Q3 2016 Earnings Call

Company Participants

- Kevin J. O'Donnell, President, Chief Executive Officer & Director
- Peter Hill, Investor Relations Officer
- Robert Qutub, Chief Financial Officer & Executive Vice President

Other Participants

- Brian Meredith, Analyst
- Elyse B. Greenspan, Analyst
- Jay Arman Cohen, Analyst
- Josh D. Shanker, Analyst
- Kai Pan, Analyst
- Michael Nannizzi, Analyst
- Quentin McMillan, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day. My name is Jack, and I'll be your conference operator today. At this time, I would like to welcome everyone to the RenaissanceRe Third Quarter 2016 Financial Results 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 Thank you.

Peter Hill, you may begin your conference.

Peter Hill {BIO 15385944 <GO>}

Thanks, Jack, and good morning, everyone. Thank you for joining our third quarter 2016 financial results conference call. Yesterday, after the market close, we issued our quarterly release. If you didn't get a copy, please call me at 212-521-4800, and we'll make sure to provide you with one.

There will be an audio replay of the call available from about 1 PM Eastern Time today through midnight on December 2. The replay can be accessed by dialing 855-859-2056 U.S. toll free or +1-404-537-3406. The passcode you will need for both numbers is 95393243. 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 11.

Before we begin, I'm obliged to caution that today's discussion may contain forward-looking statements, and actual results may differ materially from those discussed. Additional information regarding the factors shaping these outcomes can be found in RenaissanceRe's SEC filings to which we direct you.

With us to discuss today's results are Kevin O'Donnell, President and Chief Executive Officer; and Bob Qutub, Executive Vice President and Chief Financial Officer.

I'd now like to turn the call over to Kevin. Kevin?

Kevin J. O'Donnell

Thanks, Peter, and thank you, all, for joining today's call. So, we'll begin by first welcoming Bob Qutub, our new CFO. Bob joined us in August and has gotten off to a great start. He has a long career of demonstrated leadership. And I look forward to working with him as a member of the RenaissanceRe team.

Moving on to discuss our results, I am pleased with our execution so far in 2016. We maintained our Cat leadership, grew our Lloyd's operation by 20%, and grew our Specialty segment by close to 70%. We have also increased our organizational efficiency, as our run rate operational expenses are essentially flat for the year to date.

We had a strong third quarter on many fronts. Despite the recent end to the landfalling hurricane drought in the U.S., the third quarter storm Hurricane Hermine did not cause material losses or affect many reinsurance programs. And consequently, our property portfolio has performed well. We will discuss the impacts of Hurricane Matthew, which occurred in the fourth quarter, later on this call.

Looking ahead, we anticipate that 2017 may prove to be an even tougher year than 2016. Despite this, we are optimistic about our opportunities for profitable growth for many reasons. These include the investments we have made in our platforms, our people, and our capabilities, and the strong relationships we have developed with our clients. We will look to maintain our current leadership position in property cat but seek to grow in other areas such as mortgage insurance and also with our U.S. and Lloyd's platforms.

Additional sources of future growth will come from several discrete corners of the business. In property cat, we're a first-call market for bespoke cat solutions. Our cat leadership here should continue to provide attractive opportunities. Unfortunately, I didn't expect that these opportunities will always offset declining rates, but they should diminish the effect of rate reductions.

In other property, we continue to see more opportunities in areas such as quota share, property per risk, U.S. regional business and delegated authorities, which we write to our Lloyd's unit. In casualty and speciality, we plan to grow on all our platforms, including Lloyd's. We expect this growth will come from two principal sources: increased signings on existing programs, where clients look to consolidate their panels; and supporting existing customers in broader classes of business, as clients look to partner more with RenaissanceRe.

Given the market dynamics, we continue to believe the best opportunity to outperform will come from managing our gross to net underwriting risk and constructing efficient portfolios partly through our ceded strategies. Year-to-date, we're retaining less than 50% of our managed cat premium, including DaVinci. This high percentage of ceded premium serves to reduce our returns in quarters with light cat losses. However, in high loss quarters, it protects our balance sheets.

Through 2016, we have focused intensely on increasing our capital efficiency, and we'll continue to do so through 2017. Our primary means of achieving this capital efficiency has been through diversification, as we have changed our business mix from what was 70% cat excessive loss in 2013 to the point where we have approximately 50% of our portfolio in Property and 50% of the book in casualty and specialty for the year-to-date 2016.

As Bob will discuss, we plan to change our segment reporting. We're making this change to better align our financial reporting with how we manage the business. We will be moving to two segments: property; and casualty and specialty. This should also make it easier for you to understand RenaissanceRe. Lloyd's results will no longer be reported as a separate segment. However, over the coming periods, we will continue to provide stand-alone information on our managed catastrophe and our Lloyd's business for the sake of transparency.

With that, I'll turn the call over to Bob for a look at our financials and our new segment reporting approach. Then, I'll come back and share a bit more on our business performance before we open it up to questions.

Robert Qutub {BIO 15269353 <GO>}

Thanks for the kind words, Kevin, and good morning, everyone. I'd like to start by saying how pleased I am to be a part of the RenaissanceRe team. I'm excited to continue executing the company strategy, building on the great work already taking place. Jeff has left the organization in great financial condition, with a strong balance sheet, and the team has successfully executed a number of strategically important initiatives. I'll look forward to working with all of you as well, going forward.

With that, let's discuss our results for the third quarter and year-to-date. I'll begin with some highlights from the quarter. Our top line growth continued to be strong, where we were able to grow the top line in our Specialty and Lloyd's segments. We also saw abundant opportunities in mortgage reinsurance within the specialty credit line. We generated strong underwriting income of $112.9 million and reported a solid combined ratio of 67%.

Our investment portfolio generated strong returns, driven by our equity investment. And our tangible book value per share grew by 3.9% after adjusting for dividend. For the year-to-date, tangible book value per share has grown by 9.5%.

Moving on to our third quarter financial results, we reported net income of $147 million or $3.56 per diluted share. Our operating income was $87 million or $2.09 per diluted share. We generated an annualized ROE for the quarter of 13.5% in annualized operating ROE of 8%. Our book value per share increased 3.3%; and our tangible book value per share, including accumulated dividends increased by 3.9%. On a year-to-date basis, our ROE was 12.6%; and our operating ROE was 6.7%, with book value per share increasing 8%, and tangible book value per share including accumulated dividends increasing 9.5%.

Let me now shift to our segment results, beginning with our Cat segment followed by Specialty and Lloyd's. Our Cat segment, gross premiums written decreased 18%, and managed cat gross premiums written decreased 15% during the third quarter. For the year-to-date, managed cat gross premiums written are down 3%. This compares with our top line forecast of a 10% decline for the year.

The Cat segment generated underwriting income of $96 million and a combined ratio of 21%. This result was driven by light insured loss quarter and favorable reserve development of $17 million. For the first nine months of 2016, the Cat segment generated underwriting income of $246 million and a combined ratio of 38%. As a reminder, these nine-month results include a net negative impact of $46 million associated with losses from the Q2 Texas event and the Fort McMurray wildfire.

In our Specialty Reinsurance segment, gross premiums written increased by 26% relative to the quarter a year ago. The main driver was significant growth in our credit book, primarily reflecting increased mortgage reinsurance opportunity that we have been highlighting in recent quarters. Most other classes of casualty and specialty businesses were relatively flat.

As a reminder, our Specialty Reinsurance premiums are from the significant volatility as this business can be influenced by a small number of relatively large transactions. It should also be noted that a meaningful portion of the mortgage reinsurance business will earn out over multiple years.

For the year-to-date, Specialty Reinsurance premiums are up close to 70% from a year ago, reflecting strong growth in mortgage reinsurance and the inclusion of Platinum's results in our financials, following the close of the transaction on March 2015. As we have grown our Specialty book, we have also increased the use of ceded purchases to manage our assumed risk and enhance overall returns. Consequently, net premiums written in Specialty Reinsurance were up 14% in the third quarter and 43% year-to-date compared to the larger increases in gross premiums written previously discussed.

The Specialty Reinsurance segment generated underwriting income of $1 million and a combined ratio of 99%. These results include favorable development of $20 million, a decrease of $36 million compared to the $56 million recorded in the prior period. Year-to-date, the underwriting income in Specialty Reinsurance is $17 million with a combined ratio of 96%.

In our Lloyd's segment, we generated $92 million of gross written premiums in the third quarter, an increase of 25% compared to the year-ago period. The growth was driven by select opportunities in the casualty book of business. For the first nine months of the year, gross written premiums increased 20%.

The Lloyd's segment generated underwriting income for the third quarter of $16 million, with a combined ratio of 79%. Driving this increase was a 12 percentage point of favorable development and an 8 percentage point decrease in the expense ratio relative to a year ago. Year-to-date, the Lloyd's segment generated underwriting income of $19 million and combined ratio of 91%. We are pleased with these results as the book performed well. Of course, results quarter to quarter will continue to vary due to the occurrence of special events or other factors.

Turning to our investments, we reported net investment income of $51 million in the third quarter. This was mainly driven by investment income from fixed maturity securities totaling $40 million and our alternative investments portfolio, which generated net investment income of $13 million. The annualized total return for the quarter on the overall investment portfolio was solid at 5%. We benefited from strong returns in our portfolio of public equity investments that helped to offset the upward shift in the yield curve during the quarter generating unrealized losses on our fixed maturity investments.

We continue to conservatively position our investment portfolio with 89% allocated to fixed maturity and short-term investments with a high degree of liquidity and modest credit exposure. The duration of our investment portfolio remained relatively short at 2.3 years and is stable relative to where it has been in recent quarters. The yield's maturity in fixed income and short-term investments was consistent with last quarter at 1.8%.

Our capital and holding company liquidity positions remain very strong. During the third quarter, we purchased 321,000 shares for a total of $37 million, all of which we mentioned to you on our second quarter call. This brings our year-to-date share repurchases to $309 million. As we look forward, we remain committed to returning capital to our shareholders over time. Timing will depend on our view of other business opportunities, the profile of our risk portfolio, as well as our capital and liquidity profile.

Included in the equity pickup line item was a $15 million loss representing our share of Top Layer Re's results for the quarter. Top Layer Re had a yen-denominated reserve for the 2011 Tohoku earthquake, partially offset by U.S. dollar-denominated reinsurance recoverable. And consistent with our business practices, Top Layer Re economically hedged the dollar-yen mismatch.

During the quarter, both the yen-denominated reserve and the dollar-denominated reinsurance recovery were taken to zero. Since the yen had weakened versus the dollar, Top Layer Re experienced a foreign exchange loss. Again, hedging currency mismatches is consistent with our business practice. And this one is not unique, it's just large.

Now, turning to Hurricane Matthew. Although not impacting our third quarter results, Hurricane Matthew, who made landfall in early October, is a powerful and deadly storm.

First and foremost, our thoughts are with those impacted by Hurricane Matthew, especially those who lost their lives during the event.

Although it's still relatively early days, we have developed an estimate of the net negative impact of Hurricane Matthew. We currently estimate we will record $75 million of net negative impact on our fourth quarter results. Given the magnitude and recent occurrence of this event, meaningful uncertainty remains regarding losses from this event. And the actual net negative impact from this event will likely vary from this estimate.

Now, as Kevin mentioned earlier, I'd like to discuss a plan change in our reportable segments that we anticipate becoming effective with our fourth quarter and full-year results. Effective December 31, 2016, we expect to change our reportable segments to property and casualty and specialty. Although Lloyd's will not be considered a segment, we will continue to show it in our supplemental disclosures for some period of time. In addition, we expect to continue to provide transparency into the underwriting results of our Catastrophe Reinsurance business.

The new segment presentation captures the evolution of the company and the increased importance of our casualty and specialty lines of business, which now represents approximately 50% of our top line. And it also reflects our current management structure and underwriting platforms and provides insight into the results of the operations review by management.

The new segments are based on extensive work performed during 2016, some of which is still ongoing to recast our current and prior periods within our financial systems. So, the introduction of the new segment is contingent on the satisfactory completion of this work, which we expect to complete in the fourth quarter.

All prior periods presented will be re-classed to conform to this new presentation. We will likely issue an 8-K with the restated segment information for the last 11 quarters prior to our year-end earnings release. In addition, due to the pending change in segments, we will not be providing top line premium forecast.

To close my prepared remarks, I would like to thank our Chief Accounting Officer and Controller Mark Wilcox for his outstanding service to RenaissanceRe over the past 13 years. Please join us all in congratulating him and wishing him all the best as he returns to the U.S. to take on his new role as the CFO of Selective.

And finally, I'd like to iterate how excited I am to be a part of this team and look forward to meeting with all of you over the coming months, where we can spend some meaningful time on the new segments along with getting to know each other better.

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

Kevin J. O'Donnell

Thanks, Bob. I'll divide my comments between Catastrophe, Specialty and Lloyd's, and then comment on our venture unit before taking questions.

Our Cat segment performed well this quarter despite a relatively large number of events. In addition to the Atlantic hurricanes, we had an active typhoon season, with eight tropical systems affecting Japan; six typhoons making landfall in China or Taiwan; we also saw historic flooding in Louisiana,; destructive hailstorms in Colorado; devastating earthquakes in Italy and South Korea; and a wildfire in Los Angeles.

Despite this activity, the property cat market remains challenging. The good news is that better insurance companies appear to be more focused on consolidating their reinsurance panels with high-quality companies. Cedents are tiering their reinsurers with the best reinsurers getting most of the new opportunities. To many companies, Hurricane Matthew drove home the value of working with a long-term and seasoned partner, with the strongest claim-paying record when it seemed poised to make landfall as a major hurricane.

At this point, it's worth expanding on Hurricane Matthew. Even though this event took place in the fourth quarter, Matthew made landfall on South Carolina in early October and caused loss as it passed through the Caribbean and from Florida to North Carolina within the U.S. Matthew maintained hurricane strength while creating damaging winds, along about 750 miles of the U.S. coastline. Hurricane Matthew was the first Category 5 hurricane in the Atlantic, since Hurricane Felix in 2007 and looks likely to be the costliest Atlantic storm since Sandy in 2012.

As Matthew formed and was developing further in the Atlantic, our underwriters, with their team of scientists, they weather predict, closely monitored the storm, its potential for strengthening and the most likely track it would take. The range of potential outcomes from this event was highly variable. A slight difference in the track, for example, if Matthew had followed a path 30 miles west of its actual course would have made a meaningful difference in the impact to the Florida market and the broader industry. As it became more apparent that the storm would make landfall both in the Bahamas and the U.S., we made sure to be in close contact with our clients and brokers.

Our ability to develop a number of proprietary alternative footprints (20:04) to run against our industry database, our portfolio and those of our clients proved invaluable in our response. The speed and skill of our people and our systems is testament to our experience in responding to events just like this. As we have spoken about previously, we utilize both a top-down and a bottom-up approach to establishing our loss number. Matthew will be no different.

At this early stage, there's a lot of uncertainly with regard to the ultimate industry loss, and more importantly, with each of our customer's individual books and their respective reinsurance protections. As Bob mentioned, however, we expect to incur $75 million in net negative impact, which will be booked in the fourth quarter.

Over the next several months, our customers will learn more about the loss, and that information will help us sharpen our estimate. Of equal importance is the benefit we could realize from our ceded programs. We continue to see strong premium growth in casualty and speciality. This result was primarily driven by opportunities in our financial and credit lines, particularly in the mortgage reinsurance business. Our market-leading position in this space continues to serve as well as clients looks to us to build capacity.

The mortgage business is interesting and seems to be getting more attention as of late. We are a leading writer of this risk and have been in this space since 2009 when we made our investment and asset. This is a good example of a market we approached carefully, building up expertise over time, and then moving quickly to access attractive risk and taking substantial positions when the opportunity became available. While the growth in our mortgage reinsurance portfolio has been strong, we do not anticipate this growth to continue at the same pace. This quarter was similar to the last in casualty and specialty. Ceding commissions, while elevated, remain stable.

As I mentioned last quarter, we continue to monitor rates and performance of our customers' underlying portfolios. We also expect that the stability in terms and in conditions that we have seen in the past few quarters will persist. We still believe the casualty and specialty market has much to offer in terms of profitable business. Relative to many competitors, we have a small market share of most business, which gives us room to grow without adding economic capital. We have been able to construct an attractive portfolio with a great stable of clients due to our strong position in the Catastrophe business and the solid Platinum portfolio we acquired.

Overall, I'm pleased with our growth in this segment and the strength of our underwriting teams across our platforms. The disciplined approach the team has taken has enabled us to build the portfolio and serve our clients around the world.

We continue to see the strong acceptance of our casualty and specialty platform, client share optimism about the long-term growth potential of the market and are realistic about what to expect given the challenges our business environment presents. We will continue to look for opportunities to participate on the best deals that are aligned with our risk appetite and disciplined approach. This means working across our platforms to develop deeper customer relationships that can benefit from the diversified platforms, product set, and underwriting expertise that only RenaissanceRe has to offer.

We had a strong quarter in Lloyd's, which continues to be profitable for the year. This quarter's results was driven by low cat loss activity and favorable reserve development. It is a reflection of the strong underwriting platform we've developed. We will continue our ongoing focus on greater capital efficiency as the syndicate grows.

Heading into 2017, we have a strong team at Lloyd's and have constructed a very attractive portfolio of risk. As with our other platforms, we expect to deepen and strengthen our relationships with existing clients over the long term.

The growth we've seen at Lloyd's demonstrates the value of having multiple platforms to allow our clients to cede risk where and how best they choose. We expect organic growth to continue through 2017 although unlikely at the base – same base as 2015 and 2016.

Our ventures unit continues to contribute to our broader results and to our ability to execute our gross-to-net strategy. For example, the strategic investments managed by our ventures unit had significant marked-to-market gains this quarter. In thinking about our strategic investments, we employ a long-term buy-and-hold strategy. We look to buy the business, not the stock. We continue to explore new joint venture opportunities in both cat and non-cat. In doing so, we pass on many more opportunities than we execute on.

As we prepare for one-one (25:04), the ventures team is working with our underwriters on select opportunities where additional capacity could be useful. These include opportunities in the retro market and other areas where we can innovatively match risk and capital in a manner consistent our disciplined approach. As I've said in the past, we will only bring new capital to this market when there's a clear need on the part of our clients. And we're on the best position to meet that need.

And at this point, I'll turn it over to questions.

Q&A

Operator

Your first question comes from the line of Kai Pan with Morgan Stanley. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Good morning, and thank you. First, congratulations to Bob, as well as good luck and best wishes to Mark. Kevin, you mentioned in the past that it's been a long period of time we haven't seen landfalling storm in Florida. Now, we have two. I just wonder, does that change the dynamics in term pricing at Jan. 1 renewals? Even before this event, we see some sort of decelerating in term of pricing decline. Will those events actually helping the pricing moving to the positive territory? And how do you plan to – for your business?

A - Kevin J. O'Donnell

Thanks, Kai. I think, I agree with your assessment generally about the direction of pricing for property cat at the January 1 renewals. I'm not sure whether these hurricanes are going to change that, but I still feel reasonably optimistic that whatever reduction there may be at January, if any, it will be smaller than what we've seen in the past.

I think one thing that'll be very interesting and something I'm curious about watching with these storms is how the Florida market responds. As you mentioned, there hasn't been a loss there in quite a long time. One of the emerging issues in the Florida market is the assignment of benefits issue. Where Matthew hit really isn't the geographic region where that activity has been most prevalent, but it will be interesting to see whether AOP issues emerge and how much fraudulent claim activity there actually is in the Florida market.

All that said and done, I wouldn't change my pricing expectations for the January 1 renewal based on these storms.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Just a little bit follow up on that is that the pricing stay the same or maybe slightly decline? Do you expect you'll grow in that business - in the property cat business?

A - Kevin J. O'Donnell

So, I don't expect that we will grow in the property cat business in 2017. If you look last year, I think our reduction overall is around 3%. Looking at 2017, I think rate reductions are less. We anticipate lower rate reductions than we had in 2016. And I'm optimistic that our book is well-positioned to respond well to small rate reductions.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. My second question is just stepping back on your overall ROE for this year. For the third quarter is no cat quarter, and if you take out this one-off items like foreign exchange, your ROE is approaching about 10%. I just wonder, is that - in this current environment, given your mix change towards more specialty and casualty, is that the kind of ROE profile for your company going forward?

A - Kevin J. O'Donnell

I think - when I think about our portfolio, I think focusing on a quarter, granted there's always unique things in a quarter, isn't the way that we think about it. We try to build the best portfolio over the full set of outcomes. One of the actions that we're taking in part of our strategy is managing our net risk pretty aggressively. As I mentioned, we're keeping less than 50% of our gross written premium from property cat. That obviously suppresses our returns in light cat quarters but will serve to protect us in large cat quarters.

I think there's a cost to the strategy that we have, there's a cost to what I believe to be doing the right thing. And that's something that is a trade across category - light cat quarters and heavy cat quarters to provide what we think is a good return. But I think the way you're thinking about it makes some sense.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. Well, thank you so much.

Operator

Your next question...

A - Kevin J. O'Donnell

Thank you.

Operator

...comes from the line of Michael Nannizzi from Goldman Sachs. Your line is open.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Thanks so much. A couple of numbers questions if I could. The expense ratios in Specialty, so the operational expense ratio in Specialty, sort of ticked down in the quarter but the notional dollar amount was also smaller year-over-year and sequentially. And also Lloyd's was a bit more of a pronounced difference, same line item. Is there anything specific that happened in the quarter there that explains that?

A - Robert Qutub {BIO 15269353 <GO>}

It's a good question. We're overall very pleased with the work that we've done on our expenses. And our core run rate remains relatively even as we significantly grown our book of business. The Q3 decline in operating expenses comes in part from those efficiencies, but in Q3, we made some reclassifications in operating and acquisition, mainly as you pointed out in Specialty and Lloyd's up in the acquisition, which is really to conform to how we reflect some of our ceding overwrites that we have in the book for the year of 2016. The conformity has no impact on the overall expense ratio or the combined ratio. It just is a better reflection on what's driving this cost going forward.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. Got it. Okay. And then in Specialty, notwithstanding that, the acquisition - or the overall expense ratio was a bit higher. Is that a function of the higher written premiums that may be just a small proportion of those earned through in the quarter?

A - Robert Qutub {BIO 15269353 <GO>}

Just to make sure I got your question. You're focused on the combined ratio being driven by the higher gross written premium, Mike, sorry?

Q - Michael Nannizzi {BIO 15198493 <GO>}

So, in the Specialty segment, the acquisition ratio ticked up a bit sequentially. I mean, year-over-year, it's relatively flat. I was just curious, as the year progresses, I mean, is that - was that more of a function of the fact that you saw a lift in gross written premiums, net written premiums in terms of the mortgage business, or maybe you have acquisition expenses associated with the written premium as opposed to the earned dollars, or was that as you expected it to be?

A - Robert Qutub {BIO 15269353 <GO>}

I got that, Mike. What this really is, is the offset to what I was talking about on the operating expenses, the reclassification, and moving those on the overwrite up in the acquisition cost. So, you see that bump up there. Now, we've seen an underlying count of cost reductions that I spoke across all expenses, but that's the - really the principal driver there.

A - Kevin J. O'Donnell

One thing I'd add to Bob's comments, which are exactly right, is that the acquisition cost per book of business on the gross basis is reasonably steady. There's been some re-classifications, is what you're saying?

A - Robert Qutub {BIO 15269353 <GO>}

Yeah. And again, no impact at the net expense ratio or the combined ratio.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. I'll switch in. And then just within that Specialty segment, just thinking about the mortgage book that's clearly become a bigger piece of the pie. Just how should we be thinking about gross-to-net written and net earned with the longer sort of earning timeframe for that Specialty business? So, I'm guessing it's just – it's going to be different than it was in the past, obviously.

A - Kevin J. O'Donnell

Yeah. What I would tell you, starting with just the gross number. I think in – if I think of a three-year block, 2016, 2017 and 2018, we definitely wrote more than we expected in 2016, because looking forward, we think the economics afforded in 2016 are going to be better than the economics afforded in 2017 and 2018. With that, our sessions are set for the 2016 book. Most of them are proportional, so they will run through straight on an earned basis.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. And then the earnings pattern sort of in a seven-year range-ish for the mortgage specialty business?

A - Kevin J. O'Donnell

I think that's a reasonable estimate. I think that the high-end price stretches out to 10 years. But, seven year's a good estimate.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. Okay, great. And then, just last real quick on the investment portfolio. The yield sort of ticked up. I noticed that non-rated securities kicked up a little bit as a percentage of the total. Was that just sort of positioning, or was there something else within maybe one of the buckets that created the difference in the yield? I'm talking specifically about the fixed maturity investments.

A - Robert Qutub {BIO 15269353 <GO>}

Right. Overall, we've maintained a relatively short-duration book of just over two years. We have done some movements within there. But they're small in the sort of the credit side of it, but we've kept the duration really about the same. So, some of the dynamics would be on the credit side.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay, great. Thank you.

A - Kevin J. O'Donnell

Thanks, Michael.

Operator

Your next question comes in the line of Quentin McMillan with KBW. Your line is open.

Q - Quentin McMillan {BIO 19411547 <GO>}

Hi. Thanks, guys. I just wanted to touch on the net-to-gross strategy that you guys have, whether it'd be in Specialty and Lloyd's or the overall book of business. But you said you sort of – in the cap book, I'm sorry. So, you're sort of keeping less than 50% of the premiums. Can you help us to understand what benefit you're getting from the fee income that you're taking in, whether it'd be an offset fee expense ratio? How big is that, or what should we sort of be expecting going forward?

A - Kevin J. O'Donnell

I think the broader – let me start more broadly. Thinking about our gross to net. One of it certainly is taking in third-party capital and managing it. Other is more of what I would consider quota shares or specialized quota share that we call CPP, and then there's traditional excess of loss business. So, it's a combination of things. We don't necessarily focus specifically on what the fees are. We focus on the difference between the expected profit and the required capital between our gross portfolios and our net portfolios. I would think that's a better way for us to think about it.

The fees specifically for cat are in the 10-Q, so you can take a look at that. That'll be out. You'll see the number, I guess, published later today. But that's not necessarily the focus that we have in thinking about constructing the portfolio. It's purely a portfolio basis on the delta between profit and required capital.

Q - Quentin McMillan {BIO 19411547 <GO>}

Okay. That's helpful. And then shifting to specialty specifically. If I look at the accident year loss ratio ex-Cat, it was up about 680 bps year-over-year from what was a pretty strong number last year at 60.9% to 67.7%. I guess, I'm curious kind of as the portfolio mix shift is changing, I would have expected that, that number should actually be improving despite the pricing headwinds because my expectation would be that mortgage insurance is actually a lower loss ratio business particularly what you've written in 2016. So, I guess, am I thinking about that correctly? And was there any sort of one-off losses in 3Q 2016 within the specialty book in particular that may have elevated that, that we should be thinking about for 3Q 2017?

A - Kevin J. O'Donnell

So, I look much more at the – at longer-term loss ratios within the book of business. And I think we're going to have quarterly fluctuations in that book. What I'd focus much more on is whether we are seeing trends that are causing us to have less profitability or more profitability in the book of business, but it's not one that I'd focus on a quarter-to-quarter basis. At this point in time, there's no trend in the book that I would point to as being significant or worthy of further comment. On a year-to-date basis, it's reasonably stable.

Q - Quentin McMillan {BIO 19411547 <GO>}

Okay. Thanks. And then just one last one sneak in is you guys don't give guidance in terms of buybacks. I know you're opportunistic, but is net income target for the year a good way for us to think about how much you guys might expect to repurchase to the shareholders in any given year?

A - Kevin J. O'Donnell

Look – thanks. As I mentioned in my prepared comments, nothing's really changed regarding our philosophy or approach to capital management. And we remain committed to returning capital over time. And timing depends on really a number of factors, which include our view of the business opportunities, the profile of our risk portfolio as well as our liquidity profile. And so far, this year, we've returned over $350 million in the form of buybacks and dividends to our shareholders. And historically, the third quarter can tend to be light for buybacks due to hurricane season. If you look at our history, you'll see that we've demonstrated that we're good stewards of our shareholders' capital. And we turned over $1 billion in the past three years.

Q - Quentin McMillan {BIO 19411547 <GO>}

Perfect. Thank you very much, guys.

Operator

Your next question comes from the line of Elyse Greenspan with Wells Fargo. Your line is open.

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

Hi. Good morning. Just a couple of questions. One quick one. I know you did say that you were not providing premium guidance due to the new segments that you're going to put forth. Are you then going to be providing some level of premium guidance on a segment basis, or is it just we're shifting away, I guess, from premium guidance on a go-forward basis?

A - Kevin J. O'Donnell

I think everything you said is correct. Giving guidance now knowing segments are changing doesn't make sense, but we're taking this opportunity to look at the transparency that we're providing across all of our disclosures. And we feel that we can continue to provide great transparency and great understanding of the way in which we're going to deploy capital and where we're going to deploy our resources without giving specific guidance going forward.

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

Okay. And then in terms of the capital return, I noticed that you guys didn't call out a level for the Q4 to-date in the press release. I guess, were you guys, I guess, still maybe on the lower side due to the fact that we're still on hurricane season, or any kind of number you want to call out for Q4 repurchases that we've seen so far?

A - Robert Qutub {BIO 15269353 <GO>}

Really, in my prepared comments, I said year-to-date, and I meant through the call up here. And that number will be in the 10-Q when we file it today that we have really not purchased any up through this call right now. But again, it's a matter of timing and opportunities that I talked about, Elyse, that would reflect when we return – when we do perform buybacks out there.

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

Okay. That's great. And I know we talked – I mean, the expense ratio just on an overall basis, as we think about the business mix kind of shifting away from Cat and more into the Specialty and Lloyd's, any kind of – now I know it's kind of ticked around a bit on a quarterly basis. Any kind of high level views as we kind of think about the Q3 was the highest quarter this year as we think about the expense ratio on a go-forward basis?

A - Robert Qutub {BIO 15269353 <GO>}

I mean, I think – look, I'll kick off part of it just on my observations and where I've seen it. And, Kevin, you can add anything here. But I think it's a great question. I've only been here a short while. And decisions around expense management can't be divorced from the strategy or the overall business mix in any industry. In our industry, running a business, gross versus net has a big impact as does excess over loss or quota sharing. So, this play an important part on how we manage our expenses, more importantly, our capital.

And overall, we're really pleased with the work that's been done in keeping our overall expenses flat, while at the same time, growing our book of business. And the team's been executing and delivering these efficiencies across the platform, focused on helping to drive and improve ROE.

A - Kevin J. O'Donnell

Yeah, I think the area that probably gets more focused on is the casualty and specialty. Thinking about the combined ratio there, obviously, the first thing I'd look at is the loss ratio, which looks good. Acquisition costs are higher in that book of business than they are for our property cat book. The good news is though that they are stabilizing, so we've seen that over the last few quarters. And looking into 2017, we don't anticipate higher acquisition cost. And then finally, a component of what you're seeing is the fact that were purchasing more ceded than the specialty, which is having an effect as well.

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

Okay. And one question, in terms of the ceded and the retro purchases, I know that's something – you purchased more coverage throughout the book this year, and your commentary implies you guys will want to do the same next year. You also did make a comment in terms of some opportunities within your ventures unit to – on the retro side. So, I'm just trying to – get kind of tie together those comments. What kind of rates are you're expecting in the retro market at one-one, (42:28) and how you might see, I guess, growth opportunities to write the business, and how the pricing there will impact your kind of ceded strategy in 2017?

A - Kevin J. O'Donnell

Investors plays an important role and the way we think about our gross-to-net strategy. What I was mentioning specifically is we actually already had a retro – its broader than retro but a facility that provides retro risk to third-party capital. And we might have an opportunity to deploy a little bit more of that. It fluctuated massively in size over the last several years based on the opportunity, so I wouldn't read too much into it.

I think, interestingly, our ventures team has been active thinking about ways to build contingent capital structures around our third party capital vehicles as well. We're not actively looking to build materially into the vehicles that we have now, but the more flexibility we have around us serves us well as opportunities emerge.

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

Okay. Well, thank you. And, Bob, welcome to Ren. Looking forward to working with you. And I just want to echo comments earlier in the call, and wish Mark the best of luck. Thank you.

Operator

Your next question comes from the line of Josh Shanker with Deutsche Bank. Your line is open.

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

Thank you. Good morning, everybody. In the past...

A - Robert Qutub {BIO 15269353 <GO>}

Good morning.

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

...when we talked about budgeting for repurchases, you said you plan in this type of environment to return all your income to shareholders in the form of dividends and repurchases. Is that operating income, net income less unrealized gains. From a budgeting perspective, how do you think about that?

A - Robert Qutub {BIO 15269353 <GO>}

It's a good question, Josh. I think that you don't target a level. Our return in capital is – there could be a loose guideline that you may follow, but we really look at it as timing. We're committed to returning the capital back to our shareholders, but it's also a function of what we have out there in terms of opportunity for the businesses, the profile, our risk portfolio, as well as our capital and liquidity position that we have out there. Again, you can call it a loose guideline, but I would really say it's timing, and I wouldn't be contained – confined to discrete quarters or discrete years.

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

Absolutely

A - Kevin J. O'Donnell

The only thing I'd add is...

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

Yup. Yup.

A - Kevin J. O'Donnell

Just saying, Bob, coming onboard is giving us great ways to think about this. But really, nothing's changed in the way we're thinking about managing capital and returning capital to shareholders.

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

Is that loose guideline – I understand doesn't refer to timing, is that net income, is that operating income, or is that net income less unrealized gains?

A - Robert Qutub {BIO 15269353 <GO>}

That'd be net income.

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

Net income, okay.

A - Robert Qutub {BIO 15269353 <GO>}

But, again, it's loose. Loose, double underscore.

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

It can be very loose. And in terms of – the budgeting process, is that a multi-year process, or is that a one-year process?

A - Robert Qutub {BIO 15269353 <GO>}

Yeah, just coming in here, what I'm – what we're doing is it's a multi-year process, so you can see our strategy is unfolding over time and building out what we think our investments going forward and focusing in on key opportunities. This process is underway right now. And I know, Kevin, you might want to have a few words on just sort of a higher level view on the budgeting process.

A - Kevin J. O'Donnell

Yeah. We've always looked at it across a multi-year basis, obviously, with increasing uncertainty as we move out to outer years. Really, going back to the original question, that is very much how we look at our capital management strategy and specifically share repurchasing as we look at it over the long term. And we're not particularly concerned as to whether we're above or below net income in any given quarter or any given year.

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

Can the Lloyd's business continue to grow if property Cat pricing is broadly flat, while Specialty pricing continues to tick down?

A - Kevin J. O'Donnell

Yes. We – the Lloyd's business is actually a mix of the other businesses that we write, plus there's a component of insurance business that we're writing within the Lloyd's platform as well. And we believe that we've invested appropriately in the platform, at the right people, and increasingly had the right access to the business that we want to add. So, even with weight pressure on property cat, we anticipate we can continue to grow Lloyd's platform.

But as I said in the comments, I think the growth is – we're becoming of a size and the opportunity is challenging, so I think the growth we'll achieve in 2017 is less than the growth we achieved in 2016.

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

That's very fair. Well, good luck with that. Thank you.

A - Kevin J. O'Donnell

Thanks.

A - Robert Qutub {BIO 15269353 <GO>}

Thank you.

Operator

Your next question comes from then line of Jay Cohen with Bank of America Merrill Lynch. Your line is open.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

Thank you. Just a follow-up on the expense ratio issue. You obviously kind of changed the geography a little bit between operating expenses and acquisition expenses. What we're looking in the third quarter - we're looking at in the third quarter, is this a reasonable starting point for our models going forward? I assume there were no sort of catch-ups from previous quarters in there.

A - Robert Qutub {BIO 15269353 <GO>}

What you're looking at is going back to, overall, the net expense ratio really didn't change - it had no impact on it, and it is a re-class on a year-to-date basis from - between the operating and the acquisition. So, you'll slightly see an uptick going forward about 10% more, given what we've pulled back from the first two quarters. Overall, again, it doesn't affect the net.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

So, the way maybe to look at - because we do model, obviously, those separately to look at, maybe, the nine-month run rate for both and kind of use that as a starting point.

A - Robert Qutub {BIO 15269353 <GO>}

Best starting point for you to look at.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

Great. Thanks Bob.

Operator

Your next question comes from the line of Brian Meredith with UBS. Your line is open.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes. Thanks. Just a couple of questions here first. Kevin, you made a comment earlier that you think that the economics of the MI business will be better in 2016 than they will be in 2017 and 2018. I'm curious why that is.

A - Kevin J. O'Donnell

It's a combination of factors, including we were - it's our belief that some of the underwriting criteria actually tightened up to unsustainably tight levels. We were able to execute into some of the deals that we think had the best underlying/underwriting associated with them. We think going forward, the underwriting criteria at the banks. Although looser is still actually quite sound and robust, so we think there's still opportunity. But we leveraged into the deals which we think are the highest credit quality.

Q - Brian Meredith {BIO 3108204 <GO>}

Gotcha. Okay. And then what are the – just a quick question. With respect to capital management, looking at your capital base, do you look at kind of your acquired capital that you need to have on a gross basis or a net basis? So, in case the retro goes away, do you want to make sure you've got plenty of capital to withstand that?

A - Kevin J. O'Donnell

Yes. I think that's one of the most important things we look at. We spend a ton of time looking at capital, at portfolio levels, at balance sheet levels by geography, both on a gross and net basis, including in our ultimately – our ultimate risk rollups, our substantial haircuts against our ceded recoveries as events become larger, just making sure that we continue to stress the system and are not overly relying on the retro of purchasing.

Q - Brian Meredith {BIO 3108204 <GO>}

Makes sense. Thank you.

A - Kevin J. O'Donnell

Sure.

Operator

Your final question comes from the line of Ryan Byrnes with Janney. Your line is open. Mr. Byrnes, your line is open.

A - Kevin J. O'Donnell

It sounded like something from The Simpsons.

Operator

There are no further questions...

A - Kevin J. O'Donnell

There's one more. (50:52)

Operator

Your final question comes from the line of Kai Pan with Morgan Stanley. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Thanks. So, just a follow-up on the reserve releases. If you look at year-to-date, the reserve release is about seven points, last year was about 12 points. I just wonder, because recently, we've seen some primary companies take a reserve leases, starting slowing down, and some of that actually show some reserve – adverse government. I just wonder what's your underlying trend in your specialty book in particular because that's where you see the most in term of reduction, in term of reserve releases.

A - Robert Qutub {BIO 15269353 <GO>}

Yeah. If you're referring to the specialty book Q3 this year versus the comparative quarter last year, this year, it was only about $20 million in favorable development. It and was somewhat fairly granular. And there wouldn't have been any large items. Looking back to Q3 last year, there were several large items that came through. One was a restructure on the mortgage side that resulted in the $56 million of favorable development, which really reflects the change. And that's the biggest change that we've seen on a year-over-year basis.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. So, ex some large development last year, so the underlying you don't see any sort of meaningful trend in term of large inflation or from your cedent, any sort of meaningful trend?

A - Kevin J. O'Donnell

The way I think about it is exactly as you're thinking about it, which is whether we're seeing a trend either on a favorable or unfavorable side. At this point, we're not seeing any trends. What you're seeing is really kind of the idiosyncratic movement of reserves between quarters and years.

Q - Kai Pan {BIO 18669701 <GO>}

Great. Thank you so much.

Operator

There are no further questions at this time. I would like to now turn the call back to Kevin O'Donnell.

A - Kevin J. O'Donnell

Thank you. Before I close I also want say thank you to Mark Wilcox, our Chief Accounting Officer, who will be leaving us at the end of the year. Mark is a good friend of mine. And I've had the pleasure of working with him for many years. He's greatly contributed to the success of RenRe and making RenRe really what it is today. I wish Mark continued happiness, continued health and continued success as he begins his new life back in the U.S. Thank you, Mark.

With that, that concludes our third quarter call. I would like to thank everybody for participating, and we look forward to speaking to you after the fourth quarter.

Operator

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