Q1 2017 Earnings Call

Company Participants

- Albert A. Benchimol, Director, President & Chief Executive Officer
- James O'Shaughnessy, Chief Accounting Officer & Corporate Controller
- Linda Ventresca, Corporate Development Officer

Other Participants

- Amit Kumar, Analyst
- Brian Meredith, Analyst
- Christopher Campbell, Analyst
- Elyse B. Greenspan, Analyst
- Ian J. Gutterman, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the AXIS Capital First Quarter 2017 Earnings Conference Call. All participants will be in listen-only mode. After today's presentation there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn conference over to Linda Ventresca of Investor Relations. Please go ahead.

Linda Ventresca {BIO 5930519 <GO>}

Thank you, Alison, and good morning, ladies and gentlemen. I am happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the first quarter ended March 31, 2017. Our earnings press release and financial supplement were issued yesterday evening after the market close. If you would like copies, please visit the Investor Information section of our website, www.axiscapital.com.

We set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website. A replay of the teleconference will be available by dialing 877-344-7529 in the United States, and through the international number 412-317-0088. The conference code for both replay dial-in numbers is 10103952.

With me on today's call are Albert Benchimol, our President and CEO; and James O'Shaughnessy, our Group Controller and Chief Accounting Officer. Before I turn the call over to Albert, I will remind everyone that the statements made during this call, including the question-and-answer session, which are not historical facts, may be forward-looking statements. Forward-looking statements involve risks, uncertainties, and assumptions. Actual events or results may differ materially from those projected in the forward-looking statements due to a variety of factors, including the risk factors set forth in AXIS's most recent report on Form 10-K filed with the SEC on February 27, 2017. We undertake no obligation to update or revise publicly any forward-looking statements.

In addition, this presentation may contain non-GAAP financial measures. Reconciliations are included in our earnings press release and financial supplement, which can be found on the Investor Information section of our website.

With that, I'd like to turn the call over to Albert.

Albert A. Benchimol {BIO 2023727 <GO>}

Thank you, Linda, and good morning, ladies and gentlemen. Thank you for joining us today. Let me start by communicating Joe Henry's regrets, that not joining us today. He is recovering from knee replacement surgery and didn't think it was a good idea to respond to questions while under the influence of pain medication. We do have James O'Shaughnessy, our Group Controller and Chief Accounting Officer, standing in for Joe today.

Let's start. Last night, AXIS reported first quarter operating income of $51 million, or $0.59 per diluted share. Adjusted for dividends, diluted book value per common share increased by $1, or 2% for the quarter, and 8% over the last 12 months.

Our results for the quarter were under pressure from a number of unusual and one-time items, which had been previously disclosed, including the impact of the Ogden rate change in the UK, and executive severance costs, as well as an impairment of an equity method investment and higher catastrophe and weather losses in line with higher industry experience.

Notwithstanding these items, which reflect the inherent volatility of our industry, our longer term performance remains strong and the key metric of growth intangible book value per share adjusted for dividend, AXIS is in the top quintile of performance against a broader group of peers in the property and casualty marketplace both for the 5- and 10-year periods. We remain pleased with the ongoing progress to enhance our franchise and deliver a consistent superior value creation well into the future.

Indeed, our focus on risk selection and portfolio construction is delivering improved core results even against the backdrop of a challenging global P&C marketplace. We are continuing to increase our relevance and penetration in attractive markets and sectors. For example, dedicating more resources to the U.S. wholesale E&S market and also recently closing our acquisition of Aviabel, a premier European insurer and reinsurer of aviation risks in the smaller general aviation arena, which supports better balance in that line.

We are sustaining positive momentum in our strategic capital partnering activities, allowing us to expand solutions for clients, reduce our cost of capital and attractively rebalance the risk reward equation for our shareholders. Our third-party capital fees are growing healthily and we're on track to have fees associated with these activities contribute over 0.5 points to ROE in 2017 and more in the future.

Our brand continues to improve, and our ratings on various service evaluations keep rising. We're seeing very good deal flow. Unfortunately, not all business presented to us is adequately priced. So we continue to sift through these opportunities to allocate our capital where risk adjusted returns continue to be at our standards.

I'll report more on market conditions and our outlook for April 1 renewals after James covers the highlights of our financial performance. James?

James O'Shaughnessy

Thank you, Albert, and good morning, everyone. During the quarter, we generated net income of $5 million. Our operating income for the quarter was $51 million, and annualized operating return on equity was 4%. Our operating income this quarter was adversely impacted by number of items, including $59 million related to the impact of the recent Ogden rate change, including the previously announced increase in prior-year reserves of $50 million. And also an increase in estimated current accident year losses of $9 million in the quarter.

$9 million of negative other insurance income associated with our weather and commodities market business due to exceptionally warm weather in both Europe and United States. $7 million attributable to an impairment loss on an investment accounted for using the equity method. And finally, $8 million of one-time general and administrative expenses related to executive severance.

Absent these factors, underwriting income would have been in line with last year, even with higher catastrophe and weather-related losses incurred this quarter. In addition, we had strong performance from our investment portfolio.

The growth in book value per share in the quarter to $58.89 was driven by an increase in unrealized gains on our available-for-sale investment portfolio, which primarily reflected the tightening of credit spreads, and the strengthening of the pound sterling and euro against the U.S. dollar.

So now, let's move into the details of our income statement. Our first quarter gross premiums written decreased by 2% with an increase in our insurance segment, offset by a decrease in our reinsurance segment. Our insurance segment reported an increase in gross premiums written of $41 million or 6% in the first quarter compared to the same period in 2016. This increase was largely driven by our accident and health, and professional lines.

The increase in accident and health was principally due to new business from our recently established Middle East reinsurance operations and growth in the limited benefits market in United States. The increase in professional lines came from specialty areas in which we have invested in recent years for growth and diversification.

Our reinsurance segment reported a decrease of $88 million, or 7% in gross premiums written, in the first quarter of 2017 compared to the same period in 2016. Adjusting for the impact of a significant decrease in multi-year contracts and foreign exchange movements, reinsurance gross premiums written increased by $97 million, or 7%. This increase was primarily driven by our agriculture lines due to an increased treaty line size.

However, it is worth noting that we expect to non-renew a significant treaty in the second quarter, therefore we expect growth for the year in our ag lines to be much more moderate than the growth experienced in the first quarter.

Consolidated net premiums written decreased by 10% in the first quarter of 2017 compared to the same period in 2016. Insurance net premiums written were up 7%, driven by the increase in premiums written in the quarter. Reinsurance net premiums written were down 17%, reflecting the decrease in gross premiums written and an increase in premiums ceded to our strategic capital partners in the quarter.

As we have previously discussed with you, we have been ceding more of our reinsurance premiums to our strategic capital partners in recent periods. This has been the case in our liability and professional lines since the launch of Harrington Re in the third quarter of 2016. We have also increased retrocessions of our catastrophe and credit and surety lines of business.

Consolidated net premiums earned increased by 4% in the first quarter of 2017 compared to the same period in 2016. The increase in net premiums earned reported by our reinsurance segment was largely driven by premium growth in our agriculture and motor lines in recent period. The growth was partially offset by the impact of the retrocession to Harrington Re, which increased premiums ceded in professional lines.

The increase in net premiums earned reported by our insurance segment was largely driven by strong premium growth in our accident and health, and our property lines in recent periods, partially offset by an increase in premium ceded in our professional lines.

Our first quarter consolidated current accident year loss ratio increased by 4.2 points to 67.3 points compared to the same period in 2016, including $35 million, or 2.1 points attributable to catastrophe and weather-related losses, and 2.1 points due to a combination of factors including 1.4 points related to the adverse impact of rate and trend, 0.9 points related to the impact of the recent Ogden rate change in our motor lines, offset by improvements elsewhere.

Our progress in our insurance segment continues with the current accident year loss ratio ex-cat and weather decreasing by 0.7 points, principally due to the recognition of better than expected experience in our professional lines of business, as a result of our portfolio optimization actions over the past few years, partially offset by the ongoing impact of rate and trend given market conditions.

Our reinsurance segment's current accident year loss ratio ex-cat and weather increased by 4.7 points, principally due to 1.8 points related to the impact of the recent Ogden rate change on our motor lines, 1.2 points due to the ongoing adverse impact of rate and trend, with the balance due to mix and experience.

Now turning to loss reserves established in prior years, our results benefited from net favorable loss reserve development of $25 million, compared to $70 million recognized during the first three months of 2016. Net favorable loss reserve development, included $23 million of favorable development reported by a professional insurance and reinsurance reserve classes. And $23 million contributed by a reinsurance liability reserve class, partially offset by adverse development in our motor reserve class of $22 million.

The motor reserve class adverse development included $50 million of adverse development on prior years due to the impact of the recent Ogden rate change offset by continued favorable actual versus expected claimed experience for the motor reserve class. In addition to the prior year reserve adjustment, the Ogden rate change affected the profitability of the unearned premium on business we wrote prior to the rate change announcement.

As we earn this business, we are booking it at a much higher loss ratio and this had a negative impact of $9 million in the first quarter contributing close to 2 points to the reinsurance current accident year loss ratio. We expect the Ogden rate change to continue to adversely impact current accident year losses by approximately $5 million per quarter for the remainder of 2017, as the unearned premium associated with business written prior to the rate change earns-outs. We expect this impact to continue into 2018, but this should not be significant.

During the three months ended March 31, 2017 our acquisition cost ratio increased slightly by 0.2 points compared to the same period in 2016, including a decrease in our reinsurance segment ratio of 0.4 points and an increase in our insurance segment ratio of 0.9 points. The increase in our insurance acquisition expense ratio was due to the business mix change in our accident and health lines.

Our G&A expense ratio in the first quarter was 17.2%, compared to 16.6%, an increase of 0.6 points compared to the same period in 2016. The insurance segment's ratio increased slightly in the current quarter due to higher personnel expenses, offset by an increase in net premiums earned.

The reinsurance segment ratio decreased in the current quarter to 6.6% from 8.2%, reflecting the benefits of fees from strategic capital partner arrangements. In addition, corporate expenses increased significantly in the first quarter, primarily driven by higher personnel expenses including $8 million related to executive severance costs.

Net investment income was $99 million for the quarter, an increase of $50 million from the first quarter of 2016. The increase is attributable to our alternatives investment portfolio. In aggregate, the total return on our cash and investment portfolio for the quarter was 1%.

During the quarter, we repurchased an additional $151 million of common shares comprised of $128 million purchased pursuant to our board authorized share repurchase program, and $23 million relating to shares purchased in connection with the vesting of restricted stock awards.

At April 26, 2017 the remaining authorization under the repurchase program approved by our board was $836 million. On April 17, 2017 the company redeemed the remaining $351 million of its 6.85% Series E preferred shares. Therefore, we expect preferred dividends to be $11 million per quarter for the rest of the year.

In conclusion, this quarter presents a number of significant one-time and unusual item. We are comfortable however that the underlying results demonstrate the power of our various underwriting and risk management actions, good progress on our targeted growth initiatives and continued momentum in our strategic capital partnering activities.

With that I'll turn the call back over to Albert.

Albert A. Benchimol {BIO 2023727 <GO>}

Thank you, James. As usual, I'll provide a brief overview of market conditions and recent reinsurance renewals before opening up the call to questions. Generally, we're observing signs of a market that is increasingly recognizing the insufficiency of its pricing. We're seeing either small increases, flat pricing, or more moderate pricing reductions than we have in the recent past.

Unfortunately, this is not yet consistent across the board. I'm particularly disappointed by ongoing price reductions in the face of increasing loss trends in certain lines, or to see incumbents wisely reducing their exposures only to have new entrants jumping in to fill the void at inadequate prices.

The overall trend, however, is moving in the right direction, albeit more gradually than we would like. In our insurance book, the overall rate change was minus 1% in the quarter, which has slowed from the minus 2% in the fourth quarter of last year and the minus 3% seen in the first quarter of 2016. Large accounts remain more competitive to smaller risks.

Our U.S. property and casualty division achieved the price increase of 1% in the quarter, but there is still a lot of volatility around that. Property is down about 2%, while casualty is up about 4%. Both are better than last year's trends, but still not enough. For example, we believe challenging lines such as low attaching auto and heavy trucking should see meaningful increases, but there are still many offering reduced pricing in this difficult - reduced pricing.

In this difficult marketplace, risk selection and underwriting discipline become the only differentiator between profits and losses. We have a long track record in the space and feel we're well equipped to navigate through the challengers.

In now our international insurance division, overall rate change was minus 5% in the quarter, unchanged from the prior quarter and slightly better than minus 6% in the first quarter of last year. This is by far our most competitive market, but the pace of rate reductions has slowed in recent quarters. And there was a general feeling that in aviation, property and energy classes these must be approaching the bottom of the cycle.

Onshore and offshore energy are the most challenging and we have non-renewed many risks that no longer represent value to AXIS. Global property rates were down about 3% for the quarter against the prior-year rate change of minus 10%. We're starting to see signs of more discipline in the market with less pressure on rates.

In our professional lines division, the overall rate was essentially flat in the quarter, consistent with the first quarter of last year, but up from the minus 2% we saw in the fourth quarter. Primary and lower layers are generally renewing flat, or with modest positive changes, while there continues to be pressure on excess layer. That's consistent with recent loss experience.

Errors and omission lines are generally doing better than D&O. Our approach to the insurance market is to leverage our underwriting expertise and service to increase deal flow and build better portfolios. We're focused on those markets where we have the relevance, scale and higher level of confidence in our runway for profitable growth. We're highly encouraged by our progress to date, with both growth and improvements in core underwriting performance for our insurance business.

Moving on to reinsurance, we've just completed the April 1 renewals. Premiums renewing on or around April 1 represent about 10% of our annual total renewable premiums. The main renewal markets of this date are the U.S. and Asia, mostly Japan.

In Japan, property excess of loss rates were down in the 5% to 7% range, a bit less than in previous renewals. The Japanese casualty market, however, is more constructive as it is responding to recent increases in market losses. XOL cat exposed business elsewhere in the world saw reductions of up to 5%. Brokers continue to apply pressure on profit commissions and expanded coverages. Encouragingly, however, the market is pushing back and we are seeing more programs renewing at expiring terms.

In U.S. casualty, there is continued increase in reinsurance capacity with market newcomers stepping in to replace established players when they scale back participations. U.S. regional and multi-line continues to be competitive, but we are seeing some underlying primary or reinsurance rate growth on some accounts.

In the wake of the Ogden discount rate change in April, the April renewals for most XOL UK motor contracts were postponed to May 1. The few reinsurance XoL trees that did renew went for rate increases of 20% to over 100%. Our expectation is that the business that we will write will be up 40% to 50% over expiring, assuming no further changes to the Ogden rates. Overall, in the April 1 renewals we shrank our reinsurance book by about 4% over expiring treaties.

Looking forward to June 1 Florida renewals, we're seeing an increase of early placements and initial signs indicate pricing close to flat on a risk adjusted basis. In reinsurance, there is no doubt that the market is at a low point not seen in many years. We remain confident however, at the long-term prospects for this business and our goal remains to be a top-10 global P&C reinsurer once conditions improve.

We know we have the capabilities and attributes to be a value added long-term partner for our cedents. Under current conditions, however, we are content pursue growth in attractive new lines such as flood and mortgage insurance to do more for our customers, while prudently managing our exposures and earning a growing stream of attractive fee income from our strategic capital partnerships.

To conclude, I'm hopeful that sanity will prevail and that we're approaching the floor. Where conditions are promising, we will be proactive and pursue growth where risks are properly priced. In the alternative, we will not be afraid to stand back, but we remain firm that no matter the pace of market corrections, we will continue to make progress on our franchise, platform, portfolio construction and risk-lending. I'm confident that the factors that affected this quarter are temporary and our fundamental evolution continues.

Thank you for your attention. And with that, we'll be happy to open the floor for questions.

Q&A

Operator

Thank you. We will now begin the question-and-answer session. Our first question will come from Amit Kumar of Macquarie. Please go ahead.

Q - Amit Kumar {BIO 16979665 <GO>}

Thanks, and good morning. Yeah, just a couple of quick questions and I'll requeue. The first question goes back to the discussion on, I guess, the underlying AYLR ex-cat and you talked about rate and trend. Based on your commentary, is it fair to say that a mid-60s for reinsurance and a low-60s is the way to think for the full year? Or how should I think about the outlook for the segments based on your comments? Thanks.

A - Albert A. Benchimol {BIO 2023727 <GO>}

I think that's a fair way of looking at it Amit. If you look at each of the areas as James pointed out, we started-off with a number of that absent mix improvements and changes to the underwriting would have grown. But in fact in our insurance division, notwithstanding close to 1.5 points of rate and trends, we still were able to reduce the overall loss ratio down to about 60%. And I think there is nothing unusual in the experience that we saw in the first quarter that would give us any reason to give different guidance, not that we give guidance but to give you any caution for the rest of the year.

I think with regards to the reinsurance book, as James mentioned, the impact of Ogden was about $9 million this quarter. It will be a little bit less in future quarters. But in terms of the mix and rate change, I think where we are in this quarter again is not an unreasonable indicator of current performance. And again, I hasten to add that from my perspective the Ogden is something that has to run through. But ignoring the Ogden, the rest of the book continues to perform.

Q - Amit Kumar {BIO 16979665 <GO>}

Got it. The other question I had and then I'll requeue, just going back to I guess the broader capital management discussion and it seem that the buyback was more than relative to the net income, it was higher proportionately. Should we think about that slowing down going forward? Or am I over-thinking this metric?

A - Albert A. Benchimol {BIO 2023727 <GO>}

As you know, we've been committed to returning capital to our shareholders. We will continue to repurchase. We don't view this as unusually high or unusually low. We expect that, originally we were looking at a number that was at least our planned operating income. Obviously we weren't planning initially for Ogden, but we won't let that to get in the way of our stock repurchase activity.

Q - Amit Kumar {BIO 16979665 <GO>}

Got it. I'll stop here and requeue. Thanks for the answers.

Operator

Our next question will come from Elyse Greenspan of Wells Fargo. Please go ahead.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Hi, good morning. I was hoping to get a little bit of color on the reserve releases in the quarter. If you back out the Ogden charge, your reserve releases actually would have been up year-over-year. Can you just give some color on what line then, accident years to favorable development is stemming from the quarter?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Yeah. As you know there is no real predictability to the quarterly reserve releases. Our actuaries perform full ground-up reserve releases. They look at the A versus E. And they ultimately come through, some quarters will be a little bit higher, some quarters will be a little bit lower.

If you look at where we are today, I would say two things, one, you're seeing some growth in the reserve releases for the insurance book. And fundamentally that reflects increased confidence in where we are given the changes that we've then made to our book in the last three years. And so that's gone up more this year. On the reinsurance side, we continue to see professional lines and liability lines driving the reserve releases.

In insurance, it's mostly professional lines and a little bit of marine lines. There's always of course some adverse development here and there, but these were only partial offsets. I think if you look at where the lines are coming from, it's really depending on the mid-tail lines. Those would go anywhere from 2008, 2012, and the shorter-tail lines would come from more recent years than that. And my guess is that there will be a few more detail once we issue the 10-Q.

A - James O'Shaughnessy

Yes. Correct.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. And then in terms of you guys pointed out on UK, whether the derivative marks that went against you in the Q1, have those come back or what's the Q2 date there as we think about our models?

A - Albert A. Benchimol {BIO 2023727 <GO>}

These were not simply UK. The reason that we ended up with the loss is that we had this unusual occurrence of having exceptionally warm weather in both the U.S. and Europe. So usually the diversification helps us, but in this case we had a relatively tail event with not only was it exceptionally warm, but it was exceptionally warm in all places.

And as I say that, I need to comment that of course we recognize there is global warming, that's taken into consideration in our pricing and our structuring. But the changes that we saw this quarter were well above the trend lines that were estimated. Some of those unfortunately closed out. So there isn't any reversal to be seen. There isn't any significant change to our marks so far in the quarter.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. Great. And then if I look at your G&A in the quarter and I kind of back out the $8 million severance cost, it still will – probably some corporate cost maybe a little bit higher than I was modeling and I know there was some moving parts. Do you guys still as you think about the expenses that you outlined to the street is your assumption will still see the $50 million fall out of the expense base by the end of this year, just in light of some higher personnel cost that you were speaking about?

A - Albert A. Benchimol {BIO 2023727 <GO>}

That's right. Look from our perspective, we will have achieved in excess of the $50 million in cuts by the end of 2017. So we're confident that what we indicated to you is happening. Of course, a lot of these savings have now been reinvested in other parts of the business, analytics and so on, but the progress continues.

It's true that the expense in the G&A line grew up. There were a few other seasonal items. We did not believe that it was worth identifying them as exceptional. And so we're happy to give you a little bit more detail on that. But there were some seasonal items that also included the growth of G&A.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. And then one last question if I may, there was a tax benefit in the quarter, what was that?

A - James O'Shaughnessy

Yes. So Elyse, this is James here. There was a new accounting rule came in Q1, 2017 and it was on a share based comp simplification. So the tax impacts of the share based comp are now included in the tax line. Prior to 2017, the tax benefits were booked to the shareholders' equity line.

So due to the vesting schedule the majority of the tax impact is reflected in Q1 2017. And the amount of the tax benefit was also impacted by the increase in our share price. So you would expect maybe a bit of a spike potentially in Q1 with the vesting of the shares going forward. So, that was to say, an equity item before, but it's now booked to the income statement.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Just fundamentally, the way we would look at it and we talked about kind of core accident year loss, numbers with Amit a few minutes ago, I think we would be looking at a core G&A number that's about $150 million (33:32) per quarter.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. That's great. Thank you.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Thank you, Elyse.

Operator

Our next question will come from Christopher Campbell with KBW. Please go ahead.

Q - Christopher Campbell {BIO 20262752 <GO>}

Hi, good morning.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Good morning.

Q - Christopher Campbell {BIO 20262752 <GO>}

I was wondering if you could get a little bit of additional color on why AXIS is releasing the professional lines the current year reserve releases. Just kind of given the long-term nature potentially higher loss cost inflation and then some reports of an increasingly aggressive plan thus far?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Christopher, I'm happy you're asking the question because I was totally confused by your report last night. What we said is that the IELR, the loss ratio that we're putting in 2017 is reflecting the progress that we have achieved over a number of years. As those who followed us for a number of years know, is we've made some very significant changes to our approach to the D&O/E&O book.

However, we have been reserving that book very prudently without giving any credits to the impact of those changes that we have made over the last three, four years. And 2014, 2015, 2016 are emerging much more in line with what we would have expected when we wrote that book, but of course, we did not reserve it at those levels. So we reserved those years in professional lines with a conservatism that did not fully reflect the improvements.

What we are doing in 2017 is now readjusting the starting point for the 2013, 2014, 2015, 2016 years and, therefore, granting some credit for the changes in the portfolio. We, of course, have not changed our indications for 2017, which as is our practice continues to assume a prudent amount of rate and trends. And we will not revisit the 2017 loss number for a number of years, just as we have not revisited the professional lines loss numbers for 2014, 2015 and 2016. Does that help you understand the wording that we used?

Q - Christopher Campbell {BIO 20262752 <GO>}

Yes. That's very helpful. And then just kind of over the broader results, core loss ratio is up about 200 bps, how much of that is the mix shift versus just deteriorating market conditions?

A - Albert A. Benchimol {BIO 2023727 <GO>}

So, I'm sorry. Could you repeat that question?

Q - Christopher Campbell {BIO 20262752 <GO>}

Yeah. I'm just looking overall, like at the overall core loss ratio, which is about 200 bps higher year-over-year. And I just – just kind of wondering what the breakdown would be? I know the book is shifting in certain segments, like maybe accident and health and insurance. So how much of that deterioration is just writing higher core loss ratio business versus overall market conditions?

A - Albert A. Benchimol {BIO 2023727 <GO>}

So if we look at the group number, and you start with the Q1 2016 number of 61.5%, and you add the impact of Ogden which as we said is - we think of as a cat which will run through over the next few quarters, that's 0.9 points. And the rate in trend on average for the book is about 1.4, 1.5. That gives you a total of approximately 63.8%, 63.9%. We actually delivered a 63.6%, which means that our mix and underwriting has actually given us progress against the market conditions. I think, however, it is much more impressive when you split it up between insurance and reinsurance.

On the insurance side, the accident year ex-cat loss number was 60.8% last year and we've got rate in trend of approximately 1.4, which means that if we would have done nothing to the book, the loss ratio would have been 62.2%.

As Amit pointed earlier, that number came it at 60.1%. So the ongoing improvement in our book of business, underwriting and portfolio construction, actually led to a 2 point - over 2 points of improvement in the insurance book. And this is what I was referring to in my prepared remarks that no matter what's happening in the market, we will continue to make progress in our underwriting results.

Reinsurance is a little bit more complicated, where of course we have not only the impact of Ogden and the rate change. But in that area, it has been a more difficult market and we've been absorbing tougher conditions there. And the mid-60s loss ratio that we discussed earlier really reflects more of the market conditions and less of the mix shift. The mix shift we have essentially done, as I said before, the macro shifts that we wanted to make. What we are doing today are more tactical based on the opportunities available to us.

Q - Christopher Campbell {BIO 20262752 <GO>}

Great. Well, thanks for all answers and best of luck.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Thank you.

Operator

Our next question will come from Brian Meredith of UBS. Please go ahead.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes. Thanks. Good morning. Albert, I wonder, could you talk just a little bit more about the growth in the catastrophe reinsurance area? What's behind that, given where market conditions have been?

A - Albert A. Benchimol {BIO 2023727 <GO>}

I appreciate that. You are seeing growth in the gross number. In a net number, actually, it's lower and we have - as we've discussed with you in prior quarters, we've been increasing our strategic capital partnerships. We have strategic capital partners who have an interest in cat business. And as we've said before, this is a great opportunity for us to do more for our customers, provide risks that our strategic capital partners want and earn fees in the process. But what you are seeing is an increase in the gross, and you will be seeing a reduction in the net. And in fact, you'll notice in the PML, there really hasn't been much change in the PMLs.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. That makes a lot of sense. So just bigger line size that you're getting on treaty stuff?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Yes. What matters to us is to be a full service, value added partner to our customers. And we're very happy to do more for them. As I mentioned in my prepared remarks, we're unlikely to be increasing our net exposures in this market, but there is demand in the investment world for cat risk and we're happy to work in conjunction with our strategic capital partners and satisfy both their appetites and our customers need.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. And then a quick question I know on the policy acquisition costs in the insurance segment, it was mentioned a mix shift with respect to A&H, is it – there is more reinsurance or what's happening in that area?

A - Albert A. Benchimol {BIO 2023727 <GO>}

That's exactly right. As James mentioned, there is growth in that Middle East reinsurance business and that comes with higher acquisition expense.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you, got you. And then just last question for you, just curious your thoughts, lot of talk recently about intermediary competition, kind of what are your thoughts on that?

A - Albert A. Benchimol {BIO 2023727 <GO>}

We are not a direct insurer and reinsurer, so by definition what we round is going to have commission. What I can't say is that, commission changes, it depends by line. If you're writing program business or stuff like that, by definition, you're going to pay more. Some lines in the large accounts are with net. So, there is going to be some change around that.

What I will say to you is, when we look at the profitability of a proposal, whether it's a treaty or an individual risk, we look at it on a technical ratio basis, which is both the loss ratio and the commission. If we find that together the loss ratio and the commission are unattractive for whatever reason whether it's the loss part or the commission part, we will pass on it.

If we find that the technical ratio is acceptable to us and we want to write it, at that point we're a little bit less concerned whether that comes from lower commission or lower loss ratio, as long as all in the risk was attractive to us. So my answer to that is, it's up to us as evaluators of risk and return to determine which technical ratios are attractive and which are not.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you, excellent. Thank you very much.

Operator

Our next question will come from Ian Gutterman of Balyasny. Please go ahead.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

All right, thank you. Good morning, Albert. I guess, to start with the simple one, the credit business in the reinsurance, look like it shrunk about in half. Anything interesting going on there?

A - Albert A. Benchimol {BIO 2023727 <GO>}

No. Well, that's the – we discussed earlier that as part of the reduction in the gross written premiums was multiyear treaties.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay.

A - Albert A. Benchimol {BIO 2023727 <GO>}

We had a multiyear treaty last year.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it.

A - Albert A. Benchimol {BIO 2023727 <GO>}

And obviously we did not renew that. We're just writing less multiyear treaties now.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

That makes sense. Okay. You mentioned in your earlier remarks that the strategic partners is adding about half a point to ROE. If I want to track that in the income statement, is that just that $11 million of fee income from partners you reported or is there a way different way to analyze that?

A - Albert A. Benchimol {BIO 2023727 <GO>}

That's right. Obviously, there is a little bit of expense associated with that, but by and large that's the driver.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

That's what I was going to ask sir. Is the expenses, either way I can pick that up or it is a guesstimate of margins on that or?

A - Albert A. Benchimol {BIO 2023727 <GO>}

They're not huge.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay.

A - Albert A. Benchimol {BIO 2023727 <GO>}

The real margin is in our third-party capital unit, which is a small unit, but the rest of it is, it's just normal G&A. We would be incurring the underwriting expense in the rent expense whether we were taking $20 million line, or a $25 million line. So, it's high margin business.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Thank you. And then on to professional lines, can you just remind me a little bit of maybe both on the insurance and the reinsurance side, sort of where you play just by lines of D&O, E&O, EPL et cetera. And just kind of what type of customer, are you doing mostly Fortune 5's or are you doing regional's, you are doing not for profits. Just sense of the spread of your book?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Well. It is in fact a very widely spread book, but I would say that where we have changed our book over the last four years is the following. Number one, we're writing less D&O and more E&O than we have in the past. You will recall, 2013, we discussed the D&O market with you and we decided at that time that we were going to write less. Where we are writing D&O, we've significantly changed the distribution by industry. We had been overly represented in the technology and healthcare world, we significantly reduced those.

We've reduced our primary exposure. We've increased our attachment points, and we've reduced our line size. And all of those have been key drivers to our improvement. And as I've mentioned in the last call, our participation in the existing class action law suits is the lowest that it's ever been. So we feel very positive about what we've done on the D&O side.

E&O is both a more attractive market right now than D&O is, and where we have been growing. And there we have a significant amount of management liability experience and expertise in multiple professional lines, architects and engineers. We do cyber, we do healthcare, we do a number of areas. We've been growing in Europe in professional lines.

Mostly, I would say, in the mid-market area we do write some large accounts, but we're mostly in the middle market and if you look at our average customer and average policy size, those have been coming down in size. So we have been moving away from the large accounts and more into the mid-market than small. And our line size has reduced over the last three years, four years, and we like where it is right now.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay. And on the reinsurance side, is it mostly a quarter share?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Yes. Yes. It's quarter share and there it's really about underwriting the customer, making sure that there was a good book of business there, and making sure that the ceding commissions that we pay is commensurate with the profitability of the underlying book of business. And there as you know, there has been some real pressure over the last two three years at increased ceding commissions. And frankly, we've reached a limit on that. And so we're happy to renew flat where the underlying is booked, but we have not – we haven't been encouraging people to speak about higher ceding commissions.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay. And was your ceding therapy sort of the major players that I would get off the top of my head or is there a lot of regional clients or maybe high professional now or...?

A - Albert A. Benchimol {BIO 2023727 <GO>}

No, it's active players, recognized players, because of course it's really important that our customers have expertise and relevance in that marketplace. So we want to make sure that we deal with people who've got, the right book, the right distribution.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay. And then just last thing on the topic. With sort of elevated losses we're seeing in the M&A and some of the other things, are those things that are mostly still at the primary or maybe low access where it's largely defense and sort of a modest settlement or are we seeing pressure on the excess layers with claims as well?

A - Albert A. Benchimol {BIO 2023727 <GO>}

That's our experience. So as you know, first of all start with the fact that we're now writing a lot less of that business and smaller accounts. But it's true that most of what we are seeing, we're seeing elevated activity, but most of what is happening is staying in the primary layers, which is why as I indicated earlier we're seeing price increases in the primary layers and more pressure on the excess, because the excess to-date has been able to avoid the frequency that you had on the primary.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Thank you so much.

A - Albert A. Benchimol {BIO 2023727 <GO>}

You're welcome.

Operator

Having no further questions, this will conclude our question-and-answer session. I would like to turn the conference back over to CEO, Albert Benchimol for any closing remarks.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Thank you, and thank you all for participating in the quarter. And if there is a message that I hope you will take away from this, is that this was a noisy quarter. However, we do believe that the events that affected our results in this quarter are unusual in their nature and the journey continues and we are very pleased with our progress. And you have our commitment that we will continue down that path. Thank you all.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines.