Q4 2018 Earnings Call

Company Participants

- Albert A. Benchimol, Director, President & Chief Executive Officer
- Matt Rohrmann, Head-Investor Relations
- Peter J. Vogt, Chief Financial Officer

Other Participants

- Brian Meredith, Analyst
- Elyse B. Greenspan, Analyst
- Josh D. Shanker, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst
- Yaron Kinar, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the Fourth Quarter 2018 AXIS Capital Earnings Conference Call and Webcast. All participants will be in listen-only mode. Please note this event is being recorded.

I'd now like to turn the conference over to Matt Rohrmann, Investor Relations. Please go ahead.

Matt Rohrmann {BIO 15132648 <GO>}

Thank you, operator. Good morning, ladies and gentlemen. I'm happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the fourth quarter and the period and year-ended at December 31, 2018. Earnings press release and financial supplement were issued yesterday evening after the market closed. If you would like copies, please visit the Investor Information section of our website at axiscapital.com.

We set aside an hour for today's call, which is also available as an audio webcast through the Investors section of our website. A replay of the teleconference will be available by dialing 877-344-7529 in the United States, and the international number, 412-317-0088. The conference code for both replay dial-in numbers is 10127972. With me on today's call are Albert Benchimol, our President and CEO; and Pete Vogt, our CFO.

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' most recent report on Form 10-K as well as the additional risks identified in the cautionary note regarding forward-looking statements in our earnings press release issued yesterday evening. 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 Investor Information section of our website, which is located at axiscapital.com.

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

Albert A. Benchimol {BIO 2023727 <GO>}

Thank you, Matt, and good morning, everyone. And thank you for joining us to review our fourth quarter and year-end results. I'll begin by saying that this was a tough quarter. However, notwithstanding fourth quarter results that were clearly unsatisfactory, our overall performance for the year has continued to show progress on a multi-year trend of lower ex-cat combined ratios, even as we've changed the mix of business to include less cat exposure and in a declining market.

Overall, 2018 was undeniably a year where we took steps forward, both in terms of underwriting profitability and organizational progress. Let's first discuss our performance. As noted in our earnings announcement, our fourth quarter results were negatively impacted by high attritional property loss and cat activity. Based on our research and conversations with our clients and brokers, we do believe that the higher property loss frequency is broadly based across our industry and that the fourth quarter experience is more of an unusual quarter than it is a trend.

Separately, if you step back and look at our results over the past year, you'll see that AXIS delivered an improvement in full-year underwriting performance, both with and without cats. We feel the best way to review progress from period-to-period is on an ex-PGAAP basis and also on an ex-cat basis. So, on that basis, ex-PGAAP, ex-cat, the full-year calendar year combined ratio improved to 97.6% in 2018 from 98.5% in 2017 with a full 2-point reduction in the ex-cat loss ratio.

We also looked at the pro forma combined results as if the merger were effective on January 1, 2017, to do two full years of comparison. And on that basis, the full-year ex-PGAAP, ex-cat calendar year combined ratio improved from a pro forma 99.5% in 2017 to an actual 97.6% in 2018 with a 1.4-point reduction in the ex-cat loss ratio, reflecting the significant actions that we took over the past year to strengthen our portfolio. And then our efforts in that regard have only accelerated in the past few months.

As we've discussed in past earnings calls, beyond the underwriting actions, we've also made tangible progress in furthering our strategy and in strengthening our business. A highlight for the year was a successful integration of Novae into our London operations to make us a top 10 insurer at Lloyd's. The market has enthusiastically welcomed our new status. And we've seen significant new opportunities as a result of our enhanced relevance, even as we've taken additional portfolio actions that have not yet been reflected in our results.

You also recall that during the year, we launched a transformation program to allow us to better leverage data and analytics, to make us more agile and better enable us to take advantage of opportunities in the market. We announced that between the synergies relating to the Novae integration and our transformation, we were targeting a $100 million in net savings off the 2017 expense levels by the end of 2020. I'm pleased to say that as of fourth quarter of 2018, we've already achieved $70 million in annualized savings on a run rate basis.

Again to be clear, our fourth quarter results are unsatisfactory and we take ownership of that. But our performance of the quarter should not diminish the significant progress that was made in 2018 to improve our business and strengthen our leadership position.

Last year was all about laying the groundwork and furthering progress in the construction of our portfolio. This year, it's all about implementation and delivering on the expected benefits of our work and we feel that we have the wind at our backs.

Later in the call, I'll speak to some of the trends that we're seeing in the market. But first, let's turn to Pete who'll walk us through the results in more detail. Pete?

Peter J. Vogt {BIO 17059745 <GO>}

Thank you, Albert, and good morning, everyone. During the quarter, we incurred a net loss of $198 million and an operating loss of $148 million. The loss was largely attributable to cat losses associated with Hurricane Michael and the California wildfires, as well as an increase in our ex-cat and weather loss ratio. These negative factors were partially offset by continued favorable prior year reserve development and strong investment income.

Looking at the consolidated income statement for the quarter, the current combined ratio was 117.3%, an increase of 16.6 points from the fourth quarter of 2017. The year-over-year increase in the combined ratio is essentially driven by two areas. First, an 11-point increase in the cat and weather-related losses, primarily impacted by Hurricane Michael and the California wildfires, and an over 2.5-point higher ex-cat and weather loss ratio, substantially caused by the reinsurance segment, where we had both higher property per risk losses and a continuing change in mix of the reinsurance book to less cat business and more casualty business combining to increase loss ratio.

The cat and weather-related losses in the quarter totaled $269 million, net of reinsurance and reinstatement premiums. The insurance segment totaled $92 million in cat and weather-related losses and the insurance segment totaled $177 million. The losses from

Michael and the wildfires combined to come in at the midpoint of our previously provided guidance.

The quarterly G&A ratio was 11.3%. This was a decrease of seven-tenths of a 1 point compared to the same period in the prior year. The decline was driven by ongoing actions that we've previously communicated to you. Notably, in the quarter, the Novae integration generated run rate savings of $10 million and our transformation initiative produced an additional $7 million of savings. There were some one-time expense benefits in the quarter that lowered the G&A ratio. And a normalized G&A expense ratio would be 12.8%. This compares to a normalized G&A ratio of approximately 14.1% for the fourth quarter of 2017, a decrease of 1.3 points year-over-year.

Fee income from strategic capital partners was $6 million in this quarter compared to $8 million in the prior year quarter. This quarter was negatively impacted as we wrote down profit commissions of about $6.5 million due to the impact of the cat losses. This important part of our business continues to grow well with year-to-date fees aggregating $48 million, up from $36 million last year.

For the full calendar year, the company continued to show progress with an ex-cat and weather combined ratio adjusted for PGAAP of 97.6%. The ex-cat and weather loss ratio was down 2 points. The acquisition ratio was essentially flat after adjusting for PGAAP and one-timers and we generated a solid improvement in G&A expense ratio as Novae integration delivered $38 million in full-year savings and the transformation effort has delivered savings over the last two quarters.

Let's move on to the underwriting results of both insurance and reinsurance segments. Let's begin with insurance. The insurance segment reported growth in gross premiums written of $66 million in the quarter due to an increase in credit and political risk, liability and professional lines, partially offset by declines due to the Novae discontinued lines. The growth in insurance net premiums written was reflective of the growth in the gross premiums written.

For the quarter, the insurance combined ratio was 106.3%, which was up year-over-year by 12.4 points. The year-over-year increase in the combined ratio is largely driven by an almost 10-point increase in the cat and weather-related losses. The quarter included 15.6 points of cat and weather-related losses. Pre-tax cat and weather-related losses were $92 million, caused by Hurricane Michael, $62 million, the California wildfires, $27 million, and other events in the quarter totaling $3 million. This compared to $34 million in the same period of 2017. The ex-cat and weather loss ratio ticked up slightly in the quarter compared to the same period last year.

The small year-over-year increase is due to premium adjustments in the quarter; otherwise, on a normalized basis, the ratio is essentially flat. Nevertheless, this is still not a good quarter, not as good a quarter as the prior quarter. This quarter's loss ratio reflects about 4 points of pressure coming from our property book as the rest of the portfolio is performing well. Albert noted that we took a number of positive actions to improve the portfolio during the year; however, it does take time for the affected business to run off the books.

We estimate that fully 2 points of the pressure we saw from the property in this quarter and in year-to-date came from business placed in runoff during 2017 and 2018. It is these reasons that we're remaining confident in the book as we head into 2019.

As discussed in prior quarters, we believe the best way to look at the acquisition cost ratio is adjusted for PGAAP. The insurance segment acquisition cost ratio on an ex-PGAAP basis was 21.2% compared to 20.1% on an ex-PGAAP basis in the prior year, an increase of slightly over a 1-point. The increase was entirely driven by premium adjustments decreasing the fourth quarter 2017 ratio. Without that adjustment, in the prior period, the ex-PGAAP ratio would be flat year-over-year.

For the full year in 2018, insurance improved its ex-cat and weather loss ratio by 2.8 points. Insurance experienced improvement in both the legacy AXIS and legacy Novae books where we saw progress across most lines of business. And it had improvement in its G&A ratio as the Novae integration started to deliver savings, as I noted earlier. We expect that as the cancelled business runs off, as we earned in the better price business written in 2018, the underwriting performance should improve in 2019.

Let's move on to reinsurance. The reinsurance segment reported an increase in gross premiums written of $10 million in the fourth quarter. The increase is driven by reinstatement premiums in the quarter attributable to the fourth quarter cat losses as well as new A&H business. These increases were partially offset by premium adjustments in the property division as well as the restructuring of a significant treaty in our pro lines division.

Reinsurance net premiums written decreased by $38 million compared to the same period in 2017. The decrease in net premiums written reflected the increase in ceded premiums in cat, A&H, credit and surety, and liability, partially offset by an increase in gross premiums written in the quarter.

The reported current quarter combined ratio is 124%, which was up year-over-year by 22 points. The year-over-year increase in the combined ratio is largely driven by a 12.5-point increase in the cat and weather-related losses as well as almost a 5-point increase in the ex-cat and weather loss ratio.

The quarter included 28.8 points of cat and weather-related losses. Pre-tax cat and weather-related losses were $177 million, primarily attributable to Hurricane Michael, $57 million, the California wildfires, a $102 million, and other events in the quarter totaling $18 million. This compared to $99 million in the same period in 2017.

The reinsurance segment, almost 5-point uptick in the ex-cat and weather loss ratio, substantially drove the year-over-year increase in the group's ex-cat and weather loss ratio. The rise in the loss ratio was driven by a few items, including higher mid-size property loss experience. Notably, we increased our estimate for the Colombian dam loss and this impacted the loss ratio by about a 1-point.

We experienced some pressure on the property per risk book from a number of sources. There is no single event and this impacted the book by about almost 2 points. The year-over-year quarter comparison is affected by about a 1-point due to a favorable claim outcome reported in the fourth quarter of 2017. Lastly, our current book has less cat premium and more long tail casualty. This mix change drove almost 1.5-point increase in the loss ratio year-over-year.

The reinsurance segment's acquisition cost ratio was 24.1%, essentially flat to the prior year when adjusting for PGAAP. In 2018, as with insurance, the reinsurance segment saw progress with an improvement of almost a 1-point in its ex-cat and weather loss ratio across both the legacy AXIS and Novae books. And it had an improvement in its G&A ratio of two-tenths of a 1-point.

Moving on to investments. Net investment income in the quarter was $113 million, an increase from $101 million in the fourth quarter of 2017, driven by growth in income from fixed maturity securities attributable to a rise in U.S. Treasury rates. This was partially offset by a decrease in income from the hedge funds due to core equity market performance in the fourth quarter. Our current book yield is 3.1% and our new money yield is 3.6%. The duration of our portfolio is slightly less than three years.

The 50 basis points spread between the current book yield and new money rates provides an ongoing opportunity for increased investment income in the future as our asset portfolio rolls over. Diluted book value per share decreased by 5.3% in the quarter to $49.93, principally driven by operating results, net realized and unrealized losses on investments and common dividends.

And lastly, one additional item to note. With regard to the acquisition of Novae, in the quarter we've recognized amortization of VOBA of $23 million as well as approximately $16 million or 1.3 points of DAC benefit at the segment level. The net drag on operating income from the VOBA/DAC adjustment was $9 million after-tax or approximately $0.11 per share in the quarter. For the year, we experienced a drag on operating income of $48 million after-tax from the VOBA and DAC adjustment. The good news is that VOBA is almost gone, and in 2019, we expect approximately only about an $8 million net drag on operating income.

That summarizes our fourth quarter results. And now, I'll turn the call back over to Albert.

Albert A. Benchimol {BIO 2023727 <GO>}

Thanks, Pete. And now, it's been a few minutes discussing market trends and then we'll open the call for questions. The bottom line is that the fourth quarter exhibited an acceleration of the positive pricing trends we observed during the year and everything we see points to a continuation of market discipline in 2019.

Within our insurance segment, the fourth quarter was the strongest of the year with an average rate increase of 5%. This compared to average increases of 4% in the prior three quarters, bringing the average for the full year to about 4.3%. December was even stronger with average increases in excess of 6%.

From what we observe, we believe our average rate increases are ahead of the market, a belief that is supported by our retention rates that are almost 10 points lower than last year. In our U.S. division, average rate increases were plus 7% for the quarter, rising to nearly 9% in December. Rate was led by U.S. Excess Casualty and E&S Property, which both finished the year at about 11% for the quarter and the year-to-date.

U.S. programs generated rate increases at 3% for the quarter and 4% for the year, while our primary casualty book rate was up 3% in the quarter and 5% for the year. Within our North American professional lines division, average rate was relatively stable at about 1% for the quarter and year, although here too we observed an acceleration in December. Within that average, there is a fair amount of variance. Primary business was strongest at about 4%, while excess layers averaged over 2%. Our profitable small E&O portfolio was essentially flat for the year.

In our London-based international insurance division, pricing was strong in the fourth quarter with average rates up 8% bringing the full-year average up to 4%. After some firm action by Lloyd's in the year, we saw the closure of eight syndicates and over 70 different announcements of exit or significant reductions in various lines from market participants. This newfound discipline is having a tangible impact on risk appetite and pricing and there are several anecdotes of price increases in the plus 100% to 300% range in the market.

Of all the major lines, only terrorism and political and credit risk showed average price reductions in the quarter. Even perennial laggards such as aviation delivered 10% plus increases. Overall, across our entire insurance segment, 87% of the business renewed at flat or better in the quarter.

Let's now turn to reinsurance where we just completed our 01/01 renewal season with more than 50% of our business up for renewal at that date. Our team achieved bottom line growth and modest improvements in the price technical ratio. Consistent with industry trends, we saw price increases in loss-affected areas, but overall, the market was generally flat.

Conditions varied greatly by line and geography. In EMEA, Europe, Middle East and Africa, the market is still quite competitive. Rates were generally flat. Loss-affected non-cat property was modestly positive in the low-single digit and liability was strongest, as pricing reflected anticipated loss trends.

In our global specialty markets business, rates were again flat on average with the exception of engineering, in light of recent poor results and lower Lloyd's capacity, with up to double-digit increases for underperforming accounts.

In North America, there was more price action, perhaps reflective of a greater dissatisfaction with recent results in loss trends. There were very little price reductions and pricing responded to loss activity. I would note that professional lines exhibited the strongest price action in the plus 5% to plus 10% range, but in some cases, that was still not enough and we reduced exposures where warranted.

Global cat pricing was a disappointment to us at January 1. Loss-exposed accounts achieved increases anywhere from 10% to 25%, but non-loss-affected accounts renewed flat or with reductions in the low-single-digit range, especially in Europe where capacity was plentiful. Net-net, it could be described as a flat renewal.

Generally across the book, ceding commissions were flat unless the underlying book was not performing adequately. Overall, we achieved modest growth in North America and Asia and reduced our renewing book in Europe and in global specialty markets. We believe we achieved better balance in our book with a modest improvement in the price technical ratio.

Looking forward, we will have the large Asia Pacific renewals in April and the North American renewals in June and July. Both markets experienced significant cat losses recently, and we would expect to see stronger price movements in Japan when the flood risks, as well as the U.S. cat books, while other lines should continue to behave in a manner consistent with January 1. And by that, I mean that reinsurers should share in the improvements that they're seeing in their clients.

Our attitude across both insurance and reinsurance is that most lines of business require more price action for this industry to deliver an adequate return. And we intend to push hard for it. We're not afraid to incur low retention rates or shrinkage in businesses that are not delivering the right returns. While it will be imprudent for me to make overly confident statements about the future, our expectation is that the market is gaining momentum in the right direction as carriers recognized both recent claims and expected loss trends.

We remain confident that we will continue to improve our underwriting results, as the business that we cancelled or not renewed runs off our books, and the more recent better priced and more balanced business is earned through. AXIS is poised for significant continued progress in 2019, and if we stay true to our strategy and our core priorities, we believe that we are well-positioned to drive meaningfully improved profitability.

And now, let's please open the line for questions. Operator?

Q&A

Operator

The first question is from Elyse Greenspan of Wells Fargo. Please go ahead.

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

Hi, good morning. My first question is going back to some of your comments on the property losses, in particular, in the insurance book. So I think you guys made a comment in introductory remarks pointing to margin improvement in that book in 2019. Can you just, say, if that's going to be loss and expense ratio driven, or I'm assuming both?

And then, as we think about the programs running off, what type of drag should we think about you know that we could potentially see if these property losses remain somewhat elevated in 2019?

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

Right. So let me start with the background and then Pete please walk us through the specific numbers. I think that it's important to state that in the insurance book in particular, notwithstanding property losses that did not meet our expectations, the overall results for insurance actually did not deteriorate meaningfully. So, most of the deterioration that you saw with us in the quarter really related to the elevated losses that we saw in the reinsurance book and I believe Pete walked us through those in specific.

With regards to the improvements that we expect to see next year, it's our expectation that you should see improvement both in the loss ratios, as well as our G&A ratios as we continue to achieve efficiency. But Pete, you want to walk us through some of those specific numbers on the improvement?

A - Peter J. Vogt {BIO 17059745 <GO>}

Yes. So, Elyse, we should see improvements in both areas. As I said, right now, we know that there was 2 points of pressure associated directly with business, that's already been cancelled and that was just in the quarter. With regard to that, we've taken serious actions year-over-year with regard to what we did in 2018.

So I would expect to see an overall improvement just on an ex-PGAAP basis and an ex-cat combined ratio on the loss side about over - about a 1-point associated on entire company just from what we've already cancelled on the insurance book. And that does not take into account I'd say other underwriting actions, as well it doesn't take into account the expected higher rates that we got in 2018 starting to earn in, in 2019.

In addition to that, I do expect the G&A ratio - while I think this quarter, it was - as I said it was artificially low, I do expect the G&A ratio for insurance to continue to improve as we continue to get more synergies associated with Novae. As I noted, there was $38 million actually experienced in 2018, but by the time we got to the end of the year, we expect next year to be more like a $45 million, so an additional $7 million there, just on Novae. And our transformation initiatives too will continue to kick in next year as we go towards our goal of saving a net $100 million by 2020.

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

Just looking back to that - to the point that, Pete talked about a 1-point of improvement, that's essentially baked in from the business that's been cancelled, and we have on that non-renewed or cancelled business probably less than $50 million all in of UPR. So there, of course, we'll have some possible drag on that, but fundamentally, that book will be off the books and we should see that go away. I really do want to emphasize, however, that we continue to expect that the other changes that we are making on our book both in terms of pricing, portfolio construction and selection should also drive additional improvements.

A - Peter J. Vogt {BIO 17059745 <GO>}

That's why to be clear, Elyse, it's over 2 points on the insurance segment alone and right about a 1-point to the entire company year-over-year.

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

Okay. And then maybe following up on Albert's comments in terms of pointing to price. So it seems like you guys are expecting some more price increases in reinsurance as we get to April and midyear. As you think about the reinsurance environment, some of the mix shifts that you guys pointed to, a bit more casualty in the fourth quarter had an impact. How should we think about the underlying loss ratio within reinsurance trending in 2019?

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

Right. So two comments that I would make is everything that I tell you with regards to what we're seeing on the primary insurance rate changes to the extent that we're participating in quota shares. And as I mentioned, by and large, we're not seeing major changes in the ceding commissions, a lot of those improvements will drive through into the reinsurance book also. And in the XOL lines, we're also responding to losses with pricing increases where necessary. So we also expect positive trends in the underlying books in the reinsurance part.

The second comment is to your point with regards to the mix of business. And it's interesting that the way that this industry captures the ex-cat combined ratio is interesting because it gives full credit to the premium that you collect on the cat line, but it excludes the cat losses. So the more cat business you write, the more attractive your ex-cat loss ratio is. And that's really what's affecting the mix. We are writing less cat on a net basis through this year. My guess is that there will not be a major change of that into 2019.

So I would hope that the full mix impact that we saw through the fourth quarter of 2018 is the bigger piece of it, there will continue to be some small impact in 2019. But, Elyse, I think it's too small and it'll be lost in the rounding. So, I wouldn't model that. I would just note that we expect some, but too small to really stick out as a driving factor.

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

Okay, thank you. And then, one last quick question. You guys had said after – I believe after 01/01 renewals when you had a sense of the market, they would reevaluate whether you guys would have return to buying back some of your stock kind of post Novae integration et cetera. Given where your stock is trading today, I'd assume share repurchase a bit more attractive. Can you just provide us an update on your views on repurchases for 2019?

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

I think that's fair. So, we've got two countervailing positions that we will be discussing at our upcoming board meeting. The first is that obviously this was a disappointing quarter and our equity is down given the cat losses, and that's something that we need to build back up.

On the other hand, we've recognized that the price of the stock is very attractive, and that is something that we'll need to consider. So, we will be considering both issues as we sit down with our board and go through it. But I think given where we are, given the recent losses in the capital, whatever action we would do if any would be limited.

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

Okay. Thank you very much.

Operator

The next question is from Brian Meredith of UBS. Please go ahead.

Q - Brian Meredith {BIO 3108204 <GO>}

Hey, thanks. Couple of quick questions here for you. First one, I'm just curious Pete, the G&A ratio that was lower this quarter or lower expenses. Is there going to be any kind of reversal of that actually if we look into the next couple of quarters?

A - Peter J. Vogt {BIO 17059745 <GO>}

Yeah, it definitely will, Brian. As I noticed, it was normalized, it was low on a normalized basis, it was closer to 13%. And I'd say that you'll see it kind of rise to those levels over the next couple of quarters, it's not going to stay down to where it was this particular quarter.

Q - Brian Meredith {BIO 3108204 <GO>}

I guess what was meant (00:34:13) would it be maybe a little bit higher than usual in the next couple of quarters to offset that. It was a timing issue on kind of G&A expense recognition.

A - Peter J. Vogt {BIO 17059745 <GO>}

Yeah. As I've said through the year, I do think that right now we are running a little bit low that I would trend the expense ratio, the G&A ratio more to that, I'll call it, 13.4%, 13.5% level right around there.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay, great.

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

As you might imagine – Brian, as you might imagine, there were a number of adjustments, including certainly incentive comp reductions that came in, in the quarter. But the thing that is relevant in my mind is that we look at both the reported number and then we look at the normalized number. And the progress in the normalized number I think is quite strong, because last year we also had a low fourth quarter G&A ratio.

But if you look at the normalized for last year's fourth quarter and the normalized for this year's fourth quarter, the 12.8% that Pete referred to would have been a 14.1% in the fourth quarter of 2017. So, we are – the improvement is consistent, and it's across the board. It's just that obviously we hope to deliver results next year that will allow for a fuller incentive comp budget.

Q - Brian Meredith {BIO 3108204 <GO>}

(00:35:38). And then, Albert, I'm just curious. Obviously, some fairly positive commentary about the rate environment at Lloyd's. You guys kind of have a pretty big exposure there now. Are you in a position now given some of the underwriting actions that are going on with your existing book to actually see some solid growth at Lloyd's?

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

I think there are some opportunities, but I want to be very clear to everybody. Growth is secondary to profitability right now. And so, if we get offered 5 or 6 points of pricing and we think we need 10, we're not going to take that growth. So I think there are opportunities, I think this is probably the best market at Lloyd's in a number of years. And I think there are opportunities for growth and where there are those opportunities, we will take advantage of them, but profitability is our number one priority.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you, got you. I was just wondering given that there are a number of syndicates that are (00:36:36) having to shut business, that was whether you were able to take that, okay?

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

Oh, yes, those opportunities are absolutely there.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. And then I guess another question here for you, when we think about ceded reinsurance program here going forward, and I understand most of the large loss activity this year was some business that was kind running off, but any kind of thoughts or change in the ceded reinsurance program, maybe that protect a little bit against some of the volatility in attritional or other things which you're thinking about as far as cat protection, et cetera?

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

Absolutely. And to be fair, we're always looking to improve our risk funding and our ceded program, and it's probably a good time to identify that we have made many improvements in 2018 and that we will continue to make some more.

So I'll just give you a couple of quick examples. You've all heard about how difficult the third-party capital market was at the renewal. We think that we should take pride that we're one of the very few companies that actually was able to increase the amount of third party capital support that we achieved at 01/01. We have more third-party capital. We have more diversified group of investors in our third party capital. And we continue to expand the number of lines that we share with third party capital.

And to your point, Brian, one of the new facilities that we created at 01/01 in (00:38:04) is a property sidecar for our insurance book and that obviously increased quota share participation will serve to reduce or mitigate the volatility in that property book as we look through that.

We've also done a number of additions including buying some aggregate excess of loss to which prevents tail end exposure and by the way would have been almost fully utilized in an HIM scenario. So these are in the working layers, if you would – if you know what I mean. And we are going to be renewing our various property programs in May. And again, we will be looking for opportunities to enhance that. So net-net, our ceded protection package is a better package at 01/01/2019 than it was last year.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. And then one last question, I'm just curious, Albert, your thoughts on the kind of California fire and availability of kind of commercial coverage there, pricing, and is it a spot that there could be opportunities here or to kind of reevaluate it?

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

I think that one of the things that we spoke about during the year and accentuated in the fourth quarter is I think that the industry in general has a bit of an issue with property in some parts of the property cat. So I think it deserves more study before we jump in at the slightest offer of rates. I can tell you that we already got out of some of the most exposed liability lines in California last year that turned out to have been a good decision.

I think, again, right now, caution is probably the right order. We're doing more studies. We think that we need to continue to make changes in the book, that's exposed to the California wildfire. In fact, some of the non-renewed business that Pete spoke about had some of that exposure. There are a lot of changes. I think climate change is driving different patterns, different frequencies. I believe that caution and analysis is probably the first order. And then, if we can figure out good ways of taking that risk in a profitable way, we will do so. But I would caution before jumping in.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thank you.

Operator

The next question is from Yaron Kinar of Goldman Sachs. Please go ahead.

Q - Yaron Kinar {BIO 17146197 <GO>}

Good morning, everybody. Albert, in your pricing commentary, it sounds like you are taking more aggressive pricing action than the market, and it is somewhat reflected in lower retention rates. So, how should we think about the premium growth opportunity into 2019 and potentially its impact on the expense ratio if growth maybe is impacted by these pricing actions?

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

Well, the good news is that in delivering our plan and of course we don't share our plan, but I can tell you that in delivering our plan, we already took into account the fact that our pricing actions may result in lower retention ratios. And we still believe that we can deliver improvements in our core G&A ratio.

So my view is that it's still there. There's still more efficiencies to be achieved through the Novae and the transformation program. And I do expect that we will have some growth in some areas. So net-net, we're still optimistic as we mentioned earlier that the results in 2019 will include improvements, both in the loss ratio and in the G&A ratio.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay, got it. And then with regards to the elevated frequency of non-cat severity and property, you had mentioned that it's an industry phenomenon. So, is that something that's addressed through pricing, or is that also addressed through the reinsurance program shifts that you were talking about?

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

Well, honestly, I think it ultimately has to be a ground-up pricing issue, because I mean there's only so much that the ceding companies can stuff the reinsurers with and not expect that at some point reinsurers say stop. The job of the reinsurance industry is not to subsidize the profits of the primary insurance company, it's to sharing risk. But the pricing has to be right, both at the primary level and at the reinsurance level.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. And then, maybe one quick conceptual question on casualty lines. So, it sounds like at the end of the day pricing there has been relatively stable, maybe a little better in specialty lines. But as we think of possible inflationary trends, especially social inflation, how does that impact the overall profitability and adequacy of those lines? How are you thinking of that into 2019, if some of the pricing actions that you are getting tend to be in those lines that have struggled a bit more to begin with?

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

That's an excellent question. But I think there's both an industry comment and an AXIS comment. So I will tell you that our primary casualty and our excess casualty, we only play in the excess and surplus world. That's number one.

And so they tend to be highly structured and analyzed. We are actually quite satisfied with the profitability that we see in both our casualty and/or excess casualty books. We've achieved an average price increase of 5% on the primary casualty, which is certainly ahead of loss trends. There's always the risk if you would of runoff inflation. But I can tell you that when we price them, when we reserve, we don't reserve to the most recent inflationary trends, we reserve at what we assume to be the longer-term trend.

And frankly, one of the things that is driving our reserve releases is that these longer-term loss trends that we reserve with haven't developed. So, that's why we're getting reserve releases. But we will continue to reserve at what we believe is a reasonable, prudent long-term trend. And the 5% for the moment on the primary casualty, we feel very good about. The issue that we have on the excess casualty where I believe we've got one of the best E&S excess and umbrella casualty books out there, and we have very low exposure, net exposure to the auto liability which has been one of the worst drivers of losses. We're achieving 11%, 12% pricing increase.

The issue for us is that we believe that the definition of excess needs to change. 20 years ago, excess was above $2 million. Well, $2 million is a working layer today. And we think that where we're pushing is that excess needs to attach closer to $5 million to really be considered excess. And I think that speaks to your point, Yaron, of inflation, but where we insure, where we participate we're comfortable that we've got these issues of inflation and frequency covered, but we believe the industry needs to change the definition of excess to something closer to $5 million.

Q - Yaron Kinar {BIO 17146197 <GO>}

Thank you. A very helpful color. Good luck in the year ahead.

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

Thank you.

Operator

The next question is from Kai Pan of Morgan Stanley. Please go ahead.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you. And good morning. First question, and Pete you mentioned that the quarter was impacted by 2.5 points (00:46:14) large losses. If you take this out, the underlying combined ratio about 96% in the fourth quarter is still higher than the average, about 94% previous three quarters. So just wonder what's the sort of base to starting with running into the next four quarters?

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

Yeah. So, Kai, probably a better way to look at it. As I said in the quarter, you had some noise especially on the reinsurance property book and in that, with the dam loss. So I would probably tell you we are steering towards next year, maybe look more towards how our full year 2018 numbers were. And then as we mentioned earlier, we do think that even when you look at the full year given some of the portfolio actions we've taken, you should see improvement, so you should be able to see the combined ratio coming down from there, not only on the ex-cat and loss ratio, but also on the G&A ratio.

A - Peter J. Vogt {BIO 17059745 <GO>}

And I think what you're refreshing to is that point of runoff.

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

Yeah. The point of runoff business that you go away, but also as we've noted in the quarter, we had just in the quarter on the reinsurance side, we had almost a 1 point hit due to moving up the dam loss for the year or so. So I think when you start to normalize some of those things, Kai, I would say started a full year look of 2018 and then with the actions we've taken, we think that you should be able to see improvement as we get into 2019.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Just on that, besides the runoff business, what exactly you are doing try to reduce some of the volatility and improve the results?

A - Peter J. Vogt {BIO 17059745 <GO>}

I'd say a couple of things building on what Albert said. One is we have seen a positive rate and trend in 2018 - rate over trend and that's now going to start to earn in as we go into 2019. We have seen better terms and conditions for our underwriters on the primary side as they've seen what's going on with losses there and moving up on layers to get out of some working layers.

And on the reinsurance side, they continue to restructure the book to actually get pricing improvements which we've definitely seen in motor that will continue as we go in, in next year. And then probably lastly, on the volatility side, as Albert mentioned, we've actually put more ceded and retro programs in place on both the insurance and reinsurance books that we go into 2019.

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

Let me add a little to that, Kai, because I think you raised a very important point. We're not going to improve the numbers simply by cancelling business. And there are a number of areas that we are focusing for improvement and let's speak to property first. One of the issues with properties is that we can always take a look at a number of programs that just are not working for us. Some honestly we knew early on is that we would want to not renew, but 01/01/2018, excuse me, it was just too late to act on some of them, so we took some opportunities to deal with that.

That will have two factors. One in terms of the profitability, but also the truth is that a number of these programs also had significant impact on volatility. So, they will have that issue. But more importantly, we're doing more work around geospatial modeling to make sure that we are looking at our (00:49:38) concentrations. We've taken significant actions around, especially tornado, hail, the kinds of occupancies that we're looking at the kinds of rues (00:49:47), the kinds of deductibles that we're looking into.

So, this is not just canceling business and saying everything stays the same. Every part of our business is being reviewed and property is job number one for us right now. And there are significant changes, both in the risk appetite, in the structures, in the deductibles and in the distribution of that portfolio on top of price. And so, we obviously don't want to make any promises, but we're working hard to make sure that we see significant improvements in that book.

Q - Kai Pan {BIO 18669701 <GO>}

Okay.

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

With regards to other books of business, the truth is that if you look at professional lines, you know what, I think we were early. I mean, we spoke to you about some of our concerns professional lines in 2013 and 2014, we acted aggressively on that. We've taken a significant number of loss ratio points off that book. Our exposure to class actions is much lower than it's been in the past and we continue to be releasing reserves, because we realize that, last year, the year before, the year before that, we're actually better than we reserved. So from our perspective, you know we're always cautious. I think that's an area where we've got proof positive that we can identify portfolios and we can fix them. So that's working well.

Casualty, as you know we're being very cautious. We're looking to elevate attachment points. With regards to reinsurance, we're making sure that we're supporting only those customers who have good long-term relationships with us. So, we're taking actions across the entire book to ensure that the continuing book is improving, not simply through the removal of bad programs. I hope that it helps and you understand what we're referring to (00:51:40).

Q - Kai Pan {BIO 18669701 <GO>}

Yeah. That was very helpful. But if you're putting everything together – my last question is that, you've been getting close or above 10% ROE in the first three quarters of the year. And so, if you consider normalized environment, consider all the improvements you're making in your business, do you think in the normalized cat environment in 2019 you could get to 10%?

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

Absolutely. I thought we were going to get it in 2018, and it's a real disappointment to us that it isn't. And one of the reasons that the incentive comp is down is because we didn't achieve our target. It's that simple. And I fully expect that everything that we're doing will deliver double-digit ROE assuming reasonable cat activity next year.

Q - Kai Pan {BIO 18669701 <GO>}

That's great. I'm now assuming your internal target is 10%?

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

No. You should not assume that my internal target is 10%.

Q - Kai Pan {BIO 18669701 <GO>}

All right. Thank you so much.

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

Thanks, Kai.

Operator

The next question is from Meyer Shields of KBW. Please go ahead.

Q - Meyer Shields {BIO 4281064 <GO>}

Great. Thanks. Good morning. Albert, you've talked I think a fair amount about reducing volatility and we're seeing lower P&Ls in most zones. Does that imply the potential for investment portfolio duration lengthening?

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

That's a very good question. So, there are two things that this will address. One, believe it or not longer term is that you're prepared to take a little bit more equity volatility risk, since you've got less volatility risk around the cat. But the two factors that will affect our duration is both, our liability duration, but also our view with regard to interest rates and spreads. And so right now we're cautious. I don't know - I forget if Peter mentioned it, but we were about 2.8 is our average duration. And I think certainly the pressure in the near-term is to slow the rate increases, but our view is that longer-term we're probably still in an increasing rate environment. So, we are currently below our liability duration. And in the near-term, I expect that we will remain below our liability duration, but there is opportunity to extend at the right time.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's very helpful. And second question just in terms of I guess trying to forecast reserve development. Clearly, your picks have been very conservative in light of the accelerating loss cost inflation that we're seeing. Are you sticking with the same level of picks or are you actually dialing them up so that the delta is constant.

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

It's not the picks that stay the same. It's the underlying assumptions that stays the same. So by definition, you're working with different ab initio loss ratios. You're reflecting the trends for the mix of business. But when it comes to long-term inflation and long-term trends, we're keeping those at the higher levels that we've used in the past.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Perfect. Thanks so much.

A - Peter J. Vogt {BIO 17059745 <GO>}

Yeah. And Meyer I'll just build on that for a second. One thing that I did not mentioned in my remarks that impacted the prior period development in the quarter was on the reinsurance side. We have acknowledged that the ADNOC loss that occurred in 2017 that that very tragic event, the industry loss estimate is now up to $2 billion. And so we've moved our reserve up expecting it to be a $2 billion event. I don't know if everybody else in the industry has done that yet, but we felt that that was very prudent to do and that kind of weighed on some of the prior period development for the reinsurance segment.

Q - Meyer Shields {BIO 4281064 <GO>}

That's fair. Is there any way of quantifying that?

A - Peter J. Vogt {BIO 17059745 <GO>}

Yeah. I'd call it. Yeah, yeah, probably about a little over...

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

For the industry?

A - Peter J. Vogt {BIO 17059745 <GO>}

Yeah. That was a 30% increase for the industry. So for us...

(00:55:41)

...is about the same, yeah. Dollar wise, it was about $8 million - about $6 million to $7 million.

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

All right.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Perfect. Thanks so much.

Operator

The next question is from Josh Shanker of Deutsche Bank. Please go ahead.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Yes. Thank you very much.

A - Peter J. Vogt {BIO 17059745 <GO>}

Good morning, Josh.

Q - Josh D. Shanker {BIO 5292022 <GO>}

How are you doing there?. Excluding your commentary about the dam, by the way thank you very much. How are we looking at past year cats and other manmade losses? And how does that impact the reinsurance net prior period develop numbers?

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

So the prior year losses on the cats overall have been very solid. We've done very well on that. I think the last time we had some really bad surprises was in New Zealand. I will say this about our HIM losses is that we cut the total number rates. We were a little bit high on the insurance number. We were a little bit low on the reinsurance number. Net-net those reserves actually developed favorably for AXIS.

And so our reinsurance book as you might imagine was not immune to some of the adverse development that we saw in Irma, and so we had some modest deterioration in the reinsurance book, but that was more than offset by favorable development in the insurance book.

Q - Josh D. Shanker {BIO 5292022 <GO>}

And when we look at the – I mean, look you did have favorable development in reinsurance here in the fourth quarter...

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

Sure, yeah.

Q - Josh D. Shanker {BIO 5292022 <GO>}

...that was lower than it usually is. And, obviously, HIM aren't all the losses. There were some manmade events too. Can we sort of go through a catalog of what's – whether there were offsets whether it was a quarter like previous others with some one-offs or whatnot?

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

Look, I think to Peter's point, I mean if you look at the favorable development in the fourth quarter, the bulk of the reduction over longer term trends really related to both the ADNOC that we've just discussed. And the thing that was a little bit surprising is, we got some adverse development for non-cat property, which we thought was a bit late in terms of the reporting in the fourth quarter of 2018 for losses that apparently occurred in 2017. So we're digging into that. But those were the two reasons why the favorable development in the fourth quarter for reinsurance is lower. Anything you want to add to that Peter?

A - Peter J. Vogt {BIO 17059745 <GO>}

No. Those are the two major drivers, both on the property line. One is the increase in the manmade loss as we mentioned earlier as well as some late reporting on 2017 property per risk losses.

Q - Josh D. Shanker {BIO 5292022 <GO>}

And just to put a bow on this the previous cat picks, have they been accurate or they've been redundant?

A - Peter J. Vogt {BIO 17059745 <GO>}

For the most part, Josh, we've been redundant. We tend to, I believe, do a conservative view as to what we do for the cats. Overall we've been – overall our history other than New Zealand and the specific event of Irma, but when you look at HIM altogether it's been redundant. We've been pretty conservative as we've put our initial estimates up.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Okay. Well, thank you for all the questions.

A - Peter J. Vogt {BIO 17059745 <GO>}

Thank you. And as you know, with regard to the fourth quarter, we do announce the large losses. We had two press releases in the quarter one for Michael and then one for the wildfires which updated Michael. And net-net, our final number came in within the range that we reported in those press releases.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Well, good luck. Lots of changes coming I see. Good luck with them.

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

Yeah. Thank you very much, Josh.

A - Peter J. Vogt {BIO 17059745 <GO>}

Thanks, Josh.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Albert Benchimol for closing remarks.

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

Thank you, operator, and thank you to everyone on the call this morning. So, as I said at the beginning of the call, 2018 was a year where we took steps forward, both in terms of underwriting profitability and organizational progress. Look, we're not happy with the fourth quarter results, but we do remain confident that we have the right strategy and that our pace of progress will continue as we execute that strategy.

Before we conclude, I'd like to take a moment to express my appreciation to our employees. We have a great team and they've expanded (01:00:18) really substantial amount of work and delivered strong progress in 2018 for which we expect to see some tangible results in 2019.

And to everyone, we look forward to reporting to you on that progress in future calls in the year. Thank you very much.

Operator

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