Q3 2012 Earnings Call

Company Participants

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

Other Participants

- Amit Kumar, Analyst
- Greg Locraft, Analyst
- Ian Gutterman, Analyst
- Jay Cohen, Analyst
- Josh Stirling, Analyst
- Mike Nannizzi, Analyst
- Mike Zaremski, Analyst
- Sarah Dewitt, Analyst
- Seth Bienstock, Analyst
- Vinay Misquith, Analyst

Presentation

Operator

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

(Operator Instructions)

Mr. Peter Hill, you may begin your conference.

Peter Hill {BIO 15385944 <GO>}

Thank you. And thank you all for joining our Third Quarter 2012 financial results conference call. Yesterday, after the market closed, we issued our quarterly release. If you didn't receive a copy, please call me at 212-521-4800, and we'll be sure to provide you with one. There will be an audio replay of the call available from approximately 1.00 PM Eastern Time today through midnight on November 23. The replay can be accessed by dialing

855-859-2056 or 404-537-3406. The passcode you will need for both numbers is 39721045. Today's call is also available through the Investor Information section of www.renre.com, and will be archived on RenaissanceRe's website through midnight on January 12, 2013.

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

Neill Currie {BIO 6676681 <GO>}

Great. Thanks, Peter. Good morning, everyone. Thank you for changing your schedule to be able to join us this morning. We hope that our postponement of the call until today is more convenient for you, particularly those in the Northeast, and will enable more listeners to participate today.

Our thoughts today, of course, are with all of those who have been and continue to be affected by Sandy. Is a terrible tragedy, and I guess the only good news is maybe there will be learnings for other people going forward. I would like to comment on this event before going on to discuss our Third Quarter results. Sandy's appearance at this late stage of the Atlantic hurricane season has reminded people of the constant potential that exists for severe events, and the value of being prepared. The season turned out to be quite active, with 19 named storms, 10 hurricanes and 1 major hurricane. Public forecasts for 2012 under-predicted the level of overall activity in the Atlantic Basin, but correctly indicated that the number of major hurricanes would be below normal. As Sandy has underscored, though, seasonal forecasts, like models, are only a guide. Ultimately, shorter-term atmospheric conditions dictate hurricane tracks, and the potential for catastrophic landfalls always remains present, even in low-activity years.

As we all know now, there were factors such as the sheer size of the wind field, and the combination of a full moon and high tide, that contributed to making this storm so unusual. But it is important to note that the scale and the nature of the loss was not unusual. In fact, we have considered the potential effects of hurricane wind and surge on the Northeastern US for some time now, in our modeling of tropical systems in the Atlantic Basin. Right now, we are applying detailed wind and flood footprints of this storm against our book of business, to quantify the loss we have incurred. While it is too early to give you an estimate at this time, as soon as we have a high degree of confidence as to our estimated net financial impact, we will provide an update. I can tell you, though, that our expectation is that this loss is an earnings event, not a capital event, and will reduce Fourth Quarter earnings. Of course, there are always learnings from every event, and we are working hard to refine our models and to share information with our clients.

Turning to our Third Quarter results now, and the focus of this call, at the close of business yesterday, RenRe posted operating income of $104 million for the quarter and net income of $181 million. I am pleased to report we increased our tangible book value per share, plus accumulated dividends, by 5.3% for the quarter and 16.6% year-to-date. Our results reflected relatively Light Insured Cat losses, solid overall underwriting performance, and strong returns from our investment portfolio.

We have been busy gearing up for the January 1 renewal season, and are having productive meetings. Our focus remains on constructing an attractive and efficient portfolio business, and we continue to be assisted in our efforts by our strong relationships with customers and brokers, and our industry-leading risk modeling and risk management capabilities. The market conditions we talked about on our last call continue to play out. We mentioned in the Second Quarter that we believe we might be coming to a culmination of the dynamics that had increased demand for Property Catastrophe coverage. In particular, the market's absorption of our RMS 11, and the impact of catastrophic losses of 2010 and '11. At this point, we believe those dynamics have been fully absorbed by the market.

We currently don't believe that Hurricane Sandy will impact supply, and it remains to be seen whether it will change demand, including market perceptions of risk. Overall, we continue to view the market favorably, and like our book of business. Later in the call, Jeff will update you on our current estimates for the 2013 gross premiums.

Our Ventures team continued to be quite active, bringing new long-term investors into DaVinci Re, and managing our two newest side-cars, Upsilon Re and Tim Re III. We find investors and clients are interested in exploring efficient capital solutions, and options for entering new markets. The close collaboration between our Ventures and Underwriting teams to leverage the Company's expertise and meet our client's needs has always been central to our strategy, and it continues to be a differentiator for our Company.

Another key tenet central to our strategy has to -- been to manage our capital through share buybacks when appropriate. During the Third Quarter, we returned excess capital to shareholders, and anticipate that we will continue to return capital when market conditions and other circumstances warrant.

Turning to our Specialty and Lloyd's business now, those teams have done an excellent job building relationships and preparing for meaningful growth when market conditions improve. Over the years, our Specialty Reinsurance unit has contributed strong results for us, and our London platform is laying the foundation for profitable growth over the long term.

As we look forward to the January 1 renewals, we believe we are well-positioned to serve our clients and deploy as much capacity as conditions warrant. With access to more sources of capital than ever, an experienced Underwriting team, and the strength and flexibility of our capital structure, we stand ready to provide efficient capital solutions for our clients in the coming year. With that, I'd like to turn the call over to Kevin.

Kevin O'Donnell

Thanks, Neill. Good morning, everyone. Before I start with my regular comments on the quarter, I would like to briefly discuss Hurricane Sandy. To pick up on Neill's earlier comments, Sandy certainly exhibited unique characteristics. To some degree, this is the case with all storms. Contrary to some media reports, however, the development of Sandy was not abnormal, but rather consistent with climatology. We expect to see Category 1 hurricanes making landfall in the Northeast with relative frequency. And from an industry perspective, Sandy was not a rare event in terms of the type or size of loss generated.

What Sandy starkly demonstrated was the potential for damage that exists in the region. This storm underlined the fact that only knowing the category of a hurricane does not necessarily reveal its destructive potential. The important take-away for our industry is that Northeast hurricane risk is significant, and the amount of exposure at risk makes the management of this hazard critically important. We've studied the potential effects of wind and surge events similar to Sandy for some time now, and have a proprietary view of wind and flood risk from tropical systems in the Atlantic Basin. Hurricane Sandy is consistent with this view.

We are working closely with our scientists at WeatherPredict, and are running an internal footprint of the event against our book, to better understand the ramifications of this event and our clients' losses. Additionally, we are conducting a market share analysis and holding discussions with certain clients, as well as reviewing industry (brought-up) loss estimates from the modeling companies. We are busy talking to our clients and brokers to offer assistance, and to begin the dialogue to help them understand the impact of the loss. Needless to say, it is still very early days since Sandy, but we are hard at work developing our view, and of course paying our claims. That is all I will say on Sandy for now, and I will turn at this point to the Third Quarter results.

We are pleased with the progress we have made building our portfolios, and have been able to deploy significantly more capacity for our customers in 2012. Our Catastrophe book increased by approximately 20%; our Lloyd's Syndicate business increased by 50%; and the size of our Specialty portfolio grew by over 35%. We responded to what our progress wanted and our customers needed, growing at the right times and in the right ways. Because we were ahead of the market in seeing these changes, we acted early, which allowed us to grow significantly. This is a testament to the strength of our underwriters, aided by great technology and the conviction of our management to grow, as we were best able to see the opportunity and to deploy capital efficiently. While we are pleased with the growth experienced this year, not every year will provide this level of opportunity.

Starting with Property, US model changes and international property losses continue to be the primary drivers supporting the increased Property market opportunities early in the year. Regions unaffected by one of these two variables were largely flat. It is our belief that these losses and model changes have completed their lifecycle as a stimulus for better rates. We feel that we executed well against these market drivers, and we are pleased with our book of business. From an historic perspective, the US property market and certain loss-affected regions are well-rated. Though many other regions around the world, while profitable, are unlikely to produce strong returns. Even these regions, however, can be accretive when added to our portfolio, but we need to be far more selective with these risks, typically writing them on a private layer basis. We remain optimistic about our ability to construct a Property Casualty insurance portfolio that is both significantly better than the market average, and that produces an attractive return on capital.

With regard to our Specialty lines, we continue to find new and exciting opportunities to grow over time. The footprint of our portfolio continues to expand, and although we are not bullish on many Specialty lines currently, we remain optimistic that we will continue to find specific opportunities to deploy capital. While there is significant uncertainty around the LIBOR issues, we thought it prudent to recognize reserves for potential losses in our Specialty lines in both London and Bermuda for this development. The majority of this reserve is for our Casualty Clash book, which is an event-based Casualty product. Additionally the quarter we added to crop reserves, as a result of the US drought, which we believe will penetrate several of the Multi-Peril Crop Insurance excess of loss covers placed into the market.

Our Lloyd's Syndicate is performing in line with our expectations, and we continue to have growth aspirations. It's growth is not driven as much by an improving market, but rather it is simply due to the fact that we are very small within Lloyd's, and are seeing a flow of good business.

After almost 20 years in business we have seen a wide range of market conditions, and we believe that our current portfolio is full of options for us to build a very strong net book, and produce excellent, industry-beating returns. When we think about portfolio construction, we're always trying to create flexibility. We have the option to manage capital up and down, and optimize our portfolio, while also meeting our clients' needs. We could choose to retain more risk net, or potentially deploy more third-party capital. Thus we have a number of levers we could deploy to continue to generate attractive returns for our shareholders.

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

Jeff Kelly {BIO 20911735 <GO>}

Thanks, Kevin. Good morning, everyone. I'll begin with a few comments about Hurricane Sandy, and then cover our results of for the Third Quarter and year-to-date, and also provide you with our initial 2013 top line forecast. As Neill and Kevin mentioned, it is far too early to estimate the exact negative impact on our financials from Hurricane Sandy. However, in attempting to put some dimensions around it, while we think the loss will be significant, as we mentioned in our earnings release, we think this is an earnings event and not a capital event, and is likely to be contained within our expected Fourth Quarter earnings. We will provide you with our estimate of the net negative impact from the event when more information about the losses becomes available, and when we have a reasonably high degree of confidence in that estimate.

Turning to our consolidated results, the Third Quarter was again a profitable one for RenaissanceRe, driven largely by a relatively low level of CAT losses, and a rebound in investment income, primarily from our Alternative Asset portfolio. We did, however, experience some loss activity in our Specialty Reinsurance book and at our Lloyd's unit. Growth in realized and unrealized gains, and the value of some fixed maturity investments, also helped growth in tangible book value per share. We reported net income of $181 million or $3.62 per diluted share, and operating income of $104 million or $2.07 per diluted share, for the Third Quarter. The annualized operating ROE was 12.7% for the Third Quarter, and 15.4% for the first nine months of the year. Our tangible book value per share, including change and accumulated dividends, increased by 5.3% in the Third Quarter, and is up 16.6% year-to-date.

Let me shift to the segment results, beginning with our Reinsurance segment, which includes CAT and Specialty, followed by our Lloyd's segment. In the Reinsurance segment, managed CAT gross premiums written in the Third Quarter declined 31% compared with a year ago. Adjusted for $18 million of reinstatement premiums in the prior-year period, the decline was 18% year-on-year. This decline primarily reflects timing issues related to the writing of Japanese contracts in the Third Quarter of last year, in the aftermath of the earthquake there, versus in the Second Quarter of this year. On a year-to-data basis, managed CAT gross premiums written increased 4% compared with a year ago on a reported basis. They were up 17% when adjusted for $155 million of reinstatement premiums in the prior-year period, and $31 million of negative reinstatement premium adjustments in the current-year period. This compares with our top line guidance for managed CAT growth of 20%, excluding reinstatement premiums for the full year.

As a reminder, managed CAT includes the business written on our wholly-owned balance sheets, as well as CAT premium written by joint ventures DaVinci and Top Layer Re, and our side-cars Upsilon Re and Tim Re III. The Third Quarter combined ratio for the CAT unit came in at 25.1%. The results included $23 million of net negative underwriting impact from Hurricane Isaac, which was the only meaningful CAT loss during the quarter. The net negative impact, including non-controlling interest in DaVinci, was $15.6 million. We experienced net favorable reserve development of $18 million for the CAT unit, primarily related to a downward adjustment in our loss estimate for the 2008 hurricanes. We did not make any meaningful adjustments to our loss estimates for the large CAT losses of 2010 and 2011. For the first nine months of the year, the CAT unit generated a 24.6% combined ratio, driven by generally benign catastrophe losses and favorable reserve development.

For Specialty, gross premiums written increased 48% in the Third Quarter, primarily driven by timing issues related to the inception of a few large quota share transactions. For the first nine months of the year, gross premiums written are up 41% compared with the year-ago period. This compares to with our full-year forecast for top line growth of over 20%. Percentage growth rates for this segment can be uneven on a quarterly basis, given the relatively small premium base. The Specialty combined ratio for the Third Quarter came in at 121.9%.

We booked a $16 million loss related to the LIBOR-related developments for exposures arising in our Casualty Clash business in the current accident year. In addition, we strengthened our reserves for the same LIBOR event, with respect to prior accident years, by $5 million. At this point, we have not received any loss notifications on the layers we have written, and there is still significant uncertainty about the eventual loss on this event at this very early stage. Nonetheless, we thought it prudent to reflect the potential for losses, due to the amount of regulatory and litigation activity currently taking place, and likely to occur going forward, related to this event. As a reminder, our Casualty Clash product covers cedants against an amalgamation of losses from various classes of business, arising from a single event. On a year-to-date basis, our combined ratio for Specialty was 81.9%.

In our Lloyd's segment, we generated $29 million of premiums in the Third Quarter, compared with $17 million in the year-ago period. For the first nine months of the year, gross premiums written increased 52% to $134 million. This compares with our full-year top line guidance of up 50%. The Lloyd's unit came in at a combined ratio of 135.6% for the Third Quarter. The results of this segment included a $7.5 million loss on our US excess of loss crop reinsurance book, and a $2.5 million loss associated with potential exposure to LIBOR claims. The expense ratio remained high at 54.3%, but has generally been declining sequentially, as business volume there has increased. For the first nine months of the year, the combined ratio at Lloyd's was 113%.

Moving away from our underwriting results, other income was a slight loss in the Third Quarter and a breakdown of that is provided in the financial supplement. Our Weather and Energy unit, REAL, had an essentially break-even quarter. Equity and other -- equity and earnings of other ventures was a gain of $4 million, and was driven primarily by a $5 million gained recorded for our share of Top Layer Re.

Turning to investments, we reported net investment income of $45 million, driven by a few factors. Our Alternative portfolio generated a gain of $23 million in the Third Quarter, driven by a rebound in the value of our private equity and bank loan portfolios. Recurring investment income from fixed maturity investments remained under pressure, due to low yields on our bond portfolio, and totaled $25 million for the Third Quarter. Total -- the total investment return on the overall portfolio was 1.9% for the Third Quarter, benefiting from meaningful realized and unrealized appreciation in the values of fixed maturity investments, largely due to the continuing decline in credit spreads. Our investment portfolio remains conservatively positioned, primarily in fixed maturity investments, with a high degree of liquidity and modest credit exposure. During the Third Quarter we largely maintained our risk profile, only slightly increasing allocations to corporate bonds and non-agency mortgage-backed securities.

The duration of our investment portfolio remains short, at 2.2 years, which was roughly flat compared to the Second Quarter. The yield to maturity on fixed income and short-term investments decreased to 1.4%. As we mentioned on the Second Quarter earnings conference call, we believe we have capital well in excess of our requirements. And in a step that is a bit unusual for us, we repurchased shares during the Third Quarter, buying back a total of 2.4 million shares at a cost of $180 million.

Finally, let me give you our initial top line forecast for 2013. For managed CAT, we estimate premiums will be roughly flat in 2013, excluding the impact of reinstatement premiums. In Specialty Reinsurance, we are forecasting the top line to be down 5%, primarily due to timing issues related to the inception of some multi-year contracts written during 2012. Keep in mind that the growth in this segment can be lumpy, due to the relatively small size of the premium base. In our Lloyd's unit, we expect premiums to be up over 30%. Recall that this growth is off a small premium base, and we are in the building-and-growth phase for this platform.

Finally, I'd remind everyone that premium estimates of this nature are subject to considerable risk and uncertainty, and our goal in providing them to you is to give you our best estimates at this time. Thanks, and with that I will turn the call back over to Neill.

Neill Currie {BIO 6676681 <GO>}

Thank you, Jeff. Operator, we are ready to take questions.

Questions And Answers

Operator

(Operator Instructions) Mike Zaremski, Credit Suisse.

Q - Mike Zaremski {BIO 20606248 <GO>}

Could you talk about the thought process behind the $180 million share buyback? That is definitely a lot more than I believe some of us were expecting, and I guess maybe one of the drivers was your -- it looks like the growth outlook for 2013 is well below 2012 levels? And I have a follow-up, thanks.

A - Neill Currie {BIO 6676681 <GO>}

I will start on that, and then turn it over to Jeff. It's a combination of two things, the amount of excess capital that we have on hand, and two, the stock price, the valuation of the stock. Jeff?

A - Jeff Kelly {BIO 20911735 <GO>}

Yes, I certainly agree. I'd say that the -- we have been saying for the last couple of quarters that we have capital well in excess of what we think we need to run the business, and I think our willingness to buy back a reasonably large amount of stock in wind season was a measure of that confidence. I think, consistent with the initial forecast that we gave you for 2013, our best guess is that our capital position in the absence of further capital management will continue to strengthen. So we do think -- we do expect at least at this point that you should see some capital management activity in the coming quarters.

A - Neill Currie {BIO 6676681 <GO>}

Maybe we'll do a ricochet hear and come back to me. One other thing that you have to think about here, sort of playing back Kevin's comments about flexibility, you will note that our ownership of DaVinci is down, and then we instituted Upsilon and Tim Re. Had not done those things, we would need a little bit more capital. So I wouldn't take it necessarily as a negative that we are buying back shares, I view it as a positive step.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay, that's helpful. And did hear -- lastly, did I hear correctly that the outlook for the joint ventures' managed CATs would be down in 2013, in terms of premiums written?

A - Jeff Kelly {BIO 20911735 <GO>}

No. Our forecast for managed CAT premiums is -- at this point is about flat for 2013.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay.

A - Neill Currie {BIO 6676681 <GO>}

And we will continue to manage that. For example, we thought -- we feel like we have got a very good book of business. We let new investors into DaVinci because we thought they were quality, good long-term investors, and we manage the Company on a long-term basis.

Q - Mike Zaremski {BIO 20606248 <GO>}

Got it. So just as a follow-up to that, then would it be a general rule of thumb then if property CAT prices are up a lot next year, then that business could probably grow, and if they are down, maybe it would be weaker? Thank you.

A - Kevin O'Donnell

Yes. We are going to approach the market the same way I think in 2013 as we did in 2012. If we see opportunities to grow, we will certainly grow, if we don't, were not going to force it and we won't. I think -- taking a step back, though, is we think of the portfolio on a net basis, so we have a lot of flexibility as to how much net exposure we're going to retain between Upsilon, between Tim Re, with da Vinci and other vehicles that we have, traditional retro. So I think even if top line does not change, we have a lot of flexibility as to how we want to construct the net risk portfolio that sticks to us, which has the largest impact on returns to shareholders.

A - Neill Currie {BIO 6676681 <GO>}

One thing I'll point out, too, just so people understand precisely what Kevin was saying. That does not mean that we are lackadaisical on a gross basis, and we take on business that's not profitable. We'll always take on a profitable business, it's just according to how we manage the net.

Operator

Sarah Dewitt, Barclays.

Q - Sarah Dewitt {BIO 18946247 <GO>}

Hurricane Sandy, what is the threshold in terms of characterizing losses as significant, and how large of an industry loss are you looking for there?

A - Neill Currie {BIO 6676681 <GO>}

Sarah, it's Neill, I'm always the guy that says, oh Sarah, I just cannot answer that for you, so one of these days we will break that tradition. So significant -- it's one of the reasons we gave you more color this morning, to let you know that we envision that the loss on that would be contained within the Fourth Quarter, versus the somewhat ambiguous or more vague, significant. So I think that gives you enough color. Now, we will give you more of an update on the loss as we know more. It is important to us to give good quality numbers, versus sort of rushing out there with a number that may not be particularly accurate. And as to the industry loss, we're not going to give a number.

Q - Sarah Dewitt {BIO 18946247 <GO>}

Okay, that's fair. Then on the January 1 renewals, can you talk about what you are expecting in terms of rate increases, supply and demand, and the outlook for Citizens and the Florida Hurricane CAT Fund?

A - Kevin O'Donnell

Sure. As I mentioned, we're going to approach 2013 as we approached 2012. I think a lot of the drivers for price that were resident within the market over the last 18 months or so are no longer there, which were really the model change for the US and international losses. We look at the business from an exposure-based pricing methodology, and we're going to continue to provide that stability to our clients in the way we are pricing the market. Wherever the market moves is really just an outcome, it is something that really is not an area that we focus a lot of attention. It is much more about our ability to construct the net portfolio, which we mentioned. We feel that we have a very good portfolio going into 2013, and our ability to optimize the net remains as strong as it has ever been.

Q - Sarah Dewitt {BIO 18946247 <GO>}

Okay. Great. Thanks for the answers.

Operator

Greg Locraft, Morgan Stanley.

Q - Greg Locraft {BIO 4221265 <GO>}

Wanted to just pursue a bit on capital management. It looks to me like you have earned over $500 million year-to-date, you have bought back about $270 million year-to-date, and so you have got a $200 million, $250 million or so, that you have made this year that is not -- that you have yet to do anything with in terms of buybacks or deployment, or perhaps I'm wrong in that? Obviously, you have said that Sandy's contained to the Fourth Quarter and the earnings, so you're not going to lose money in the Fourth Quarter. So how do you think about that extra $250 million-plus that you've made from here? Is it more buybacks, is it a special dividend, is it a dividend hike? What's sort of your appetite, given you did a lot in the Third Quarter on the buyback front?

A - Neill Currie {BIO 6676681 <GO>}

Greg, I hope you're doing okay up there, and didn't too wet. It's Neill. So I agree with everything you said, with one caveat, is that we have 60 days to run on the Fourth Quarter, so we don't know whether it will be profitable or not for the Fourth Quarter, but everything else you said I agree with. So with that, I will turn it over to Jeff.

A - Jeff Kelly {BIO 20911735 <GO>}

Yes, so just expanding on that a bit, Greg, I would say we don't look at it that -- quite that incrementally. We look at our capital position overall, and I would say in addition to the comments that we've both made here, we think our balance sheet is very strong. As Kevin mentioned, we have a lot of different levers to manage the risk profile of the business, and like I said in my prepared remarks, we've had a fair amount of -- we've been saying we have capital well in excess of what we need to run the business. I think what we have today is, as I expressed, is enough confidence to do something we haven't done before, which is to buy back shares during the wind season. So I think it is reasonable, without saying a specific number, I think it is reasonable to expect us to continue to return capital in the coming quarters.

The way we -- anytime we consider that, we consider a whole range of options to do that, and those could include anything from paying down debt to managing the size of our preferred shares that are outstanding, to share repurchases, ordinary dividends and special dividends. We really do look at everything all the time. That said, I'd have to say at this level of -- or roughly this level of our share price, we'd have a biased toward share repurchases as the primary means of managing that excess capital position.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay. Great. Thanks. I'll try to get a little color on Jan 1, I don't know if you'll be able to provide it, but the initial guidance of flat is -- you know, in a world where it seems that Property CAT pricing, at least pre-Sandy, had been slipping a bit. So is this -- are you guys thinking you're going to take some market share? How are you thinking about the market year-over-year into Jan 1?

A - Neill Currie {BIO 6676681 <GO>}

Greg, I will start, then over to Kevin. Please, everyone, take these estimates with a grain of salt. We see -- as being a first call market, we get to see some mighty big deals, and it's an imprecise science when we give you estimates. We're just trying to give you general guidelines. So with that, I will turn it over to Kevin.

A - Kevin O'Donnell

Yes, I couldn't agree more. I think it's -- the market price, and our ability to participate in it, is that we have first call capabilities for the business that is available. I think whenever there is a loss, and Sandy is certainly going to provide losses, we tend to emerge with stronger relationships for those that we protect. That could create opportunities, but it is one in which I think -- we are forecasting flat, that is the same as before Sandy hit, when we were looking at our budget; it is the same way we're approaching it after Sandy hit.

A - Neill Currie {BIO 6676681 <GO>}

Yes, one piece of color perhaps, too, Greg, is that after losses, there is a lot of learning here. Some people learn more than others, and there may be some people that said, you know what, my retention -- you know, we've seen a couple of these now with Irene, maybe my retention is a little high, they want to look on the frequency side. Maybe some folks that said holy smokes, if I've had this kind of loss from something that was not really even a Cat 1 when it hit, they might re-look at the amount of capacity they want to buy. So there is some potential things that could occur.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay. Great. Then one last one if I can. This is a Top 10 -- probably a Top 10 event, if you take the midpoint of Eqecat's range, for better or worse. Sounds like again it is going to be contained -- well, I mean your guidance is it will be contained within the Fourth Quarter result; that is pretty impressive. What are the key learnings in the early days that you are pulling away, from really the science and marketplace perspective, as it pertains to the core Prop CAT business for this event?

A - Kevin O'Donnell

I think the world --

Q - Greg Locraft {BIO 4221265 <GO>}

I'm sort of interested vis-Ã -vis your competitors. Like how you all are thinking about it versus where they may be?

A - Kevin O'Donnell

To -- keeping it very simple, if you think of the world as personal and commercial, and then think of the world as regional and national. Within this, I think the biggest area of uncertainty for where losses are likely to come from, from this event, is from commercial and national accounts, and one of the components in that -- there has been talk in the press about business interruption and contingent business interruption. A lot of the risk that -- or uncertainty around this loss will emerge from that type of portfolio, and we tend to be a little bit lighter in there compared to some of our competitors.

The next really would be commercial on the regional basis, and that would be smaller-type commercial accounts, some of which will have flood, some will not. In most instances, when flood is purchased it's sub-limited, but there is coverage in both of those buckets. Again, we have a relatively lighter market share there than in personal lines. In personal lines, generally, a lot of the damage we've seen on television is really around flood-related losses, and in most personal lines flood's not a protected peril, so from a reinsurance perspective I think we're reasonably well-protected there on both the regional and national side.

Additionally, I think there'll be some D&F participation in this loss as well. If you reflect back, it's not a dissimilar way in which we thought about the Thailand loss, in the -- where BI and CBI, which I think will be a significant area of uncertainty in how that will flow in. But that is really kind of a highest level as to where losses will come from and how they will flow into the market.

Q - Greg Locraft {BIO 4221265 <GO>}

That is great.

A - Neill Currie {BIO 6676681 <GO>}

Two other points, quickly, Greg, is of course some of our competitors are interested in writing pro-rata coverage than we are, and the folks with pro-rata will have a little bit different outcome here. And secondly, loss -- it's early for us yet, we are studying this right now, but it sure is helpful having a group dedicated to the science here like WeatherPredict. So we have ideas that can be confirmed, we've got specialists in storm surge and storm surge models we look at. This will help validate the work that we have done there.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay. Thanks a lot.

Operator

Amid more, (Indiscernible).

Q - Amit Kumar {BIO 15025799 <GO>}

Good afternoon. Just going back to the discussion on Hurricane Sandy, I know you touched upon BI, can you also talk about the demand surge component, and does that become a bigger deal down the road?

A - Kevin O'Donnell

Yes, I think demand surge is something that we model after each event, and in general terms demand surge within models becomes -- increases as the size of the loss increases, but each of our events will have some element of demand surge. I think the one thing that -- demand surge will affect accounts with losses, so again with the skew of our book being more residential than commercial, I think although unfortunately a lot of people will experience increased prices for things that they need to purchase, it may not necessarily flow-through to the insurance market or reinsurance market, just because of the way the coverages are working on this event.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. And the other question I have, and I guess it relates to the competition and the models, just like we had all these modeling resets; do you think that maybe this wasn't fully understood, and there is a high likelihood that many of the modeling companies will have to go back and reset their models, and that could potentially lead to additional pricing pressure?

A - Kevin O'Donnell

I think there's different ways to think about that, and I think from an industry loss perspective and a return period, my intuition tells me where this sits within vendor models is not going to be a crazy return period. I can tell you from our perspective, where -- what we are seeing and what we know today from a macro event perspective, we will not need to change our perception of risk or our models in 2013, depending on -- from learnings from this event. I would say, though, that on individual accounts we will probably learn things, and we'll reflect that specifically in pricing, but it won't be a 2006; or 2011-type model change in which there is a reset on the perception of risk.

A - Neill Currie {BIO 6676681 <GO>}

Along those lines, interestingly, going back to the formation of our Company in the early 90s, as I recall there was only one modeling company that understood an event like this could happen this far north, that it could continue west. But over the years, I think all of the modeling companies have done more work in this area, particularly in the last couple of years, so I think there is an acknowledgment that this can occur, it's just a matter of the return period.

Q - Amit Kumar {BIO 15025799 <GO>}

Okay. Thanks, that's all I have for now. Thanks for your answers.

Operator

Vinay Misquith, Evercore Partners.

Q - Vinay Misquith {BIO 6989856 <GO>}

The first question is the impact of Sandy on pricing, just curious as to what your perspective is? And in that context, looking at how much did RMS 11, how much did that raise pricing for Property in the Northeast? And do you think that there is more to go in terms of pricing because of Sandy?

A - Kevin O'Donnell

Let me start with RMS 11. RMS 11 changed its view of risk in the Northeast, which -- several of those elements of change were things that we had already incorporated into our model, so it is difficult for us to carve out as to how much RMS 11 drove behavior, because our behavior was not as linked to RMS 11 as some others, but certainly prices did improve.

With regard to Sandy, I think Neill touched on this and it is a way in which we sometimes think about the world, it is from a supply and demand perspective. So from a supply perspective, I don't anticipate that the -- this will be a material reduction in the supply of reinsurance capacity to the Northeast. From the demand perspective, I think there is a lot that is going to be learned between now and even year-end, and one -- the way we sometimes think about it is, it is my belief that there going to be a big gap between the economic loss from Sandy and the insured loss, and then there will be a big gap from the insured losses to the reinsured loss. When there's gaps like that, we look for opportunities to provide better protection to our customers, the insurance companies; and the insurance companies, with that better protection, can provide better protection potentially to their customers. So we are hopeful that as people understand where coverage is retained, there are opportunities for increased a demand, which could have a resultant change in price.

Q - Amit Kumar {BIO 15025799 <GO>}

Okay, that's helpful. The second question was on guidance. What were the assumptions for pricing? So were you assuming down pricing before? And the second is, what were your assumptions on the potential benefits of the depopulation program?

A - Kevin O'Donnell

When we build our assumptions we do look at the full year, so we look at things that are occurring in Florida and how the market may change down there, and obviously as you go further out there is more uncertainty. We do look at where pricing is, we look at what is likely to renew, what new layers are likely to come to the market. But the number that we think about is really how we want to play all those variables against our net portfolio, so focusing on what we think is a macro price change really wouldn't tell the whole story as to how we think about constructing our portfolio. We believe our portfolio has a lot of independence from the market, because of all of the levers on capital and retained risk that we have embedded within the construction of it.

Q - Amit Kumar {BIO 15025799 <GO>}

Okay. And was the potential benefit from the depopulation considered within guidance?

A - Kevin O'Donnell

Every dollar that comes out of a state-protected facility within Florida tends to have more reinsurance premium associated with it. Some of the change that one could anticipate in Florida is new companies forming, and also existing companies having an increased access to state-retained business. I think we look at that as having an increased opportunity for reinsurance -- for us to sell more reinsurance. So we do have an overlay that there is a positive trend within the Florida market for more reinsurance capacity to be deployed.

Q - Amit Kumar {BIO 15025799 <GO>}

That's helpful, thank you.

Operator

Jay Cohen, Bank of America/Merrill Lynch.

Q - Jay Cohen {BIO 1498813 <GO>}

One clarification and then one question. The clarification, just so I fully understand this, when you say the loss from Sandy will be contained within your Fourth Quarter, is that essentially a suggestion you do not expect to lose money in the Fourth Quarter?

A - Neill Currie {BIO 6676681 <GO>}

Yes, Jay. To be clear, Greg kind of touched on this earlier, based upon what we know now, that is correct. But we have got 60 days to go, so I'm not going to promise you a profitable Fourth Quarter until it is over. But yes, it should be contained. It should be a profitable quarter, all things being equal.

Q - Jay Cohen {BIO 1498813 <GO>}

Great. Then second question, you kind of make a comment relating the BI loss here, and maybe to the Thai floods, and I guess I saw them pretty differently. The Thai floods, my assumption was -- they lasted for months, and it was a highly-industrialized area of Thailand; where this one, I don't think it should last for months, and I don't get a sense that there is a huge amount of manufacturing capacity on coastal New Jersey. I was surprised that you brought that up.

A - Kevin O'Donnell

I think your -- I hope your assessment of those two things are true, but I think there's -- whenever there is a component of interruption to a business, there is going to be potential for business interruption. I think you're in a very different environment for interpretation of BI coverage between Thailand and the US as well. So I think, I'm not -- we don't have certainty as to how this will play through, but I was trying to highlight that that is a significant source of uncertainty, with the ultimate loss from Sandy.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it.

A - Neill Currie {BIO 6676681 <GO>}

I think the punch line is that any type of business interruption, contingent business interruption, is very difficult to ascertain. It is one of the hardest parts from a reserving standpoint.

Q - Jay Cohen {BIO 1498813 <GO>}

Absolutely. Thank you.

Operator

Josh Stirling, Sanford Bernstein.

Q - Josh Stirling {BIO 17463087 <GO>}

So we're obviously all sort of sitting at home trying to figure out how to understand this and help clients, and you guys probably have the best database, especially with respect to things like exposures and history. I am wondering if you could just help us with some basic facts, or something approaching facts, which is a rough sense of how much of the property in the exposed regions, especially on the commercial line side, what percentage do you think might have flood coverage and business interruption related to that, or contingent business interruption? Then it sounds like you guys have a sense of this, but how that might differ between national and regional accounts?

A - Kevin O'Donnell

That is a difficult question in a lot of different levels. Commercial lines, large commercial lines accounts often have flood cover, but in most instances that is sub-limited. So we need to figure out what the sub-limit is compared to the TIB value. Then a lot of -- it's not uncommon for the BI and CBI wordings to be more manuscript, so again it is going to be up to the specific account to determine whether they have coverage or not, and it tends to be something that is, among losses that are ceded, one in which there is more of a negotiated process than some other more cut-and-dry property coverages.

One thing we're currently doing for some books of business and some of our customers is, we have a detailed flood map, and we are taking our customers location-specific information, and then mapping it against where the floods were most profound along the -- particularly along the New York, New Jersey coast. But that is not something we have rolled up to be at the industry level, we're doing it more on an account level to help our customers understand the exposure that they have. So I don't have a specific answer as to what percentage of commercial businesses, or percent of businesses, are impacted. We are taking a more ground-up approach, and talking to our customers from that perspective.

Q - Josh Stirling {BIO 17463087 <GO>}

Kevin, that is very helpful. Is the intuition -- I mean, you responded related to commercial lines, sort of like large account commercial lines. Is the intuition for the regional writers, or say small standard policies or mid-market, things like that typically don't come with flood coverage, and therefore business interruption doesn't typically apply?

A - Kevin O'Donnell

I think it will be more of a spread, as you go further down. I don't have specific data on this, but if you move to smaller and smaller, ultimately to a BOP-type policy, I would imagine there will be less take-up rate than the more -- much more sophisticated Fortune 500 buyer, for this type of coverage.

Q - Josh Stirling {BIO 17463087 <GO>}

Got it. Then this my last question, in a typical scenario does -- what sort of level for your larger accounts would you expect the CBI and the flood limits -- or the flood sub-limits to be? Is this sort of a fraction of the total exposure, sort of a trivial level for some of these large buildings we're seeing on television, or is that something that they would actually approach the insured values of the property?

A - Kevin O'Donnell

It tends to be pretty significant sub-limit, but what we are seeing is on a 40-story building we're seeing a lot of damage ground floor and below. I think it's whether the sub-limit actually is -- comes into play or not. I think it is early days to figure that out at this point.

A - Neill Currie {BIO 6676681 <GO>}

Yes. That it is very account specific, and I know our D&F folks will reply, as we look at the losses, that they will underwrite an account and they will come in above the sub-limit. So in the larger accounts, the underwriters look at this quite closely in terms of what that sub-limit is.

Q - Josh Stirling {BIO 17463087 <GO>}

Right, great. Thanks for taking the time. Good luck.

Operator

Mike Nannizzi, Goldman Sachs.

Q - Mike Nannizzi {BIO 15198493 <GO>}

One question I had, Kevin, can you talk a little bit about any retro purchasing that you did in the quarter, or any appetite that you've had that's been different from prior quarters, just given the availability of some alternative capital? And just a couple follow-ups, thanks.

A - Kevin O'Donnell

Sure. Look even outside the quarter, we were pretty active purchasing retro this year, and I think you can extend that retro purchasing into things even as starting Upsilon as a sidecar and starting Tim Re as a sidecar. A sidecar from an economic perspective works very much like a retro, depending on how you structure it. So I think we -- overall we were aggressive in the market purchasing retro this year compared to perhaps last year, but I wouldn't say that that is a shift at all in how we think about purchasing it. A more typical approach for a retro purchase would be to go out with a program at a specific point in time to manage the gross to net portfolio. We view it as much more of a dynamic process where, at any point in time we will look in the market for retro opportunities that enhance the net returns of the book of business. We had good success with that in 2012.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Great. Thanks. Then just one capital question, how much did the reduced run stake in DaVinci year-over-year influence the share buyback decision, versus your outlook on how much premium you may write at 1/1?

A - Jeff Kelly {BIO 20911735 <GO>}

It was certainly a consideration, but in the -- I would say in the grand scheme of how we view our overall capital structure and excess capital position, it wasn't a dominant reason in our decision to move forward with that.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Okay. One last one, crop and flood losses this year were obviously significant; both are government-run programs. How do you think about these sort of -- how these events could potentially impact the way that these programs are run, if at all, or the potential for some of the risk to move into more of a private-market format? And thanks for all your answers.

A - Neill Currie {BIO 6676681 <GO>}

That is a great question. There is area of opportunity here. We no longer are in the crop business as an insurer; we view that business now as a reinsurer, sort of for the reasons mentioned, the government influence there, quite frankly. However, it is interesting on the flood side. I think that the steps we've made -- you know, this is obviously going to cost the US government in a tough time, with the fiscal cliff hanging over and the deficit, so I think over the coming years there's opportunities for the private market to certainly be involved and to participate.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Is that something you'd want to do on the flood side?

A - Neill Currie {BIO 6676681 <GO>}

Sure. We do it everywhere else.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Thank you.

Operator

Seth Bienstock, TimesSquare Capital.

Q - Seth Bienstock {BIO 16459134 <GO>}

Just following up on the LIBOR losses, what percentage of the reserves that have been posted is IBNR at this point?

A - Jeff Kelly {BIO 20911735 <GO>}

Seth, all of it is IBNR.

Q - Seth Bienstock {BIO 16459134 <GO>}

Okay. Just second, about five years ago, I think also in the Casualty Clash book, Ren posted I think $55 million in losses for potential sub-prime exposure. Was wondering if you could provide us roughly how much of this amount has been paid out to date?

A - Jeff Kelly {BIO 20911735 <GO>}

I think on the sub-prime exposure, to this point about 75% of that is paid out Seth.

Q - Seth Bienstock {BIO 16459134 <GO>}

Okay. Great, thank you very much.

A - Neill Currie {BIO 6676681 <GO>}

Operator, our time is about up. Let's take one more question, and then I think we will have to -- it is lunchtime here in Bermuda.

Operator

Ian Gutterman, Adage Capital.

Q - Ian Gutterman {BIO 3106649 <GO>}

I will just limit myself to two, and follow-up with the others later. First, any exposure -- you obviously talked about where you are exposed on the CAT side. Is there anything to think about on either Lloyd's or the Specialty business to this kind of this event?

A - Kevin O'Donnell

Yes. Within Lloyd's we do write some Property CAT, so that is a similar analysis as to what we would do here in Bermuda.

Q - Ian Gutterman {BIO 3106649 <GO>}

Right.

A - Kevin O'Donnell

Additionally, in Lloyd's we have a very small book of D&F business, so direct and facultative reinsurance, and I think there's certainly exposure that can come through in there. We have gone though that book of business, we've -- and continue to look through to determine if there is exposure that will come through from there.

Q - Ian Gutterman {BIO 3106649 <GO>}

What kind of retentions do you take on that book?

A - Kevin O'Donnell

Again, it depends on the account and the pricing, so a lot of them are layered, structured programs, and we look at really what the risk return is by layer. As Neill had mentioned, it's not uncommon for us to be above the flood sub-limit on those deals as well.

Q - Ian Gutterman {BIO 3106649 <GO>}

Got it. And the Specialty book?

A - Neill Currie {BIO 6676681 <GO>}

Ian, I'm sorry, sticking with the D&F book, then the Specialty, interestingly it took us a while to get that the D&F book up and going, because a lot of people that write D&F, frankly, don't go to the trouble of properly allocating the property exposure, and we've spent millions of dollars making sure we got this right. So we can go back in on every individual risk in that D&F book and look at the footprint, so we know where it is and we know our exposures. And all of those potential losses are rolled into our estimated losses, and will be in our estimate when we put it out, and is within our estimate now.

Q - Ian Gutterman {BIO 3106649 <GO>}

Great. Kevin, when you mentioned that this event played out largely as you guys might have anticipated, the only place I can think of that might be a little bit different is would you have modeled an event like this for this kind of wind field and so forth, would you have thought hurricane deductibles would have been in play, because it would have been a hurricane, and the fact that it is not, could that be something that could be worse than you would have modeled for this type of event?

A - Kevin O'Donnell

One thing, again, if we look at any given event there's unique characteristics that one can point to and say that is something -- that is so idiosyncratic, it is hard to represent within a model. When I think about the fact that we have this sort of event, we have flood, we have surge, we have wind events, at this level, at a frequency in which we are comfortable, I think the wind -- with where the wind speeds are, and then the application of the hurricane deductible, I don't think has as a material impact us -- on us for this event, as a reinsurer.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. Even though some of your national cedants have said they are going to waive those, and you have to follow-the-fortunes?

A - Kevin O'Donnell

Yes. But I think -- I'm speaking specifically for this event.

Q - Ian Gutterman {BIO 3106649 <GO>}

Got it, okay.

A - Kevin O'Donnell

If that decision was made on significantly larger events, called it a major hurricane, Cat 3 or above, the implication of waiving or not applying hurricane deductibles can be significantly more material to a reinsurer like us.

Q - Ian Gutterman {BIO 3106649 <GO>}

Got it. Okay. Thanks so much, and I'll let you guys go.

FINAL

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A - Neill Currie {BIO 6676681 <GO>}

Operator, thank you. It is lunchtime here in Bermuda. Thanks, everyone, for joining us. I will just say in closing that an event like Sandy reminds us that the hurricane season is not over, and in fact stretches through November. I remember -- I am an old guy, I remember way back when, having an event in the Gulf around Thanksgiving. So it's not over until it's over, but I am confident whatever happens, we will be there to meet it in good position for next year. Thank you very much.

Operator

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