Seeking Alpha

MGIC Investment Corporation Q3 2007 Earnings Call Transcript

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question comes from Howard Shapiro.

Howard Shapiro - Fox-Pitt Kelton

Hi, a couple of questions. Given your new loss guidance for 2008, have you had any discussions with the rating agencies, are they still comfortable with the ratings they have on you and your capital stand, your capital adequacy? And then just if you could clarify, does your guidance for next year assume a 10% decline in property values? Thanks.

Curt S. Culver - Chairman and Chief Executive Officer

On the 10%, that is over the next year and a half I would say, Howard.

Howard Shapiro - Fox-Pitt Kelton

Okay

Curt S. Culver - Chairman and Chief Executive Officer

On the other, the rating agencies, Mike and Larry had met with them. I'll let Mike describe those meetings.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes, Howard. We met the rating agencies over the last two weeks, they have seen our forecast and I guess with respect to their comments I think I'll... I saw one of them was out this morning, Fitch reaffirmed, put us on negative watch, but I think I'll let the rating agencies publish something today.

Howard Shapiro - Fox-Pitt Kelton

Okay.

Operator

Our next question comes from Geoffrey Dunn.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Thanks, good morning.

Curt S. Culver - Chairman and Chief Executive Officer

Good morning.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Looking at your delinquency mix, I wanted to get a gauge of what that's looking like in terms of '05 and '06, and even early '07 vintage, mainly to try to gauge how much more severity creep we could see as that moves forward over the next year.

Curt S. Culver - Chairman and Chief Executive Officer

Larry?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

Well, the inventory buildup in the quarter, roughly 10,000 items was split about 3400 items on the bulk side and 6800 on the flow side. Most of that buildup, bulk and flow, had to do with the newer books, specifically the '06 book, and as far as that goes, the '06 book is still on its upward leg of delinquency development. The bulk business, as Curt mentioned in his opening remarks, a lot of Florida and California, so on the bulk severity, we see that continuing to increase through '08 at a pretty good clip. On the flow side, we see an increase, but much smaller magnitude given the lower proportions of California and Florida in the flow portfolio.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Can you just give me an idea of your current 90,000 odd loans in default, what's the mix of '06?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

'06 is about 20,000.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

And just a last follow-up, what's the pricing differential on average between the '06 loans and the '05 loans in your book?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

On the flow side, probably not much different because the rate card is there and on the bulk side, I guess there was... the mix is quite different from book-to-book and the presence of deductibles. So I guess rather than giving you that number, which I don't have at the moment, we'd have to talk more than just price and factor in and give you a feel for the mix differences as well.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Okay, I will follow up, thanks.

Curt S. Culver - Chairman and Chief Executive Officer

Thanks Geoff.

Operator

Our next question comes from Steve Stelmach.

Steve Stelmach - Friedman, Billings, Ramsey

Hi, good morning.

Curt S. Culver - Chairman and Chief Executive Officer

Good morning.

Steve Stelmach - Friedman, Billings, Ramsey

Could you just give me an update on... I think in the second quarter you guys talked about sort of loss mitigation through fraud detection. Have you seen any sort of mitigating factors that's helping you guys in that respect or are you guys still sort of paying out losses and what could be the presence of [ph] fraud?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

Well, fraud has been present in the past and it still is and more so on the bulk side than the flow side. Our... we are paying more. So the absolute number of fraud cases is probably up a tad, but as a percentage of the flow and the bulk paids we are not seeing any material change.

Steve Stelmach - Friedman, Billings, Ramsey

Okay. And then the second question is, if you're looking for breakeven results in '08, could you just give us sort of your feel for liquidity in cash flow for '08 and sort of get comfortable with your liquidity position? I know your debt services is relatively small.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, liquidity at the holding company, we've got about $230 million right now at the holding company and recently received a $100 million special dividend from the writing company, $50 million of it paid in September and $50 million paid in October. So we anticipate having somewhere around $300 million of cash at the holding company by year-end.

Steve Stelmach - Friedman, Billings, Ramsey

Okay, year-end '07?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

That's correct.

Steve Stelmach - Friedman, Billings, Ramsey

Got it. Okay, thank you.

Curt S. Culver - Chairman and Chief Executive Officer

Thank you.

Operator

Our next question comes from Mike Grasher.

Michael Grasher - Piper Jaffray

A quick follow-up here to Geoff's earlier question. Can you elaborate on the rate on change that you may be seeing on the '05 book, I think you mentioned the '06 book still on its upwards leg. Can you clarify the '05 book?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

Well, the '05 book, it's a tale of two cities in a way that the first half of '05 is doing better than the second half, and up until a couple of quarters ago the '05 book was on a delinquency path akin to '03 and '04. But beginning early this year, mid-year certainly instead of copying out and following the flattening curve of '04, the '05 delinquency kind of just kept on trucking. And it's more of a second half of '05 story than a first half story. The '06 book is above the '05 book, given its stage in life relative to the economic environment.

Michael Grasher - Piper Jaffray

Okay. That is helpful. And then just a quick question on operating expenses. Should those fall back into about a $75 million run rate on a quarterly basis?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes.

Michael Grasher - Piper Jaffray

Okay. Thank you.

Curt S. Culver - Chairman and Chief Executive Officer

Yes.

Operator

Our next question comes from Eric Wasserstrom.

Eric Wasserstrom - UBS

Thanks. I just wanted to follow up on Howard's line of questioning and I realize there you made some commentary about the rating agencies publishing and just some commentary a moment ago about liquidity at the holding company. But can you help me frame or understand the factors that would require you to need to raise capital?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, I guess, we need to raise capital if there was an issue with respect to the rating agencies, none of them have said that with respect to capital. They are concerned about the industry and they are concerned about our operating loss for this year and I think their overall concern is not the capital or liquidity, but rather when they return to underwriting income, that is the major concern.

Eric Wasserstrom - UBS

And can you talk a little bit about your... safety of your dividend at this point given you are projecting zero operating income or less for the next four, five quarters?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

I think the operating... I guess the question there concerns the liquidity at the holding company, cash flows with respect to getting dividends out of the writing companies; that's a quarter-to-quarter decision, as we ask for special dividends. And the dividend issue would be discussed at each of our quarterly Board meetings then we announce after that. And we would also announce if you will any decision with respect to... we have with respect to special dividends.

Eric Wasserstrom - UBS

Great. Thanks very much.

Operator

Our next question comes from George Sacco.

George Sacco - J. P. Morgan

Hi, I apologize if I missed this, but the guidance you gave for growth of insurance in force, 8% to 10% for 2008. That actually seems a little bit low given what we are seeing today in the type of market share gains the industry is seeing. Is there something maybe a capital constraint or something that's keeping you from growing faster than that?

Curt S. Culver - Chairman and Chief Executive Officer

No, the factor that was limited to that would just be the fact that we are doing very little bulk business within that number.

George Sacco - J. P. Morgan

Okay. So it's basically bulk shrinking, but you are still getting potentially high double-digit type growth in the --

Curt S. Culver - Chairman and Chief Executive Officer

Yes, we are talking 10% growth --

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Overall, yes, but no growth on the bulk, maybe finding [ph] on the bulk.

George Sacco - J. P. Morgan

Understood. Okay. Okay, that's good. Thank you.

Curt S. Culver - Chairman and Chief Executive Officer

Yes.

Operator

Our next question comes from Brad Ball.

Brad Ball - Citigroup

Thanks. Another try at the capital adequacy question. You guys said yourselves that you thought your capital position was strong. We can't see what measures the rating agencies use, but what do you use to define strong capital? Is it your risk to capital ratio and can you just give us a hint as to what risk to capital ratio the rating agencies would tolerate?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, I think you have to talk to them about it, but we are, yes, obviously we are at 7 to 1, somewhere around 7 to 1 risk to capital and that's a very strong position relative to any kind of industry standard. But again, their... as I mentioned before, their discussions and their public releases recently have not been about capital adequacy in the industry. As a matter of fact, they've said just the opposite. More concerned about the short-term underwriting losses if you will. They are just concerned about how long the duration is if you will during this period.

Brad Ball - Citigroup

So the key ratio you focus on to say that your capital is strong is the risk to capital ratio?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

That's correct.

Curt S. Culver - Chairman and Chief Executive Officer

Correct.

Brad Ball - Citigroup

Okay. Just a quick follow-up, you raised your guidance for paid significantly for a next year, but it seems like what remains uncertain is what will have to happen with the reserve account. Reserve building was significant this quarter. Can you give us any visibility on what kind of change in reserves we might face going forward, was this quarter a major cash up and should be viewed as unusual or is this a run rate at the $370 million range?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, I think the key with respect to the incurred and the reserve build up, as you said, will be a function of what happens again the delinquencies. Clearly this quarter we had some significant changes albeit not only a change in the level of delinquencies, but average severity as you probably noted was up significantly, especially in the bulk side and the level of paids that are increasing out of California and Florida markets etcetera.

So there were increases in delinquencies, significant increases in severity, and then finally increases in claim rate by some of the... most of the states. However, going into the fourth quarter, if we see a similar increase in just delinquency levels, I think you'd see a similar incurred number and reserve buildup. So it will be a function of what happens primarily to the delinquency level, but also what's happening to the underlining severity. So I think the only guidance I can give is that with respect to incurreds, it will be paramount to the underlying development on loss rates and equally important on what's happening to the pure level of delinquencies. Clearly we had a significant increase this quarter. We hadn't experienced that before and I can't remember when we had an increase of $10,000 in a quarterly... and we saw that late in the quarter. And our concern would be if that continues, as Larry talked about, some of these books kicked off significant changes in July, August and September. If that continues then we could see a similar increase.

And relative to next year, again it's a function of delinquency levels, do they continue to build or level out and then there might be some leveling if you will of incurreds.

Brad Ball - Citigroup

Thanks.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Too early to call that.

Operator

Our next question comes from David Hochstim.

David Hochstim - Bear Stearns

Hi. Sorry, following up on that, how do we think about the loss reserve there because you keep putting... so this quarter you are putting almost $400 million, next quarter you might put in another couple of hundred million. I mean, do you ever use that to pay any of these claims, because you are basically paying claims and building reserves?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, David, what I said again is that we are experiencing month-to-month increases in delinquencies and severities. You saw that in this quarter release, that's the severity on the bulk business I think jumped up 10,000 per case. And the cases in California are increasing significantly. If we continue to see that buildup, yes, there probably will be that type of increase on a quarter-to-quarter basis. We need to see some, if you will, leveling off and we have not seen that yet, especially the last three months. So the answer to your question, in the fourth quarter if we continue to experience the same type of acceleration in severity that we saw and some deterioration in claim rates and the increase in delinquencies, you'd see the same level of reserve buildup, I think. To the point that some of these markets start to level off, then we will report that out and there will be changes accordingly.

David Hochstim - Bear Stearns
I don't know if Larry can speak to this, but is it possible to say that in some books of business, in bulk or in some places in California and Florida you are seeing a measurable acceleration in maturation of those policies and that basically delinquencies are not only occurring at high... reaching higher levels, but it's happening faster and do you have any sense yet of what the ultimate peak delinquency rate could be? And I guess people are asking about the seasoning of the '05 book, but if you see the losses in the '06 book and in '07 and '08 instead of '09 and 2010, is that... can you tell if that's happening or --?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management
Yes, David, going back to Curt's comments about the speed and the extent to which some of these markets have changed, California had basically thrown out very little in a way of claim activity and we knew at some point here that was going to soften. So we were pricing California starting late '05, certainly into '06 at four times what it had been performing at, and hope that we keep an eye on it and if it's started deteriorating, at some point we knew it would, we would had a bit of a cushion there to react and adjust accordingly. But beginning in '06, California specifically, that book went from boom to bust quite rapidly. So it is coming out of the blocks a lot higher steeper and as akin to Michigan maybe a tad worse if you compare delinquency curves, and who would have thought between early '05 and early '06, California would have gone from the virtually no claims to being on a par with Michigan?

David Hochstim - Bear Stearns
All right. But I guess what I'm wondering is do you think it's going to get a lot worse than Michigan or it's just got as bad as Michigan faster than you thought?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management
Well, we are modeling at the MSA level. Curt kind of through out that 10% nationally decline, but a lot of the MSAs in California, if you look at the MoodysEconomy.com, some of them are worst than that. And so we are using those kind of declines to project the California '06 in conjunction with looking at its actual path trajectory and even comparing it back to the late '80s and early '90s when Southern California had a similar event. So to answer your question, when it exactly turns is still to come, but we are looking at it in a number of different ways; one, model using price outlooks at the MSA level, actual trajectory and comparing it back to the late '80s, early '90s.

Curt S. Culver - Chairman and Chief Executive Officer
And the quarterly results, David, are very telling and once we do see those plot points on where they... what the next quarter brings, it will give us a greater indication on when it turns, and we haven't seen that yet. I am hopeful as you I think with your questioning that Peter's out sooner because of the velocity of the change. But we'll have to wait and see, and we have no indication of that yet.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management
There is a number of factors that are still kind of moving around, one of which is being the cure rate. So it's not just a matter of analyzing or making a call, a new notice activity in a stable cure rate environment, we've got rising notices in a declining cure rate environment.

David Hochstim - Bear Stearns
Is it possible that part of the problem is that you have more investor loans than you realized and I mean, if that's the case, is there some misrepresentation on the part of the lender and you have some recourse?

J. Michael Lauer - Executive Vice President and Chief Financial Officer
Well, again, as Larry mentioned earlier, we check every claim we pay relative to the conditions under which it was insured and deal with that accordingly. I don't think it's because we had a lot

more investor loans, but I think some of these markets had a lot more investor activity, which also affects their neighbors. And with the declination of values... decline of value in those markets impacting everyone that lives there, and I think we are experiencing some of that relative to the markets in which we did, where we do have homeowners. But many of the neighbors treated us as an investment and impacted the values significantly.

David Hochstim - Bear Stearns

Well, that would be hurting, that would be affecting severity and that would explain the increase in severity, but it wouldn't necessarily explain the pleasing [ph] of delinquency because of your lending to homeowner, you have a pretty benign employment environment still.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Right, yes. I agree. There are a lot of people buying as owned occupied had a bit of speculative attitude going in.

David Hochstim - Bear Stearns

Yes.

Curt S. Culver - Chairman and Chief Executive Officer

Or weak credits which we'd talked about

David Hochstim - Bear Stearns

Right. Okay, thanks.

Operator

Our next question comes through from Andrew Brill.

Andrew Brill - Goldman Sachs

Thanks. Can just talk to how the '07 book is tracking relative to 2006 at this stage? I think [indiscernible] report this morning mentioned that looks as if '07 is tracking in line to worse than the '06. And I guess just as a follow-up to that, and to the extent that it is tracking worse, do you still think we could see improving delinquency experience in '09?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

The '07 book is performing akin to '06, maybe a tad worse, but by and large in line. I think the next few months, no insurance will improve significantly. Really the only outlet now is by and large Freddie, Fannie conforming the high LTVs are being underwritten tougher. The Alt-A, some of the players are gone so on and so forth. And if you just think about, let's say, some of that hit mid-year, so loan apps starting the third quarter converting into fourth quarter new insurance written for us. So I'd say the first two quarters certainly and into the third quarter new insurance written for us, but in our pipeline, commitment pipeline, we are seeing improved mixed characteristics. And so we think all in all '07 then will be akin to '06 and then '08 will improve because some of these higher risk segments, the underwriting guidelines and the pricing changes that Curt talked to will be in effect.

Andrew Brill - Goldman Sachs

And I guess just as a follow-up, can you just give us a sense of how much of the increased loss origin this quarter related to the provisioning for new delinquencies as opposed to the provisioning for the aging of existing delinquencies?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes, this is Michael Lauer again. The... I would tell you this that the most significant impact on the reserve to the tune of may be four to five times was the severity, coupled with some of the rate changes, not so much the delinquency level. So what Larry talked about before was the significant increases we've seen in the severity as well as deterioration in cure rates is a major impact of the change, not as much as the new delinquency change.

Andrew Brill - Goldman Sachs

That's it. Thank you.

Curt S. Culver - Chairman and Chief Executive Officer

Thanks.

Operator

Next question comes from Amanda Lymen [ph].

Donna Halverstadt - Goldman Sachs

Actually it's Donna Halverstadt. I had a follow-up to some of the liquidity questions. When you disclosed that you had drawn the $300 million on your credit facilities that you drew the entire line; to the very recent rating agency comment that said that the $300 million could be increased to $500 million. One, is that true, and if so, is there any sort of MAC clause or covenants that would prevent you drawing that additional $200 million?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

There's no covenant problems on it.

Donna Halverstadt - Goldman Sachs

So you do have an additional $200 million available under that line?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

That's correct.

Donna Halverstadt - Goldman Sachs

Okay. And then one other follow-up to liquidity. The $65 million payment on account that you made to the IRS on July 2nd, do you have any thoughts of tax sharing arrangements in place that would let the writing companies reimburse you for that outside of the special dividend process?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes, we have a tax sharing agreement with a writing company.

Donna Halverstadt - Goldman Sachs

Okay and so, did they upstream $65 million?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes.

Donna Halverstadt - Goldman Sachs

Okay, thank you.

Operator

Our next question comes from Steve Madsin [ph]

Curt S. Culver - Chairman and Chief Executive Officer

Steve, are you there?

Operator

Sir, if you are using the speakerphone, please lift the handset or check the mute button.

Curt S. Culver - Chairman and Chief Executive Officer

Steve? Or we will go to the next question, operator.

Operator

Our next question comes from Geoffrey Dunn.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Thanks. Just a couple of follow-ups. Can you give us your current liquidity at the holding company?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

$230 million at September, round numbers.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Okay. And in terms of assessing your capital position with rest of capital, I don't think the numbers... the numbers have been skewed over the last 10 years as you have got into more non-traditional risk.

Do the rating agencies put much weight on that number, and if they don't, which is kind of what I have been hearing, is the risk that you could come at a kind of disagreement in terms of the where your capital really is?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

No, because we meet with them several times a year and of course they run various risk scenarios and in the event, if they were changing their model and telling us we were short of capital, they would indicate that. Okay?

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Okay.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

But I mean, generally, you judge this industry based on the risk to capital level, 7 to 1 is a pretty conservative level right now to be at, but obviously you are correct; it's not the same 7 to 1 that it might have been 20 years ago when we were 22 to 1. And think about that, we were 20 to 1, 15-18 years ago and AA. So it's changed, it's probably lower than it was, but they don't publish that, but certainly they have added and it published them some things that they've added additional stress test for the various different types of new products in the industry.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Okay. Last question, you mentioned that a lot of the provisioning this quarter was mainly related to severity and going back to the previous comment about the trends you saw this quarter continue with the month-to-month jumps, there is no reason we wouldn't see another big provision. If '06 is a more expensive year than '05 and it's only 20,000 of your 90,000 delinquencies, why wouldn't we expect those trends to continue and for continued big reserve building given your comments?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, I think it's a function of Florida and in California again in that mix, and if that would continue, in fact you would see that. I think I tried to state that that in fact if we had the same type of changes in the fourth quarter as we saw in the third quarter, you would see the same type of buildup.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Last question, do you still expect '05 delinquencies to peek at the end of this year? And for '06 to peek by the end of next?

Curt S. Culver - Chairman and Chief Executive Officer

'05, I don't think is going to peek this year, probably a good chance next year just because of the burn off and the levels that it just find it hard to sustain itself and I guess before I lose the thought, keep in mind captive reinsurance on the flow business, the '05, '06, '07 we have about 40%, 45% of each of those books covered by reinsurance, most of which is excess reinsurance. And it acts as a back stop if you will and I think we talked about it in prior call. And using these projections we think these captives come into play on a material level mid '09, certainly late '09 depending upon whether it's a 4/10/40 type of structure or 5/5/25. So evening with some of these high loss scenarios given the captive reinsurance and the revenue streams we are seeing, we think roughly 40% of these flow books by virtue to the captives has about an 80% or thereabout loss ratio backstop provided by these captives.

Geoffrey Dunn - Keefe Bruyette & Woods, Inc.

Thank you.

Operator

Our next question comes from Howard Shapiro.

Howard Shapiro - Fox-Pitt Kelton

Hi, just two follow-ups if I could. Why wouldn't you plan to raise pricing even on your core flow business, just given kind of a fact that risk is being reprised generally across markets and delinquencies are rising even in that sector?

Curt S. Culver - Chairman and Chief Executive Officer

Well, Howard, I mean, you have to look at the longer-term picture of pricing on the flow business and the reality is if you look at the last 20 years, the pricing is adequate, and allows double-digit returns. We are going through a space here in a couple of states whereby it is not going to... it is going to run at a higher loss ratios in particular. But that doesn't speak to the national pricing or what will happen in California and Florida two years from now when these vintages. The late '07, the '08, the '09 play out are going to play out very nicely. So it isn't one where you can easily change. I mean, even as Larry found the captives where they kick in at 4 and 5 per 100, we are not going to get the benefit of that until '08 or probably '09. And so these books are going to still run very close to those numbers. So the flow of business is still running other than a couple of states very close to pricing models and in fact in many states better than. You can't change it annually to reflect that.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

Yes, and then aside from the market or competitive issues with price increases on a flow business, we have to file in 50 states with 50 regulators, and when you go through that process, it's not just look into one or two books as of late, they'll look at the last 5, 10, 15 years even before they'll justify your rate increase.

Howard Shapiro - Fox-Pitt Kelton

Okay. And then just one other question, are you noticing just given the kind of very sizable, very fast increase in delinquency, any problems on the part of servicers in terms of handling these delinquencies and working through them? And how might that be affecting your numbers or your ultimate loss severity?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

Yes. Our claims department has been at work with a lot of the servicers over the last few months certainly assessing their loss mitigation efforts. We are working on customized plans, loss mitigation; loan modification plans with some servicers. With some servicers, we are putting MGIC people in place to help with that effort. We have also hired outside third parties to help connect with the borrower, which is one of the major obstacles in pulling off of loan modification; delinquent borrowers tend not to answer the phone or door. So we are coming at it from a number of different aspects.

Howard Shapiro - Fox-Pitt Kelton

Okay. And just one... I am sorry, you were to say something?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

No.

Howard Shapiro - Fox-Pitt Kelton

Okay. And just one other question, are you noticing that I guess when you are working through these and you ultimately reach the borrowers that you are having better success than just kind of the straight delinquency process. I guess what I am getting at is, is the industry just so overwhelmed right now that it looks maybe a little worst than it actually is once you kind of get through to the borrowers?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

The servicing industry overwhelmed, I mean, from a reporting process, I think things are pretty well automated. So I think we are getting all the delinquencies that are out there, but if the servicer is overwhelmed or not interested in focusing on loans with insurance, that's why we are putting people in place to make sure that work is done.

Howard Shapiro - Fox-Pitt Kelton

Okay. Thanks.

Operator

Our next question comes from Jim Shanahan.

Jim Shanahan - Wachovia Securities

Thank you for taking my call. I had a... a lot of my questions have been asked and answered. The one clarification though. When you talk about you have a 10% nation-wide decline in home prices assumed over the next year and a half, is I think what Curt said. And some higher assumed home price depreciation in certain costal markets. I think you mentioned California specifically. What kind of home price depreciation are you actually assuming there in California for some of those MSAs specifically? High teens?

Curt S. Culver - Chairman and Chief Executive Officer

Larry will give you some of the models we are working off on those numbers.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

Yes, once again, Curt through out that 10% nationally, but we work off of the MSAs and then you got to overlay these MSAs with the specific exposure in loan products we have in place in these various MSAs. But Riverside is 9% to 10% decline from fourth quarter for... and these are two-year in our pricing models, forecasting models, we look at the two-year appreciation. So these are two-year numbers.

So, Riverside 9%, 10% negative; LA 7%, 8% negative; Phoenix almost 20% negative; Vegas 18% negative; parts of Florida, we've got Orlando 13% negative; Tampa 6%, so on and so forth. And rather than rattle up more, once again we have internal markets score that we look at, it projects the outlook, the price change two years. We also look at and quite heavily adopt the MoodysEconomy.com outlook. And they cover basically all the MSAs. We do look and prefer Case Shiller Weiss, but it doesn't cover many MSAs.

Jim Shanahan - Wachovia Securities

Okay. And one question... one more question, how does the creation of this credit rescue fund impact MGIC or other MI companies if at all?

Curt S. Culver - Chairman and Chief Executive Officer

The... we are talking about Citicorp?

Jim Shanahan - Wachovia Securities

Yes, the $80 million to $100 million Fed orchestrated credit reserve fund?

Curt S. Culver - Chairman and Chief Executive Officer

I don't think that will have an impact.

Jim Shanahan - Wachovia Securities

Okay, thanks, that's all. Thank you.

Operator

Our next question comes from Rob Ryan.

Robert P. Ryan - Merrill Lynch

I assume that's me, Rob Ryan from Merrill?

Curt S. Culver - Chairman and Chief Executive Officer

We did too.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

I think it is Rob.

Curt S. Culver - Chairman and Chief Executive Officer

It sounds like you.

Robert P. Ryan - Merrill Lynch

Yes, on maybe a little bit of a brighter note in terms of things that limit losses somewhat, you buy book year explain what your expectations are for the timing and the magnitude of reimbursements from captives, like sort of '05, '06, '07, when it hits in, what kind of attachment points there are, what it actually does? I understand the 80% backstop for those flow books. But the timing would help, and then on the bulk side, how much of a benefit are you getting from writing your 2006 transactions about a third of them with deductibles?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Okay. The captive question first. As I said earlier on a material level, they kind of kick in on an incurred basis. At this point, we are forecasting middle '09, late '09. And what I mean by that is material $100 million or better at that point. Prior to that, certainly we have got quota share, but quota share is only

Curt S. Culver - Chairman and Chief Executive Officer

To about 7% --

J. Michael Lauer - Executive Vice President and Chief Financial Officer

7%, 8% of those books and that's all in place now and we'll... as our losses increase, that benefit will increase, but on a relieve basis it's 7%, 8%. But the real kickers or outcomes from the excess layers and once again, we pay the first 4 or 5 per 100, so that's even on '05, '06, that's the first leg, we're paying the first 4, 5 per 100. We don't see that being consumed until middle or late '09. And that's when the materiality kicks into $100 million or better than. And I'm sorry, I forgot the second question?

Robert P. Ryan - Merrill Lynch

Bulk deductibles, the '06 bulk and deductibles, any benefit there?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, yes, the '06 and that goes back to an earlier question, somebody ask about the bulk pricing compared to the year prior. One is the mix and two is presence of deductibles and we did have more in a way of deductibles. Some deals had none and then some deals might have had 100 on a blended basis, I think it was 20-30 basis points overall.

Curt S. Culver - Chairman and Chief Executive Officer

20 basis points.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

So on some of the bulk business in '06, we're paying because there is no deductible and some were in that deductible layer.

Curt S. Culver - Chairman and Chief Executive Officer

I think about a third of that book business in '06 was... had deductibles in front of it, Rob, which is about around $6 billion or $7 billion out of the $18 billion or $19 billion that we wrote.

Robert P. Ryan - Merrill Lynch

And the rough size of the deductible, number of loans per 100, how many have to occur that you don't pay until the payments kick in?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, again, I think it was in area of about 100 basis points, but let's assume that's in the ballpark; on these bulk loans typically severity might be 30%-35% and that's in line with the stuff that's been published in the capital markets, average severity. So if that's the case, 3 per 100 or so would consume those deductibles.

Robert P. Ryan - Merrill Lynch

Okay. And on... switching back to the captive mortgage reinsurance. Yes or no, are you anticipating hitting attachment points for all three years, '05, '06 and '07, and if you do, do you anticipate going through the mezzanine layer and losses start to comeback to you because it is not a complete excess of loss, it's only a mezzanine?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

The first question, yes. We think '05, '06, '07all consume not to the same degree, but they get into the 4 and 5 per 100 and we do not see them consuming the second layer and getting into our layer.

Curt S. Culver - Chairman and Chief Executive Officer

Into our layer.

Robert P. Ryan - Merrill Lynch

Great, thank you very much.

Curt S. Culver - Chairman and Chief Executive Officer

You bet.

Operator

Our next question comes from George Sacco.

George Sacco - J. P. Morgan

Hi, just wanted get some historical perspective; if we go back to the 1980s, how high did your loss ratio peak and... on an annual basis and how many years was it over 100%?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

George, this is Mike Lauer [multiple speakers]

George Sacco - J. P. Morgan

Yes, just... I understand things are a little different. I am just curious as to how long more so I guess did it persist, was it 3 years, 4 years? I mean, how long did it take, I guess, to kind of run through some of that business maybe?

Curt S. Culver - Chairman and Chief Executive Officer

Well, it was probably that time period, but again what happened then was 100% coverage all the way around between us and Fannie and Freddie, and so you had severe market deterioration in oil patch states where you had incidences sometimes 30 to 40 per 100. So you owned all the housing within that.

George Sacco - J. P. Morgan

Right.

Curt S. Culver - Chairman and Chief Executive Officer

This is not the case here.

George Sacco - J. P. Morgan

Right.

Curt S. Culver - Chairman and Chief Executive Officer

These are more isolated houses, etc. and --

George Sacco - J. P. Morgan

Right.

Curt S. Culver - Chairman and Chief Executive Officer

So it's a far different story.

George Sacco - J. P. Morgan

Okay.

Curt S. Culver - Chairman and Chief Executive Officer

And we can pay 25% in cut and run.

George Sacco - J. P. Morgan

Okay.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

George, not specific to your question but back to that captive question from the prior caller, I just want to make one other comment and that is, those comments we made, that's overall general to the book, specific lender captives might do better or worst, some lenders produce better results than others. So, actual results may vary by lender.

George Sacco - J. P. Morgan

Thank you Larry.

Operator

Our next question comes from Scott Frost.

Unidentified Analyst

Yeah. Could you give us an idea of what holding company expenses are expected to be for 2007 and for 2008?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

We don't have any... all the operating expenses are down in the writing company.

Unidentified Analyst

Okay. So dividends and interests is what you pay?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

That's correct.

Unidentified Analyst

Okay. Thank you.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Primarily, yes.

Curt S. Culver - Chairman and Chief Executive Officer

Operator, next question.

Operator

Yes, sir. Our next question comes from David Paulson.

Unidentified Analyst

Yes, thanks. I'm trying to understand how conservative the reserves are kind of reflecting other questions much earlier. You normally have paids being a lot less or I guess materially less than reserves for like a prior period. It's maybe 20% to 30% less. Does that mean if you have paids... a paid prediction of 1.2 to 1.5 and current reserves are 1.5ish now, that we should assume just more buildup in next few quarters, so to catch up to that paid prediction?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, once again, as I said before, a lot of this is going to determine what happens specifically to the acceleration that we saw, does that continue for X number of more quarter or does it start to flatten out. So really it's going to be a... and you are probably not going to be comfortable with, this is going to be a quarter-by-quarter review. We need to look at the development in each of these markets and the levels of delinquencies and see when they start to slow down.

Clearly if they don't slow down and they stay at these current levels, then you'd see those type of ratios. But it can change depending upon the mix and what happens to severity in each quarter and as Larry and some of the other questioners talked about earlier, the turn at which some of these books slowdown. Right now they have not slowed down with respect to delinquencies and claims rate, and we need to see the turn, we have not seen it yet. So I think we have to monitor it quarter-to-quarter.

Unidentified Analyst

Well, can I then just assume that you are being somewhat conservative, or that you are being kind of exact in your reserving right now, are you seeing 1.5 is what we have and that sort of... in this case versus what we have done in prior years, that is sort of being in line with paids more than it is in the past and that if, let's say, the acceleration continues in the fourth quarter, we would see the paid losses being projected upward.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes, I think two things. Each quarter obviously we will give you an update on what the experience has in the current quarter and if there is a significant change in delinquency and a change in the factors we are using, you'd see a continued buildup. In the event that some of these factors begin to mitigate, we will talk about that and we will have discussion and talk about maybe a lower level of buildup.

Unidentified Analyst

Okay.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

I can't be any more I guess clear than that. Right now clearly in the environment we are in, it seems to be changing quite rapidly and we need to see some type of mediation, we have not seen it.

Unidentified Analyst

Okay. Just one other quick thing, this... I haven't seen MoodysEconomy.com, is this 10% decline nationally, does that essentially match them or is it some kind of modeling off of various MSAs... predicting would decline?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

I mean, I think that's a ballpark estimate of their overall national forecast for the next... over the next two years. But more important than that number is specific MSAs and how much volume we have in those MSAs. So I hate in a way using that national number because it may not reflect our portfolio.

Unidentified Analyst

Okay, great. Thank you.

Operator

Our next question comes from Si Lund [ph].

Unidentified Analyst

Hi, Si Lund from Morgan Stanley. First question on the covenants, which were brought up earlier in the bank facility, is there still a minimum net worth covenant in the credit facility, was that adjusted at all when that was upsized?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

It was non adjusted. It's still the same.

Unidentified Analyst

Still $2.25 billion.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes.

Unidentified Analyst

Okay. And then also what was the statutory net earnings in the quarter?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

I don't have any stat statements in front of me.

Unidentified Analyst

Was the C-BASS loss... since it's held with the [indiscernible], I presume that the C-BASS write-down was also included in stat results?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes, it would be.

Unidentified Analyst

Okay. And then is there... given what will be stat net loss, is there a potential need for capital infusion down to the opco in 2007 or 2008 and was that why the credit facility was increased?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

No. The stat numbers, I don't have them in front of me. But the stat numbers ironically would be probably positive this year, okay, because the release of contingency reserves. So you're thinking about two different types... we are talking about statutory statements versus GAAP. So that wouldn't be an issue.

Unidentified Analyst

But the C-BASS write-down I believe would be an issue though, because it is down at the operating company; is that right?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

That's correct.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

It's at the writing company, but you have to take into account the release of the contingency reserves as well to get the stat net income.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

We can go through that offline, but on a statutory basis, we've got release of contingency reserves as part of the statutory calculations and on a statutory basis, I'm sure that we're positive in '07, okay, on a forecasted basis. But --

Unidentified Analyst

Okay.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

I don't have it in front of me.

Unidentified Analyst

Okay. And so, we can't assume a stat net loss in 2008, because you're talking about the GAAP net income, net loss for 2008?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

You could have a GAAP net income loss in 8 and a stat positive. Okay?

Unidentified Analyst

Okay, we can talk about it offline. I would like to walk through the mechanics of the write-down of the opco on C-BASS.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Okay.

Unidentified Analyst

Okay. Thank you.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

You bet.

Operator

Our next question comes from Jordan Hymowitz.

Unidentified Analyst

Hey guys. I had a question you guys have... seems like a fair amount of capital to surplus 7 to 1. Where do people start getting concerned, is it 10 to 1, 13 to 1, 15 to 1? I mean, forgetting the gray area, where do you think is more of bright line?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, as I said earlier, 15 years ago we were 20 to 1 and we were AA plus. So... but things have changed and you have to ask the rating agencies where they get uncomfortable, is it 15 to 1, or 17 to 1. I can't answer that because none of them use just that number. Okay? They look at capital, but they also look at a number of other things including the book of business obviously and other issues and run various types of stress tests, and against that they get comfortable and give a rating. And clearly it's not just the risk to capital, and it can vary by company because of other leverages. You could have a low risk to capital on a statutory basis, but have a significant amount of leverage issue that they would have issues with them and would rate negatively accordingly. So it really is a rating agency issue.

Unidentified Analyst

And let me ask the question differently. To the extent that some MI companies have been running much higher risk to capital ratios because their credit has been much better, if their capital credit deteriorates more towards the mean, the risk to capital ratio that the regulator should be comfortable with would move towards the mean as well?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Once again, I... you really need to have discussions with Moody's and Fitch and S&P and they can air some of that out there. They'll all be publishing some more information I think the next couple of months... in the next quarter, they will be issuing reviews again and talk a little bit about it. But it's not just the risk to capital.

Unidentified Analyst

Okay. Thank you.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

You bet.

Operator

Our next question comes from Steve Stelmach.

Steve Stelmach - Friedman, Billings, Ramsey

My follow-up question has been answered. Thank you.

Curt S. Culver - Chairman and Chief Executive Officer

Thanks.

Operator

Our next question comes from Jonathan Adams.

Unidentified Analyst

What percentage of your claims reached a maximum payout and has that percentage changed over the past year?

Curt S. Culver - Chairman and Chief Executive Officer

Well, total claims in the quarter, total being bulk and flow, 75% were the percent options. So that would be the full payout if you will. 18% or so percent were pre-sales and about 7% were acquisitions. Last quarter, the breakdown was about 71% option, 19% pre-sales, 10% acquisitions. So you can see it from quarter-to-quarter things are moving to the percent option and the acquisition pre-sales mitigation opportunities are diminishing and that's why we are boosting our efforts, loss mitigation not so much to pre-sales or acquisition, although though those are still in place, but it's more of the loan modification aspects rather than acquisition.

Unidentified Analyst

Okay, thank you.

Operator

Our next question comes from Al Copersino.

Unidentified Analyst

Hi, I had a quick question about sort of following up on the credit facility questions. How much debt capacity would you say you have? I don't hear you saying you need to tap it at this time, but I am curious that capacity you would say you have overall?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Well, I mean, it's... that again would be a function of the rating agencies, where they are comfortable. I mean, clearly we could probably take it up a couple of hundred million debt to equity ratios relatively modest. So... but I don't think much more than that. So it's not a significant amount. They look at two things, they look at debt levels relative to equity and double leverage and they also look at the ability to fund that at the holding company.

Unidentified Analyst

And again, the holding company expenses would be roughly $80 million, $85 million for dividends and --

J. Michael Lauer - Executive Vice President and Chief Financial Officer

$40 million something for interest, yes.

Unidentified Analyst

$40 million something for interest. Okay, thanks very much.

Operator

Our next question comes from Peter Wargos [ph].

Nandu Narayanan - Trident Investment Management

Actually it's Nandu Narayanan from Trident. I guess my question really relates overall to the loss experience you've had this quarter and what you'd expect for the housing market going forward because already based on everything you have been saying, the losses you have experienced to delinquencies, everything have been a lot worst than you had anticipated just a quarter ago. I am just looking at your numbers from last quarter's 10-Q, you have roughly what $56 billion-$57 billion of risk in force and about $4.4 billion in equity, something in that range. Clearly, the... given the potentially for much more significant losses and given that we seem to be at least in the worst housing market since the great depression, your very survival is in question if in fact things get appreciably worst in the housing market. What is your central scenario here in terms what's likely to happen because we haven't even seen a significant downturn in the economy overall, we've not had a recessionary condition yet in the economy or anything even remotely like that yet. So there is a reasonable possibility that things get dramatically worst and obviously given the discussion we've had constantly about the rating agencies, the rating agencies in the last few months based on their downgrades of all the sub-prime debts and everything else have demonstrated that they really have no idea, their models are terrible. So where do you come out on this because clearly you are the insurance company, since your capital, your survival that's in question if in fact things get much worse; were your assumptions different from the rating agencies and how bad do you really think it's going to get?

Curt S. Culver - Chairman and Chief Executive Officer

Well, we've discussed this far stressing our book that we are utilizing the numbers that Larry had... relative to market deterioration. And clearly I would say that's a stress scenario and leads to the numbers that we forecast for next year. Now... I mean, if you want to paint the world is going to end picture, which you are, I mean, so be it. I don't agree with you in any respect. Employment is very strong and again if you travel across the country, we certainly are having a hard time hiring people everywhere we are. So I don't see any issues relative to employment. I see new underwriting standards relative to business going forward. I see new pricing relative to business going forward. We've modeled in I think very draconian loss estimates relative to how we think books would play out and with that we are more than adequately capitalized as the rating agencies will tell or have told going forward. So I look at it from totally different aspects. We've got so many good things going on in the business, fundamental side of the business that we are in the insurance business and we are paying some losses based on what's happened from '05 and '06 and early '07, and we have got more than enough capital to pay those losses.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

And you mentioned our risk in force, overall even though the bulk is weighted towards California and Florida, overall we are still distributed pretty well geographically. No state is more than 10% I think.

Curt S. Culver - Chairman and Chief Executive Officer

More than 9%.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

But aside from that, the geography on a time path, roughly half the book is '04 and prior. So looking at those older books, we are really not seeing any elevation to those delinquencies, they may not be declining as quickly as they once, but they're not increasing if you will. So --

Curt S. Culver - Chairman and Chief Executive Officer

And if I can also add, Larry, as we said earlier, the '05, '06 and '07, have about 40% of the flow book also reinsured out, which will cap our losses on... at certain levels on about 80% loss ratio. So we've got... we are in strong position.

Nandu Narayanan - Trident Investment Management

Well, I guess though, if I just look at your current loss experience for this quarter, correct me if am wrong, I mean, do you all realizing losses which... on loans which have basically been delinquent already for two or three months or more, correct? Because it takes a little bit of lag before the delinquency happens at the level of the mortgage holder and it shows up as a claim to you. So you are not even seeing the full impact perhaps of August and the turmoil in August and the continued deterioration of housing market we've seen since then?

Curt S. Culver - Chairman and Chief Executive Officer

And we've modeled that into our numbers in the fourth quarter and next year though, where we think the numbers will be, as I said, I think a draconian or stress scenario --

Nandu Narayanan - Trident Investment Management

And again, macroeconomic assumptions, do you make any assumption about unemployment, how bad the economy might get given the housing market because clearly what's been --

Curt S. Culver - Chairman and Chief Executive Officer

That is your decision on how you want to do that. Thank you.

Operator, we've have time for one more question please.

Operator

Our next question comes from Robert Bose.

Robert Bose - Green Mountain Asset Management

Yes, hello. I think a follow-up on David Paulson's line on paid to incurred. Can you give us an idea of the relationship, how it's trending with paid to incurred, say, like from prior... maybe you prior quarter second quarter to what you are doing in third quarter?

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Once again, are you asking what about the fourth quarter, what the trend should be -- ?

Robert Bose - Green Mountain Asset Management

No, just... you're seeing the ramp up in reserving, but --

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes.

Robert Bose - Green Mountain Asset Management

Your relationship of paid losses to incurred losses, 2Q versus 3Q.

J. Michael Lauer - Executive Vice President and Chief Financial Officer

Yes, I think it's going to continue to go up. If we assume... as I said earlier, if we assume we are going to continue to have another increase like we had in delinquencies in the fourth quarter, which we could have, traditionally you would see an increase in the fourth quarter, then... and if we had similar types of severity changes, you could see the same type of buildup in the fourth quarter. But it will be dependant upon delinquency levels and some of those changes, but we'll report that out again after the fourth quarter.

Robert Bose - Green Mountain Asset Management

All right, good. Just one, one more, did you say you are going to do a supplemental? I am looking in particular for the number of loans or the delinquency rates by LTV and vintage; is that something you guys are going to put out?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

No, what we did do on the last page of the supplement we put out on the website is there is 2005, 2006, and 2007 vintages, so with some select criteria and delinquency rate is included in that for those vintages for bulk and flow.

Robert Bose - Green Mountain Asset Management

But not on LTV striations?

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

That's correct.

Robert Bose - Green Mountain Asset Management

All right. Very good.

Lawrence J. Pierzchalski - Executive Vice President - Risk Management

You bet.

Curt S. Culver - Chairman and Chief Executive Officer

Well, thank you. It's been a spirited call and I understand the significance of that. Clearly as we said, the loses dominate. But please don't lose sight of all the good things that are going on relative to the company and the strong capital position that we are in to deal with those issues. Thanks so much.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Thank you and have a great day.

PRESENTATION ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.