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Bloomberg Transcript

Q3 2016 Earnings Call

Company Participants

- Craig W. Howie, Chief Financial Officer & Executive Vice President
- Dominic James Addesso, President, Chief Executive Officer & Director
- Elizabeth B. Farrell, Vice President-Investor Relations
- John P. Doucette, Executive Vice President, President and Chief Executive Officer of the Reinsurance Division
- Jonathan M. Zaffino, Senior Vice President & President-North American Insurance Division

Other Participants

- Elyse B. Greenspan, Analyst
- Jay Gelb, Analyst
- Josh D. Shanker, Analyst
- Kai Pan, Analyst
- Michael Nannizzi, Analyst
- Quentin McMillan, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, everyone and welcome to the Third Quarter 2016 Earnings Call for Everest Re Group. Today's call is being recorded. At this time, for opening remarks and introductions, I would like to turn the conference over to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead, ma'am.

Elizabeth B. Farrell {BIO 1986541 <GO>}

Thank you, Keith. Good morning and welcome to Everest Re Group's third quarter earnings conference call. On the call with me today are Dom Addesso, the company's President and Chief Executive Officer; Craig Howie, our Chief Financial Officer; John Doucette, President and CEO of our Reinsurance Operation; and Jon Zaffino, President of North America Insurance Operation.

Before we begin, I will preface our comments by noting that our SEC filings include extensive disclosures with respect to forward-looking statements. In that regard, I note that statements made during today's call which are forward-looking in nature, such as statements about projections, estimates, expectations and the likes are subject to various risks. As you know, actual results could differ materially from current projections or expectations. Our SEC filings have a full listing of the risks that investors should consider in connection with such statements.

Now, let me turn this call over to Dom.

Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Beth. Good morning and welcome to our third quarter earnings call. This morning we have very positive results to report, although many are probably already more interested in next quarter as a consequence of Hurricane Matthew. We will get to that, but first a bit about the third quarter.

As you're seeing, the operating earnings per share were $6.53, which translates to a 14% annualized operating ROE. This, of course, beats expectations in part due to another light cat quarter. However, that is only part of the story. Overall, the attritional combined ratio has improved year-over-year, and I believe represents the more relevant part of the message.

In both the reinsurance and insurance segments, there is positive movement. Reinsurance, for example, on a year-to-date basis, has improved the attritional combined ratio from 82.7% to 80.7%. This is partly due to a lower frequency of large risk losses, but also a result of continuing to modify our portfolio in the face of a declining rate environment to achieve the best risk-adjusted returns.

In addition, and perhaps more impactful, are the newer lines of business we are taking on, which in general include mortgage and credit exposure, as well as structured products. John Doucette will give some detail on these in his report.

On the insurance side, the story is also favorable after excluding Heartland, which, as you know, was our crop operation that was sold during the quarter. Excluding crop, the North American insurance operation reported a year-to-date attritional combined ratio of 96.4%. This is higher than our longer-term objective, partly due to an increased expense ratio, as we are currently ramping up and investing heavily in this segment, both domestically and internationally.

This is consistent with the strategy we have discussed in the past. A build-versus-buy strategy has been our best option as we have been able to capitalize on the Everest brand and the talent availability coming from recent M&A transactions, as well as corporate restructurings.

Also elevating the insurance attritional combined ratio this year was an abnormally high level of weather events. Taking all this into account, we are extremely pleased with our portfolio and how the operational build is progressing. Jonathan Zaffino will later give you further details on the insurance operation.

To sum up, our reinsurance and insurance operations generated underwriting income excluding cat losses through the nine months of $583 million, which on average is almost $200 million per quarter. When combined with average quarterly investment income, operating earnings are in the range of approximately $315 million per quarter before cat losses. At our current effective tax rate, that equates to approximately $275 million. This number is relevant as you begin to think about the impact of Hurricane Matthew on fourth quarter results.

Currently, our modeled estimate for an industry loss that ranges between $3 billion and $9 billion are $75 million to $200 million net of taxes and reinstatement premiums. At this early stage, this is our best estimate and would appear to be contained within our otherwise normal quarterly operating earnings.

Turning to other items of note, first is net investment income was above the prior year's quarter and on a year-to-date basis essentially flat. Given the current investment environment and the current reinvestment rates are lower than maturing assets, this is an outstanding result.

Not unlike the underwriting portfolio, we take similar action on the investment front. Rotation into good risk-adjusted bets has been the strategy which has maintained yield, but with one of the lowest betas in the industry.

Second, with the aforementioned sale of our crop operation in the third quarter, we clearly were not at the scale we needed to be in order to be sufficiently profitable. The outcome was essentially a transaction which converted our insurance book into a reinsurance program, taking advantage of the expense synergies that our client can bring to bear in a larger portfolio.

Finally, I would like to highlight the $200 million of share repurchases that were made since last quarter. This brings the year-to-date number to $386 million. We continue to manage capital with an approach that considers our long-term business opportunity. This essentially means that while we do buy-in capital, our bias is that we will continue to find ways to put capital to work profitably and grow the franchise. Our history would suggest that we have managed this effectively. And therefore, as always, we elect not to give guidance on this point to maintain our flexibility.

While current market conditions do not point to any rapid growth, there remain numerous opportunities to put capital to work. In particular, we see a continued pace in the insurance segment, as well as specialty areas in the reinsurance sector. Therefore, for now, we will maintain our current capital management strategy of share repurchases and dividends at a level less than our projected earnings.

With that, I want to thank you and turn it over to Craig for the financial highlights.

Craig W. Howie {BIO 17579923 <GO>}

Thank you, Dom, and good morning, everyone. Everest had a solid quarter of earnings with net income of $295 million. This compares to net income of $89 million for the third quarter of 2015. Net income includes realized capital gains and losses. On a year-to-date basis, net income was $623 million, compared to $621 million in 2015. After-tax operating income for the third quarter was $273 million, compared to $200 million in 2015.

Operating income year-to-date was $630 million, compared to $755 million in 2015. The primary differences were catastrophe losses and foreign exchange. The overall underwriting gain for the group was $432 million for the first nine months, compared to an underwriting gain of $498 million for the same period last year. On a year-to-date basis, the overall results reflected gross catastrophe losses of $151 million in 2016, compared to $61 million in 2015.

In the third quarter of 2016, the group saw $18 million of catastrophe losses. These losses primarily related to Hurricane Hermine in Florida. This compares to $34 million of catastrophes during the third quarter of 2015.

The overall current year attritional combined ratio through the first nine months was 85.2%, down from 85.8% for the same period in 2015. The 2015 attritional ratio included a $60 million loss estimate for the explosions at the Chinese port of Tianjin. Our year-to-date expense ratio was 5.8% as we anticipated with the build-out of our insurance platform and our Lloyd's Syndicate.

For investments, pre-tax investment income was $123 million for the quarter and $358 million year-to-date on our $17.5 billion investment portfolio. Investment income year-to-date declined only $5 million from one year ago. We've been able to maintain investment yield without a dramatic shift in our overall investment portfolio.

However, as Dom mentioned, we have gradually shifted allocations within our alternative investment bucket to de-risk the portfolio. We have reduced our exposure to emerging market debt and public equity, while committing more toward fixed income limited partnership investment, all while maintaining a conservative, well-diversified, high credit quality bond portfolio. The pre-tax yield on the overall portfolio was 3% and duration remained at about three years.

Foreign exchange as reported in other income. Foreign exchange gains were $2 million in the third quarter. Year-to-date foreign exchange losses were $29 million, compared to $62 million of foreign exchange gains in the first nine months of 2015. Both of these results are unusual and represent a $91 million pre-tax swing year-over-year.

The 2016 foreign exchange losses primarily reflect the relative strengthening of the U.S. dollar against other world currencies, including the British pound and the euro. The foreign exchange impact is effectively an accounting mismatch, since its offset in shareholders' equity through translation adjustments and unrealized gains due to the positive impact of holding foreign investments that are available for sale. Overall, we maintain an economic-neutral position with respect to foreign exchange, matching assets with liabilities in most major world currencies.

Other income also included $10 million of earnings and fees from Mt. Logan Re in the first nine months of 2016, compared to $15 million of income for the same period last year. The decline essentially represents the higher level of catastrophe losses during 2016.

On income taxes. The 13.2% year-to-date annualized effective tax rate on operating income was lower than the 14.8% tax rate at this time last year. This is primarily due to foreign exchange losses and the higher level of catastrophe losses in 2016. A 13% to 15% effective tax rate on operating income for the full year is in line with our expectations, depending on the amount of catastrophe losses for the remainder of the year.

Stable cash flow continues with operating cash flows at $951 million for the first nine months of 2016, compared to $802 million in 2015, which in part is reflective of our strong reserve position compared to actual paid losses.

Shareholders' equity for the group was $8 billion at the end of the third quarter, up $433 million or 6% over year-end 2015. This is after taking into account capital return through $379 million of share buybacks and the $144 million of dividends paid in the first nine months of 2016, which, combined, represent a return of 84% of net income.

Additionally, we repurchased another $7 million of stock after the third quarter closed. These purchases will be reflective in the fourth quarter 2016 financial statements. Book value per share increased 10% to $196.67 from $178.21 at year-end 2015, generating 12% growth in shareholder value, including dividends. Our strong capital balance leaves us well-positioned for business opportunities as well as continuing share repurchases.

Thank you. And now John Doucette will provide a review of the reinsurance operations.

John P. Doucette {BIO 7178336 <GO>}

Thank you, Craig. Good morning. We are pleased to report another strong quarter for our reinsurance operations, delivering $203 million of underwriting profit to the bottom line. This compares very favorably to Q3 last year, with profits up $87 million quarter-over-quarter. The difference is predominantly driven by higher cats and the loss at the Chinese port Tianjin last year, ultimately resulting in about an 8-point improvement to the combined ratio to 80.1% this quarter. The attritional combined ratio also dropped from 85.2% to 78.9%, as the Tianjin losses added 6 points to the third quarter attritional loss ratio last year.

Despite the soft market condition, we successfully executed our reinsurance strategy with our global reach, longstanding client and broker relationships, responsiveness, strong and sizeable balance sheet, and innovative capital structures, sustaining and even modestly growing our premium writings.

For the quarter, our total reinsurance segment gross written premium was $1.25 billion, up 1% from Q3 last year. On a constant currency basis, premiums grew 2%. Our total reinsurance net written premium was $1.22 billion for Q3, up 13% from last Q3. The net premium result was affected by the Heartland sale and the assumption of this crop portfolio out of the insurance segment and into the U.S. reinsurance segment. Year-to-date, our gross reinsurance premium was down 3%, but down only 1% when adjusted for currency movement. On a net basis, year-to-date reinsurance premiums were up 1%.

The U.S. reinsurance premium growth was strong in the quarter, up 9%, due to growth in structured reinsurance transaction, in particular in the mortgage and credit space, in addition to increased premiums on facultative casualty and crop reinsurance business. This was offset by lower premium on weather, marine, surety and property pro-rata business.

Notably, the structured reinsurance deals require broad expertise and scale to execute, and often provide significant benefit over and above the pure-risk transfer and, consequently, are not subject to the same pressures as the remainder of the reinsurance market.

The segment combined ratio was up to 78.4% from 73.8% Q3 last year. We had 3.4 points of cat losses versus none in the prior Q3, this driven this quarter by Hurricane Hermine and some development on events that occurred earlier in the year due to late reporting. Our attritional loss ratio was up almost 5 points due to non-cat weather events in Texas and the Midwest, and in addition, to a higher loss ratio on the new crop reinsurance premium. Conversely, the crop reinsurance premium has lower expenses, contributing to the 2.3% decline in the commission expense ratio.

Our international reinsurance segment premium was down 4% for the quarter, but only 2% on a constant dollar basis. This was primarily due to lower property pro rata business in the Middle East, which was offset by growth in our Latin America and international back business. Overall, we had better attritional ratios due in part to the Tianjin loss last year as well as better experience in certain regions. Lower cats, including the least prior-year catastrophe reserves, further benefited results this quarter.

Our Bermuda segment premiums were down 9%, or 7% on a constant dollar basis, driven by a lower load of business in Europe. Excluding FX, we saw a growth in London this quarter. Overall, the combined ratio improved 6.8 points to 90.7%. The current year attritional loss ratio was down about 15 points, with roughly half due to the impact of the Tianjin loss in last Q3. This was somewhat offset by higher commission expenses due to changes in business mix.

Recently, the reinsurance industry was confronted with its first significant Florida wind loss (19:13) in over a decade, but Matthew will be a lesser impact to the industry than initially feared. Nonetheless, we are comfortable that our exposures are well-controlled given the gross portfolio we have built, as well as the various mitigation tactics we employ.

Additionally, our global diversification across various lines of insurance and reinsurance buffers the group loss to such events, making them manageable. Although Matthew will not be a game-changing loss for most collateralized or traditional players, it may test the functioning of various collateral mechanisms. As a buyer of both traditional and collateralized reinsurance, we are familiar with the complications and potential headaches of collateralized arrangements.

These complications compound with uncertainty around the ultimate outcome of a large event, such as Matthew, given new ceding and untested claims management processes. However, while Mt. Logan provides significant collateralized support ultimately serving our clients, it stands behind Everest and is invisible to our ceding, unburdening them from the inherent complexity of such arrangement.

With the suite of solutions to best match the risk capital, including our $8 billion of equity, Mt. Logan, our catastrophe bond, and other internal and external sources of capital, we offer our clients meaningful capacity from a trusted partner. And we continue to look for ways to broaden our value proposition to our clients with these various solutions. Mt. Logan, in particular, continues to draw interest from new investors, including various pension funds, and we look forward to increasing the scale and the scope of the benefits that Logan provides to Everest's clients and shareholders.

With respect to the current activity in the market and looking ahead to 1/1 renewal, the reinsurance market seems to be trying to find a floor, with many underwriters resisting furthering the rate concessions over the last several renewals. Many competitors' management teams are increasingly realizing that the returns may no longer cover their cost of capital, assuming a normalized level of cat losses, and also seeing that they can easily miss earnings estimates with a few large risk losses for small to medium cat events.

Everest, with its significant expense advantage and broadly diversified global portfolio, continues to produce solid returns despite the competitive rate environment. Casualty business is also stabilizing as the market is taking a stand against further increases to ceding commission. We have also seen some aggressive firm order terms for casualty placement face stiff resistance in the casualty treaty markets.

In addition, some of the loss activities seen by our clients spark demand for facultative casualty reinsurance, and we continue to see increased demand in the mortgage credit area. The casualty reinsurance pricing stabilization is offset somewhat by the moderate decreases in original casualty and E&S rates.

We also remain cautious of new large capacity in the broker markets. Nevertheless, as large insurers continue to bundle their programs, they are seeking partners like Everest who have underwriting expertise in all classes of business and in multiple territories around the world. This plays into our strength as a large diversified global reinsurer that addresses the market with decades of relationships in creative, responsive underwriting, all at a significant scale.

Thank you. And now, I will turn it over to Jon Zaffino to review our insurance operations.

Jonathan M. Zaffino {BIO 16652236 <GO>}

Thanks, John, and good morning. I'm pleased to share with you third quarter results for the Everest global insurance operations. Similar to last quarter and in consideration of the divestiture of Heartland on August 24, I will be discussing our quarterly results excluding this business. The full results of the insurance segment inclusive of Heartland are covered in our financial supplement released yesterday.

As respect to premium production overall, our many strategic initiatives aligned toward the singular objective of building a world-class specialty diversified insurance organization, continue to gain momentum. Many of the new underwriting divisions incepted over the past several months are showing increased contributions to our growth and ultimately to profitability. Third quarter marks the seventh consecutive quarter of underlying growth for our global insurance business, again excluding Heartland.

As a result of these efforts, gross written premium in the quarter expanded 25% over the prior-year quarter to $371 million. This is reflective of the continued investments we have made in our U.S. and London platforms, along with the continued strong contributions from our Canadian and Accident and Health operations.

Net written premiums for the quarter increased 23%, compared to third quarter of 2015 to $318 million, which is in line with our net to gross ratio for the second quarter. On a year-to-date basis, gross written premiums increased by $185 million or 19% over the prior-year period to $1.1 billion. Likewise, net written premiums increased $129 million or 15% to $970 million, which again was in line with our expectations.

Turning to the combined ratio, the GAAP combined ratio for the quarter was 101%, which improves to 99.5% on an attritional basis. Year-to-date, the GAAP combined ratio was 102.2%. Again, on an attritional basis, excluding the impact from previously-announced cat events and prior-year development, the year-to-date combined ratio improves to 97.1%.

This is inclusive of the expenses associated with the build-out of our U.S. and Lloyd's platforms, which added nearly two points to the expense ratio year-over-year. We do anticipate our Lloyd's operation will absorb much of this increase, as earned premium increasingly works its way through, thus mitigating the impact here.

The loss and loss expense ratio for the quarter was 71.3%, which improves to 69.8% on an attritional basis. The loss and loss expense ratio for the quarter was impacted by some notable property per risk losses and a slight change to the loss ratio for our Medical Stop Loss business. This was a result of a re-evaluation of our experience over the first six months of this year and our expectations of this business going forward. It should be noted that this particular unit continues to deliver strong results for us, including post this adjustment.

On a year-to-date basis, the GAAP loss and loss expense ratio was 73.3% with an attritional of 68.2%, essentially flat year-over-year, with the difference being predominantly 4.4 points of cat activity for events in the second quarter.

I'll now provide some color on the performance of our major insurance portfolio, starting with the North America P&C book, which is our largest business. The core P&C portfolio delivered 19% growth in the quarter, building upon a similar number from the second quarter this year. Growth was balanced across short tails, specialty and casualty lives.

Further, our new business lines launched in the U.S. which have been discussed on recent calls, contributed nearly 11% to gross written premium in the quarter, double the contribution from the second quarter of 2016. We are encouraged by the growing momentum within these portfolios and, hence, the opportunities ahead.

The Accident and Health group delivered another solid quarter of growth with a near 30% increase over the prior-year comparable quarter, continuing the consistent trend we have experienced throughout the year. Our efforts to thoughtfully grow our Medical Stop Loss segment have been successful as have our efforts to complement this growth with new products across Medicare supplement, sports disability and short-term medical markets.

Our Lloyd's operation also continued its expansion. The Syndicate contributed $16.4 million to insurance growth in the quarter, demonstrating the increased momentum we are gaining within this platform, despite a difficult trading environment. Year-to-date, Lloyd's has now delivered nearly $35 million of premiums in the insurance segment, yet only $9.7 million of earned premium, which again temporarily impacts the expense ratio. We are encouraged by the growth trajectory of this platform and we will maintain our discipline in seeking profitable opportunities for growth.

From the rate side, we see a very similar picture to what we witnessed in the second quarter of this year. Within the U.S. market, we continue to achieve positive rate on auto lines, both commercial and personal, as well as on the general liability side. The professional liability market continues to be competitive, but the rate decreases in the mid-single-digit range across lines being common.

The U.S. property market remains in a prolonged soft cycle. However, the magnitude of rate decreases continued to moderate through the third quarter. Large individual risk losses, coupled with the severity of North American cat losses this year, punctuated by the first named storm making landfall in Florida in over a decade has provided a dampening to the rate decreases often sought. Thus, despite a competitive market dynamic, we believe opportunities for profitable growth through a diversified portfolio remain.

As respect to the Canadian market, again, a similar story to the second quarter. The market remains competitive for most lines of business. For the major lines, liability rates remain essentially flat to prior quarter. Canadian property rates have generally flattened in cat-exposed areas within certain provinces, yet outside of these areas there remains moderate rate pressure.

We will keep a close eye on the January 1 renewal cycle to see how the market reacts to the record cat losses within Canada this year, particularly the upcoming reinsurance renewals and any corrector (30:20) rate measures that may follow.

The management liability lines remain very competitive, while other specialty lines are likewise feeling great pressure but ultimately a bit moderated. So, again, it's a bit of a mixed situation, yet trending similar to prior quarters. The notable difference here is the uncertainty of the property market as we enter year-end.

In conclusion, we look forward to carrying our strong top-line momentum into the fourth quarter and into 2017. We are encouraged by the underlying trends of the many new businesses we have cultivated over the past many months and especially with the talented leaders we've attracted to Everest to lead these initiatives for us. As we continue to add scale to our growing insurance operations, we expect these ventures to become a more meaningful profit contributor to our global portfolio.

With that, let me turn it back over to Beth for Q&A.

Elizabeth B. Farrell {BIO 1986541 <GO>}

Thank you, Jon. Keith, we are open now to take questions from the audience.

Q&A

Operator

[Operator Instruction] And we'll take our first question from Kai Pan with Morgan Stanley. Please go ahead. Your line is open. Kai, please check the mute button on your phone. Okay. We'll go next to Elyse Greenspan with Wells Fargo. Please go ahead.

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

Yes. Good morning. First off, I was hoping to – in terms of your premium outlook, with the commentary on marketing assistance was great (32:00), but as we think about going forward, do you think the reinsurance growth will kind of stay at about 2% or so ex currency and the insurance growth kind of stay in line with the Q3 level as we think about the Q4 and into 2017?

A - Dominic James Addesso {BIO 1428096 <GO>}

Elyse, we don't really try to give guidance on where we think our premium growth will come from. We do, of course, think that directionally, on the insurance side, is that will be the side of our business that will grow at an increased pace relative to reinsurance.

It's hard to say at this point until we get a little further along into renewal season, depending on where rates are and depending on what the opportunities that are presented to us. So I think a conservative view like you're describing is not unreasonable, but there's a lot of variability around that number.

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

Okay. Great. And then, in terms of the international reinsurance segment, the underlying loss ratio in that segment was pretty strong, about 47% in the quarter. Was there anything one-time impacting that number?

A - Dominic James Addesso {BIO 1428096 <GO>}

Craig?

A - Craig W. Howie {BIO 17579923 <GO>}

Elyse, this is Craig. What happened this quarter was we saw – in the past, we had seen a number of one-off type losses that were non-catastrophe-type losses that held up the attritional ratio in that segment. We were able to bring that loss ratio down more in line with where it should be, absent those losses.

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

Okay. Great. And then, in terms of the insurance business, now that the crop sale has been completed, do you think we're at a point where on a go-forward basis that segment, well, may be running a little bit off of your long-term goals, but the margins stabilize on a profitable level from here?

And then, combined with that, when do you think that will – what timeframe do you think we'll see the expense ratio normalize there for some of the hirings that you've done in that business?

A - Dominic James Addesso {BIO 1428096 <GO>}

Well, certainly for the next several quarters, I think we'll see the expense ratio remain where it is, remembering that we'll continue to pursue growth. So there will be quite a few quarters, frankly, where the written and the earned will be out of line, so to speak; in other words, a written will be well above the earned. We have actually – our expense growth through the nine months has actually been consistent with our top-line growth. So the rise in the expense ratio is explained just purely by that.

I would also add that, if you compare our expense ratio to many of our competitors or peer companies, we're well below industry average from the expense ratio point of view. So we're not discouraged by the amount of investment we have to make in order to grow this business.

And as far as the overall combined ratio, we should expect that – given the fact that crop is now out of the picture, we should expect that to be more stable and frankly even improve over time, particularly as we grow some more of the specialty lines of business that we're focused on.

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

Okay. Great. Thank you. And then, one other thing. If at all possible in the supplement in the future, maybe you could include the insurance results, the prior-year quarters, just on a pro forma basis excluding the crop business, to help with the comparables. That would be pretty helpful. Thank you very much.

A - Dominic James Addesso {BIO 1428096 <GO>}

We appreciate the suggestion and we'll certainly talk about that. The other thing I want to add at least to your question is that – not to add to your question, but to add in response to your question, is that the other thing keep in mind that affects reinsurance premium growth, they have a fair bit of pro-rata business. So, depending on what happens with some of those accounts, that can have an impact on the percentage growth. So you have to keep that in mind as well.

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

Okay. Thanks very much.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you.

Operator

And next, we'll try to go back to Kai Pan with Morgan Stanley. Please go ahead.

Q - Kai Pan {BIO 18669701 <GO>}

Yeah. Thank you. Can you hear me now?

A - Dominic James Addesso {BIO 1428096 <GO>}

Yes, Kai.

Q - Kai Pan {BIO 18669701 <GO>}

That's good. Thank you. Sorry for the earlier trouble. Maybe expense control on my side. So, just a follow-up on Hurricane Matthew losses, $75 million to $200 million of net losses. I just wonder, could you give a little bit more detail in terms of in Florida or in North Carolina, is it wind or flooding? And how does that compare with your expectation, because you have been pretty proactively like shaping your portfolio in that part of the region?

A - Dominic James Addesso {BIO 1428096 <GO>}

Well, I'm going to make a few comments and then ask John Doucette to jump in here. But I think, frankly, it's a little early to maybe get into the specifics that you're after. The estimates that we use were based on modeled output and, as I said, the industry range. We, frankly, used $3 billion to – the $9 billion, I know there is a number lower than that on both the low side and the high side. We just rounded it to $3 million to $9 billion so that you had the full range of what the outcomes might be.

I don't think the loss here is outside our expectations frankly. Our market share numbers, again, on this net basis that we're describing here is somewhere between 2% and 3%. Probably middle of that would be a good estimate to use, but that's kind of the range of the outcome, and that's not outside of our expectations.

John, do you have anything further to add to that?

A - John P. Doucette {BIO 7178336 <GO>}

Thanks, Dom. Good morning, Kai. Add just a little bit more on the loss. Most of the loss would be a reinsurance loss to us most likely, although we would have potentially some insurance losses potentially in South Carolina.

And in terms of the overall split of the loss, we would point to you that some of it would be coming from the Bahamas where Everest is one of the larger reinsurers and have been for a long time in the Caribbean. So, maybe about 25% of the loss, and again, that number will move around, but I'm just trying to give some directional guidance. But the majority of the loss would be a reinsurance loss coming from our Florida clients.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. And then, given sort of like we have some sizeable losses this year, looks like January 1 renewal rate is probably sort of stabilized. I just wonder, given the current market environment basically flat pricing, would you expect to keep your reinsurance attritional combined ratio sort of stable going forward, or it will continue to have some pressure on the core margin side?

A - Dominic James Addesso {BIO 1428096 <GO>}

I would think that would be relatively stable. And again, keep in mind that, I think in large part, that's a question about property cat. And things can change a lot based on other lines of business, growing the casualty portfolio, growing mortgage credit. All those things have an impact on the reinsurance attritional loss ratio and the resulting combined ratio. So, mix can play a big factor, as well as what I mentioned to Elyse, pro rata, if some of those accounts go away or get reduced, that has a favorable impact as well.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. And my last question, we have seen recently some tick-up in terms of merger and acquisition activities in the space. And also in the press, there is a specialty insurance business like a potential looking for sale. I just wonder, looking at your strategy build-versus-buy, sort of like are you interested in some of the – like a potential business out there you might be interested as sort of acquisitions as well, or any particular platform you would like to look into to grow?

A - Dominic James Addesso {BIO 1428096 <GO>}

Well, of course, it's all hypothetical because it all depends on what's out there. Generally, I'd have to say that most, if not all, properties that where companies are seeking strategic options, given Everest's size and scale, we get an opportunity to look at. And obviously, we've made a decision to continue on the path that we're on.

In most cases or in many cases, it can be result of price, it can be cultural fit. Integration is a challenge. And in many cases, in acquisitions, you have to look not only to what you can combine but what you have to eliminate. And what we prefer to stay focused on is what we can add to our existing portfolio.

In addition, over the last 18 months or so, the market has presented many opportunities to hire some great talent. So we're very pleased with that. And frankly, that's a more cost-effective alternative, without having to put the kind of goodwill in the book.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Thank you.

A - Dominic James Addesso {BIO 1428096 <GO>}

I hope that answers the question.

Q - Kai Pan {BIO 18669701 <GO>}

Yeah. Thank you so much. And if I may, just quick last one, is that your survival ratio on asbestos it dropped to 5.1 years in the quarter. I just wonder like what do you see the trend there and when do you do your annual reserve study? Thanks.

A - Craig W. Howie {BIO 17579923 <GO>}

For asbestos, we always look at asbestos on a quarterly basis, Kai. We do the annual review during the fourth quarter. We always continue to look at any and all trends that are out there, as well as any clients that are taking charges that we would have exposure to. But, again, we'll look at that in the fourth quarter.

A - Dominic James Addesso {BIO 1428096 <GO>}

And if there was anything material, as Craig said, during any particular quarter, we would have to put something up some way (42:52). But again...

Q - Kai Pan {BIO 18669701 <GO>}

Thank you so much.

A - Dominic James Addesso {BIO 1428096 <GO>}

... it is subject to the year-end reserve review as well.

Q - Kai Pan {BIO 18669701 <GO>}

Much appreciated.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you.

Operator

And our next question comes from Michael Nannizzi with Goldman Sachs. Please go ahead.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Thanks so much. Just a couple of numbers ones, if I could. Craig, you mentioned that tax rate would be in that sort of 13% to 15% range. If there are more losses in the U.S. proportionally than in a typical fourth quarter, I would think that the tax rate would be lower. Or is there something else that would cause the tax rate in the fourth quarter?

A - Craig W. Howie {BIO 17579923 <GO>}

Michael, that's correct. If there are more losses or the higher end of the catastrophe losses, we would be at the lower end of that rate that I said, 13% to 15%.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. The year-to-date is around 13%, right? So it wouldn't be lower than what you experienced through the year-to-date, it would just be at that same level?

A - Craig W. Howie {BIO 17579923 <GO>}

It really depends on how high it is and with respect to our planned losses in the fourth quarter. So again, that's an annualized effective rate. So the guidance that I gave of 13% to 15%, we'd be on the lower end if we had higher catastrophe losses.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Okay. Thanks. And then, I know we don't see Mt. Logan on a standalone base anymore, but can you give us some color on sort of what the performance was in that portfolio in the third quarter, and whether you would expect the fourth quarter and the impact of Matthew to be similar there as it is on balance sheet book?

A - Craig W. Howie {BIO 17579923 <GO>}

Yeah. So what we take through are the earnings and fees that we take through are through other income. So far year-to-date, we've taken sort of $10 million, compared to $15 million last year. The reason that it's lower this year is because of the anticipated estimate for losses in the Logan book will lower the amount of fees that we get, and so those losses are settled. So essentially that's what you're seeing through Logan so far this year.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. And then, any change to 4Q deployment expectations given your sort of early read on Matthew? Or is it within your sort of load enough that it doesn't change your perspective on deployment?

A - Dominic James Addesso {BIO 1428096 <GO>}

I'm not sure – the deployment meaning?

Q - Michael Nannizzi {BIO 15198493 <GO>}

Sorry. Buybacks, capital share repurchase.

A - Dominic James Addesso {BIO 1428096 <GO>}

Yeah. No, I think what my comments and my remarks related to really the annual earnings. So a quarter only as it impacts the annual earnings. So, again, we'd look at the entire year. It's not just a quarter.

Q - Michael Nannizzi {BIO 15198493 <GO>}

I got it. Okay. And then just one last quick one, if I could. Following up on Elyse's question in the international segment, the loss ratio looked like it was mid-40%s, pretty low by historical standards even going back to like hard market years. Was it that losses there were sort of more normal relative to higher losses in the linked quarter last year or were they actually sort of even lower than a more normal year, a more normal environment?

A - Craig W. Howie {BIO 17579923 <GO>}

Yeah. So in the past, we had elevated losses, including losses all around the world, Latin America, as well as floods in Middle East and North Africa as well. So in essence, what's happened is we've seen lower levels of those losses, as well as a different mix of business that's coming through those books. And what you're seeing is a ratio that's more in line with where it should have been in the past.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Great. Thank you so much for all the answers.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Michael.

Operator

The next question will come from Jay Gelb with Barclays. Please go ahead.

Q - Jay Gelb {BIO 21247396 <GO>}

My only question is Baden-Baden in terms of the (46:52) European Reinsurance Conference is ongoing. Any live feedback you can provide us in terms of what the expectations are coming out of there?

A - John P. Doucette {BIO 7178336 <GO>}

Well, good morning, Jay. It's John. So it's going on right now. So we haven't had too much feedback from our team that's over there. But we do send a meaningful team from covering both Continental Europe plus Middle Eastern, African clients and others that make their way there as well. So I think one of the messages that we have is the continued build-out of our capabilities. We've added various people in our European operations and, with that, have added product lines that we can support.

So I think the larger buyers are continuing to consolidate their placement, which we are a net beneficiary of. And the fact that we have meaningful capacity to deploy with Mt. Logan and Everest also helps us be even more relevant to the clients. And as I said, we have been viewed as a stable partner. And with the increase in our capabilities, we expect to have more trading opportunities with our European and Middle East-Africa clients.

Q - Jay Gelb {BIO 21247396 <GO>}

That's helpful. Thank you.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thanks, Jay.

Operator

And we'll go next to Josh Shanker with Deutsche Bank. Please go ahead.

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

Yeah. Thank you for taking my question. If we think about 2017 and beyond and then look at the expense ratio in insurance, how much of a drag is there from the significant growth going on? And so where do you think next year, with Heartland changing and what not, where does that shake out?

A - Dominic James Addesso {BIO 1428096 <GO>}

Well, as I mentioned before, currently – and I don't know that I would describe it as a drag, given the fact that, as I pointed out, we have even on the insurance side one of the lowest expense ratios in the business. So our expense ratio insurance-wise year-over-year is elevated by 2 points.

I would expect that differential to remain there for a few quarters, if not several quarters, because we certainly would expect the written premium growth to far outpace the earned premium growth. And our actual expenses are growing consistent with the written premium growth. So, when the earned premium starts to stabilize relative to the written, then you'll start to see that expense ratio come in a bit.

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

But you're putting it - given the current size of the book at 220 basis points sort of build-out expense on top, is that the right way to think about it?

A - Dominic James Addesso {BIO 1428096 <GO>}

That's how we're thinking about it right now. Correct.

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

And...

A - Dominic James Addesso {BIO 1428096 <GO>}

And by the way, my point, though, is that we're calling it a build-out, and then one word you could use is investment, but the reality is, is that those expenses will be covered once the earned premium comes in to match it. Or said a different way, our expense growth is consistent with our written premium growth.

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

And I think there's - I'd have to go review the last quarter as well, but as Heartland comes out, I've been looking back trying to compare 3Q 2017 to 3Q 2016. On the expense ratio, how is that going to direct it?

A - Dominic James Addesso {BIO 1428096 <GO>}

The expense ratio of - maybe I'll answer it by the combined ratio basis, because I think this is what you were getting at; if not, come back again. But right now, our attritional combined ratio is in the mid-90%s I'd say, right, 95%, 96%, somewhere in there.

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

And you did 101% for the quarter.

A - Dominic James Addesso {BIO 1428096 <GO>}

Yeah. But I'm talking about ex-cats and et cetera. So we think that our base book is running right now in the mid-90%s. We would expect over time, frankly, that number to improve more dramatically from improvements in the book of business and affecting the loss ratio. So, that I think is where we see the major benefit coming from.

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

And the quota share relationship with Heartland incepts on 1/1, that's right?

A - Craig W. Howie {BIO 17579923 <GO>}

The new quota share absent our business. In other words, Heartland was actually sold on August 24. There were - so essentially, what happens at that date is that insurance business then transfers over to the reinsurance business on the Everest books. And then we have a quota share with the new company to take in a certain percentage of their overall book going forward in 2017.

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

On the first day of the year.

A - Craig W. Howie {BIO 17579923 <GO>}

Correct.

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

Well, would that be a considerable thing? Are we going to notice that in a large way? I mean, I don't know how to model that exactly. Can you talk a little bit in this relationship besides of Heartland, how big this new crop business is?

A - John P. Doucette {BIO 7178336 <GO>}

This is John. I think for the next year or so, we would expect it to be about the same size, maybe a little bit larger than what the Heartland book was.

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

Okay. Thank you for all the answers. Appreciate it.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Josh.

Operator

And we'll take our next question from Quentin McMillan with KBW. Please go ahead.

Q - Quentin McMillan {BIO 19411547 <GO>}

Thanks very much, guys. Sorry to be the dead horse in terms of the expense ratio question on the insurance segment, but I'm just thinking about it on an absolute dollar basis. The dollars that you spent were about $44.5 million in the third quarter.

Is the dollar value better maybe run rate basis of a way for us to think about it, because obviously you've been very active in the hiring? Just not sure if there was also any incentive bonuses that were paid that maybe gets stripped out next year, or anything else in there that we should think about outside of the ratio, but just on an absolute dollar basis to help?

A - Dominic James Addesso {BIO 1428096 <GO>}

By the way, Quentin, thanks for referencing to us as a dead horse, but – Quentin, $44 million that Quentin is referencing, I think...

A - Craig W. Howie {BIO 17579923 <GO>}

Includes Heartland.

A - Dominic James Addesso {BIO 1428096 <GO>}

Right. So you have to carve that out.

A - Craig W. Howie {BIO 17579923 <GO>}

So, but as we carve that out, back to the point, yes, you're right, expense dollars are definitely up. As Dom said, expense dollars are going to be up as net written premium is up as well because we are growing that book. I don't think you're seeing an outsized increase in expenses with respect to the increase in net premium.

So, from a percentage basis, the overall expense ratio has gone up just over 2 points. And that's the way we're looking at it for now that it will still stay at that level until we build out this book. And then, as you see the build-out of this book in some of these new programs, that business will earn-in over time. And as it earns in, that's when you'll see that expense ratio start to moderate.

A - Dominic James Addesso {BIO 1428096 <GO>}

And the other way that you might want to think about it, Quentin, is in terms of building models, you might want to also consider modeling the expenses or looking at our expense ratio relatively to written as opposed to earned.

Q - Quentin McMillan {BIO 19411547 <GO>}

That's good. Good thought. Thank you. And then, just in terms of coming back to 1/1, it sounds like, John, your expectation sounds like it's for a flattish renewal, which should be better than we've obviously seen recently.

Can you just talk about any change in sentiment or perception? Obviously, Matthew was on a crash course to a lot more damage than what ultimately happened when it turned east. Do you think that there is a psychological impact from that that we're going to feel at 1/1 where when you go to clients, you'll be able to have a more honest conversation that the risk is real and that there's no more ability to give more in in pricing? And just sort of talk about that dynamic at the 1/1 renewal, please.

A - John P. Doucette {BIO 7178336 <GO>}

Sure. I think it is something that's real. I think, remember, this is the first real landfall in 10 years. So I think that's factoring in to the psychology of the conversation and the psychology of the buys of some of the clients. I mean but, look, there's a lot of capital out there. And we ultimately don't know how it will go, but there'll be pockets we think will do better than others. We do think that the U.S. is stabilizing, particularly in the property and on the casualty as per our conversations about the ceding commissions and casualty rates and pushback we've seen.

So, I mean, we saw some of that at 6/1 and 7/1 on both the property and the casualty side. So, internationally, it really depends on the geographic territory or whether we think rates are going to be flat or not. So, but I do think – to your point, I do think that it's not just Matthew, but it's also risk losses. We've seen some large risk losses that can do some real damage to reinsurers' quarterly income. And I think that also is starting to factor in to the conversation.

Q - Quentin McMillan {BIO 19411547 <GO>}

Thanks, guys. And if I could just sneak one last one in on the mortgage insurance opportunity. You guys have sort of indicated in the past that you'd prefer to play it on the reinsurance side, I believe, because you can be a little bit more nimble to enter and exit the market as you see opportunistic options available to you. But can you just sort of give us a sense of what size you are and potentially sort of what you might look to grow that book of business over the next couple of years?

A - John P. Doucette {BIO 7178336 <GO>}

So we have written – several of these deals are multi-year deals, and so they earn-in over a seven-year period or longer. And so earned premium certainly from the GSEs has not been that high, but from the deals we've already executed, we expect to see future premiums coming in from those, from some of the MIs. They've been more on a quota-share basis. Those have been larger to-date and it really depends on what their capital needs are going forward as to whether those are going to be a growth opportunity or not. It really depends on a lot of different things.

Certainly, the regulations have caused them to de-lever from 25:1 to about 18:1 and they're using reinsurance to buffer that capital support. We like that. So we do see, to answer your question about opportunity and capacity, we see a lot of runway here on the reinsurance side and we expect to continue to put forth capacity at the appropriate price.

Q - Quentin McMillan {BIO 19411547 <GO>}

Great. Thank you so much, guys.

Operator

And it appears we have no further questions. I will return the program to our presenters for any closing remarks.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you to all that participated in the call. And kind of in summary, let me just say that we're obviously pleased with the quarter. Notwithstanding that, there's challenges remaining at there, as you all know. Certainly, market pricing is at the top of the list and insurance growth for us is a journey that requires a lot of hard work. We remain confident, however, that as far as cycles are concerned, we had proven that we can effectively manage through these cycles, managing our exposures and our P&Ls, and taking advantage of the opportunities that the market is giving us.

On the insurance side, we remain focused on the specialty areas in particular, because this gives us better opportunity to avoid commodity-type pricing. The ratings and scale make a difference and give us an opportunity to grow our insurance book. And while, as evident by the questions, expenses are up, but the growth there, as I said, is consistent with our written premium growth and as it should be. The earned just has to catch up. And, again, I want to emphasize that we're still best-in-class on the expense ratio side. So, that's something organizationally we pay attention to in both businesses.

Overall, our flexibility allows us to commit our capital and resources to the best opportunity, and our plan is to just continue this approach, which has been successful for us in the past.

Thanks for your interest in Everest and have a great day.

Operator

And ladies and gentlemen, this will conclude today's program. Thanks for your participation. You may now disconnect. And have a great day.