Bank of America Merrill Lynch Insurance Conference

Company Participants

- Albert A. Benchimol, Director, President & Chief Executive Officer
- Unverified Participant

MANAGEMENT DISCUSSION SECTION

Unverified Participant

We find our seats. Next presenter is AXIS Capital. We've got Albert Benchimol, President and CEO of AXIS. Albert joined AXIS in 2011 as CFO and became CEO the next year. Prior to AXIS, he was Senior Executive at PartnerRe for a number of years, about a decade. And since joining AXIS he has built a very experienced team of people. The pace of change of the company continues to increase, I would say. And to talk about the change, where the company is going, it's great to have you here Albert.

Q&A

Q - Unverified Participant

Let me start looking forward into 2019. Let's pretend for a second this is your employee group here and you want to lay out the key initiatives for 2019. What are the two, three, four things you'd focused on?

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

What I would tell my team is to continue on the path that we've been on for the last several years and just make further progress. And when you focus on it, it's really three major issues right? It's all about customer engagement. So, how do we make the customer experience, the broker experience better? How do we give them faster turnaround in their quote? That would be number one.

Number two, let's continue to improve the quality of the portfolio. Let's improve the profitability, let's reduce the volatility and let's make progress there. And the third area is, let's make sure that we've got an efficient and effective platform that we can cost effectively deliver our value and manage our costs and keep more of the profits at home. So, those are the three things.

Now the way you drive that is using technology, using analytics, continuing to develop talent. But when we talk about InsurTech, when we talk about analytics, it's not to make an announcement oh gee, we just put some money in this firm or that firm. It's what is this going to do to our customer engagement model? What is this going to do to improve our turnaround time on quotes. What is this going to do to improve our ability to select better risks. So three things: customer engagement, portfolio optimization, cost control.

Q - Unverified Participant

When you talk about – when anyone talks about customer engagement, you typically think about a retail-focused business, personalized business as an example where it's seemingly critical. You don't hear it as much with a commercial-oriented company. What sort of put that in your head several years ago where customer engagement was going to be – it was the first thing you mentioned when you made your list?

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

Yeah. Look, at the end of the day, the insurance business is we sell a promise. We – our job and I love the mission of insurance. It's something that I'm passionate about is we basically give people the courage to take necessary risk in the pursuit of their goals. Nothing in this economy moves without the protection of insurance. But basically you're asking people to put their money upfront with the hope that if anything bad happens to them, you will be there to help them in the future. It's a business based on trust. It's a business based on relationships.

And so I think customer engagement is really important, that's number one. Number two nobody likes to buy insurance. So how do you make the purchase decision as simple as possible and although we are not in the personal lines business, I would argue that in the small commercial business it's the same issue. Most entrepreneurs, the last thing they want to think about is filling in an application about how do I buy insurance. They're focused on selling, on making payroll, on developing new markets. So the easier we can make it for them to purchase insurance and then the more solidly we can deliver on our promise, I mean that is customer engagement. And so one of the things that I'm proudest of in AXIS is that we regularly come out number one on claims surveys. And that's really important because that's our true product.

And then, for brokers, brokers want to succeed. Brokers want to deliver coverage to their customers and they want to be able to do so quickly. So, if you can turn to a broker and say, look, if you show me these types of risks, I'm going to come back to you very quickly and very likely with a positive attractive quote. The less time they spend on placing the risk, the better it is for them. The better we do on claims, the less phone calls they're going to get from their customers going like why did you get me this insurance, I've got a claim and I'm not getting good service. So, all of those things are very, very important in terms of customer engagement, customer satisfaction.

Q - Unverified Participant

When you talk about customer engagement, then you're also talking about your intermediary partner.

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

Of course.

Q - Unverified Participant

Yeah. I wanted to talk about the market. When we have executives like you out here, we want to get your perspective on pricing and market conditions, so give us your outlook both for insurance and reinsurance for 2019.

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

We actually just published just this morning, I believe, some statistics on that. So you'll find that on our website and what we did is we provided a three-year scan of pricing by different lines of business and it's very interesting. 2016 was demonstrably a negative year on pricing. 2017 was spotty, mostly flat, property up a little bit obviously because of the hurricanes in 2017. But if you look at pricing in 2018, almost all of our lines of business are up, so we've got a nice trend going from 2016, 2017 to 2018. So, the trend is up.

What we are seeing is concerted action around pricing and I want to focus on two really big markets and then I'll talk about loss trends. The world capital for international specialty risk remains in London. And London has been a challenging market for a couple of years but in 2018, Lloyd's under Jon Hancock's who's the Director of Performance Management took a very strong, very firm action with regards to focusing on unprofitable lines and taking significant action on profitable lines.

While they were doing that they've basically scrutinized every plan for every syndicate basically demanded actions. And as a result of that, you've seen literally over 70 different announcements from different syndicates, saying they were getting out of certain lines, or significantly reducing their appetite on certain lines. The net of which resulted in a much firmer market. And in fact, in the fourth quarter, the international – the London market was our best quarter from a price perspective. And the anecdotes that we're getting from January, we haven't finalized the numbers yet, are that is continuing. So that's very positive.

In the U.S. market, you're seeing a number of very large organizations trying to improve their underwriting results and they're reducing capacity, they're increasing prices and so on. And so here, again, we're seeing a positive move. And I will tell you that in the E&S market where we play, we're a leader in the E&S market in the U.S. property and casualty. We've been getting double digit on property on E&S Property, we've been getting double-digit on E&S Casualty. And so we're seeing real moves there.

The reason for those moves is that the loss trends in particular around commercial auto liability and around primary D&O are very strong. And of course property results are very poor in (00:07:46) the industry. So we're finally getting to a situation where the industry is taking action. So by and large my expectation is that we will continue to see what I'm going to call rational pricing action which is in those lines of business that are remaining profitable. I don't expect to see much there and in fact might even see some price decline. But where you have loss trends that are very high, where you've got losses reported last year, you'll see pricing increases.

The reinsurance side on the quota share we get the same deal, plus or minus any change in the ceding commission. By and large, at the 1/1, most ceding commissions were flat, maybe down a little bit which means that basically reinsurers held the line with their customers or maybe improved a little bit. The one disappointment we have to admit was cat. The you had (00:08:38) 1/1 cat result – renewals were on average, I'm going to say flattish, they were down low-single digits in the year for loss trade accounts. But after two really terrible years, here's an interesting statistic, in the last eight years, we've had three of the four worst cat years, 2011, 2017 and 2018. (00:09:04) is Katrina in (00:09:07) in 2005. So three of the four worst cat years in the last eight years and cat rates are 30%-plus below where they were in 2011. That's just not sustainable.

And so some work needs to be done there and certainly we're hoping to see in April and June that where we have more loss affected accounts in Japan and by the way, JV (00:09:30) is continuing to deteriorate. That's a loss that's now in the double-digits and going higher. So I expect to see some action in Japan. And certainly in the Florida and the U.S. markets in June and July, we would hope to see some action and if we don't, we will reduce our capacity.

Q - Unverified Participant

The insurance pricing, you expressed some of these views on the fourth quarter call, it felt like your pricing commentary was a bit more upbeat. You gave higher numbers than some others. Do you think you are ahead of the market and can you tell that by how your retentions look?

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

So first of all, AXIS does not write the market. We're a specialty insurer and global reinsurer. So you do tend to see different rates of price changes reflecting the markets which we're in. In some cases, that's negative. For example for the last few years, aviation was bad, energy was bad and so on and so forth. But those are recovering.

I would say that yes, we are on the forefront of what I would call market discipline. And the evidence that we have for that is we sit down with our brokers. We look at their average price increases. We look at ours. We look at the reactions of the brokers when we give them our quotes. And by and large I would say that we are ahead of the market. That's fine with us. One clear piece of evidence is that our retention ratios are 10 points lower than they were last year.

So we've had a 10 point reduction in our retention ratios. What we are finding is that sometimes we'll give a quote, broker will be upset, he's going to go elsewhere, and they'll come back and they'll say, well I was able to place X amount of this. I still need some help. Can I still get your capacity at your original terms? And we feel good about that. So we will continue to focus on price. And I said this, I don't know how many times but right now, our primary focus is on the bottom line not on the top line. And so, we will do whatever we need to make sure the bottom line gets stronger and the top line will eventually follow.

Q - Unverified Participant

It sounds fairly sane (00:11:39). And I wanted to ask you about Novae, and really the response you're getting from your distribution partners following that deal and now with everything integrated.

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

So, Novae one year after the acquisition, I have to say has been really satisfying. It's been a real success. One of the things that really attracted us to Novae is that while we were top 10, top 15 in most of our chosen markets, we were not yet as relevant as we wanted to be in the London market. And so, we were very specifically focused on improving our positioning in the London market and Novae provided just a perfect fit there. And what we liked about Novae was that they're well-respected underwriters, good book of business and they have already started improving their own portfolio, so we felt they were on the way.

To your point with regard to the distribution, we were really encouraged because Novae was a small company that had had some challenges in the past. And so, while the distribution liked dealing with Novae, there were some concerns about can they do more for us than whatever. And now, that they've got AXIS behind them, now that they've got the talent that they used to have before, they have the products they used to have before, but now they have a much stronger insurer behind those underwriters, they're feeling really good about that.

And let me say that, as we brought the two companies together, I'm really proud of the job that we've done of holding the teams together. The leadership is literally 50% Novae legacy executives, 50% AXIS legacy executives. We've kept substantially all of the business we wanted to keep. We've kept substantially all of the staff that we wanted to keep and we're now a solid top 10 player in the Lloyd's market.

Q - Unverified Participant

And the expense reductions or the expense initiatives have come in largely in line, if not better.

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

Absolutely. When we originally announced the acquisition after our due diligence, we were planning on about $50 million in cost saves. Somewhere early in 2018, a quarter into it, we felt that we could squeeze some more and so we raised our expense target to $60 million. And then separately, I'm sure you know this. We've had a transformation effort in the company where we're looking for an additional $40 million of savings.

So between Novae and our transformation efforts that we initiated in 2018, our target is to eliminate $100 million off the 2017 expense base by the end of 2020. And as of the fourth quarter of this year, on an annualized basis, we were at about $70 million. So, we've made a lot of progress in one year towards that $100 million goal.

Q - Unverified Participant

Outside of Novae, where are the other expense reductions coming from?

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

The expense reductions are trying to be more efficient in what we do. So for example, we introduced a new service model for both our IT function and our finance function. And so whereas we had a more decentralized function, we did more centralization of the function to get more efficiencies in processes and so on. We used to have a standalone A&H unit which we took literally from $0 because it didn't exist in 2010 to $500 million of premium in 2018. But that was still much smaller a division than our insurance and reinsurance businesses which were $3 billion plus apiece.

And we felt that we had reached a bit of an asymptote in terms of the benefits that we could get in - as a standalone entity. So we split up the A&H business, took the insurance divisions of A&H, realigned them into the insurance core segment, took the reinsurance business and aligned that into the reinsurance segment and we actually allowed each of those business units now to better leverage the scale, the resources, the distribution relationships but we also no longer needed some of the divisional support that was there, so we were able to cut costs there.

But a lot of that is really about doing things more intelligently, improving processes, using more robotics, doing a number of things that we can do to effectively do it. What matters to me is not so much the $40 million net savings for the transformation. The gross savings are going to be much more than that but we're also going to take a lot of those savings and we're going to be reinvesting in the business. And so, we're going to invest much more in analytics, much more in technology, much more in enhancing the way we build our portfolios, drive data and so on. So, the $40 million is the net savings that we hope to achieve. But within that number, there's going to be a significant amount of reinvestment so that we can be, as I like to say, smarter, better, faster.

Q - Unverified Participant

But that could drive better loss ratios, better growth.

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

Absolutely.

Q - Unverified Participant

You mentioned A&H as a business has that - you've been at this now awhile, it must be...

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

Eight years.

Q - Unverified Participant

Eight years. Has that matched your expectations?

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

I think that what I feel very proud of is that while the market has changed since we launched it, the business was agile enough to refocus and remain successful. So, let's be clear when we started the company we were hopeful to develop more of a retail A&H capability but that ultimately did not pan out. With the financial crisis and distribution available through credit cards, banks, credit unions all of those things that were part of the original plan, the affinity business just did not develop the way we wanted it to. So, we very early on decided that we need to shift to more of a wholesale model. And so, since then we've shifted more to the wholesale model. So, you could say that the original goal of a retail distribution did not happen. But when I look at the business today, it's $500 million of premium. It's delivering an underwriting profit. It's providing great diversification to our portfolio. I'm very pleased with where we are now.

Q - Unverified Participant

Jumping to the fourth quarter for a second, when you have a quarter where you have elevated attrition or losses and you say we've looked at this, it's nothing systemic. How do you go about actually looking at it? What's the process involved?

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

Well there's two things that we do. Everything that we do is the bottom up and top down. So, we look at the losses and we say, where do they come from? Are they related to a specific portfolio? Are they related to a specific risk class? Did we miss something about a risk class, about a region, about a concentration issue? Right? So, we look at all those things. And frankly, we didn't see any pattern that would say there's something that links it there. Importantly, being a hybrid company, we have access to both our book of business but also the reports that we get from our reinsurers, from our clients on the reinsurance side.

And we've done a lot of claims coming up from the reinsurance side too. So, we were seeing that our clients were getting the same thing. And then we pick up the phone and we talk to our friends in the industry. What do you think and so on. And in fact, we've now confirmed it because you've seen a lot of earnings releases where a number of firms have basically reported increases in ex-cat loss ratios specifically related to property.

So, we're now seeing 3 data points or 4 – it's actually 3 (00:19:15) that confirm that it's not an AXIS issue, that it's not a specific issue, but it really was a very unusually volatile quarter for property.

Q - Unverified Participant

Stuff happens, as they say.

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

Stuff happens, but look. I think property has been a challenged line for the industry for a couple of years. This is a line of business that clearly needs rates and where each of us needs to look at our portfolios and make some changes. And certainly we're doing that.

Q - Unverified Participant

You have worked to reduce your net catastrophe exposure. Are you really you want to be on that front at this point?

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

We've made a huge amount of progress. And again, we just released some data where we demonstrated that our aggregate annual PML. So, as insurance companies, we all release our PML for Southeast for California Quay (00:20:08) for whatever, right, at the 150, 100, 200 a year. We just released our annual aggregate PML at the 1-in-250 which is all cats from all sources what is the potential at 1-in-250 and that number has gone down almost 50% from 2011 to today, quite a significant reduction in aggregate annual PML.

And we are doing a better job of constructing our portfolio. We're certainly doing a very good job of sharing some of these risks with our strategic capital partners. We're using more reinsurance and so we're down. But you can expect us to continue – to look to continue to further reduce the volatility of our earnings because we understand that when the industry gives us 20%, 25% ROEs as they did in the first part of the century, it's okay to assume volatility for those returns.

But when we're earning low-double-digit at best in the industry, I don't think that we should be taking on too much volatility for those kinds of returns. So, we're very happy to take on volatility for high returns. But at the returns that we're being offered today, we think we should reduce our volatility.

Q - Unverified Participant

Let's open it up to the floor for any questions. We've got right there and just wait for the mic.

Can you talk about the capital markets and its impact on property cat? I mean Markel (00:21:37). If my calculations are correct, they had about $3.5 billion of AUM. And their cat losses for 2017 wound up being $2.3 billion. So they lost two-thirds of their AUM. Obviously your vehicle did a lot better and...

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

Yes, it did.

Q - Unverified Participant

So the question is like, my guess is there's going to be a switch and plus on top of that a lot of insurance companies like Markel bought CATCo and you have Mitsui buying some other current leaders, some other company recently. And so that, the capital markets companies are increasingly being purchased by insurance companies. So one would think that from a rational standpoint, that things would – the returns would rationalize to a more reasonable level, especially since a lot of the participants in these kind of companies are tend to be family, offices, retail, investors, blah, blah that a lot of them got blown away last year and the year before.

So can you talk about what you'd expect in terms of potential changes in the capital markets and how that could impact the pricing to you guys on the insurance side?

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

Absolutely.

Q - Unverified Participant

Because (00:22:53).

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

Sounds like – if you don't mind I'd like to take a broad perspective on capital markets and their interest. And bottom line, there is going to be continued interest from pension plans and sovereign funds specifically around the fact that they're looking for diversification in their portfolios and they're looking for risks that are not correlated to economic risk and cat risk in particular is diversifying. And so, there's always going to be a fundamental appetite for diversifying risk from, at the very least, pension plans and sovereign funds. We may or may not see hedge funds in there. That's just whether it's hot or not. And retail money may or may not be interested in the volatility in that.

But I think sovereign funds and pension plans will always be interested and there's a lot of money there. So right now, Wall Street has (00:23:52) said that the ILS market was about $93 billion as of the end of 2018. That's almost 15-ish percent of reinsurance capital of approximately $600 billion give or take. But what matters is not $93 billion on $600 billion. What matters is how much money is actually sitting on the sidelines ready and willing to be put to use at the right time.

So if you adjust in (00:24:18) the pension plans and you took the totality of pension plan assets and they would just put 1% of the totality of global pension plan asset, you could approach $400 billion. And that's equal to the totality of the limit in the cat world right now. So there's a lot of capital and I think that we have to expect that over time there will (00:24:39) be capital. My issue is not about the capital itself, I think it's a great idea, is that that capital has up to now not demanded a return.

They're very happy sharing the return, participating in the return. And so if they're not demanding a return, they're going to get a low return. And I think that to your point about a number of mutual funds if you look at their 2, 3, 5 year results, they're not impressive. And so I think that the capital markets, the ILS providers they need to say, I'm willing to put money in but it needs to be more. And that's really I think where the next issue has to be. Because up to now they've been very much run by models.

And historically the industry does a combination of modeling but also managing its business. We lose money for a couple of years. We need to make money to make it back, so we raise prices no matter what the model says. And so I think that we need to make sure that the capital markets providers support higher prices. And certainly we're encouraging them to do that.

Q - Unverified Participant

Actually that raises - let's go with another question from the audience. Do you have one here? Yeah. Just wait for the microphone.

Well actually, we have a gigantic ILS group ourselves that got blown up.

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

So raise prices.

Q - Unverified Participant

So yeah. So I actually asked our group that and it seems like a pretty interesting sleight of hand. I asked why they were buying into the ILS product itself versus just buying the equity of the ILS underwriters and/or reinsurance companies. And by buying the equity, it gets put into an equity box...

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

That's right.

Q - Unverified Participant

...which is charged a different capital to our group versus the "uncorrelated" cash from the underlying ILS even though it's the exact same cash flow which is crazy to me. So then, I think about it and I say, well what would I do in your shoes. Well, I would underwrite as much ILS as I can at 4% returns and charge a management fee instead of having the investors buy in my equity. So I'm wondering if in your opinion, ILS underwriters are writing stuff to the greater fool which is us.

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

So I'm very happy to say that our approach at AXIS is so different to what you just described.

Q - Unverified Participant

Okay.

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

Because we have a huge amount of respect for our strategic capital partners and the only thing that we do with our capital partners is we do quota share. We don't play against them, we don't use them, we don't try and create structures where we win, they lose or vice versa. Our product at AXIS is here's the entire portfolio - we write $7 billion of risks across the world, across different portfolios. And when we say that if you folks want insurance risk, what do you want, do you want more of this, do you want less of that.

And another thing that I'm very proud of is that at AXIS, I believe that we are the company that shares the broadest range of risks with capital markets, a lot of companies share a lot of cat of course. We share cat, we share casualty, we share D&O, we share E&O, we share agro risk, we share credit risk. And so, what we believe is that we are the vehicle that sources, structures, prices risk and builds portfolios, and we know that there are investors in the world that want access to those portfolios, and we're really happy to work with them.

But we are not going to leverage our capital partners because that is not a viable long term strategy. We'll buy bonds, happy to buy bonds. But, if you're a capital partner of ours, you're going to get a quota share return and if we do a good job for you, you'll pay us a profit commission which I'd like to earn. Divesting (00:28:29) is the only way to avoid the agency risk that really hurt the financial markets in 2008.

Q - Unverified Participant

Then taking a step from that, let's say the possibility of something happening is 10%. You guys as an industry charge whatever 12%, make a little spread for yourself. But then, the brokers want their cut and then, you have this agency problem to some extent. Irrespective of what you try to do, if your whole industry has $600 billion, you guys are a very, very small component of that. Inevitably, wouldn't the return on equity in this industry fall almost to a bond rate eventually, when all the capital essentially go to ILS versus the equity?

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

So, I think over time, this industry is going to become much more efficient. But in the near term, it's most likely going to be property and property cat which is going to be more interesting to the capital market.

It's because most of the capital markets are interested in something that has a relatively short period of uncertainty and the nice thing about cat as you know January 1 to January 1 and you know what you've got. You're dealing with D&O, you're dealing with E&O, you're dealing with liability, a number of those lines of business, you're not really sure where the liability is for five, six, seven, eight years. And so, I think that it's going to take some time before those risks are available to be transformed into a form that is available to the capital markets and you never say, never. And I'm sure that over time we will do that.

But for the moment, I think that short tail lines are by and large the most easily available to the capital market .And to your point, I think that we as insurers, we can get double digit ROEs simply by saying that there are certain lines of business where there is an appetite for that risk at a lower return. And so, we will keep less of that ourselves but we will be a servicer of that risk. And so, we will keep less capital, we'll have more fees, and we'll be able to make the way asset managers do, a very nice double digit return on ROE for the risk servicing part of that component. And then we have to also try and make a double digit ROE on the other risk that we have in our portfolio. So, I am absolutely not supportive of the view that we are going to be pushed down as an industry to a low single digit return.

Q - Unverified Participant

To understand your last point correctly, do you mean that you'd essentially almost become like a mortgage underwriter in a way that you process the mortgage and sell it off to...

(00:31:13)

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

With the big difference that we will always want to keep a piece of that risk, so that the alignment between ourselves and our investors is whole.

Q - Unverified Participant

Right.

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

To give you an example, we're currently ceding about half of our cat reinsurance book already. In 2011, we were ceding zero of our cat reinsurance book. Today, we're ceding half of our cat reinsurance book. I have no problem in the next several years ceding a greater percentage of that.

Q - Unverified Participant

You can just raise money at one month...

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

Yes, we did.

Q - Unverified Participant

(00:31:45)

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

I'm very proud. I mean, Ben Rubin who runs our Risk Funding group is in the back of the room here. I think he may have been the only individual in the industry to raise - actually that's not true, RenRe did (00:31:56). But very few people were able to raise new capital in this market at 1/1 and we're very proud of the fact that not only did we raise more capital but we increased the breadth of our investor base at 1/1 so we're very proud of what we've done there.

Q - Unverified Participant

When you hire former Merrill people, that's probably how it works out.

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

Yeah.

FINAL

Bloomberg Transcript

A - Unverified Participant

Why don't we - we got to cut it off here unfortunately. Albert, thank you very much.

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

Appreciate it.

A - Unverified Participant

I'm not going to shake your hand because...

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

No, don't.

A - Unverified Participant

But thank you very much.

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

Appreciate it.