S&P Global
Market Intelligence

Assurant, Inc. NYSE:AIZ

FQ4 2012 Earnings Call Transcripts

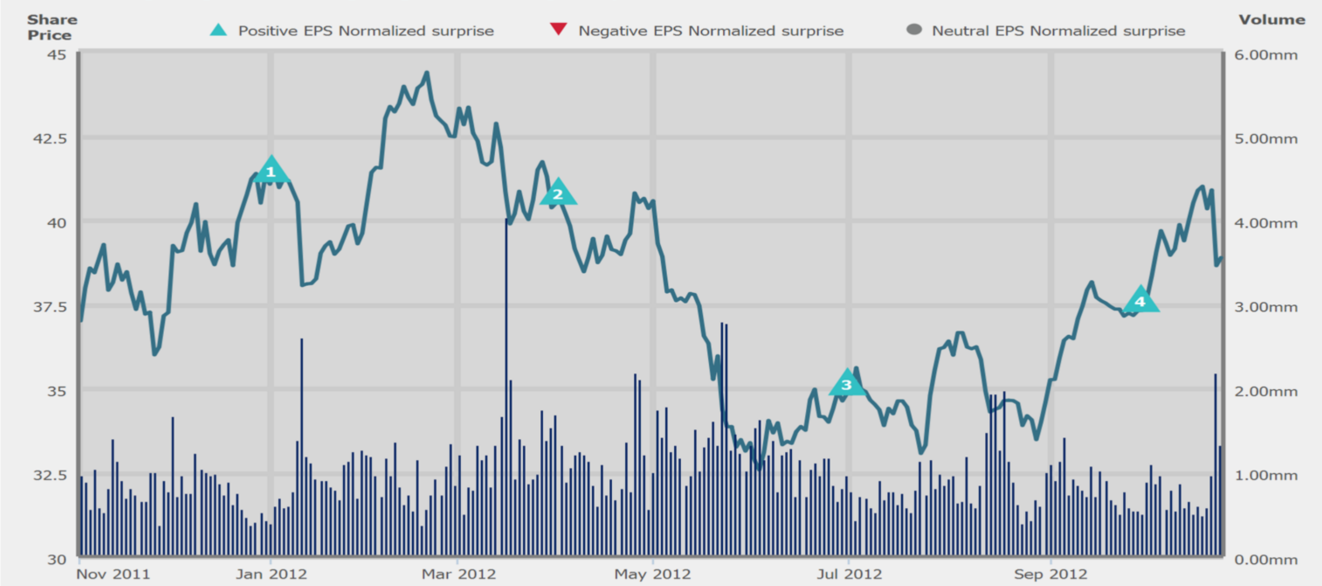
Thursday, February 07, 2013 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2012-			-FQ1 2013-	-FY 2012-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	(0.28)	0.07	NM	1.54	4.89	5.27
Revenue (mm)	2097.64	2160.98	▲3.02	2070.22	8438.45	8508.27

Currency: USD
Consensus as of Feb-07-2013 12:03 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2011	1.36	1.65	▲21.32 %
FQ1 2012	1.43	1.76	▲23.08 %
FQ2 2012	1.38	1.81	▲31.16 %
FQ3 2012	1.43	1.55	▲8.39 %

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Call Participants

EXECUTIVES

Christopher John Pagano
Executive VP & Chief Risk Officer

Francesca Luthi
Executive VP and Chief Communication & Marketing Officer

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Robert Brian Pollock
Former Chief Executive Officer

ANALYSTS

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

John Matthew Nadel
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Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

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BofA Merrill Lynch, Research Division

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

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Presentation

Operator

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

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

Francesca Luthi
Executive VP and Chief Communication & Marketing Officer

Thank you, Kevin. Good morning, everyone. We look forward to discussing our fourth quarter and full year 2012 results with you today. Joining me for Assurant's conference call are Rob Pollack, our President and Chief Executive Officer, Mike Peninger, our Chief Financial Officer, and Chris Pagano, our Chief Investment Officer and Treasurer.

Yesterday afternoon, we issued a news release announcing our fourth quarter and full year 2012 results. Both the release and corresponding financial supplement are available at Assurant.com.

All prior period financial information presented in the release in the financial supplement and on this call reflects the new accounting guidelines for deferred acquisition costs, which the company adopted as of January 1st, 2012.

We'll start today's call with brief remarks from Rob and Mike with Chris participating in the Q&A session.

Some of the statements we made on today's call may be forward-looking. And actual results may differ materially from those projected in these statements. Additional information on factors that could cause actual results to differ materially from those projected can be found in yesterday's news release as well as in our SEC reports including our 2011 form 10-K, third quarter 2012 form 10-Q, and upcoming 2012 form 10-K. Each is filed with the SEC.

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

Now I will turn the call over to Rob.

Robert Brian Pollock
Former Chief Executive Officer

Thanks, Francesca, and good morning everyone. In 2012, we accelerated growth in the specialty areas we are targeting for expansion. And align resources to best support these opportunities for the future. We also prudently managed our capital. Our strong balance sheet continues to provide great flexibility. We did this in a year when our results were significantly affected by Super Storm Sandy. As we start the new year, we are well-positioned to grow profitably.

I'll highlight our 3 key metrics, discuss capital flows, and offer some comments on our progress at each business. Then Mike will talk about specific results for each of our segments.

Operating return on equity excluding accumulated other comprehensive income or AOCI was 10.4% for the year. This includes $163 million of after-tax catastrophe losses.

Book value per diluted share excluding AOCI increased by 13.8% for the year reflecting a combination of our earnings and re-purchase activity.

And revenue defined as net earned premium and fee income increased by 2.4% in 2012 driven by strong contributions from specialty property and solutions.

Turning to capital management, we secured $580 million in dividends from our operating companies. This was about $40 million more than the operating income from our businesses in 2012. We returned $472 million to shareholders through stock repurchases and common dividends. Since our ITO in 2004, we've increased our dividend every year.

During the fourth quarter, we did not implement a new share repurchase program because of Sandy. It was the largest flood event our business has experienced. By the time we were able to report an estimate of total losses, we had entered our earnings blackout period. Despite this interruption, we did buy almost $11 million shares in 2012 representing about 12% of our shares outstanding at the end of 2011. We continue to view our stock as attractively priced and repurchases as a prudent use of capital.

Now I'll turn to the businesses. Assurant Solutions expanded in several targeted areas. In 2012, our net earned premiums from service contracts increased by over $120 million. Our domestic vehicle service contract business was a primary driver as we continue to benefit from the rebound in auto sales that started in mid-2009.

We further strengthened our position in Latin America, a key market for Solutions. In the fourth quarter, we signed a ten year agreement for service contracts with Novo Mundo, one of the largest retailers in Brazil with more than 180 stores.

At the same time, we continued the phased rollout of our Telefónica partnership and are now servicing their mobile customers across 5 countries in Latin America.

In addition, we recently expanded our relationship with Sprint by launching a mobile device protection program for Sprint's wholesale network partners.

Solutions sales pipeline is robust. And the business is very focused on achieving its' 14% ROE goal in 2014.

At Assurant Specialty Property, we made tremendous strides in 2012. The investments we've made to better serve homeowners and clients from loan tracking all the way through claims adjudication were evident in our response to Sandy. Our employees quickly brought relief to our policyholders impacted by the storm. The swift deployment of our frontline team insured that claims were processed and paid quickly.

Focusing on customer service and supporting our clients helped us further expand our lender placed business in 2012. Despite a shrinking overall mortgage loan inventory, we were able to increase the loans we track nearly 3 million to over 31 million loans in total. We're well-positioned to gain more as portfolios move between servicers in the months ahead.

Our multi-family housing business, another target area, achieved double-digit revenue growth in 2012. Our resident bond products, which complement our renter's insurance offerings helped us cross-sell our products to existing clients and in turn to their residence. We'll well-positioned to capitalize on the trend of renting versus owing in the U.S. housing market.

We're also pleased with our progress at Assurant Health. Despite a challenging fourth quarter, we grew sales for the third consecutive quarter. We completed the rollout of our network agreement with Aetna with a more competitive products sweep and a broader choice of network providers, we've experienced double-digit sales increases in many key Aetna markets. And we saw a pickup in small group sales that we believe reflect our improved competitive position. Those increases combined with the continued success of our affordable choice and supplement products helped us grow the total number of insured lives by about 6% in 2012.

We will evolve our strategy as new rules related to new rules related to healthcare reform unfold. Currently for example, we're evaluating our options and fine-tuning our strategy related to healthcare exchanges. While preliminary regulations were issued in November, many open questions remain related to timing and availability. As we adapt, we remain confident that our long history in the individual healthcare market and deep customer insights uniquely position us to succeed.

Finally, we were pleased by our strong results at Assurant's Employee Benefits. Several years ago, Benefits strategically focused on voluntary and the shift of small business benefit plans from employer funded to employee paid offerings. We responded by diversifying our product sweep, enhancing our distribution, and rolling out easier to use enrollment and administrative platforms.

In addition, we strengthened our dental network in 2012 with our United Concordia arrangement. We now offer the largest dental PPO network in many markets. The success of this approach is evident in our 2012 results. Voluntary drove about half of benefit sales and over a third of its premiums.

While the economy still presents challenges for small businesses, we believe that our voluntary products and capabilities have us well positioned for success. Overall, we're pleased with our progress in 2012. We see many opportunities to focus on market segments where we can compete differently. Examples include mobile, multi-family housing, voluntary benefits, and affordable healthcare. Achieving steady improvements across all of our businesses is our focus in 2013.

And with that, I'll turn to Mike for more detailed comments on the fourth quarter and the outlook for this year.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Thanks, Rob. I'll start with Solutions where net operating income for the quarter reflected $28.1 million of previously disclosed charges for U.K. intangible impairments and workforce reduction primarily in our domestic credit and European operations. Absent these items and a non-recurring tax benefit of $3.5 million, net operating income declined in the quarter as weaker domestic results offset continued growth and favorable experience in Latin America.

Several factors contributed to the decline in the U.S. The previously disclosed loss of a mobile client effective last October reduced net earned premiums by about $22 million in the quarter.

Second, we incurred expenses of approximately $5 million in our mobile and vehicle services businesses to enhance our technology platform and support new business growth.

And finally, we saw less favorable underwriting experience in our service contract business.

These factors increased our domestic combined ratio excluding disclosed items to 98.7% for the full year, above our long-term target of 98%. While quarterly experience can fluctuate, we expect the combined ratio to return to the target level in 2013.

In 2012, we saw improved performance in our international operations led by Latin America. Absent disclosed items, European underwriting results also were better. Canadian results remained strong. And we made additional progress in China.

Overall, Solutions international combined ratio excluding the disclosed items was 102.4% for the year, a 160 basis point year-over-year improvement. In 2013, we expect an additional 100 to 200 basis point reduction primarily from profitable growth in Latin America and additional expense initiatives in Europe.

Our pre-need business remains an important contributor to Solutions' overall results. Fee income increased more than 30%. And sales were up by 14% for the year. These results reaffirm our strong relationship with SCI and the value of its broad funeral home network.

Across Solutions, we expect modest increases in both net earned premiums and earnings excluding disclosed items in 2013. This will be driven by a combination of profitable growth and expense management initiatives.

Looking ahead to 2014, Solutions continues to target a 14% ROE. Achieving this goal will require further progress in international especially in Europe. Improved results in the U.K. during 2013 is a critical step.

In the fourth quarter, our U.K. operating loss was about $4 million excluding disclosed items. Based on the actions we've taken, we expect lower losses in the first half of the year followed by a small profit in the second half of 2013. We believe we are on track to deliver on this commitment for the U.K. and to continue to improve our overall European results.

Fourth quarter earnings in specialty property were depressed by Sandy. Excluding the impact of the storm, results were strong. Revenue increased by 13% as our loan portfolio continued to grow. Fourth quarter and full year results also benefitted from better non-catastrophe loss experience, which is consistent with reported industry results.

The growth in written premiums was driven by previously disclosed loan portfolio addition and approximately 650,000 of loans newly added in the fourth quarter. Prior coverage on about 200,000 of these loans was flat cancelled, so they began producing premiums in the fourth quarter.

An existing client acquired 300,000 more loans this January, which will increase premiums in the first half of this year as prior coverage will also be flat cancelled.

As a result of the loan activity late last year, our placement rate in the fourth quarter increased by 2.87%. While this is very high by historical standards, it's important to note that absent the impact of the new loan portfolios, the rate would have remained consistent with the third quarter. We expect placement rates in the near term to fluctuate reflecting the state of the housing market and the changing composition of our track loan portfolio. Over time, we continue to expect placement rates to decline.

As a percentage of our portfolio exposed to hurricanes grows, we continue to manage risk prudently. In January, we replaced about 60% of our total 2013 re-insurance program at rates comparable to last year's program. We'll provide an update on the completed program in June.

The impact of our next generation product continues. Feedback from clients is positive in the 14 states where it's already available. And by the end of the second quarter, we expect to implement it in 14 more states. And we'll continue the rollout to other states through the end of this year.

On the regulatory front, our discussion with the New York Department of Financial Services continue. But we do not have new information to share at this time.

In Florida, we've had discussions with the Office of Insurance to introduce the features of our new next generation product. And now expect to file in the first quarter.

On the federal front, the Consumer Financial Protection Bureau published its mortgage servicing guidelines in January. These were in line with Dodd Frank and largely consistent with our current practices.

There's been speculation about potential new arrangements for Fanny Mae, but no changes have been announced. We continue to believe that an addition to our new product, we have the capabilities, expertise, and infrastructure to offer solutions to the government's sponsored entities as they work to control the costs of their programs. We'll provide you an updated view of the business once these regulatory matters are resolved. In the meantime, we continue to believe that returns for the business will be attractive, albeit lower in the future.

For 2013, we expect specialty properties revenue to increase slightly from 2012 due to growth in our lender placed portfolio and multi-family housing. Our overall results will continue to be influenced by placement rate trends, premium rate changes, loan portfolio activity, client renewals, and catastrophe losses. We expect our expense ratio to remain approximately level with 2012 as we continue to improve efficiency while further improving client and customer service.

At health, changes in the minimum loss ratio rebate liability significantly affected fourth quarter net operating income. Due to favorable loss experience on certain blocks of business, we increased our MLR rebate accrual in the fourth quarter. The accrual reduced our net operating income by $9.7 million after tax. In contrast, we made a refinement to the MLR calculation that increased net operating income by about $4.4 million in the fourth quarter of 2011.

Several other factors contributed to the drop in net operating income for the quarter. Net earned premiums declined reflecting the continued shift to lower premium products in our individual business and fewer small group insured lives.

Also, as we have priced business with the MLR targets in mind, loss ratios are beginning to move up. Throughout 2012, health continued to tightly manage expenses and reduce its' capital. General expenses excluding commissions declined by 11% in 2012. Due to the low capital intensity of the business, health also was able to contribute approximately $160 million of dividends to corporate in 2012.

In 2013, our loss ratio should continue to trend up toward MLR targets. Our effective tax rate will remain elevated due to limitations imposed by healthcare reform on the deductibility of compensation and certain other payments. We'll continue to look for opportunities to further reduce our cost structure to offset these pressures. But the rate of reductions will be slower than in the past.

Recent sales momentum is encouraging. And we expect to continue to increase in the total number of insured lives in 2013, although the market remains very dynamic.

Taking all these factors into account along with the absence of the substantial 2012 real estate investment income, we expect a decline in health's earnings in 2013. Nevertheless, we remain optimistic that our relentless focus on creating affordable solutions for our consumers will allow us to take advantage of the potentially large market opportunity created by healthcare reform.

Employee benefits posted strong results for the fourth quarter. Net operating income increased 18% over the same period in 2011 due to favorable results across major product lines. Dental experience was especially strong. And disability incidents and recovery rates remained relatively stable throughout the year.

Our results also demonstrated growing momentum in the voluntary benefit space. In order to provide greater insight into our progress, we are now showing voluntary net earned premiums and sales in our financial supplement.

Continuing in our efforts to focus resources, we sold a small subsidiary of benefits that provides disability advocacy services during the fourth quarter. This sale will reduce both fee income and expenses by approximately $8 million per year. But will not impact net operating income.

Overall, we expect 2013 revenues at benefits to be roughly level with 2012 as the continued strength of our voluntary offerings are tempered by limited growth prospects for traditional employer paid coverage.

We plan to lower our reserve discount rate for new long-term disability claims incurred in 2013 by 50 basis points to 4.25%. This will have about a $4 million bottom-line impact. The new discount rate combined with lower investment income will lead to a reduction in segment profitability in 2013. To partially offset these pressures, benefits continues to closely manage its' expenses and capital.

Moving to corporate matters, our capital position is strong. We ended the quarter with approximately $530 million in deployable capital in addition of our $250 million buffer. As Rob noted, following Sandy, we did not repurchase additional shares in the fourth quarter. Going forward, our capital deployment strategy remains the same. We expect to balance returning capital to shareholders with ongoing investments, both to support organic growth and in acquisitions.

For 2013, we anticipate operating and company dividends to approximately equal operating earnings. As always, dividends will be a function of growth in the business, rating agency or regulatory requirements, and investment performance.

Despite low interest rates, our investment portfolio continued to perform well. Our conservative management and low asset turnover helped moderate the pace of the yield decline in our portfolio. However, yields will continue to decline absent changes in the macro environment.

Overall, we are pleased with our 2012 results and progress in creating long-term value for our shareholders.
And with that, we'll ask the operator to open the call for question.

Question and Answer

Operator

[Operator Instructions] And our first question will come from line of Chris Giovanni with Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

I guess first question in terms of the outlook for top line at property. I mean, you note slight increase, but you talk about a few potential factors around placement rates, premium rates. I'm curious if you factor in -- or what changes you factor in related to those with the slight uptick for top line growth?

Robert Brian Pollock
Former Chief Executive Officer

Yes. So, I'll start and then I'll let Mike add some color. Obviously the movement in loan portfolios is driving our top line growth, Chris. And, as Mike pointed out we already know we've got another portfolio coming in the first quarter. I'll let Mike talk about the mechanics of how different portfolios can come in, but this is driving things, I think it fits in very well with our strategy of being aligned with market leaders. And we think we're well positioned as portfolios continue to move around. So despite that overall inventory of mortgage loans being down, we are growing. Mike, do you want to…

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Yes. I'll just add a couple things. I mean, we've announced several loan portfolio additions over the course of 2012, and then the ones that come in -- that I mentioned coming in this quarter, when you get the flat cancel business that, sort of immediately comes on to your books and drives up written premiums in a particular quarter. Other portfolios, and we had some, I think earlier in 2012 we had 1 million loan portfolios, and another 2 million, and those are coming at renewal. So, those gradually build up over time. So, we try to factor all those things going on, and then make reasonable assumptions about the other factors that drive the growth.

Robert Brian Pollock
Former Chief Executive Officer

And there's just a great variability depending on the portfolio, because some of the ones Mike mentioned had a placement rate of about 1% obviously higher quality loan portfolios. Placement rate of some of the others are quite a bit higher.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

And I'll just reiterate, the growth in our placement rate was, as Rob said, driven by the changing composition.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Understood. And then does -- the premium rate changes, does it contemplate anything beyond what we know from California?

Robert Brian Pollock
Former Chief Executive Officer

Not specifically. As I said we would certainly if we get future things that would meaningfully impact our forecast, we'll give you an update. But I certainly reflect the new product we've rolled out that Mike mentioned, and that -- we've certainly made assumptions on what might happen there related to servicers making decisions around deductibles, or coverage amounts, Chris.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay. And then I guess you've obviously been very successful getting cost out of the business. So, I guess I'm surprised that you kind of continue to see expense management opportunities in most of the segments in 2013. So, I wanted to see if you could maybe give us an update of the run-rate cost reductions that you've taken out of the business to date, and what the incremental opportunity could be here as we move forward?

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

I'll start, and maybe Rob can amplify if he wants. I think, sort of a business-by-business story, Chris, and we're constantly working that. And at [indiscernible] for example, probably a notable example, where we've been working at it for a couple of years. We've got some of the easier things, and then as you farther, you get into a more complicated changes like simplifying the systems environment et cetera. In property they've had cost driven by the substantial growth that they've had to add staff to handle that and maintain the customer service levels. So, now they're working, they're still getting that kind of growth and this helps some dampen the impact of that. They're also investing in their systems and looking for opportunities to become more efficient. And then in Solutions, I think there they took some actions in the fourth quarter. They continue to look for opportunities to streamline their business too. But I think you really have to look at the expense story as an over -- a business by-business on.

Robert Brian Pollock
Former Chief Executive Officer

I think that's right. And I guess what I'd add is, that movement of resources to the important areas and away from things that, for instance that Domestic Credit Business. We know that business is going away, we took a lot of expenses out in the fourth quarter, okay. And, we want to make sure we're putting our resources on the best opportunities.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Yes, and I think -- I guess another couple of examples there is in benefits for example, where they've essentially taken resources out of that traditional employer paid business, and moved them into the voluntary business. In Solutions, I commented on some of the expenses we incurred in the quarter to build out our technology platform, and VFC and in Mobile. And so we're trying to fund some of those things by, as Rob said, redeploying resources from other areas in the company too.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay, and then last one; I guess last quarter and some prior quarters, you've given some insight into share repurchases through the first few weeks of the given quarter. Wondering if you could give us an update for 1Q to date?

Robert Brian Pollock
Former Chief Executive Officer

Sure, let me just start and I'll turn it over to Chris who can provide all the details. But, one of the big things is, we mentioned we didn't implement a new repurchase program, because we were blacked out, Chris. And, that blackout will remain in effect through next -- sometime next week I guess, just because of the earnings blackout. I think more important, is to think about, if you sit and look at our business, our businesses generate a lot of free cash flow, and I think we have a history of prudent capital management. And I'm going to let Chris talk a little bit about, just how all that comes together.

Christopher John Pagano
Executive VP & Chief Risk Officer

I think, and again, the fourth quarter situation notwithstanding, there's -- absolutely nothing's changed with our respect to capital management. We continue to execute on our priorities, capitalizing the existing businesses, looking to deploy capital in profitable growth opportunities either organically or through acquisition. And then, return capital to shareholders there through dividends of share repurchase. We continue to believe the shares are undervalued, and that share purchase is a prudent use of deployable capital. And as we begin 2013, we feel very good about our ability to execute on those priorities, $530 million of deployable capital. As Mike mentioned, early estimates are that we'll be able to dividend operating earnings up to the holding company throughout the course of the year. And also the ability if we need to on an opportunistic basis access the debt markets in something in the $300 to $400 million if that presented itself. So, we feel very good about our flexibility, but again, most importantly long-term nothing's changed about capital -- our view on capital management and its role in creating long-term shareholder value.

Operator

Our next comes from the site of Jimmy [indiscernible] with JPMorgan.

Unknown Analyst

I had a couple of questions. First one on just the weak performance in the extended service contract business in the U.S. Can you give us some details on the causes of the weakness, whether it's concentrated at the one product, or a specific distributor, and the chances of it continuing? And then secondly on capital deployment; do you expect any other users for capital deployment other than the share buybacks? And if you are looking at deals, what type of hurdles they've have to meet? Given your stock prices, I'd assume that deals would be unlikely, but maybe you could talk about that as well.

Robert Brian Pollock
Former Chief Executive Officer

Sure. Just in a general, and then I'll let both Mike and Chris comment. We will have variability and results from quarter to quarter on the service contract business. We still expect to be at that 98% combined ratio next year. So, I wouldn't there's nothing there that we see as anything particularly problematic.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Yes, I'd agree with that. We look at our experience sort of client-by-client in the service contract. We had a handful of clients that had, as Rob said; we saw some ticks-up in their loss ratio. But, part of managing this business is to look at the loss experience as it emerges, and have regular dialogue with the clients, and implement corrective actions when we see things going off track. So, that's sort of the process we're going through now.

Robert Brian Pollock
Former Chief Executive Officer

And then on the capital deployment front, I think Chris summarized well that, there's no difference in how we're looking at things, but I'll let him expand on how we view our capital and deploy it.

Christopher John Pagano
Executive VP & Chief Risk Officer

Yes, I think the key to capital deployment and the various uses of our deployable capital is discipline. And we have certain targeted growth areas in each of the segments where we look to -- are looking at opportunities on a regular basis. We have specific hurdle rates by business, depending on the risk profile of the opportunity. And then, again, when the opportunities are not there, we are willing and have demonstrated the ability to, and the willingness to return capital to shareholders. We've returned about 1.5 billion over the last 3 years in the form or share repurchase, another 200 million of dividends.

So, again, I think that's an indication of our discipline here. We look at a lot of deals. The pipeline is active. We are regularly sourcing, having conversations about growth opportunities, regularly sourcing, having conversations about growth opportunities, but absent those opportunities meeting our financial requirements, we are going to return the capital to shareholders.

Operator

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

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

Rob, I want to start with, perhaps, maybe more of a strategic question for you around the lender place business. If I look at your full year results in specialty property, it is clearly driven by the force place business; it was a very strong year, even reflecting the higher catastrophe losses as your ROE was about 27%. So my question is this, given all of the various state and regulatory pressures, the focus around this business, have you considered trying to preempt some of these pressures by submitting proactively for premium rate reductions in conjunction with your next-generation product filings? Why not, instead of reacting, getting out in front of this issue and show folks if it is Fannie or if it is others, that you recognize that the returns are probably unsustainably too high and you are willing to bring them down without someone forcing your hand?

Robert Brian Pollock
Former Chief Executive Officer

Yes, okay. I think, first, John, rating is a state-by-state process, and it is based on A, our experience and what we expect is going to be an indication of experience moving forward. So I think that is quite important. Second, as Mike mentioned, we know that our risk profile is increasing. We just looked at our storm activity this year where we are going to have severe, but infrequent events and we have got to make sure that our premiums reflect that. That being said, our next-generation product provides a lot of flexibility to allow premium rates to be lower and that can come from a majority of different factors. Again, I go back to the other comment Mike made, we understand that returns will be attractive in the business but they are going to be lower, which I think is a reflection of the issue that you have raised that we are trying to be responsive to. So, saying all of that, we have the capability and expertise that are winning business in a market that overall, probably is declining. So I think that is just indicative of the model that we have.

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

Yes, no question. Obviously, you have some great relationships out there -- [indiscernible] and others so, that makes a lot of sense. Then, I guess related to that, Rob, have you guys specifically been at the table with Fannie Mae or Freddie or the FHFA, I think it is? Can you give us any color on the discussions, if at all?

Robert Brian Pollock
Former Chief Executive Officer

Remember, John, we talk to these guys all of the time, okay because they are looking at how the programs work, we have capabilities. There are a lot of technical points around how these programs work. We have been in, we have talked to them and we talk to them regularly. We think we have that new program that we have talked about, our next-generation product --- that can respond to many, many of the issues being raised in the market.

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

Rob, does that next-generation product, where there is a lot more flexibility to get the premium levels down, is that premium level down because deductibles might be higher, or is that premium level is down because the actual rate on line is down?

Robert Brian Pollock
Former Chief Executive Officer

Well, first, the first is obviously the case that if they choose to have deductibles higher, things can change; they can change coverage amount. But remember in that next-generation product, we are introducing some more sophistication, so there is different geographic ratings. What that would imply is that there are some geographic areas things may go up a little, but others they are going to go down; it is all dependant on the particulars, John.

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

Okay, and then separately, one quick one on the health side. I recognize that the visibility remains cloudy around this business, but your outlook indicates we should expect that earnings are down in '13 versus '12, when we adjust 2012 for those real estate gains, so can you just clarify for us what the baseline 2012 earnings number is, and can you give us any help around order of magnitude decline?

Robert Brian Pollock
Former Chief Executive Officer

I will let Mike talk a little, but I want to go back to when Healthcare Reform was enacted, we changed our strategy, and what did we tell people? We said that fundamentally, we have a strategy, we think the strategy is a winning strategy that can deliver returns that will be attractive to shareholders when healthcare is fully implemented. Why? Because we believe this is a specialty business in the individual side of things, will continue to be and that we have unique skills that we can bring to the table. Remember, as Healthcare Reform is implemented, there are different changes along the way that are going to cause bumpiness in the results. Mike, do you want to just comment on this?

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Yes. I think, John, obviously you take off the real estate income that we talked about in the fourth quarter. Quarter over quarter you had the mechanics of the MLR causing some noise, so if you looked at the full year, we probably -- it does not spread evenly. Part of the reason, again, one of the challenges in forecasting this, is that our rebate liability is made up of a lot of separate calculations -- we have talked about that before. You have credibility of experience that is always informing your calculations, too, so that can introduce a certain amount of volatility. We had an excellent year in 2012, too. Experience, generally, was pretty good. As we move forward, you have got credibility changes in the formulas that are going to impact our results, you have got upcoming changes around guarantee issue that go in at the beginning of 2014, and as we price for the MLR targets, that is going to drive our lost ratios up, too, so you have got a lot of different things going on.

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

Just to be more clear, what is the 2012 baseline we should be thinking about, Mike?

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Obviously, so many moving parts, but about 25, about 35 million. I am just not sure.

Robert Brian Pollock
Former Chief Executive Officer

It is primarily taking out the real estate income, John. That would be the main one.

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

One more quick one, I am sorry. The 300,000 loans that are coming on in 1Q, can you give us a sense on the placement rate on that, since it is a flat cancel?

Robert Brian Pollock
Former Chief Executive Officer

I believe that will be a placement rate that is relatively high.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Higher than the block.

Robert Brian Pollock
Former Chief Executive Officer

Yes, I think that one is going to be a little bit higher.

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

Higher than what? I am sorry.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Than the block, in general.

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

Got it.

Robert Brian Pollock
Former Chief Executive Officer

One last one that I would add on healthcare that Mike has mentioned in the past, is that the provisions -- and Mike talked about this around non-deductibility of expenses, John, will be another contributor to healthcare results being challenged next year.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

That will show up in the tax rate for the segment.

Operator

Well go next to the site of Mark Finkelstein with Evercore Partners.

Mark Finkelstein

Actually, I want to go back to one of John's questions. I guess, maybe one health, is it possible to give us a dollar value of the impact to health, from purely the phase in the credibility feature changes that will go between '12 and '13?

Robert Brian Pollock
Former Chief Executive Officer

Off the top of my head, no, but again it is something we could look at. It is very complicated. Mike mentioned these 400 different calculations, and just in the fourth quarter, you get things moving over and under that target medical loss ratio, it can suddenly have you putting up a rebate that you had not anticipated.

Michael John Peninger

Former Chief Financial Officer and Executive Vice President

One of our challenges is that we have business spread over the whole country, so when you are doing these separate rebate calculations, you do not have total credible experience in very many of those cells, so as experience builds and becomes more credible, then you can sort of factor that into your MLR calculation, but whether that experience is good or bad will determine the amount of the adjustment. So, there is just a lot of complexity under the covers, here.

Mark Finkelstein

Okay. On solutions and the 14% ROE target in '14, which you still expect to achieve, my question is, does something more dramatic have to happen as you get later to '13 or into '14 on either the combined ratio improvement side or on the capital allocation? I am just trying to think about how you get there.

Robert Brian Pollock
Former Chief Executive Officer

Yes. First, I just go back and look at the progress we have made over the last several years, which the overall ROE has improved within solutions, and we think that we have outlined a pathway to get there. So, we have that combination of the growth, we have embedded business on the books that will earn out, that we think we have aligned the site on the profitability, so that will be one. You are going to see us continue to manage expenses; that would be a second way we will get there. Third, we are always looking for capital efficiency, and will continue to try to do that. So, I think it is going to be all of these factors and combination helping us get there.

Mark Finkelstein

Okay. Maybe just on the expense side, obviously you are cutting expenses in health, pretty dramatically --- you are cutting expenses in solutions -- I guess the expectation for corporate is actually a bigger loss, rather than what you have been experiencing, and I am just kind of curious if you could just walk through the activities that are happening at the corporate segment that is driving a higher cost load, visa vie, cutting expenses everywhere else. What are the investments in the activities that are occurring there that we should be thinking about?

Robert Brian Pollock
Former Chief Executive Officer

First, I think if you look at the numbers that we have put out, I think the corporate level expenses are rather flat, year over year, maybe up a couple million. Obviously, there is a number of things related to just being a public company, but in addition to that, we trying to fund some small incubation and growth initiatives, such as solar etc. that we might bring out to others. I think that is really the driver in any increase, Mark, is really those investments to help fund the growth. We are trying to look at some different opportunities -- solar is one example that we have talked a little a bit about, but we are seating a certain amount of experiments around the company and each of the businesses to try to look for more opportunities in the market, and we think that is a prudent use of a relatively modest amount of capital to help keep fuel for future growth.

Mark Finkelstein

Okay. Maybe just one more, if I may. On specialty property outlook, you kind of suggested that expense is relatively flat, or expense ration --- I cannot recall exactly what you said -- but is there any guidance or feel that we should get in terms of the average rate assumed in that guidance number between '12 and '13?

Robert Brian Pollock
Former Chief Executive Officer

That is kind of what we talked about in the prior question, Mark. The rate assumptions in the guidance are sort of state by state, reflecting experience, and then also combined with expected growth in the loan portfolio, but no overall average -- down 5, down 7, down 3, no overall, overriding kind of outlook. No, it's going to be a function of where the policies show up.

Operator

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

Sean Robert Dargan
Macquarie Research

To follow up on John's question about your discussions with Fannie Mae, there have been press reports about a consortium. If there was a consortium with the attributes that have been talked about in the press, would that be something that you would want to join or would be able to join?

Robert Brian Pollock
Former Chief Executive Officer

Well, first we don't speculate, but again, I think our next-generation product addresses a multitude of uses that can help any of the GSEs get lower premiums if that's their choice. And the flexibility around that and being able to -- remember, the servicers are our client. We can provide the servicer with infinite flexibility on how they deal with that portfolio of theirs that can produce lower premiums on GSE loans, depending on the particulars.

Sean Robert Dargan
Macquarie Research

And as a follow up, last year you had given kind of a steady state estimate of placement rates and as the housing market improves, I think the mortgage insurers have seen new notices of default come down 25, 30% year over year. I'm just wondering where you think that steady state placement rate will shake out because I think you said overtime you do expect it to decrease.

Robert Brian Pollock
Former Chief Executive Officer

Well, that's right. We do expect it to go down and I think what we looked at overtime was returning to levels we've seen in the '06/'07 timeframe. Now, again, that was our best thinking at the time. We also know, however, it's going to fluctuate, you can see that in the portfolios we've brought on the books. I think another important trend that we've tried to outline is we also think that placement rate is being impacted as voluntary carriers are leaving the more cat-prone areas. So we don't have a full clear line of sight on that yet, but we're working on it and we know that, our placement, as Mike mentioned, is going up in the more cat-prone areas.

Operator

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

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

I want to return to health if I may with 2 questions. The rebate, remind us, this is a catch-up for what periods, for what quarters?

Robert Brian Pollock
Former Chief Executive Officer

The rebate is accrued for 2012 experience, so at the end of the year, we're holding how much of the --- the premium we earned in 2012 that we'll have to rebate.

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

Okay. With that, looking at Assurant Health, the loss ratio for the full year was around 74%. I guess my question is, I know there's going to be some difference between the GAAP MLR and your regulatory MLR, but I guess my question is once you get full credibility, maybe this is another way of asking John's question, but once you get the full credibility, where would that be if you had the full 80 -- the full 80 MLR on a regulatory basis?

Robert Brian Pollock
Former Chief Executive Officer

Yes, I think we've talked about that being in the medium 70s or 75, 76, somewhere in that range and that's a function of we have business that subject to the MLR guidelines, we have our Affordable Care products and some business that's not so it's sort of a blended. But I think you're going to see us move up into that 75, 76, 77 kind of range would be probably equating to the 80% MLR target.

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

Okay. And then, I didn't realize that was the ultimate. I thought that was for this year. And then if I may, the --- you're affordable choice product, is that MLR exempt?

Robert Brian Pollock
Former Chief Executive Officer

By and large, yes. I think it is, yes. Again, the -- if you look at when we set the strategy up, we talked about the PPACA products, which are subject to the MLR and ones that aren't. We started from a very small base of the other products. We've had nice growth there, but still a small percentage of our overall block. That business is not subject to the MLR and I think that points out what Mike said. I think when he talked about that 75 to 77, that's on the Affordable Care Act product that are subject to the rebate.

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

Okay, and then the Affordable Choice plans that you sell will have that lower --- will have the total [indiscernible]?

Robert Brian Pollock
Former Chief Executive Officer

I mean, we're going to get -- our reported overall loss ratio is going to be a blend of MLR products and non-MLR products.

Operator

We'll go next to the site of Mark Hughes with Suntrust.

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

The placement rate on the new 300,000 loan block, how does that compare to the 650,000 that you brought on this quarter, or fourth quarter?

Robert Brian Pollock
Former Chief Executive Officer

I don't think we have full line of sight on the 300,000 we're adding yet, Mark.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Well, we do think, as we said earlier, it's going to be higher than the Black's average. So it's not like a we've had a couple of portfolios that have had placement rates that are more like the 1-percenters or something. This is going to be higher than that.

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

Yes, with the 650, did you say that 200,000 of those were flat canceled?

Robert Brian Pollock
Former Chief Executive Officer

Correct.

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

Within the 300,000 loans, how many of those are going to flat canceled?

Robert Brian Pollock
Former Chief Executive Officer

Those are going to be flat canceled as well.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

All of them.

Robert Brian Pollock
Former Chief Executive Officer

So that will impact our premiums, start --- depending on exactly the date of the flat cancel.

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

Right, so actually a higher number of flat cancels in this new block?

Robert Brian Pollock
Former Chief Executive Officer

Right.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Right. Once we take over the business, it will all come flat cancel.

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

Right. And then you mentioned a couple time, portfolios passing between servicers in the months ahead. Is that to say there's a lot of visibility you've got for incremental pickups?

Robert Brian Pollock
Former Chief Executive Officer

Exactly. In other words we -- if you look over the course of '12, we won some portfolios through RFP. But our alignment with leaders has really helped us. If we look at the general trend that's going on and put this over perspective, in the '08/'09 timeframe, a movement from specialty to money center bank. Now we're seeing a movement away from money center bank to specialty server and our alignment with the leaders has us positioned as those movements occur.

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

And do you still go through the RFP process in those cases?

Robert Brian Pollock
Former Chief Executive Officer

Not when it's just a loan portfolio that the servicing rates might be purchased by another servicer.

Operator

We'll take our final question from the site of Seth Weiss with Bank of America/Merrill Lynch.

Seth M. Weiss
BofA Merrill Lynch, Research Division

I have a question on free cash flow emergence going forward, specifically within health and specialty property. I know that the health given was 160 in 2012 and you mentioned capital efficiencies in that business. So if you could think about how the --- help us think about how we could think about that for 2013? And then specialty property, I know that the long-term visibility is a little bit less than the placement rates, the fluctuate around, but can you let us know how to think about capital release in that business, maybe as it relates to the total risk in force coming down as placement rates come down over the next few years?

Robert Brian Pollock
Former Chief Executive Officer

Sure. So let me start and then maybe Mike can comment on property. But on the health side, an important thing to remember there is first, on all these businesses, we capitalize to AM best ratios but because of where health --- our health business was and the evolution, we didn't take any dividends for several years even though we made money. This year, if you look at the money we took out, we took out several years' worth of earnings as a result of that because it has been sitting there and the rating agencies were comfortable with the progress we made that that made sense. Mike, you want to talk about how to think about capital on the property side?

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Yes, in property, we've talked about, the capital in the business or the equity being in that 50 to 55% of premium and so as the -- and one of the drivers of the capital equipments is the premiums. So as premium were to moderate, capital potentially can come out, although it has to be due to changes in exposure that's what fundamentally -- the premium is sort of used as a surrogate for exposure, so as exposure is reduced, then we can take the capital out of the business.

Seth M. Weiss
BofA Merrill Lynch, Research Division

Okay, understood. So if we think about it that way, the next-generation product also will have a little bit of [inaudible] benefit as exposure comes down with the reductions in premium related to that, right?

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Correct.

Seth M. Weiss
BofA Merrill Lynch, Research Division

And just one mechanical follow up on specialty property and loans tracked, if we look at 31.2 million loans tracked, that encompasses the -- just the 200,000 that are flat canceled, there'll be 450 on top of that which will emerge overtime, right?

Robert Brian Pollock
Former Chief Executive Officer

No.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

I think the full 650 go into the loan count, the way we do the calculation.

Robert Brian Pollock
Former Chief Executive Officer

Right. So I think that what's not in that 31.2 is the ones that are going to be added in the first quarter.

Michael John Peninger
Former Chief Financial Officer and Executive Vice President

Right, but also, if you're trying to reconcile, you've got attrition in the existing portfolio, so we start with the 30.8 or whatever it was. We add 650 and then we get some attrition and that's how we end up at the whatever, 31.2 or something.

Seth M. Weiss
BofA Merrill Lynch, Research Division

I see. And just out of curiosity because I know you've added a bunch of new portfolios over the last 12 months, is there a way to think about the gap between those that are still rolling on with the renewal process, Chris?

Christopher John Pagano
Executive VP & Chief Risk Officer

Well, the loans go onto the system, that's what we're tracking. It's policies related to those loans that come on over time.

Robert Brian Pollock
Former Chief Executive Officer

It's really the placements that are going to occur on the loans, which is a good point you're driving that, that we will still have pickup in some placements on some of the portfolios that were flat canceled.

Robert Brian Pollock
Former Chief Executive Officer

Thanks for joining us this morning. We encourage you to reach out to Francesca and Suzanne with additional questions. We look forward on updating you on our progress for the first quarter conference call on April 25th.

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