a virus exclusion. On the reinsurance, it's still early, right? We still have to figure out what the BI losses are going to be if they come to fruition for our clients. And then they'll have to go through and say whether there's protection on the risk or quota share, or for that matter, excess of loss on a cat basis. So this is going to play out over the next several quarters.

A lot of contracts have hours clause for those kinds of events. There'll be a lot of discussions back and forth as to when do we start counting, how do we count them. So there's a lot more uncertainty and some other folks in the industry, I've echoed the same comments that it's going to be a little bit longer to figure out what it means. Because in general, the contracts are not written to really cater for those kinds of event. There's not a specific virus protection. It's really meant primarily to be a property coverage, by and large, from -- I'm talking from cat-excessive loss perspective. So people will have to sift through the language and see what it means to each and every one of them.

**Jamminder Singh Bhullar**
*JP Morgan Chase & Co, Research Division*

Okay. And then just lastly, on the acceleration of growth in your insurance and reinsurance premiums, how much of this is pricing versus you potentially gaining share or just increased demands for some of the lines that you're in?

**Marc Grandisson**
*President & CEO*

Yes. At a high level, about 15%, 1-5, of the increase in premium came through acquisition. Barbican is definitely one of them. We also had acquired a team on credit and surety from Aspen towards the second half of last year. That's about 1-5, 15%. 25% is due to rate. The rate increase this quarter across our P&C was between 5% and 10%. So it's actually better than the fourth quarter of '19. And the rest, 60%, is truly growth in exposure, new business one-offs or unique situations or opportunities, one of which François mentioned in his comments.

**Operator**

Our next question comes from Mike Zaremski with Crédit Suisse.

**Michael David Zaremski**
*Crédit Suisse AG, Research Division*

Sticking -- moving back to MI. Can we talk about capital requirements? Capital charges for loans and nonpayment are usually materially higher than for performing loans. I know I saw it in the prepared remarks, you said that the PMIER sufficiency ratio is well in excess of 100%.

Has the FEMA designation kicked in? And is it to allow Arch and other MIs to potentially hold less capital? Or just kind of how should we as investors think about the capital requirements and how that could play out over the next 3 to 12 months as nonperforming loan levels or deferred loan levels increase?

François Morin
*Executive VP, CFO & Treasurer*

Yes. I mean to answer your question, the answer is, yes, the -- it's actually in the wording in PMIERs that when there's a FEMA-designated zone, the capital requirements of -- for delinquencies are reduced by 70%.

So -- and given that all 50 states have actually declared -- have been declared a FEMA disaster zone, currently, we are adjusting at the end -- starting at the end of March and going forward, we're adjusting the PMIERs capital requirements to reflect that haircut, I'd say, on the capital charges for delinquent loans.

There's a bit of a discussion going on with FHFA around how long that will be available. I think the industry and FHFA are working together on that and the GSEs to come up to clarify everything. I think there's a bit of -- some technicalities and maybe it wasn't, I'd say, perfectly considered or worded in the wording of the PMIERs, but still, we think that they'll -- we expect that the, call it, the haircut on the capital charges will remain in place until we're -- we have a bit more visibility on how some of those loans will cure and go back to performing.

**Michael David Zaremski**
*Crédit Suisse AG, Research Division*

And just the final part, François, that you mentioned in terms of the clarification on how long. Does that play into why Arch has decided to most likely not repurchase stock for the remaining of the year? I guess maybe this is a broader question. I -- it feels like prior to COVID, you guys were playing kind of more, I'd call it, offense than most carriers. Does COVID change the playbook? I know this is a broader question. And is the lack of MI earnings and maybe some of the clarification of capital kind of why you're not purchasing stock when it's trading below book value?

François Morin
*Executive VP, CFO & Treasurer*

Yes. Well, I'd flip it a little bit on you. I like to think we played a fair amount of offense in Q1 on the P&C side. So I think our view is that we -- again, we said it before, we like optionality. And the fact that we have a strong balance sheet, we want to keep it that way. We want to be able to take advantage of opportunities that may surface.

So does COVID change the playbook? Not per se, but we think there will be probably a fair amount of disruption that's going to emerge in -- through the end of 2020 and maybe beyond. So that's really -- that's the Arch playbook, and Marc can chime in, but that's really how we think about having the opportunity or the ability to execute on those opportunities.

**Marc Grandisson**
*President & CEO*

Yes. Clearly, we had played the MI market. We still are in the market, very involved. We were, by and large, a lot more allocation of capital to the MI always with the lookout, as you guys know us, but if something were to develop and get better on the other side and more -- the very important piece of what we do every day, the P&C that we would shift and allocate more capital there. And I think as we look through the first quarter and the perspectives, we have business reviews with everyone and understanding and hearing even after COVID-19. Even though there might be a little bit of a dip in premium in the second and third quarter, it's clear that opportunities are there. And our first mission, as François mentioned, is to deploy capital. This is what I believe our shareholders want us to do, is to deploy capital towards insurance underwriting. And I think we have an increased level of opportunities that wasn't there 6 months or 9 months ago.

So capital. And as I said, capital becomes very important as we go through the next year or so. So we'll be able to deploy it and make, hopefully, great returns for our shareholders.

**Michael David Zaremski**
*Crédit Suisse AG, Research Division*

So I guess, Marc, what you would then -- we should continue to expect the non-MI operations to continue playing offense and growing at a fairly fast pace?

**Marc Grandisson**
*President & CEO*

Well, right now, based on what we see in terms and conditions and opportunities, the answer is yes, we should expect that to happen. Absent, as I said, the market getting a bit softer in terms of GDP because of exposure stagnating for a while. But, yes, by and large, our focus is to play more offense on the P&C side, both insurance and reinsurance.

**Operator**

Our next question comes from Yaron Kinar with Goldman Sachs.

Our next question from Ron Bobman with Capital Returns.

**Ronald David Bobman**
*Capital Returns Management, LLC*

And I hope everyone's well, of course. I had a couple of questions. The mortgage business and the reinsurance purchases, and in particular, the Bellemeade notes. I'm wondering prospectively, do you think that the capacity will be there to sort of continue to be put in place? And is the game plan to sort of continue to, as best you can, buy sort of like-sized and like-structured protections for the mortgage book, and in effect, put that through into primary pricing on the mortgage book?

**Marc Grandisson**
*President & CEO*

So the first question is I don't know when it's going to come back. We expect this to come back. I think there was a healthy market, a healthy level of interest before COVID-19. So we would expect that to come back when things gone back to some more normalcy of sort. But time is ahead of us. We don't know when that's going to happen. And if it were to come back, I guess the question will be an economic decision, right? If it does fit within our return and risk profile, we would continue doing those transactions the way we did. We might do more, we might do a bit less. So it will be depending on our view of the pricing and what kind of recovery we get from this. I do believe as a general rule that our risk management mantra is still important. We like to have some downside protection. And I think this proves very useful in these events of late that they would come in and play a big part in supporting us if things were to go a little bit worse than we would expect them to do so. So I would argue that there's definitely a price at which things -- or conditions at which things are a bit difficult to do, but I would expect us to still do them within reason for this reason I just mentioned.

**Ronald David Bobman**
*Capital Returns Management, LLC*

I have a cat reinsurance sort of market question. Are there going to be a lot of instances -- in the context of COVID and losses and ceded losses, are there going to be a lot of instances where primaries have cat towers and cat protections that are peril-defined as being sort of natural catastrophes or is this a narrow peril listings in the reinsurance treaties that -- because the pandemic isn't, I guess, deemed or classified as a natural cat, there would not be stated coverage in a reinsurance treaty?

**Marc Grandisson**
*President & CEO*

Yes. I mean just sorting the case. What I would add to this, though, Ron, is you have followed the fortunes in many contracts on a quota share and risk excess. So -- and on natural perils, I don't think it's a majority of the covers -- the coverage that are purchased right now. I think it's a little bit different. I think the -- it's also different in the U.S. versus international. But I think that we'll expect a lot of discussions because I'm not sure it's as natural peril-specific as you think it could be. It was a softer reinsurance market for a while. So when that happens, conditions tend to be a bit broader than one would expect.

**Operator**

Our next question is from Yaron Kinar with Goldman Sachs.

**Yaron Joseph Kinar**
*Goldman Sachs Group Inc., Research Division*

Great. First question on MI. Have you been able to book the U.S. MI using a consistent methodology that was used by the rest of the MI book? What would the loss ratio look like this quarter?

François Morin
*Executive VP, CFO & Treasurer*

Well, I mean roughly speaking, if we -- I mean if we extrapolate for the year for the -- we're saying the remainder of the year is going to be, call it, 100 combined ratio just to be on the safe. So if you annualize the minus 25% expense ratio, ballpark, it gets you a 75% loss ratio plus or minus.

**Yaron Joseph Kinar**
*Goldman Sachs Group Inc., Research Division*

Okay. And maybe that also answers my next question, which was, would the GAAP accounting basically make the results in the MI business progressively worse quarter-over-quarter? Or do you expect it to be kind of flattish in the breakeven range through the rest of the year?

François Morin
*Executive VP, CFO & Treasurer*

Very hard to know. I mean we -- I mean it depends on how quickly the delinquencies are going to show up. If all the delinquencies show up in Q2 when they start, right -- you could see a scenario where people missed their first mortgage payment on April 1, they missed their second payment on May 1 and along the way, they kind of told their servicer that they want to take advantage of the forbearance program, we could expect a significant amount of delinquencies to show up in Q2, not as much as Q3. It might be flip-flopped. People might try to keep making payments and call their servicer in July. I don't know. So it's very much a function of how quickly we think the delinquencies are going to show up that will dictate a bit more the volatility from quarter-to-quarter in 2020 on how the, call it, the calendar quarter loss ratios are going to look like.

**Yaron Joseph Kinar**
*Goldman Sachs Group Inc., Research Division*

Okay. Okay. And if I turn to insurance, can you maybe talk about the programs business, how you'd expect that to perform both from top line and margin perspective in the face of COVID?

**Marc Grandisson**
*President & CEO*

Well, yes, that's a good question. It's not really workers comp exposed. So that piece we can take off. It doesn't really have maturity of credit lines. The lines that we could think it's -- it would be exposed to is property. And almost the totality of all the policies exclude -- have a viral -- virus exclusion. So that should not be a significant contributor to the loss experience on the programs business.

**Operator**

Our next question comes from Phil Stefano with Deutsche Bank.

**Philip Michael Stefano**
*Deutsche Bank AG, Research Division*

Yes. I was hoping you could give some commentary on your thoughts around the flow of new business for MI this year. How does this feel like purchase originations versus refi originations are going to shake out? And maybe within that, you can embed a commentary around what you see with pricing. I guess in my mind, the risk-based pricing and rates are -- would react in real time to the extent that there were changes in the economic environment. And this might be one of those instances where you could actually flex pricing up. Does it feel like we're starting to see that come through as the flow of business [indiscernible]...

**Marc Grandisson**
*President & CEO*

Three questions in there. That's pretty cool. I'm trying to keep it up, Phil, so you tell me if I'm wrong on this one. The No. 1 had to do with the origination going forward, right? So the -- what we can tell you with the industry, we don't know but the industry consensus seems to be 20% less production this year. What that means for us and the market, I mean we sort of follow along. We have about 1/3 -- if you look at the MBA, 35% penetration of -- more of mortgage insurance, 45% private MI, so you can follow through. So about 18% to 20% decrease. So if all else being equal, we should expect lesser production from that perspective. And you're right, I think we are still continuing -- we're continuing to see a lot of refinancing, although there's a glut and there's a lot of movement and a lot of things that are blocked actually at the origination of the mortgage originators because there's so much demand for that due to the historically very low mortgage rate.

But we do actually see some purchasing happening. But I think it's going to be probably more along the lines of the last -- rolling rate over the last 3 quarters, I think, is what we should expect. So again, it's hard to tell if the purchase market is going to come back in wild fashion. But certainly, there is a lot of pent-up demand out there, which also helps the house price index. We believe the house prices are going to go down not as much as you might think, maybe in a single-digit percentage over this year because of all the pent-up demand, so -- which talks to the purchasing market being still there, not gone altogether.

I think the article this morning in Wall Street Journal that there's a lot of -- there's a good pricing sustained as a result of higher demand for housing. That's the second part. The third part, which was about the pricing. Of course, right, we look at -- I mean the things have changed. We look at things in a different light with the risk -- different risk characteristics. We went through more than once through our portfolio on our risk-based pricing and our various assumptions and parameters. And we're making adjustments as we see it appropriate across the industry. I do want to think that the MI industry sees it as a, hey, there's a bit more risk, there's a bit more losses. So maybe we should do something about it. And I do expect them to follow suit in general. We do have indication that people are -- have increased their expected loss in their pricing.

**Philip Michael Stefano**
*Deutsche Bank AG, Research Division*

When we think about the expected returns that you're seeing in MI, have they changed materially? And maybe the insurance is a better place or a better lever to be exercising at this point to put capital to use. Can you just tell me any thoughts around that?

**Marc Grandisson**
*President & CEO*

No. It's very, very well put. I think this is exactly -- I mean I think 2 years ago, I would have said to you that, except for a few spots on the P&C insurance and reinsurance, that the MI provided by far the superior return. So when we rank order things, François and I go through it, then our executive team go through it, we rank order the 3 business, the investment in repurchasing shares, MI was up there and it has been there for quite a while. And I think it's -- our loss expectation is probably not as low. It's probably modified somewhat. So depending on the pricing going forward, we'll see how that falls out. But clearly, the returns from the PMC unit has been inflating and then putting them higher in the positioning -- the relative positioning for capital allocation without a doubt.

**Operator**

Our next question is from Meyer Shields with KBW.

**Meyer Shields**
*Keefe, Bruyette, & Woods, Inc., Research Division*

I do feel like I'm beating a dead horse here, but does your first quarter COVID reserve in P&C, does that assume that FDA policy requires direct physical damage but doesn't have a virus occlusion? Does that assume that that's an absolute defense?

François Morin
*Executive VP, CFO & Treasurer*

Well, I'll start, and I'm sure Marc will chime in. As you know, it's -- again, we said it's very early, but where we have taken some books and reserves on -- particularly, I mean on property, right, is there are certainly a very small subset of our policies that don't have an exclusion. So for those, we felt it's prudent to -- we expect losses to come through, and we booked the ID&R to go against those policies. And those are generally outside of the U.S. I mean they are outside of the U.S. So it's in the U.K., it's in Canada on the insurance side. And we also have a small amount in some property fact deals that may specifically cover pandemic, and we expect that some of these -- some of the certificates will have to respond. So it's a bit -- it's mostly in insurance, a little bit in reinsurance, but that's where we -- that's kind of how we thought about booking the reserves on BI. Yes, I mean in the U.S., no question that you need property damage to have the BI respond. That's a fact. Yes. There's proposals out there that people want to make it retroactive and challenge that. We'll see how far -- how that goes. But for the time being, we don't have reserves on those. We don't think it's correct. We want to think it's right. So we -- we've relied on the policy wording to make our assessments of reserves on those policies.

**Marc Grandisson**
*President & CEO*

And the other piece I would add to this, François, is that there are other lines of business, Meyer, where we have this 3 data that we can point to and say this is what we think we would expect this to develop to. And one example is trade credit. We have a small portfolio, but we did actually do proactively reflect the fact that we might -- we're expecting an increased level of claims for the -- based on what we write this year. So that's something that we pick our loss ratio specifically.

So most of them, on the property side, I agree absolutely what François said, we did more granularly at a level, the claims level, the portfolio level. And I think we've taken a loss ratio approach to the other lines of business where we've seen historically losses emerge as a result of events such as this one.

**Meyer Shields**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. That's very helpful. The second related question, I'd just as soon get my arms around what sort of events would constitute second quarter COVID-related P&C losses.

François Morin
*Executive VP, CFO & Treasurer*

Boy. I think the development of BI losses will -- firstly, we have to go through the insurance business, the insurance companies, tallying their losses, evaluating every claim. I mean this is not an easy thing to do from a 30,000-feet position. Meyer, you have to go through the claims process, evaluate things, talk to clients, brokers and whatnot. So it's going to take a while before things get sorted out. A couple of things on presumption of workers comp coverage, that's also part of that. I think -- there was lot of things developing. So I'm not even sure second quarter we're going to have the ultimate picture. That's for sure. It's going to take a bit longer to go through all these losses, how they accumulate and also in line with the question I just had earlier in how it -- if it does, and how and if it does accumulate towards a reinsurance recovery. So that also might happen towards the end of this year. So this is going to take a little while to sort out. And that's not even talking about potential litigation and whatever else could happen out there. So it's going to be a while.

**Marc Grandisson**
*President & CEO*

This is going to be a slow developing cat loss.

**Operator**

Our next question comes from Brian Meredith with UBS.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Yes. So 1 or 2 quick questions here. First, Marc, can you tell us what is the status of the Coface investment? And if indeed, the transaction goes through, should we anticipate some type of impairment charge on close given where Coface stock is relative to your agreed investment?

**Marc Grandisson**
*President & CEO*

So everything is a lot too early at this point in time, right? They themselves are going through evaluating and looking at this and our -- as you know, we made that investment with a long-term strategic vision. We also know that they are -- they have been proactive in many things. And we also know that the credit -- that the credit quality of what they had underwritten through the end of last year was -- is also different as well than what it was in 2008. So we're trying to triangulate all these things. We still have a lot of process to go through from a regulatory perspective. We expect to receive this towards the end of the year. So that's all I'm going to say about Coface is we are sort of monitoring, staying close to it and see what we're going to do about it, if we do anything about it.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Got you. And then my second one, just going back to the MI. If I think about the lawsuits you guys are seeing potentially for the rest of this year that you're going to have, what does that mean for 2021 as far as the MI results? How far are we into the deductible on the Bellemeade transactions? How much additional could there potentially be in '21?

François Morin
*Executive VP, CFO & Treasurer*

Well, again, it's very premature. I think the answer to that question, again, will very much depend on the level of delinquencies and how quickly they get -- come to us. And now we see the economy going back, opening up a little bit. So the people will go back to work. And by fourth quarter of 2020, we see already some people carrying -- going back to having current loans, et cetera. But yes, I would think that a reasonable expectation for 2021 is that, yes, we should do better than 2020. The loss ratio should be coming down. I don't think to the level it was in 2019, but as -- because let's -- we would think that no question that some people will -- there'll be some jobs lost and there may be some actual claims that actually convert to actually -- or delinquencies that convert to real claims and pay claims. That may be late in 2021, as you know, with a 12-month forbearance program and then the time to really go through all the process to go to -- to paying the claim will take quite some time. So I would -- at a high level, I would think that the 2021 loss ratio would be better or lower than 2020, but not at the same level as low as it has been in -- as it was in 2019 for sure.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Got you. That makes sense. And so I think what I'm trying to do is just scale this, like how much additional loss could we potentially have here in the MI book before you hit the Bellemeade deductibles, right? Just what's kind of a worst-case there?

François Morin
*Executive VP, CFO & Treasurer*

Well, let me try this, and maybe Marc will chime in. We've looked at a bunch of -- a variety of economic scenarios. Some are based on our own internal analysis, like the RDS stress test that we run through our portfolio. Some are based on external economic scenarios such as the Moody's -- what's published by Moody's, the severe, the S3 and S4 economic scenario is that under most scenarios, again, we don't expect to -- we get close, but we don't expect to attach with the Bellemeade transactions. And those are, in particular, like the S4 where we get very close. We might start attaching a few years down the road, but it's -- those are severe stresses. So how we think about it is, does it even impact 2021? The answer is probably not. It probably starts to really -- we really start to recover a few years down the road. And I mean to us, it's a -- I don't want to say necessarily sleep-at-night insurance or coverage, but it's really there to say we think we've run some very severe stresses. They don't seem to attach with the Bellemeade, but more often they get to be worse -- a little bit worse than what we're thinking, what the scenarios could look like. We tell ourselves, well, we got $3 billion of coverage that is available to us if things get much worse.

**Marc Grandisson**
*President & CEO*

At a very high level, Brian, if you think of the Bellemeade retention, and we talk about this amongst ourselves, is that we have about $1.5 billion to $1.6 billion of retention. So that sort of gives you a sense for how many -- how much losses we would need to go through to start to get some recovery. So that I think that should give you $1 billion a year premium earned. So that gives you some kind of benchmark. I think we're trying to figure a way -- we'll talk to Don, obviously, and François. We'll try to find a way to make it a bit more clear to everyone because it's not an easy thing to explain. But I think at a high level, what we just said to you is true, that the level of retention is high enough that we don't expect it in the next couple of years.

**Operator**

Our next question comes from Mark Dwelle with RBC Capital Markets.

**Mark Alan Dwelle**
*RBC Capital Markets, Research Division*

Just to continue with the MI discussion. As you're contemplating within the guidance of no earnings for the balance of the year, are you assuming a case average per reserve similar to what you've been reserving at or something more similar to the -- like after hurricanes or something of that nature?

**Marc Grandisson**
*President & CEO*

We're just assuming a -- we apply a forbearance rate and then we apply conversion from forbearance to claims that we would do. And the severity is pretty close to 100% on most of those cases. So it's really more binary than you might think it is. So there's not much -- I mean the 2 big variables are really the forbearance and our view of the conversion from forbearance to claim, ultimately, which is very uncertain at that point in time.

**Mark Alan Dwelle**
*RBC Capital Markets, Research Division*

Within that, then, are these being evaluated on literally a case-by-case basis? Or is it the -- or are you applying just sort of a formula to all of the losses that whatever some particular bank presents you over some period of time?

François Morin
*Executive VP, CFO & Treasurer*

Well, I think it's a bit early to know exactly how everything is going to play out. I mean no question that -- as I said earlier, we're -- we expect more delinquencies to come through. No question that we would expect a higher cure rate on those than we would see from a typical delinquency in a, call it, normal economic environment. So -- but we don't know yet how we're going to book our reserves at the end of the second quarter, and let alone, third or fourth quarter. So the answer is, yes, probably, I mean if you compare a regular delinquency to what we're -- we expect, the delinquencies we get through forbearance programs, there's no question that there's a higher cure rate. And then associated with that, the severity, et cetera. So I mean it's the product of those gives you the total incurred loss in the quarter. But it's -- we will look at them a bit differently for sure than we would otherwise in a, call it, a regular quarter.

**Marc Grandisson**
*President & CEO*

But -- Mark, just to make sure it's clear to you because you did ask specifically how do we develop our scenario. And we have -- we do go at the individual loan level with the risk characteristics and applying assumptions and shock on the unemployment and whatever else you have around, house price index. And we go through the lifetime of that loan and see what's going to result. You can think of it as the ladders -- series of ladders going forward, decision tree of sort. And then at the end, we come up with the ultimate projection of the claims based on the assumption that we had. So that was a bottom-up approach we did. And we verified this, at least try to get some perspective from a top-down approach, which François mentioned, the Moody's S3 and S4. So -- and those seem to converge very nicely, and by coincidence, I would add to a similar number for ultimate claims.

**Mark Alan Dwelle**
*RBC Capital Markets, Research Division*

And then just the last question, and again, this is another sort of process question. But I mean suppose I'm an individual and I default beginning in April and May, as François described before. And then I get recorded as a delinquency in forbearance, let's say, sometime in June. And I take advantage of the 6-month requirement. You'll put up some type of reserve for me in probably the second quarter. Will you be able to release that reserve back then as quickly as, let's say, October, which would be the end of the 6 months, which would then provide offset against any additional adds that you would otherwise be taking in, say, the fourth quarter for people who are newly delinquent or further delinquent?

François Morin
*Executive VP, CFO & Treasurer*

Correct. I mean if the borrower cures, and I think there's a little bit of work that has to be done exactly on how borrowers are going to exit the program. I mean initially, there's, I wouldn't say confusion, but people thought, well, they have to make a balloon payment, do I just defer my payments, et cetera. I think the government is stepping in to make sure that there is no -- I mean that the expectations are clear on both sides. But correct, if somebody after 6 months in October or November or December, they -- everybody's back. I mean for that particular borrower, they're back to work, and they go back to current and they strike a -- they reach an agreement with their borrower to just effectively -- let's say, they missed 4 or 5 payments, and they agreed to just tack those on at the end of their mortgage period, they would -- whatever reserves we had put up on that particular loan would get eliminated, reduced to 0, and they would be available if we think there's new coming in that we -- yes, so it's a reduction and [indiscernible]...

**Mark Alan Dwelle**
*RBC Capital Markets, Research Division*

Just to clarify, second and third quarter, you would think of kind of as reserve accumulation and then beginning in perhaps the fourth quarter, you would start to see offsets develop, assuming people follow that type of a pattern.

François Morin
*Executive VP, CFO & Treasurer*

Assuming -- yes, but again, what we don't know yet is, is everybody or is the vast majority of people are going to use the forbearance programs in Q2 or are they going to try to make a couple of payments and then -- maybe there'll be more in Q2 and Q3 and Q4. I mean the timing of it is uncertain. But assuming -- I think which is what -- I mean assuming -- I think what you were assuming is for somebody who starts on the forbearance program earlier, and then, let's say, it's just temporary where they do go back to work and they go back to current. They cure their delinquency in the fourth quarter, correct. I mean there would be -- we would be see -- potentially see a reversal of the accumulation of reserves that we saw in Q2 and Q3.

**Marc Grandisson**
*President & CEO*

Yes. So Mark, I would add to this, to be cautious, to be very cautious when we compare the development of the GSEs versus now, again, having more of a front-loading of reported delinquencies that could -- from there to your point, go plus or minus, but a lot more front-loading of delinquencies recognized at the beginning than it was in 2007 and '08, where it took a while for the claim -- took like 2, 3 years for real delinquencies to really pick up and peak. So it takes a while to get there. I don't think we're going to see that this time around. I think we should expect more of a front-loading, which means a little bit more activity from a loss perspective in the first -- in the next couple of quarters.

**Operator**

Our next question comes from Geoff Dunn with Dowling & Partners.

**Geoffrey Murray Dunn**
*Dowling & Partners Securities, LLC*

First, a technical question on PMIERs. Are forbearance loans treated the same way from an aging standpoint, meaning that you'll get that asset charge progression as well? Or is it just that initial point in time asset charge? It seems there's kind of confusing interpretations out there on that front.

François Morin
*Executive VP, CFO & Treasurer*

Sorry, Geoff, I -- we couldn't quite hear. I mean you're not coming through very loudly, so.

**Geoffrey Murray Dunn**
*Dowling & Partners Securities, LLC*

What I was asking is are forbearance loans subject to the aging asset charges on the PMIERs or are they just held at a point in time, that initial charge? It seems like some of the language out there is a bit confusing and up to interpretation.

**Marc Grandisson**
*President & CEO*

Yes, true. I think that it's unchartered territories as well for the GSEs. I think there was a lot of discussions between the MIs and the GSEs and the FHFA to try to figure out. So I don't have an answer to this one, Geoff.

**Geoffrey Murray Dunn**
*Dowling & Partners Securities, LLC*

Okay. And then I'm still trying to piece together your underwriting outlook for the remainder of the year. It sounds clear that incidents assumptions will be below a normalized level because of the potential for cure activity. And it seems like the implication is that your forbearance expectation is a lot higher than the near 6% number we've seen from April 26. It's not maybe 2 or 3x that, if I'm looking at the math right. So obviously, you have a cumulative loss expectation for the year, maybe not all the pieces that generated. But what are some of the higher level assumptions that get you to that kind of level of loss activity, whether it be unemployment, home [ work ]? What are some of your macro assumptions that support the cumulative loss outlook for the remainder of the year?

**Marc Grandisson**
*President & CEO*

Yes, I think -- yes, that's a good question. I think you were right on the forbearance comment. I don't think -- we don't think it's going to be 5% or 6%. I think if you ask us, we're -- our modeling is pretty much like 15%. That's sort of what we would expect forbearance to peak at. And then the question remains to your point about the conversion, which is the one that is so hard, as you know, to pin down. But we can use something between 1 in 7 to 1 in 10. There's no real reason to that other than it seems to be in the ballpark of what we would expect. If we look at the current annuities or the current delinquencies, as you know, Geoff, the ultimate claims rate that we ascribe as an industry is closer to 7% or 8%. So to go to a 14% or 15% does not seem too crazy right now. The biggest one -- so we -- the sort of what we use, I think if you look at the S3, that's sort of where our assumption sort of would converge to, if you will. You all know that model. So this is pretty much where we are. I think the biggest thing that we'll have to debate for the next several quarters is how do we convert from forbearance to claim. That's going to be, as you know, the biggest question mark that we'll have to go through.

**Geoffrey Murray Dunn**
*Dowling & Partners Securities, LLC*

I'm sorry. Are you suggesting the -- you said 14% or 15%, are you suggesting that the incident assumption will be higher than normal or lower than normal?

François Morin
*Executive VP, CFO & Treasurer*

I'm sorry, I can't hear you. Can you repeat it, please, Geoff?

**Geoffrey Murray Dunn**
*Dowling & Partners Securities, LLC*

Are you suggesting that the incident assumption will be higher than normal or lower than normal? You're saying 14%...

**Marc Grandisson**
*President & CEO*

No, higher, higher than normal. If normal is 7% of 1 in 14 right now, 1 in 13 on new delinquencies, I would expect it to be 1 in 7 or 1 in 6, 1 in 8. That's what sort of what the model implies. I'm not saying this is what's going to happen, but you're asking about the parameters of the deal, and this is what -- of the modeling.

**Geoffrey Murray Dunn**
*Dowling & Partners Securities, LLC*

Okay. Wow, all right. And then my last question has to do with your reinsurance strategy. Obviously, the ILN market is hot right now. Does that create any interest with the company of looking at a traditional QSR to supplement your ILN strategy longer term?

**Marc Grandisson**
*President & CEO*

We haven't really looked at it.

François Morin
*Executive VP, CFO & Treasurer*

I mean we have -- I mean everything is on the table, right? I mean it's all based on the economics. No question that in the last couple of years, to us, the Bellemeade transactions were very efficient, provide a lot of capital relief, and we thought it was a good protection to get for a variety of reasons. Again, we expect them to come back, but assuming that they're not back for, let's say, the end of the -- until the end of the year or maybe beyond, no question that we will probably think of other ways to protect the portfolio. And a traditional reinsurance agreement is something that would be on the table for sure.

**Marc Grandisson**
*President & CEO*

Geoff, I think you've asked about MSRs as well. So I think we're starting to evaluate all these things. Nothing is -- but everything, again, is on the table. We're looking at everything.

François Morin
*Executive VP, CFO & Treasurer*

Geoff said QSR, right? I mean is that correct, Geoff? I mean I heard QSR. Did we answer your question, Geoff? I just want to make sure we answered it correctly.

**Geoffrey Murray Dunn**
*Dowling & Partners Securities, LLC*

You did.

**Operator**

Our next question comes from Ryan Tunis with Autonomous Research.

**Ryan James Tunis**
*Autonomous Research LLP*

So yes, I guess I'm trying to unpack that, the answer to the last question on the forbearance to claims rate being higher than -- if I heard that correctly, your modeling that gets to breakeven is assuming that that's actually higher than, say, a random notice that you have received in December.

François Morin
*Executive VP, CFO & Treasurer*

Yes. That's true.

**Marc Grandisson**
*President & CEO*

This is the model. You're stress testing it while you stress -- you're pushing for the scenarios because it's so uncertain. But who knows, right? It's an opinion.

**Ryan James Tunis**
*Autonomous Research LLP*

Right. It's certainly not quite how I think most people are thinking about it. But yes, that does sound somewhat conservative. And I guess in terms of thinking about the rest of the year, like one thing I noticed that gave you [indiscernible] is you've got these 3 buckets, like I think it's like 3 or 4 months delinquent, and it's, I think, 5 to 11 months and 12 plus. Is there expected pressure as these delinquencies age? Like is there -- like do you kind of recondition what the expected loss might be? Is that potentially a source of pressure later on in the year?

**Marc Grandisson**
*President & CEO*

Well, it's not a high number of claims, so that's not a massive amount. We have about $250 million of reserves or something like this. And François will correct me if I'm wrong on this one. But I do believe that there is -- a lot of them also are older, vintage, so have been in and out of delinquency. Some of them are coming back in and out of cure. So we're -- if there is pressure going forward, typically, it will impact not only the more recent bookings. It will -- it would impact all prior book years that you have. And specifically, those are currently in delinquency because it does -- they may not be the ones that can avail themselves of the forbearance program. They may have been in default before that event occurred. And they might be in a worse position than most borrowers if they're currently -- they were delinquent at the end of '19. So yes, it would tend to ascribe a higher possible incidence to those claims.

**Ryan James Tunis**
*Autonomous Research LLP*

Understood. And then I guess my last one is kind of housekeeping. But on the premium yield number, first of all, how much was that helped this quarter by any of the single premium stuff? And then has the outlook for that changed at all, just given the, I guess, elevated refinancing activity? I'm not sure if the composition of book changes.

**Marc Grandisson**
*President & CEO*

It fell about 10% to 15% of premium for the quarter because of the refinancing.

**Operator**

I'm not showing any further questions at this time. I would now like to turn the conference over to Mr. Marc Grandisson for closing remarks.

**Marc Grandisson**
*President & CEO*

Thank you very much, everyone. Stay safe out there. We're looking forward to have more to report and talk about at the second quarter. In the meantime, be good. Thank you.

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