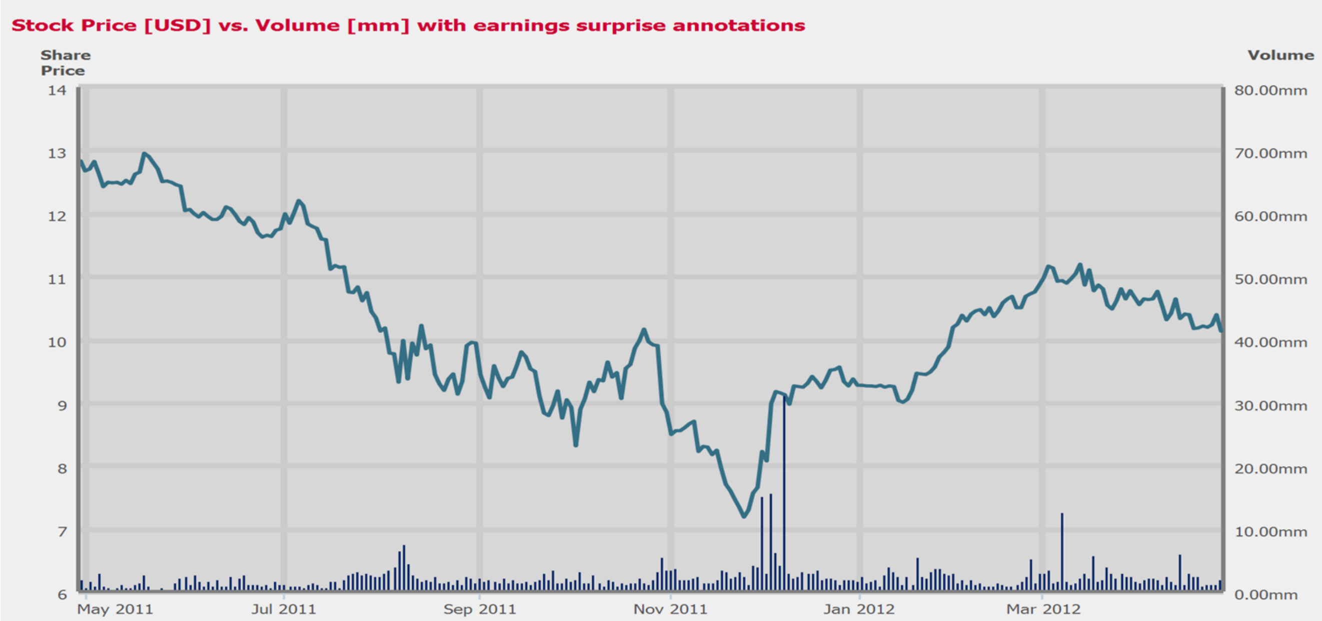
S&P Global
Market Intelligence

Old Republic International Corporation
NYSE:ORI
FQ2 2012 Earnings Call Transcripts
Thursday, July 26, 2012 7:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ2 2012-			-FQ3 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.03	(0.19)	NM	-	-	-
Revenue (mm)	1013.44	-	-	1084.99	4456.11	5936.00

Currency: USD
Consensus as of Jul-26-2012 3:52 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ2 2011	0.02	(0.25)	NM
FQ3 2011	(0.16)	(0.43)	NM
FQ4 2011	(0.16)	(0.11)	NM
FQ1 2012	0.21	(0.01)	NM

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Call Participants

EXECUTIVES

Aldo Charles Zucaro
Chairman & CEO

Christopher Stephen Nard
President & COO

Karl William Mueller
Senior VP & CFO

Scott Eckstein
Director of Account Services

Unknown Executive

ANALYSTS

Brett Reiss

Jim Ryan
Morningstar Inc., Research Division

R. Scott Frost
BofA Merrill Lynch, Research Division

Stephen Mead
Anchor Capital Advisors, LLC

Unknown Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the Old Republic International Second Quarter 2012 Earnings Call. Just a reminder, today's conference is being recorded. [Operator Instructions] I'd like to remind everyone that this conference is being recorded.

And I would now like to turn the conference over to Mr. Scott Eckstein with MWW Group. Please go ahead, sir.

Scott Eckstein
Director of Account Services

Thank you, operator. Good afternoon, and thank for joining us today for Old Republic's conference call to discuss second quarter 2012 results. This morning, we distributed a copy of the press release. If there is anyone online who did not receive a copy, you can access it at Old Republic's website, which is www.oldrepublic.com. Please be advised that this call may involve forward-looking statements as discussed in the press release dated July 26, 2012. Risks associated with these statements can be found in the Company's latest SEC filings.

Participating in today's call, we have Al Zucaro, Chairman and Chief Executive Officer; Chris Nard, Chief Executive Officer of the runoff RFIG business; and Karl Mueller, Old Republic's Chief Financial Officer.

At this time, I'd like to turn the call over to Al Zucaro for his opening remarks. Please go ahead.

Aldo Charles Zucaro
Chairman & CEO

Thank you very much and good afternoon to everyone. In today's earnings call we'll be assuming that everyone who is listening, first of all, has read this morning's news release and secondly has a reasonable current understanding of the various activities in which we've been engaged in that last 5 or 6 months in particular.

And specifically on that score, we're referring to the plan we had organized to spin-off to the Old Republic shareholders, the company's ownership in the combined Mortgage Guaranty and CCI or Consumer Credit Indemnity businesses that are included within our Republic Financial Indemnity Group or RFIG, as we refer to it, which is the holding company subsidiary that owns the MI and CCI businesses.

The objective, of course, with that plan was to use a standalone corporate vehicle in the person of RFIG, to access the capital markets and therefore -- and thereby have an opportunity to raise fresh capital to at once replenish the capital base to offset the cumulative losses we've incurred to-date in our mortgage guaranty book-of-business, in particular, and to add to that capital base to possibly enable a re-entry into the business. So, as we reported in late June the entire plan was aborted, and we did that in response to the views of some mortgage insurance stakeholders.

As a group with reasonably confluent interests, they believed that retention of the RFIG company within the Old Republic holding company system during an extended run-off period would ultimately lead to greater value for mortgage guaranty beneficiaries. So it is that we obviously listen to and we considered those concerns and obviously we concluded that Old Republic's long-term interests as a diversified insurance business could best be served and protected by aborting the plan before it took flight.

As we note in this morning's news release, the effects on Old Republic's consolidated operating results and on the company's shareholders' equity account of the RFIG runoff business, those effects have been distinguished from those of our separately funded and managed general and title insurance segments.

And we think that this type of segmented presentation of our consolidated operations provides both shareholders as well as any other interested parties, a realistic picture of the separately active and runoff portions of our business as well as their respective impacts on the true economic values being delivered by the enterprise.

To do all this, we've obviously burdened this morning's financial report with a much greater array of numerical data. Obviously, we believe that numbers can speak volumes and if a reader takes a little more time to digest all of those numbers we think that they do provide a true portrayal of the substance of our company's active business, and of its future prospects with respect to the core -- the 2 core portions of the business that are very much active.

In succeeding quarters, therefore, we will be following the same reporting approach, until such time as the RFIG segment settles down to a more hum drum state, so to speak. As we noted at the outset, we have3 participants on this call. We will speak briefly and add a little additional color to the 3 segments of our business, both active and inactive. And we will focus on important balance sheet items and then as was suggested, we'll open the session to a question-and-answer period.

So, starting with a look at our largest business of general insurance, the results this past quarter were not as good as they were in the first quarter, obviously, nor were they as good as we had expected.

As always, we need to emphasize that individual quarters' results are not particularly meaningful in a business that has to be managed over market driven cycles. At best, an annual period is certainly more telling than a single quarter. But be that as it may, the basic story now relative to this year's second quarter and first 6 months is that we needed to be a little more, perhaps much more heavy handed in our loss provisions for the current accident year on the one hand, and we experienced on the other hand, a lesser level of redundancies relative to prior year's loss reserves in the inventory of unpaid claims.

If you look at the table A information on Page 3 of the release, which basically shows the historical general insurance segment inclusive of the CCI product line before it gets reclassified, there is about a 10.2 percentage point increase in the quarterly claim ratio and a 4 percentage point increase in the first half claims ratio, in both cases vis-à-vis the comparable periods of 2011.

So to put these changes in perspective, we might note that the second quarter rise of about 10.2 points as I say, was almost equally divided between current and prior year's cost increments whereas the year-to-date change of 4 percentage points was more heavily weighted towards prior years.

Post reclassification of the CCI results which we show in the reclassified table C, we would say that the relationships between current and prior year's cost increments or savings, if you will, are relatively the same.

So in each case the largest uptick in loss ratio stems from our workers' compensation line, which as you may know is the largest premium source we have at Old Republic. And to be more granular about it, the significant drivers of this cost accretion are the combination of the -- of what occurs in high unemployment environment such as we're in and that relates to the combination of lingering disabilities and more recently -- more accentuated inflationary pressures stemming from both greater costs and utilization of pharmaceuticals.

You have to remember that when it comes to workers' comp, the proportion of the total workers' comp claim that relates to the pure indemnity side of the benefit amounts to maybe 55% or so, whereas the historical expense relating to healthcare and drugs and what have you has been around 45%, and we're seeing that relationship change to some degree to the point where now it is more like 48% medical and 52% indemnity.

Let's see. So having said all of this, however, does not by any stretch of the imagination, indicate that we are seeing a train wreck coming down the rails. But we do expect some continuing upward pressure on the claim ratios for a while longer. And then as we show in the release, the expense ratio was greater by a couple of points this year and we reported on this in the first quarter as well. And all of this was due to the amortization of previously deferred acquisition costs adjustments. And these adjustments are called for by new Financial Accounting Standard Board accounting guidance that all companies need to be -- need to address.

So you should see the end of this adjustment, if you will, by the end of this year. So when all these claim and expense numbers are added together, they obviously result in a lower underwriting margin. At this juncture, however, we still expect 2012 to be in the black underwriting-wise.

Going back for a minute to the top line of the general insurance business, you can see that we're experiencing some pretty healthy premium income growth and all of it is due to the combination of some upward pricing trends that we've been experiencing for the past 18 months or 24 months or so. As well as the greater insurance needs that emerge and that are emerging from a very slow rebound in the U.S. economy.

Let's see, I think we'll move on here with Chris Nard and some discussion of our RFIG as well as Title Insurance businesses.

Christopher Stephen Nard
President & COO

Thank you. As you're aware earlier this year we had combined the mortgage guaranty companies and our CCI business under the same umbrella. These businesses have been in a runoff status since 2011 and 2008, respectively. And as we've shown in today's press release the combined businesses now report as the Republic Financial Indemnity Group segment.

As we discussed previously, the purpose of the combination of these businesses earlier in the year was to prepare them for the partial LBO and the eventual spin-off from Old Republic as an independent public company. The strategy was then to work to recapitalize these businesses outside of the Old Republic Holding Company structure, as we did not and do not have the financial resources at the Old Republic parent company level to fulfill that.

As we reported last month, we've canceled the planned spin-off of RFIG and have therefore retained these lines of businesses within the Old Republic Holding Company system. As we look at them going forward, our mission with respect to these businesses continues to be the same.

First off, to manage them in a fair and economical way, so that we're able to maximize the claim payment resources for the respective policyholders and beneficiaries. Two, to explore ways to utilize their infrastructure and systems and technology in support of unaffiliated businesses and lastly to continue to seek external capital sources for the purpose of the long run continuation of these lines.

From an operating standpoint in the quarter on the mortgage guaranty side of RFIG, it continues to reflect a continuation in the trends that we've seen present for the last several quarters now. These include a continued downtrend as we've talked about in the past on newly reported and on the total delinquent loan population.

Unfortunately, however, we are not seeing any real improvement in the cure ratios over the period. Now they've been somewhat stable, but we've not seen the improvement that we would like to see in the cure ratios to really start moving ahead with the delinquent populations.

The earned premium line continues its downward trend largely due to the business' runoff status. On the loss side of the business, paid claims were down in the quarter. But we think that's largely indicative of the choppy nature of the rescission patterns as these books age and obviously the well reported difficulties in the foreclosure processes in various states around the country.

In the quarter, changes in the reserve provisions were largely impacted by increases in our reserve factors related to our expectations for the performance of the loan balances in the early stages of the delinquency cycle. And with regards to the expense side of the business, we've continued to make good progress in structuring the run-off operation at RMIC and in the second quarter the expense ratio came in at 8.5% helped by the fact that the severance costs associated with staff reductions were mostly all paid for in the prior quarter.

Let me switch over to the CCI side of the business. In the CCI side, the net premiums were up in the quarter. That's largely because of timing related to various retrospective premium plans that we have in place in that business. We think that the 6-month premium comparison is really more indicative of the long-term trend in that business and as you can see from the 6-month comparisons revenue is down about 20% for the first 6 months of the year.

The most significant change in the CCI line for the quarter relates to the reserve provisions. They include downward adjustments for future salvage recoveries and an upward adjustment to cover what we think is a more extended claim litigation period related to various legal disputes at the Company. Paid claims in that business continue to reflect downward trends and this appears to be the point to the burnout of that book as this economy moves ahead.

Now let me take a second and transition to a brief review of our improving results in the title insurance business for the quarter. Old Republic's title business has begun to show consistent improvement quarter-to-quarter. In the second quarter of this year, we posted a pre-tax profit of $22.5 million in comparison to the second quarter of 2011, where we posted a $5.5 million profit for the same quarter.

Total premiums and fees have shown comparative growth and we were just up -- just a little bit over 23% in comparison to last year's second quarter. This trend continues to be supported by improvements in volume in several markets around the country, increases in refinance activity and lastly market share gains, which we've incurred over the last 3 years or so. Our share, the title company's share in the first quarter this year, which is the most recent metrics that we have, was about 13.7% which was up from 13% from the year-end 2011.

Title expenses for this year's second quarter were down to 88.3% versus 92.3% in the second quarter of 2012, and finally the claim ratio for the second quarter was slightly better at 7.3% than it was for the same period last year. In looking at our title results for the quarter, we're encouraged by the progress that we're making in this segment, particularly given the uneven recovery that we continue to see in the housing markets across the country.

I'll take a second now and turn it over to Karl Mueller, our Chief Financial Officer.

Karl William Mueller
Senior VP & CFO

Thanks, Chris. First of all let me say that very little has taken place since the last quarterly call with respect to our consolidated financial condition. As we reported in this morning's press release, we ended the quarter with roughly $15.8 billion in consolidated assets and $3.7 billion total shareholder's equity or $14.50 per share.

The composition of balance sheet since year-end in the first quarter has really not changed to any significant degree. In the makeup of the investment portfolio, which consists primarily of high-quality fixed income securities, remains substantially unchanged and it continues to reflect good market appreciation.

As noted, we added another $0.07 per share to our book value during the second quarter and $0.22 year-to-date stemming from unrealized gains in that portfolio. Year-to-date the consolidated loss reserves are developing at essentially a breakeven level, and what this means is that the prior year's reserves have not developed adversely to any degree.

During the second quarter we reduced our consolidated outstanding debt to $573 million and that's down from $913 million at the end of last year. We accomplished this through the repayment on May 15 of this year of our $316 million 8% convertible debt issue. Additionally, just a few weeks ago, we completed the final repayment of PMA's outstanding external debt that we had acquired in the fourth quarter of 2010. Both of these repayments were made using funds that had been earmarked and set aside from the proceeds of the $550 million convertible debt issue that we took to market last year in March.

The elimination of these high-yield debt instruments from our balance sheet are additive to our operating results and that benefit began showing up in this year's second quarter. Our quarter-end debt-to-equity ratio stands in at 15.5%. Our total debt to total capitalization is 13.4%, and these percentages would be comparable to year-end 2011 of 24.2% debt-to-equity and 19.5% debt to total capitalization.

We believe that these debt leverage ratios will hover in this area for the foreseeable future and therefore provide more than enough flexibility for us to issue additional debt if the need arises and to do so without putting undue pressure on our balance sheet leverage or our ability to service the debt.

From a consolidated cash flow perspective, we reported a year-over-year improvement in our operating cash flows to a positive $130 million for the first 6 months of 2012. We did see increased operating cash flows from each of our operating segments for the 6 months of this year, although the RFIG run-off segment is still producing negative cash flows as we continue to see claim payments exceeding our premium volume.

From a parent company liquidity perspective, we ended the quarter with cash and short-term investments, held at the holding company and other non-regulated subsidiaries, in the neighborhood of $285 million. The amount of funds that are available to dividend up to the holding company continues to be sufficient to meet our cash flow needs, and these needs typically include our minimal level of operating expenses, our external debt service, the settlement of any intra-system payable balances, and our regular common shareholder dividends.

Schedule F to our March 21 press release summarized the historical dividend paying capacity from each of our regulated subsidiaries along with the actual dividends paid to the holding company over that extended period of time. As that schedule clearly shows, since 2007 the vast majority of dividends have stemmed from the General Insurance Group with smaller amounts being received from the Title and Life Insurance operations.

We believe that our General and Title segment companies in particular are adequately capitalized to support the current level of operations to provide for a reasonable level of growth in these businesses and of course to provide for the unquestioned ability to meet our just obligations to the policy holders of each of our individual insurance companies. Therefore, we don’t anticipate any material deviation from the historical level of dividend payments that are reflected in that Schedule F that I referred to earlier.

With that, I will turn it back to Al for any closing comments.

Aldo Charles Zucaro
Chairman & CEO

Well, I think we have pretty much covered the waterfront as we usually try to do in these quarterly phone calls as well as earnings releases and the 10-Q reports that follow that we sent to the SEC.
So without much further ado, we’ll just open up this visit to questions that you have there and if you will address them to me, we will -- one of the 3 of us will respond to each such question. So let’s go ahead.

Question and Answer

Operator

[Operator Instructions] Our first question today is from Jim Ryan, Morningstar.

Jim Ryan
Morningstar Inc., Research Division

First question is on the CCI –- well, first of all, let me also mention that the new format is very helpful and I hope you continue that. Regarding the CCI, I see that the claims are up quite significantly or the cost. When you were doing the spin-off there was conversation or statements made that Old Republic still stood behind certain parts of CCI. Is there a point at which the CCI expense or claims is then transferred back to Old Republic Corp?

Aldo Charles Zucaro
Chairman & CEO

Well, if you look at the SEC filing that we had for in anticipation of the spin-off, Jim, you will see that we disclosed the fact that we had moved the CCI business from a reinsurance standpoint from our General Insurance Group to the RFIG segment. However in doing that, we willfully limited the exposure of the RFIG, CCI assumed reinsurance subsidiary to as I recall an 85% loss ratio, such that, if the loss ratio were to exceed 85% cumulatively over a period of time, the General Insurance Group subsidiaries that were in fact involved with the CCI product would bear that cost as long as it exceeded the 85%, so that has not changed. What we've done here in the tables that you see, is that we've taken that entire CCI product experience and we have shown it as a part. We've taken it out of the General Insurance business and we've put it into the RFIG business and that in fact is to adhere to or is required in segment reporting. So that's what we think adds clarity to the various parts of our business and what is in run-off versus what remains in an active operating mode. Karl, do you want to add anything to that?

Karl William Mueller
Senior VP & CFO

Well, Jim, the only thing I might add is that if you look to the footnote beneath the table, it will...

Aldo Charles Zucaro
Chairman & CEO

In the news release.

Karl William Mueller
Senior VP & CFO

In the news -- I am sorry, in the news release, it does in fact quantify the amount of pre-tax operating losses that remain with general insurance companies from a legal perspective.

Jim Ryan
Morningstar Inc., Research Division

Okay, I see that. Okay. Secondly, could you give us an annual run rate on the holding company expenses as [indiscernible] I mean for the dividend, the debt, the holding company expense?

Aldo Charles Zucaro
Chairman & CEO

Well, basically what you have Jim is, we've got a $550 million, maybe $560 million total debt structure most of which namely $550 million is in that convertible debt issue that we put out early in 2011 and that's got about a 4% all-in cost attached to it, so that's $22 million, and then you've got maybe $5 million or $6 million of internal costs for legal expenses, accounting fees, some very little management expense since we don't have a super structure sitting on top of the holding company here; so maybe you're looking at $30 million or so. Now that's offset to some degree by interest we get, we received at the holding company level from various insurance subsidiaries that are capitalized with various debt instruments. And I don't remember what that number is. But if you use $6 million, $7 million if you promise not to hold it against me, that's about what you're looking at. So, we're probably looking at $20 million, $21 million of net expense at the holding company year-in, year-out, now that we've paid-off that $316 million of debt which was costing us close to 9 points -- 900 basis points.

Jim Ryan
Morningstar Inc., Research Division

Okay. It's $21 million plus the dividend cost?

Aldo Charles Zucaro
Chairman & CEO

Correct.

Jim Ryan
Morningstar Inc., Research Division

Okay. Okay, and finally just as a update, any thoughts on any changes to the existing debt, is there any thought about modifications or new debt or anything along those lines to alleviate the one issue there is with the mortgage insurance possibility being declared insolvent?

Unknown Executive

Well, Jim, we've looked at a number of options and have held some discussions, but at this point given our current liquidity position and we believe that we can adequately manage our way through for the foreseeable future without making any modifications.

Operator

And next we'll hear from Christopher Seifert [ph], Kingston Capital [ph].

Unknown Analyst

I had 2 questions; the first one is for Chris Nard probably, it's best addressed to him, and relates to the CCI business line. The first is -- the $1.2 billion that's listed as risk in-force on your first quarter 10-K or 10-Q rather, I'm just trying to understand to make sure that the book of business that associates with Table B in your press release here, and then secondly if you could comment at all on the tail of that business over what time period we'll be likely to see that CCI portfolio run-off?

Christopher Stephen Nard
President & COO

Let me do the last one first. The tail on that business -- that business is written as a traditionally is what I would call a full insurance policy that has a fixed stop loss associated with each one of the customers book of business. So that has unlike the regular traditional primary on the mortgage guaranty side of the business that serves the function of truncating the tail as the business starts to burn out. So as we've reported in the last few quarters, we have begun to see a steady consistent decline in the paid claims trends in that business, and that's driven largely by we think as we mentioned earlier the burn out of the books of business that are still within those stop losses and then obviously accounts where they might have burned through the stop loss in its entirety, that business is truncated but yet contractually essentially because of the stop losses on it. So that's the thinking on the tail section of that business. I look to Karl to see on the -- I am not sure I followed the first part of your question trying to match the risk in-force with Footnote B. Any restatement?

Unknown Analyst

Yes, I guess just to clarify, I am just trying to get a better sense of how the book will run down over time and obviously as you mentioned one way to look at that is just how your benefit and claims costs evolved.. And I was curious, if another way to look at it is, how your risk in-force evolves -- and the risk in-force has been down significantly over the last couple of years. I was wondering if that's a good way to track how the portfolio is shrinking over time.

Aldo Charles Zucaro
Chairman & CEO

Yes, I think what you're seeing, this is Al. I think what you are seeing there, Christopher [ph], in terms of the loss ratio particularly in the second quarter of this year for the CCI. As Chris mentioned in his comments, that was really driven by somewhat unusual amount of certainly a much greater amount of provision for litigation expenses, which we have to defend against a couple of -- at least a couple of lawsuits we have which we typically disclose in the 10-K as well as the 10-Q, the biggest one of which as we disclosed is with the Countrywide Group of companies. And what we have done there this quarter -- what we did there this quarter was to in fact assume that the cost of that litigation, namely the legal fees attached to that litigation, would continue for a more extended period of time. The other thing what we did has to do with the nature of the product in addition to the features that Chris mentioned before. There are 2 distinctive features to the CCI product in addition to as I say what Chris mentioned before. One is the fact that anywhere depending on activity on individual accounts but anywhere between 40% and 45% of the book is subject to some sort of retrospective premium adjustment which is driven by the level of claims activity and those premiums get adjusted on account-by-account basis, right. Each account moves and that's what Chris was talking about when he says, basically its pool insurance on account-by-account basis. The other distinctive feature of the business is that, unlike mortgage guaranty where we pay a claim -- when we pay a claim we're done with it. In the CCI product when we pay a claim we acquire ownership to the note and that note gets put into a salvage inventory and then we proceed to collect on that note. Now we don't always collect. Sometimes we don't collect -- if we do collect we don't collect the full amount of the note, but there is a relatively long tail aspect to that collection, what we refer to as salvage. And what we did this quarter as part of -- and which is one of the reason you see the loss ratio popping up to the degree that you see, i.e. the expenses -- the legal expenses on one hand, but the other thing was that we reduced the amount of expected salvage recoveries in the future. And the reason we did that was because we feel increasingly vulnerable from the standpoint of the employment picture in this country, et cetera, et cetera, and of course as you know whenever people don't have a job, their ability to meet their continuing obligations is reduced and therefore we said to ourselves, listen, we better lower our sights as to how much salvage and segregation we may have on this. Just one final comment to put it in perspective for you, we on our current years in that business we are down to maybe 5% -- is that around 5% or 6%, Karl, salvage recovery expectation?

Karl William Mueller
Senior VP & CFO

That's correct.

Aldo Charles Zucaro
Chairman & CEO

5% to 6%...

Karl William Mueller
Senior VP & CFO

For the most recent, I think, yes.

Aldo Charles Zucaro
Chairman & CEO

Whereas in good years, pre-2006 and so forth, it was not unusual over a 15- or 20-year period after the payment of the claim that we would collect ultimately on any 1 year's salvage, 20% or 25%. It's a very slow track type of thing, but it is an asset of some value to the business. So it's those 2 elements...

Unknown Analyst

That's helpful. And the increased salvage loss you booked is that -- am I correct in understanding that, that's associated with an entire pool of claims as opposed to a particular loss incident?

Aldo Charles Zucaro
Chairman & CEO

Yes, it's associated with all the claims that we have already paid and all the claims that are in reserve.

Unknown Analyst

Okay, great. And maybe just one other short question as it relates to your general business and the incremental reserves you took this quarter there. You mentioned that some of them had to do with your legacy business...

Aldo Charles Zucaro
Chairman & CEO

We did not say that. We didn't say anything about legacy business on the general insurance business.

Unknown Analyst

Prior year business? You mentioned that some of the reserves had to do with the current loss year and other incremental reserves related to prior loss years?

Aldo Charles Zucaro
Chairman & CEO

Okay, so what we mean there is the reserves at the end of 2011 not developing as redundant as they had done in the past. The level of redundancy is lower. And what we also said is that with respect to the current year that we were a little more, as I put it as I recall, a little more heavy-handed in terms of our expectations as to how much more reserves we needed for pharmaceutical and healthcare types of costs that are associated with worker's comp business.

Unknown Analyst

Are any of your incremental reserves associated with legacy asbestos in environmental issues?

Aldo Charles Zucaro
Chairman & CEO

No, no. We historically have not had a great book of A&E reserves at Old Republic.

Operator

Next from Anchor Capital Advisors is Stephen Mead.

Stephen Mead
Anchor Capital Advisors, LLC

A couple of questions. On the cash flow statement, $130 million for 6 months, I was just curious how the 2 quarters kind of look, first quarter versus second quarter, and is that a consolidated number and includes the negative cash associated with RFIG?

Unknown Executive

Well, first of all, that is a consolidated number. In terms of the split between the quarters I believe first quarter we reported $49 million, $50 million of positive cash flow. So, incrementally what is as...

Stephen Mead
Anchor Capital Advisors, LLC

$80 million...

Unknown Executive

$80 million increase.

Stephen Mead
Anchor Capital Advisors, LLC

Yes. Okay. I was wondering whether from a cash flow standpoint what RFIG, was their cash needs lower?

Unknown Executive

Yes, I think as I mentioned in my comments, we saw improvements in all of our major operating segments although RFIG continues to produce negative operating cash flow, it's a smaller negative, if you will.

Stephen Mead
Anchor Capital Advisors, LLC

And then, how much of a year-over-year gain have you achieved in terms of the interest expense at the holding company level, if you look at what 2011 interest expense was?

Aldo Charles Zucaro
Chairman & CEO

Well, again, we paid off that $916 million, Steve, in May of this year. And that's got 9 points -- 900 basis points attached to it, okay? That's roughly $27.5 million. Annually, we've about 1 month out of that -- 4 months rather.

Unknown Executive

Of $4 million.

Aldo Charles Zucaro
Chairman & CEO

Yes, $4 million.

Stephen Mead
Anchor Capital Advisors, LLC

Okay. And then, going back to the North Carolina situation and the addition of the RFIG from a capital standpoint, if you look at what the deferred payment obligation is in terms of as an asset and also as what accounts as capital, and I didn't know when that 50% cash payment ended, and I was just wondering how do you transition in terms of capital at that operation, when that 50% period runs off or stops, and what -- who makes the decision on that at this point?

Aldo Charles Zucaro
Chairman & CEO

Well, we can't speak obviously for the North Carolina Insurance Department, all we can say is what our understanding is of the order that it has issued and the understanding we've from recurring discussion we have with the North Carolina regulator. As you may see, we've disclosed that the initial order that was issued back in mid-January of this year indicated that the 50% approach was good for 1 year. The understanding was that the Insurance Department would then proceed to retain some professional consultants, such as actuaries and what have you to make a finer determination of what was likely going to occur in a longer runoff period. And we understand that, that study, that consultancy, is currently in place and is about to -- should reach finality in the next month or 2. And at that point, we'd expect the department to make a decision as to whether it would lengthen the runoff period beyond 1 year.
As to your specific question relative to when the deferred payment obligation would be paid, that again will rest with the department at the department's discretion, but what would have to occur would be that the department would decide that there are enough funds in place to not only pay the DPO, the Deferred Payment Obligation that's in place at a particular point in time when he makes the decision to pay it as well as funds that remain to pay the claims that will be incurred in the future, right? So, it

is not inconceivable, I mean going from -- again, you may remember this, Steve, we've said right on several occasions that at least our direct experience with runoffs of books of mortgage guaranty business, that those can take place over an extended 10-year period and we've direct experience with that. Our expectation would be that this time around should be a mirror image of that -- that it will take a good 10 years to runoff the book, starting in August. As we've also disclosed, Steve, we have expectations right now that the book will continue to runoff adversely, certainly this year, next year, 2013, and perhaps even 2014. And then we -– our best projections indicate that the business turns profitable there, okay, after that. And those profits will obviously offset the accumulated losses from 2012, '13 and maybe even '14, right? So, that's what you've to be thinking of that the decision is likely going to be made once the business stabilizes into a profit position once there is a perception that the loss years are over with and now we're going to more of a stable situation, that it is at that time that a regulator would more likely than not, make, reach a decision as to how much, whether all of the deferred payment obligation would be paid. I know that's a longwinded answer, but it's the best one we can give you.

Stephen Mead
Anchor Capital Advisors, LLC

Oh, and it would be logical that they wouldn't force you into a situation where you'd have to pay it all at the end of the 1-year period...

Aldo Charles Zucaro
Chairman & CEO

As long as there is a question as to -- that there are -- so long as there is a perception I should say, that there are more losses to be incurred in the future, right? Nobody would want to give up of liquidity and run the risk that when those future claims get paid there is no money to pay that, right?

Stephen Mead
Anchor Capital Advisors, LLC

In other words, they're going to do what, hopefully, would make most sense, right?

Aldo Charles Zucaro
Chairman & CEO

Absolutely. And we've every expectation that whether [ph] [indiscernible] with this runoff, whether it's us or anybody else is going to approach this thing in a very reasoned business-like basis.

Stephen Mead
Anchor Capital Advisors, LLC

Just going back to the general insurance, on the elevated claims in the second quarter, the details -– talks about the general liability claims, a big jump in that, I was trying to get a sense of how much of the claims in the quarter were more event-driven versus trend-oriented?

Aldo Charles Zucaro
Chairman & CEO

Are you looking at the statistical exhibit, Steve?

Stephen Mead
Anchor Capital Advisors, LLC

Yes, in other words, in the...

Aldo Charles Zucaro
Chairman & CEO

Are you looking at the general liability portion of that? Is that what you're doing? Yes, as you can see there, let me turn to that, but when I get to it here, as you can see, that's a relatively small line for us compared to workers' comp for example, it's piddling, right, we have, what, $68 million -- $69 million in the first half of this year of earned premiums versus workers' comp of 435, and then GL, it is more than any other line in GL is what some of us refer to as a crapshoot line in that most of the claims end up in litigation and therefore you're always playing Russian Roulette with some of these claims. And so the answer to your question is that, it is more of an event-driven type of occurrence when you see a spike in loss ratio, than it is a systemic type of issue.

Stephen Mead
Anchor Capital Advisors, LLC

The ability over time on the worker's comp to get the offset in premium?

Aldo Charles Zucaro
Chairman & CEO

Well, again, as you may recall from past discussions, our workers' comp business is also just like the CCI product that we were discussing before, is in fact subdivided into 2 major categories, there is an adjustable portion to it, which pertains to workers' comp policies we issue to major customers who have strong balance sheets and therefore strong ability or desire to control their destiny and therefore absorb a portion of the losses. And that portion of the business has got some adjustable feature inherently attached to it, right? The rest of the business, and I would say that's probably 40%, 42% maybe of our total book of business, involves some sort of risk-sharing approach with the customer. The other 58% or so, 55% or so, is traditional workers' comp insurance, and there we're in the open markets, we're dealing with the open markets, we get the opportunity to in fact re-price the product every year, because they're usually 1-year policies. And it's the old story with workers' comp, you're always playing catch-up when you get yourself in some sort of difficulty. And unfortunately or fortunately depending on your point of view, those rates have to be filed, approved, et cetera, et cetera, and there is always a lag between the recognition that there is a brewing problem claim-wise with the workers' comp and the time that you're able to in fact support a rate increase, and even when you get a rate increase approved then you've got the markets to deal with and the competition. So, as our old chairman used to say, once you're in the comp business you're always in the comp business because unless you stay in it, if you have a problem you're never able to resolve it except by staying in it and being able to re-price the product ever so, on ever so a gradual basis.

Operator

And next we'll hear from Brett Reiss, Janney Montgomery Scott.

Brett Reiss

Long time shareholder personally in for clients, I think from the last conference call, there was -- I think I heard that there was a chance that the North Carolina Insurance Commissioner was reviewing in the next 3 or 4 months and might change the amount that they're allowing you to pay on cash claims and the portion, the 50/50 split into reserves which would allow you to stay in runoff, which I take it to be good, and that if they changed that ratio it might force you into receivership, which you'd rather avoid. From your answer to Mr. Mead's question, are you more comfortable that they're going to orchestrate matters so that you can remain in a runoff status?

Christopher Stephen Nard
President & COO

Yes, this is Chris Nard. What we were referring to is the 50/50 DPO percentage. As Al mentioned, that order went in place at the beginning of the year and it necessitated that we pay the claims, 50% in cash and 50% in a deferred manner. What the department is looking at currently as we referenced was there -- the actuaries they've engaged are looking at the books to determine if they think 50/50 is the right number, is 60/40 the right number? Or is some other combination correct? And I think the purpose of that exercise is to determine what is the most amount that can be paid in cash without jeopardizing the solvency of the business. So, we'd not expect in any case that a revised amount would result in a situation where the business went insolvent in some period.

Brett Reiss

Right, right, but just in case something like that happened, you'd prefer that not to happen because that would trigger the technical default and you'd have to address the convertible debenture, but that you said on the last call, you'd not even in those circumstances have to contribute any additional capital to the RFIG subsidiary?

Christopher Stephen Nard
President & COO

Correct. That's right.

Brett Reiss

Okay, if that worst case scenario occurred, although you've been able to silo and insulate the other businesses legally from having to contribute any capital. Do you think that would impact the brand in the other 2 good businesses?

Aldo Charles Zucaro
Chairman & CEO

Well, it is not just a legal matter. It's a matter of what the regulations of insurance companies dictate, right? I mean, when we sell a particular insurance company's policy to a customer that customer has got every right to assume that the assets and the capital that's in that company, from which the policy has been issued, cannot be violated. Okay. I mean that's the way the business functions and as a matter of fact is illegal to portray, let's say, a company such as ORI being obligated for everything, no. Every one of our insurance companies is obligated only for the exposures it has assumed policy-by-policy. That's the answer to your question. Including the payment of dividends, every quarter, whether from a formula standpoint, we've the ability to declare and pay a dividend without regulatory approval, we still must go through the process of advising each of our insurance regulators that we're bound to take a dividend out of a company. And that regulator has got every right in the world to say, yes or no. And no regulator is going to in fact allow us to take money out of an insurance company beyond what is legitimately payable by that company as by way of a dividend.

Brett Reiss

And your ability to do that –- it –- there's no difference in your ability to do that whether we're in runoff on RFIG or receivership?

Aldo Charles Zucaro
Chairman & CEO

Yes, because the runoff or receivership of the RFIG subsidiaries, i.e. in this case the Mortgage Guaranty subsidiaries has got nothing to do with the actively managed companies we have in the General Insurance business, let's say, right? The capital structures and the obligations of those companies do not coalesce.

Operator

And we do have one further question from Zane Keller [ph].

Unknown Analyst

I'm just wondering if your mortgage insurance subsidiaries actually placed into receivership and your bonds by -- the convertible bonds are put to you, how long do you have to raise the necessary liquidity to repay those bonds?

Aldo Charles Zucaro
Chairman & CEO

Well, first of all, as Karl indicated before we don't have any expectation that, that situation is going to be created. Secondly, if push comes to shove, as Karl also intimated, we think we have the wherewithal within our existing corporate structure and in borrowing capacities to in fact come up with the money to handle that kind of the situation in a -- if it occurs unexpectedly.

Unknown Analyst

And what gives you such a great confidence that you'll have that capability because you have...

Aldo Charles Zucaro
Chairman & CEO

Because we know what assets we have in our insurance companies and other companies in the system and we know the extent to which those assets can be in fact liquefied to honor that debt.

Unknown Analyst

Just so I understand your liquidity situation, you have $280 million in cash available and if the bonds are put that will be $550 million, so how would you bridge that $200 million-plus liquidity gap in such a short period of time?

Aldo Charles Zucaro
Chairman & CEO

On the basis that I just indicated, right, that we have other sources, both insurance and non-insurance, from which we believe we can draw funds, for at least period of time, so that our back is never against the wall. And we do try to manage this business in anticipation of events as best we can imagine them, such that we're hopefully never caught flatfooted. That would be a dereliction of our duty if we allow that to occur.

Operator

Next from Bank of America/Merrill Lynch is Scott Frost.

R. Scott Frost
BofA Merrill Lynch, Research Division

I had a question about -- you had mentioned in the release that your MI book is, this should be ultimately profitable in 2021. Were the reserve study, was that done by a -- was that vetted by a third-party? And if so, when is that going to be revisited? When would we expect that analysis to be done again?

Aldo Charles Zucaro
Chairman & CEO

What we do regularly is to come up with an analysis, which is referred to as a premium deficiency reserve calculation and that is performed by a combination of internal accountants and actuaries and other qualified professionals. And then, that is then reviewed by -- once a year by our external auditors. And then finally we provide those analyses pretty regularly to the insurance regulators who do look at them although we have no understanding that they are agreeing with them or not, but anyway at least we are reporting those numbers to the regulators fairly regularly. So the direct answer to your question is that, one, the process is a complete process at the end of each year in conjunction with the annual audit of our financial statements on the one hand, and then each quarter if not sooner we monitor the -- let's say, payment, loss payment patterns of a particularly quarter or month, let's say, relative to our expectations that are built in the models to determine whether the train is getting off the rails. And so far, we believe that these PDRs or Premium Deficiency Reserve calculations we have made indicate that over an extended 10-year period of a runoff, that at the end of the rainbow there would be enough money to pay all of our obligations.

R. Scott Frost
BofA Merrill Lynch, Research Division

Then that would include the deferred portion of the claims I'm assuming?

Aldo Charles Zucaro

Chairman & CEO

Correct.

R. Scott Frost
BofA Merrill Lynch, Research Division

And also, can you describe maybe what if any – what do the auditors do with the results you provide? I mean, I'm assuming that this means you don't, for example, have middlemen come in and vet the numbers or conduct an independent analysis to support that. You give the numbers to the auditors and to the regulators and they take them -- and the auditors...

Aldo Charles Zucaro
Chairman & CEO

The auditors -- as you may know, particularly the major auditing firms of which ours is one, all have actuarial talent, professional actuarial talent.

R. Scott Frost
BofA Merrill Lynch, Research Division

Do they vet the results?

Aldo Charles Zucaro
Chairman & CEO

Well, they have to in order to pass upon the validity of the financial statements that they are auditing, right, inherently.

R. Scott Frost
BofA Merrill Lynch, Research Division

Does that usually occur in the third quarter of every year or fourth quarter, when does that usually -– so it's in -- in preparation for the year-end financial statements, so I'm assuming that's the third or fourth quarter timetable?

Aldo Charles Zucaro
Chairman & CEO

As you know, publicly held companies, at least the major ones in this country, have to have a quarterly review, a non-audit quarterly review of their financials performed by their independent accounting firms. And the accounting firms typically do a review of the quarterly numbers, however they do it. They've got systematic ways of doing it. And they do look at trends and so forth in each quarter relative to the past quarters or the past year and so forth. And when –- so that that by the time we file our 10-Q, they have reasonable satisfaction. I should really let Karl speak to that, because his knowledge of the auditing situation is much more current than my own.

Karl William Mueller
Senior VP & CFO

Well, I think Al had it right that throughout the year we prepare various analyses and given the focus on the RFIG book-of-business our firm does review the quarterly analysis. Now, the full scope of their work is as of year-end, which is the date of their audit opinion. So, while they review things on a quarterly basis, the valuation conclusions are as of December 31.

Operator

And at this time, there are no further questions. I'll turn the conference back over to management for any additional or closing remarks.

Aldo Charles Zucaro
Chairman & CEO

Well, thank you. We don’t have any additional comments and as always we’ll conclude this visit by saying that we appreciate very much everyone’s participation and interest in our Company, and we’ll look forward to our next quarterly visit. On that note, you all have a good morning or afternoon or whatever time it is that we’re reaching you on this global market of ours.

Operator
And ladies and gentlemen that does conclude today's program. We’d like to thank you all for your participation.