Q2 2012 Earnings Call

Company Participants

- Jeffrey Kelly, EVP and CFO
- Kevin O'Donnell, EVP and Global Chief Underwriting Officer
- Neill Currie, CEO
- Peter Hill, IR

Other Participants

- Ian Gutterman, Analyst
- Josh Shanker, Analyst
- Josh Stirling, Analyst
- Michael Nannizzi, Analyst
- Mike Zaremski, Analyst
- Sarah Dewitt, Analyst
- Vinay Misquith, Analyst

Presentation

Operator

Good morning, my name is TeShauna, and I will be your conference operator today. At this time, I would like to welcome everyone to the RenaissanceRe Second Quarter 2012 financial results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session.

(Operator Instructions)

Mr. Peter Hill, you may begin your presentation.

Peter Hill {BIO 15385944 <GO>}

Good morning, and thank you for joining our Second Quarter 2012 financial results conference call. Yesterday after the market closed we issued our quarterly release. If you didn't receive a copy, please call me at (212) 521-4800, and we'll make sure to provide you with one. There will be an audio replay of the call available from approximately noon Eastern time today through midnight on August 22. The replay can be accessed by dialing (855) 859-2056 or (404) 537-3406. The pass code you need for both numbers is 11170297. Today's call is also available through the Investor Information section of www.renre.com, and will be archived on RenaissanceRe's website through midnight on October 10, 2012.

Before we begin, I am obliged to caution that today's discussion may contain forward-looking statements and actual results may differ materially from those discussed. Additional information regarding factors shaping these outcomes can be found in RenaissanceRe's SEC filings to which we direct you. With me to discuss today's results are Neill Currie, Chief Executive Officer; Jeff Kelly, Executive Vice President and Chief Financial Officer; and Kevin O'Donnell, Executive Vice President and Global Chief Underwriting Officer. I'd like to turn the call over to Neill. Neill?

Neill Currie {BIO 6676681 <GO>}

Thank you, David. Good morning, everyone. RenaissanceRe reported operating income of $111.5 million, and net income of $142.3 million for the Second Quarter. This resulted in an increase in tangible book value per share plus accumulated dividends of just over 4%. Our results reflected strong underwriting performance and benefited from continued relatively low levels of catastrophe loss activity. Over the last year or so we have been saying that we expected pricing in the property catastrophe market to improve gradually and steadily.

That view generally held true through the First Quarter of this year. We had anticipated additional firming at the 6-1 renewals, but as it turned out, pricing was relatively flat. We believe this was due primarily to new supply entering the market, several existing reinsurers becoming more interested in writing southeast hurricane-exposed business and the increase in demand was a little less than the market generally anticipated. We believe that the primary factors that were driving the pricing increases for over a year, that is, those learnings from the CAT losses of 2010 and 2011, and companies having the time to form a view on RMS 11. We feel like both of those things have been absorbed by the marketplace now.

I feel our decision to grow our property catastrophe book substantially at 1-1 was a good decision, and although pricing was generally flat at 6-1, we were able to write enough attractive business -- or define enough attractive business and write it, to grow by 11% during the quarter and just over 20% year-to-date. We now have a larger, more attractive book of business. We were able to produce this attractive portfolio as a result of executing well on what we call our three superiors. Superior customer relationships, superior risk selection, and superior capital management.

Turning to our international business, we were also able to improve the quality of that book. As we indicated last quarter, we continue to serve our clients in loss affected markets such as Japan, Australia, and New Zealand by being a stable source of capacity, being there for them they needed us. We integrated our expertise in science and risk modeling with our underwriting capabilities to develop an enhanced view of the risk we were assuming in those regions. Our ventures team continued work closely alongside the underwriting this quarter developing the most efficient ways for our clients to manage their risk and creating attractive opportunities for investors.

In early June we announced the formation of a new sidecar, Tim Re III, to target a portfolio of Florida specific risks. This vehicle was formed is to help our customers and brokers by bringing more capital to the Florida marketplace. It also offers the flexibility to expand and to provide more capacity should it be needed post event. Tim Re III typifies the flexibility we build into our capital structure, which allows us to allocate the right capital, at the right time, for what we consider to be the best opportunities. We were also able to bring new partners into DaVinci Re, who we feel will be valuable additions over the long-term of this franchise.

Outside of property catastrophe, we have a strong specialty reinsurance team that continues to evaluate opportunities in a challenging marketplace. It is positioned to grow meaningfully when market conditions allow. We are pleased with the progress and results at our Lloyd's unit, where margins have continued to improve as the operation has scaled up. With the majority of our book now written for the year, we will remain focused on serving our clients as the rest of the hurricane season unfolds. The dynamics of the upcoming January 1 renewals can be affected by the level of losses during the Atlantic hurricane season, and whether or not insurance and reinsurance companies are surprised by the losses that result from those events.

From our standpoint, as we have often said, we don't wish for any particular loss scenario or outcome. Rather, we strive to be able to play whatever hand we're dealt, and to play it well. With the strength and flexibility of our capital structure, our underwriting discipline, and solid client and broker relationships, we are well-positioned to continue to target attractive business opportunities as they arise. So with that, I'll turn the call over to Kevin.

Kevin O'Donnell

Thanks Neill. Good morning everyone. Today want to talk to you about each of our businesses, so let's begin with CAT. Last spring we revised our models and mapped out a strategy to optimize our portfolio against what we thought would be a shifting market. Through our efforts over the last year we constructed a significantly better portfolio than we would have achieved simply by renewing our existing book. Although we found good opportunities to grow at 6-1, we made a good call by growing by a larger amount earlier in the year, when we believed that rates were best. We increased our peak exposure in Atlantic hurricane, and the geographic diversity of our book.

In addition to changing our inward book of business, we completed Tim Re III, adding more vertical diversification to our Atlantic hurricane exposure. We also improved the portfolio through additional seated participants, leaving our net exposure reasonably flat compared with last year. The unique combination of our experienced team, strong ratings, and superior access to business allowed us to execute this strategy and construct a portfolio that we feel is an attractive one.

Moving on to Florida, there was a lot of speculation prior to the renewal that significantly more limit would be purchased. At the time, we thought that this view was optimistic and the corresponding hope for significantly better pricing was unlikely. As it turned out, supply was greater than demand, with there being more capacity available than there was new limit purchased. Even though the net result was that market prices were about flat, we are nonetheless pleased with the portfolio we constructed. Over the last year we spent a lot of time talking with our customers about the impact of the RMS model revision. With the market having completed a full renewal cycle with the new model, we believe its impact on supply and demand is fully reflected.

However, our customers remain concerned about the potential effects of future model changes. And I believe that the most enduring impact of the new model will be the increased focus on developing an independent view of risk. With our extensive in-house modeling capabilities, we believe we are well-positioned to assist customers in developing this independent view, which will allow us to further differentiate ourselves from our competitors. That covers my main points on US CAT.

The international primary CAT in retro markets were pretty quiet over the quarter. We increased our international exposure during the first half of the year through better pricing and loss affected regions and improved opportunities to cede risk, including through our sidecar Upsilon Re. I am pleased with the expanded profile of our book, and happy that we had success in growing some historically difficult perils such as Japanese typhoon.

Our specialty business is doing well, and while opportunities for growth are somewhat limited right now, loss emergence remains favorable. Persistent low yields should make cash flow casualty underwriting increasingly less attractive, thereby increasing the likelihood of better market pricing at some point in the future. This trend has been going on for a while, and it still may be some time before prices increase but I'm hopeful that conditions will improve, and we will continue to monitor these markets closely.

With all the attention on US drought, it is worth noting that we have about $8 million of agriculture related premium, of which $3 million is exposed to US MPCI excess of loss reinsurance mostly written through Lloyd's. Although our premium is relatively small, keep in mind that this business is low rate online, and consequently we remain exposed to the ongoing drought. Looking forward, if losses do materialize, we believe we are well-positioned to grow if the market improves in 2013. Our Lloyd's business continues to improve, driven partly by our growth into existing infrastructure. The book is pretty close to our original forecast for this point in time. I am optimistic that due to our relatively small size within the Lloyd's market, we will continue to have good opportunities to grow, which should further improve our client ratio.

I'm pleased to report our ventures team has been successful over the quarter in adding to our franchise with the structuring and funding of Tim Re III and raising new capital for DaVinci. Additionally, REAL is having a good summer. To remind everyone, REAL provides risk mitigation products against weather-related event such as temperature and precipitation for corporate clients worldwide. In general the summer season tends to be a lot smaller than the winter season, and during summer we are generally protecting customers from unusually cold weather, so we are benefiting from the high temperatures across the US.

Thanks, and I'll now turn the call over to Jeff.

Jeffrey Kelly {BIO 1390834 <GO>}

Thanks Kevin and good morning everyone. I will cover our results for the Second Quarter and year-to-date, and then give you an update to our 2012 top line forecast. The Second Quarter was again a profitable one for RenaissanceRe, driven primarily by our relatively low level of insured losses, the higher level of earned price increases, and favorable reserve development. Weak alternative asset performance hurt net investment income in the quarter, although the total investment return was strong due to realized and unrealized depreciation in the value of some fixed maturity investments.

Adjusting for reinstatement premiums, top line growth was strong in the quarter and on the year-to-date basis. We reported net income of $142 million, or $2.75 per diluted share, and operating income of $111 million, or $2.14 per diluted share, for the Second Quarter. Net realized and unrealized gains, which accounts for the difference between the two measures, totaled $31 million. The annualized operating ROE was 13.7% for the Second Quarter, and 16.7% for the first six months of the year. Our tangible book value per share, including change and accumulated dividends, increased by 4.3% in the Second Quarter, and was up 10.8% year-to-date.

Let me shift to the segment results beginning with our reinsurance segment, which includes CAT and specialty, and then followed by our Lloyd's segment. In the reinsurance segment, managed CAT gross premiums written in the Second Quarter totaled $628 million, compared with $619 million in the year ago period. Adjusted for $23 million of reinstatement premiums in the prior year, and $31 million of negative reinstatement premiums in the current year, managed CAT premium growth was 10.6% in the Second Quarter.

It's probably worth spending a minute or so on the negative reinstatement amount. During the Second Quarter of 2012, our remaining IBNR for the 2011 New Zealand and Tohoku earthquakes of approximately $130 million was allocated to the contract level. In so doing we reestimated our allocation of losses from higher rate online retro contracts to lower rate online primary reinsurance contracts, resulting in a $30.7 million downward adjustment to our estimate of ultimate reinstatement premiums from these two large events. In addition, the reinstatement premiums were also impacted by changes to the ultimate losses for these two events.

The net impact from the $30.7 million movement and ultimate reinstatement premiums, and $4.7 million of favorable movement in reserves from these -- in these losses for these two events was $19.8 million after considering DaVinci non controlling interests, profit commissions, and other items. Premiums in the quarter included $38 million of gross premiums written by our new sidecar adventure, Tim Re III, which targeted a defined portfolio of a Florida specific contracts. On a year-to-date basis, managed CAT gross premiums written increased approximately 20% compared with a year ago, after adjusting for reinstatement premiums in the prior and current year periods.

This compares with our top line guidance for managed CAT growth of 20% excluding reinstatement premiums for the full year. The top line growth during the quarter and on a year-to-date basis was driven by favorable market conditions as well as growth in the book. As reminder, managed CAT includes the business written on our wholly-owned balance sheets, as well as CAT premium written by our joint ventures DaVinci and Top Layer Re, and our sidecars Upsilon Re and Tim Re III. The Second Quarter combined ratio for the CAT unit came in at a profitable 33.8%. The results included $21 million in estimated losses from the derecho storm system that hit the mid-Atlantic states in late June.

We experienced net favorable reserve development of $33 million for the CAT unit. Some of the major drivers of the net favorable reserve development, including reductions to our net loss estimates for the Tohoku earthquake of $11 million, the Thai floods of $4 million, and a $24 million reduction related to a number of smaller prior-year events. Partially offsetting these was $6 million of reserve strengthening for the February 2011 New Zealand earthquake. For the first six-months of the year, the CAT unit generated the 24.4 combined ratio, driven by generally benign catastrophe losses and favorable reserve development.

Specialty reinsurance gross premiums written totaled $37 million in the Second Quarter, which was up meaningfully compared with $24 million in the prior-year quarter. The top line growth was primarily due to the inception of several new quota share programs and some loss related premiums. For the first six months of the year, gross premiums written totaled $138 million, which was up 39% compared with the year ago period. This compares with our full-year forecast for top line growth of over 20%. Percentage growth rate for this segment can be a little uneven on a quarterly basis given the relatively small premium base.

The specialty combined ratio for the Second Quarter came in at 64.7%. There was no meaningful large loss activity for our book during the quarter, and the combined ratio included $8 million of prior-year net favorable reserve development. On the year-to-date basis, our combined ratio was a profitable 62.7%, and included $20 million of favorable reserve development. In our Lloyd's segment, we generated $50 million of premiums in the Second Quarter, compared with $34 million in the year ago period. For the first six months of the year, gross premiums written increased 49% to $105 million. Growth in this segment was consistent with our full year top line guidance of up 50%. Specialty premiums accounted for most of this amount.

The Lloyd's unit came in at a combined ratio of 103% for the Second Quarter. The results of this segment included $3 million of net favorable reserve development, which helped the loss ratio by 11 points. The expense ratio remained high at 53.7%, but has been declining sequentially as business volume in this segment has increased. For the first half of the year, the combined ratio was a profitable 99.7%, with a loss ratio of 43.4% and an expense ratio of 56.3%.

Moving away from our underwriting results, other income was a profit of $11 million in the Second Quarter, and a breakdown of that is provided in the financial supplement. Our weather and energy unit REAL reported a $6 million profit for the quarter, and we also booked $4 million gain for assumed and seated reinsurance contracts accounted for at fair value. The profit at REAL was a result of summer positions we took on in the US and in the UK which benefited from unseasonably warm temperatures. For the first six-month of the year, other income was a loss of $28 million, primarily related to losses at REAL. Equity and earnings of other ventures was a gain of $7 million. This was driven primarily by a $5 million gain recorded for our share of Top Layer Re's results. We also booked a $2 million gain related to our stake in Tower Hill companies.

Turning to investments, we reported net investment income of $15 million, which was driven by a few factors. Our alternative investments portfolio, principally private equity, generated a loss of $10 million in the Second Quarter. Recurring investment income from fixed maturity investments remained under pressure due to low yields on our bond portfolio, and totaled $22 million for the Second Quarter. The total investment result of the overall portfolio was 0.7% for the Second Quarter. Net realized in unrealized gains included in income totaled $31 million during the quarter.

For the first six months of the year, we reported net investment income of $82 million, which benefited from strong performance of the alternative asset portfolio in the First Quarter. The year-to-date investment return on the overall portfolio was 2.5%. Our investment portfolio remains conservatively positioned, primarily in fixed maturity investments, with a high degree of liquidity and modest credit exposure. During the Second Quarter we added some credit risk to our investment portfolio by increasing our allocation of corporate bonds while reducing our exposure to US Treasuries and short-term investments. The duration of our investment portfolio remains short at 2.2 years, which was roughly flat compared with the First Quarter. The yield to maturity on fixed income and short-term investments increased slightly to 1.8%.

Despite having deployed more capital to our underwriting activities earlier this year, we believe we have capital in excess of our requirements. During the Second Quarter, we resumed active share repurchases, buying back 1.2 million shares at a cost of approximately $88 million. Subsequent to quarter end, we have repurchased an additional 71,000 shares, for a total of $5.3 million through this past Monday. Our ventures team remains active in meeting with potential long-term investment partners about joint venture opportunities. Our stake in DaVinci declined again to 31.5% as we have continued bringing on new investors. We view DaVinci as a long-term vehicle that offers clients a parallel risk profile to that of our CAT unit.

Finally let me give you an update to our top line forecast for 2012. Given that we have already written the bulk of our full year premium during the first half of the year, we are maintaining our prior top line forecast for each of our segments. As a reminder, that guidance is up 20% for managed CAT, up over 20% for specialty, and up 50% for Lloyd's. Thanks and with that I'll turn the call back to Neill.

Neill Currie {BIO 6676681 <GO>}

Okay thank you Jeff and Kevin. I will impart a little bit more information for the folks on the call. I broke our FRIPP principles or values, you may not know what those are, but they are Focus, Respect, Integrity, Precision and Passion. And I failed Number 4, I referred to Peter as David, his predecessor. So with that we will open the call up for questions.

Questions And Answers

Operator

(Operator Instructions)

Mark Karmeski, Credit Suisse.

Q - Mike Zaremski {BIO 20606248 <GO>}

Hi. it's Mike Zaremski, thanks. In layman's terms, I'm hoping to clarify what exactly triggered the changes in reinstatement premiums and how that ties in with reserve changes? Was that triggered by downward loss estimates on 2011 CAT events, or was there a contract misinterpretation? If you could help with that.

A - Jeffrey Kelly {BIO 1390834 <GO>}

Yes sure. Let me give it a try and perhaps spend just a couple of minutes on this, because it is a bit of a unique situation in that we rarely see significant movements in reinstatement premiums. Unless there is a large movement in the underlying loss estimate for the events, and in this case, there really was not. So the two events that contributed to the negative reinstatement premiums were the 2011 New Zealand quake and the Tohoku quake.

So just in explaining the dynamics at work here, when we initially estimate our ultimate loss after an event, that estimate is a ground up assessment of the event, the contracts we believe could be exposed. And in some instances we have reported claims and can attach some of the reserves at the contract level, that is, ACRs, but frequently early on a significant portion of that loss estimate is classified as IBNR. Most of the contracts in the property Cat market contain a reinstatement feature, so we also have to estimate the level of reinstatement premiums resulting from the event.

For IBNR, since we don't know which contracts will attach to those premiums, those premiums are estimated based on an estimate of the underlying business mix. So the relative mix of weather, in this case, it was retro or primary reinsurance. As we get more information, we can begin, and indeed in this instance, did move IBNR -- event IBNR down to the contract level, or down into ACRs. During that process, then we are better able to judge the level of reinstatement premiums, what they will be, and that was the case with our exposures to the Japanese and New Zealand quakes this quarter.

As I said in my prepared remarks, we moved about $130 million of event IBNR for these two events down to ACRs, and in the process obviously had to make the call on which contracts were attaching and which we were not. For both events, more of the loss was -- ended up being allocated to lower rate online primary contracts than higher rate online retro contracts than we had originally estimated, and as a result, our estimate of the premium -- reinstatement premium came down. The difference in rate online for between the retro contracts and the primary reinsurance contracts can be significant, and as an example, could be as much as 25percentage points. And that was really the primary driver of the change, not a significant change in the ultimate losses for either event.

As we noted, the premium came down $30.7 million and the net favorable reserve development between the two events was $4.7 million for, overall, a $26 million impact. And the other thing that is probably worth noting at this point as well, is that these -- for quakes, these events are still relatively recent. And with the passage of time, more information is going to become known to us, and our estimates about the ultimate loss and therefore, most likely, the allocation of reinstatement premiums among these contracts will continue to change.

And as soon as we have any new information or better estimates for those, they will be reflected in that period. So it was mostly a function of the allocation among contracts, rather than a change in the overall loss for the events themselves.

Q - Mike Zaremski {BIO 20606248 <GO>}

Then to clarify, then was there adverse involvement on New Zealand? And positive development or lower development on Tohoku and the Thai events? Or was that noise related to the reinstatements?

A - Jeffrey Kelly {BIO 1390834 <GO>}

No. There was a slight amount of favorable -- there was, I think, a little over $10 million of favorable development on the Tohoku quake. And I think it was just under $6 million adverse on the New Zealand quake.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay. Switching gears, would you be able to comment on the limits on your XOL US MPCI? I know some peers have said that the limits are fairly high relative to the premiums.

A - Neill Currie {BIO 6676681 <GO>}

Hi, this as Neill, maybe I will take a crack at that. As Kevin indicated, some of that business is relatively low rate online business. So you have more exposure, they are higher layers. But put it in context, that is a $3 million premium item. We have over 100 $3 million or greater premium items on the reinsurance assumed book. So I wouldn't want to focus too much attention on this particular area.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay thank you. I will get back into the queue.

Operator

Sarah Dewitt, Barclays.

Q - Sarah Dewitt {BIO 18946247 <GO>}

Hi. Good morning. Given your comments that property catastrophe reinsurance prices are flat, to what extent do you think you can continue to grow managed CAT premiums further in the current environment?

A - Kevin O'Donnell

Hello Sarah. The next opportunity to have meaningful growth in the property cat book is really 1-1. And thinking about that, I think the way to think about the world is what has driven price increases over the last 12 to 18 months. I think we need to split the world into, very simply, US and non-US. The primary driver in the US has really been an updated view of risk, primarily driven by the RMS model release. Then outside the US was really a response to some large losses in specific territories. Most of those elements have been built into pricing. So going forward, I think we're going to have a different set of dynamics that can play into how prices change.

But a lot of that will be determined over the next several months. I think where prices are generally, particularly in the US, is there is ample opportunity to build good portfolios. Outside the US, it is a little bit more difficult but we've certainly seen a lot of rate increase, moving many deals to a more -- to what we would call the attractive bucket. So I think there is still good opportunities to grow, but as far as where pricing goes, I think there's a lot of that story that will be totaled over the next couple of months.

A - Neill Currie {BIO 6676681 <GO>}

Sarah, it's Neill. Add a couple things to what Kevin said. I think we will see how the financial crisis in Europe plays out. We saw over the last year, one very meaningful client decide to purchase more reinsurance because of the affect of their assets. So as a some people with exposure in that area, if things change there, or people may decide to buy more, which would create opportunities. And even though I said the RMS 11 was pretty well digested by the marketplace, there might be a few people that want to top up their programs. So those are other influences that may create opportunities.

Q - Sarah Dewitt {BIO 18946247 <GO>}

Okay. Could you be a bit more specific about what opportunities you are seeing in the US?

A - Jeffrey Kelly {BIO 1390834 <GO>}

No ma'am.

A - Neill Currie {BIO 6676681 <GO>}

Not to be trite, but we do see additional opportunity in there, may be people that want to top up their programs. Kevin, do you want to add anything?

A - Kevin O'Donnell

No. I think Neill pretty much summed it up.

Operator

Josh Shanker, Deutsche Bank.

Q - Josh Shanker {BIO 5292022 <GO>}

Good morning, everyone. Sorry to ask you more questions about the negative restatement, but would it be wrong to say that you had favorable development in areas of the business where you get a reinstatement premium, and you had unfavorable development areas of the business where you do not receive a reinstatement premium?

A - Jeffrey Kelly {BIO 1390834 <GO>}

No I don't think it would be right to say that Josh. It is, specifically on the two events that I mentioned -- although the one event, the New Zealand quake from February of 2011 actually had adverse development and negative reinstatement premiums. So if you had adverse development you would actually expect positive reinstatement premiums. But the other things being equal, the issue there was as we allocated the IBNR down to ACRs, the change in mix there between retro contracts and primary had such an effect on the reestimation of the reinstatement premiums, that it was more negative -- it was negative as well as even seeing a small increase in the loss estimate for that.

For the Japan quake, we had favorable development there so you would expect to see negative reinstatement premiums there. But again, the reallocation of the IBNR to ACRs resulted in mostly, again, a mix effect there on the reinstatement premiums.

A - Neill Currie {BIO 6676681 <GO>}

Josh, this is Neill, I cannot resist a way in. I think Jeff has done a very eloquent job explaining this. But picture this scenario. If some of these losses were in remote regions, say, New Zealand. Therefore a lot of the primary business is relatively low rate online, whereas the retro session business covers many territories. So you might have a rate online on the primary book of business of, say, 4% rate online and on the retro book, it could be 18% to 22%-ish. So this is a highly unusual situation where you have got the differences in the rate online. Typically what would happen is you'd have one client go down and another client go up, roughly the same exposure limits, and we would not be talking about this.

Q - Josh Shanker {BIO 5292022 <GO>}

I think that is a good explanation. Given the new allocation in the reserves, a number of your competitors have started using some maybe called an RDE, which is a general pool for future losses. Are these losses that you have reallocated to? Are you comfortable that they will evolve into case? Or is this unallocated losses for multiple events that could develop, and therefore you have the reserve up?

A - Kevin O'Donnell

No Josh, this is not, I think, what others might call an RDE, or what you might call an RDE. These are event -- we reserve specifically for and separately for each event. So this is simply a process of moving event IBNR, so when the event occurs, we establish both ACRs and IBNR for each event. And this is just the process over time of moving, as we get more information about that event, moving that out of event IBNR down to the contract level.

Q - Josh Shanker {BIO 5292022 <GO>}

Okay thank you. And I just wanted to say that I always appreciate the high-level of disclosure, especially on this, where your losses remain for those events. If you can do that in the future, it is always appreciated.

Operator

Josh Stirling, Sanford C. Bernstein

Q - Josh Stirling {BIO 17463087 <GO>}

Good morning. I wanted to follow-up, I think two, if I heard them correctly, comments that Kevin made. One -- both around your risk taking -- risk-taking and risk management posture. One, I think I heard you say Tim Re III adds vertical diversification. And separately, that you took -- that you've increased your top line pretty substantially but you've kept your net exposures relatively flat. And I'm wondering if you can walk us through how the different pieces are moving. Whether you are buying more retro, you're getting better terms or just restructuring in a clever way to be able to improve returns for shareholders without taking much more risk? Thanks.

A - Kevin O'Donnell

Sure. Let me start with Tim Re III. What I mean by saying we're more vertical diversification is historically we have commented that we are hot down low in Florida, meaning we have a larger market share of smaller losses than larger losses. What Tim Re III really focused on is taking some of the high rate online, or the lower layers in Florida. So we changed the risk profile throughout the distribution for Atlantic hurricane.

The second piece is just what I was commenting on our net book, where disclosures last Atlantic hurricane -- or the last wind season to this wind season for Atlantic hurricane are about the same. That is really combination of how we wrote our inwards book of business over the last 12 months. But the bigger piece really is the amount of ceded and the way in which we purchased, or ceded, for the year. So it's kind of a combination of things, where Tim Re III played a role in that ceded, but very much focused on the low end, the rest of the ceded was a blend of things across the distribution as well as specific spots within the distribution.

A - Neill Currie {BIO 6676681 <GO>}

Right. So to add to Kevin's comments, we would have written the business we put in Tim Re III ourselves. But by ceding that off to other investors, it, de facto, it gave us more vertical distribution in the Florida market than we had before. And I do think it is worth pointing out that the team has done a very good job purchasing retrocession to make an attractive book even more attractive and efficient.

Q - Josh Stirling {BIO 17463087 <GO>}

I will ask a follow-up. Given what you just said, this is almost a softball. But investors spend a lot of time talking about the impact of the capital markets, new capacity coming in, taking the edge off of pricing. Yet, you guys are big retro buyers, and I suspect that you are probably buying reinsurance from a lot of these new entrants. I'm wondering if you could comment on how you think the net-net, with perhaps lower peaks but more counter parties with which to spread the risk, how we as shareholders should be thinking about the net benefit for RenRe? Thanks.

A - Neill Currie {BIO 6676681 <GO>}

Well Josh, if there are any softballs being tossed, I get first crack. But I appreciate you raising -- it is quite true, sometimes people say -- Oh my goodness, there's competition out there. Well there is always competition out there, and we are in a very fortunate position to control so much business coming in that we have the opportunities on the incoming. Then we avail ourselves of new capacity to make our portfolio more efficient. So that is the good side of additional capital coming to the market, it can help us out. Kevin, would you like to add to that?

A - Kevin O'Donnell

I think Neill is absolutely right. There has been a lot of discussion about the collateralized markets. And I think we are uniquely positioned where we can sell across the spectrum of products that people want to buy. So we have partner balance sheets, we have the ability to provide collateralized products, and the ability to provide traditional reinsurance on rated balance sheets. So from a competition standpoint, I think we are uniquely well positioned.

You're absolutely right on the capital side, we are also, I think, very well integrated to know when there's opportunities for us to purchase ceded from collateralized markets, and manage the basis risk that might exist between reinsurance and those collateralized products. So I see that yes there is a degree of competition is introduced, but it also creates an opportunity for us.

Q - Josh Stirling {BIO 17463087 <GO>}

Great thanks guys. Good luck this summer.

Operator

Michael Nannizzi, Goldman Sachs.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Thanks. Just a follow-up on that -- a different slice here, can you talk about these collateralized vehicles and where are you seeing the most competition to your own preferred slice of the market head to head? And how do you differentiate the capacity and service that you provide from these other collateralized vehicles? And just one follow-up, thanks.

A - Kevin O'Donnell

Sure. I think the collateralized markets are increasingly playing across the distribution, where, going back historically, CAT bonds came in, traditionally at the high end of the reinsurance filler. As different funds form with different strategies, they participate at different levels within the reinsurance tower. I think we, again don't, -- we look at them as just competition, whether it is a reinsurance company we're competing with or collateralized market. And I don't think that it has been a particular disruption at any one point in the distribution. Again, it does create some opportunity in that we can buy from the collateralized markets and manage the basis risk.

And secondly because of our flexibility, I'm thinking of how cedants want to transfer risk and how we want to match that against our capital. We can start an Upsilon Re, we can do lots of different things to play in if we think there's a certain tranche of the market and that is providing attractive returns.

A - Neill Currie {BIO 6676681 <GO>}

Michael it is Neill. One additional comment that several of our clients have mentioned to us is on the -- collateralized reinsurance is great, you've got a high probability of collection, et cetera. But they don't know the long-term liability of that collateralized market, necessarily. So we have been around about 20 years, we are known for paying claims and being there after a loss, where sometimes people are little more hesitant to cede business to somebody that may be there for the short term. So I think that it is an advantage to us by having multiple capital resources, and having a track record of being there for our clients for the long-term.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Thank you for those answers. Then one, on DaVinci, obviously the stake moved lower as you had some outside investors get involved. I'm guessing you sold a piece of your interest then didn't increase the size of the total size of DaVinci's capital base. How do you anticipate that move from here? I think you have mentioned a range of what you would like your stake to be, or where you would like it not to be outside of. How should we think about that in whether or not you would choose to issue new paper or continue to sell down your own stake? Thanks.

A - Neill Currie {BIO 6676681 <GO>}

Good question. I won't answer it too specifically, but what we do is we have opportunities to introduce new partners into DaVinci, if we think they are good long-term partners, we will try to make room for them. And that is what happened in this case. So we would've been happy keeping our own stake, but we had some good long-term guys, so it was reduced. I think we have said historically that we typically like to keep our ownership between 25% and 50%. It could go a little under that or a little over that, but we think that is the strike zone.

Operator

Ian Gutterman, Adage Capital.

Q - Ian Gutterman {BIO 3106649 <GO>}

Hi, thanks. First, that was a very helpful, thorough discussion on the reinstatement. I just have one clarification left on it. The fact that as you allocate IBNR that there was less retro than you thought. Does that imply, then, there is still unused retro limit that could develop adversely the future?

A - Jeffrey Kelly {BIO 1390834 <GO>}

Yes. This is Jeff. I think the answer to that is probably, but I think what we are saying here is that our assessment at this point is some of those contracts are not being hit, or not attaching related to the specific event. So I would not say that they have the potential to develop adversely because of the way we allocated. As I did say, though, the one thing you should remember is that this allocation that we just made this quarter is based on what we know today. And we could learn more going forward that theoretically could -- we could reallocate some of the loss to -- back to the retro accounts. But this is based -- our allocation this time is based on what we know right now.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay, because that was what is getting at.

A - Neill Currie {BIO 6676681 <GO>}

Let me just add to that just briefly, to make sure there's not any misunderstanding. Because, once again Jeff did a good job, and he is technically correct is a good CFO should be. But when we take down reserves on an account, we're not going to take those reserves down unless we are pretty confident that we have got the good data from the clients. That is what happens, we start off putting up the loss and then we get additional information, as that information comes in, if we feel confident we can take that down then we will do it.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. The reason I ask, you can probably guess, is one of the big New Zealand cedants, and I can't remember if you are on them or not, but they raised their estimates substantially again here. So I didn't know if that sort of thing would pose a risk if we saw that, or more of those?

A - Jeffrey Kelly {BIO 1390834 <GO>}

The way our book is written, that -- those large adjustments by some of the big primary writers in these regions actually affect the retro as well. So we try to map it through the whole exposure set that we have, not just look at primary's up. And we look at it, if the primary's up, what impact is that likely to have on our retro writings as well.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay great. Then one other, and this, Jeff, might be a little complicated too, but I'm focused on Page 19 and 20 of the supplement where you do the reserve roll forwards. And I know I've asked this before, but I continue to be surprised at how little paid CAT there has been. So what I was looking at, I looked at those disclosures as of year end first, and it looks like last year, you had about $1 billion of 2011 accident year CAT losses, and you paid about $300 million in 2011, so about $700 million left on a gross basis. And I see you only paid $32 million from prior year losses year-to-date so far. I'm on page 20. That just seems incredibly slow.

But then the other thing I noticed was that $32 million is net, and your gross was $257 million, so you had a huge recoverable paid this quarter of $225 million. I'm just trying to understand, is that something that can continue as that $700 million of losses works down? Or was this up front, and going forward gross will be net on your paids? It just surprised me how much of your gross pays were covered net this quarter.

A - Jeffrey Kelly {BIO 1390834 <GO>}

Well Ian, you are right. There was a lot of -- there were a lot of paid a losses combined with a lot of recoveries. And off the top of my head, I can't predict how those recoveries will flow through, except that I think if you look at the net recoverable on our balance sheet, it has declined significantly over the course of the year. So it can't fall below zero, obviously.

A - Kevin O'Donnell

If I can add just a couple comments to Jeff. We do have some quota share which will participate proportionally through our loss. The other thing that can happen is the international events sigma reports, which is the trigger for many ILWs in the Second Quarter, which will trigger some payments for the excess of loss index based contracts.

Operator

Vinay Misquith, Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

Hi. The first question is on the investment income. You usually have a little bit of adjustment in that. Can you help me understand what that is for the fixed income securities, please?

A - Kevin O'Donnell

Are you talking -- Vinay, are you talking about the fact that sometimes we have derivatives, mark to market, or realized gains and losses?

Q - Vinay Misquith {BIO 6989856 <GO>}

Yes.

A - Kevin O'Donnell

So if you look at Page 15 of our supplement, in the top line. Actually, if you look at the fixed maturity investments from March -- the First Quarter to the Second Quarter, there is about a $4 million decline. Virtually all of that difference is related to derivative gains and losses in the various -- in those two quarters. So the $26 million in the First Quarter contained about $1 million of derivative gains, and the $22 million in the Second Quarter contained about $3 million of derivative losses. So on an -- it's basically absent the derivative gains and losses, which are primarily offset in unrealized gains and losses in the investment portfolio. That number was really pretty constant over the two quarters.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay that is fair. And what is the normal number that we should use for the derivative gains? Are they zero, or are they plus $1 million, minus $1 million? Just trying to get a sense of the run rate?

A - Kevin O'Donnell

I really don't think you can take a run rate, Vinay. It depends on what happens in the market and in this instance, interest rates fell. I think some of those derivatives are hedging duration in some of the investment mandates we give our managers. So when interest rates fall as they did during the quarter, we experienced derivative losses that are marked against that fixed maturity income number. So I would not say there is a run rate number you can use. I think if you think about it though, Vinay, just in terms of thinking about if you went back to the beginning of the Second Quarter and just say we ended with a portfolio of about $5.5 billion worth of fixed maturity investments, the yield on the portfolio was about 1.6%.

That is about $24 million, $25 million of income which is right around what the derivative -- absent the derivative number, the number would have been. Then the hedge fund number has been tracking -- not the hedge fund, the private equity and hedge fund number has been tracking recently pretty close in line with movements in the S&P 500. And we had -- I think the S&P 500 was down 3.3% in the Second Quarter, and if you multiplied that times our $360 million private equity portfolio, you would have come up with about a $12 million decline, which is pretty close to the $10 million we posted.

So you can't always think of the private equity exactly mapping to the S&P 500, but I think the last few quarters it has been pretty close. So that is one way to think about, if you want to think about how to look at that investment income number going forward. With the derivative income, or losses, really just offset in unrealized gains and losses on the investment securities.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay that's great. You guys have some great disclosure so it also would also be helpful if you just threw that line in somewhere so that could have a sense for the run rate. The second point, the second question was on Tim Re and Upsilon, curious about what your plans are for next year? Should you choose -- will you be more willing to keep those premiums net for yourself, and how much were you reinsuring that, this year?

A - Kevin O'Donnell

Sure. Okay it is really a question of what happens with pricing as to whether we decide to review these vehicles are not. I think from the Tim Re perspective, as Neill had mentioned, that's business we are happy to keep. It depends on really how we structure the portfolio, but it is more of a portfolio shaping vehicle than it is one in which it is pure risk transfer. I think with the Upsilon one, that one is a little bit more difficult. So if pricing moves down substantially, I think that we would exit some of that business and we would non renew Upsilon Re. If the market's about flat, I would anticipate that we would be very comfortable with the vehicle going forward.

Q - Vinay Misquith {BIO 6989856 <GO>}

And if you could remind me, how much you kept net from both these vehicles, please, this year?

A - Kevin O'Donnell

Tim, I'm trying to remember off the top of my head. Tim was just under 20%, I think, is how much we kept net. Then Upsilon, we added a little bit more to the quarter, and we are at, I think, about 55% of that, ballpark. So those numbers are rough, but we're about 20%, just under, for Tim, and just over half for Upsilon.

Operator

At this time there no further questions.

A - Neill Currie {BIO 6676681 <GO>}

Terrific, good questions today. We'll look forward to speaking to everyone after hurricane season. Thank you very much.

Operator

This concludes today's call. You may now disconnect.