FINAL

Bloomberg Transcript

Q1 2016 Earnings Call

Company Participants

- Jeffrey D. Kelly
- Kevin J. O'Donnell
- Peter Hill

Other Participants

- Brian Robert Meredith
- Ian J. Gutterman
- Jay Cohen
- Joshua Shanker
- Kai Pan
- Meyer Shields
- Michael Nannizzi
- Sarah E. DeWitt
- Vinay Misquith
- William Wilt

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Jonathan, and I will be your conference operator today. At this time, I would like to welcome everyone to the RenaissanceRe First Quarter 2016 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.

Thank you. Mr. Peter Hill, you may begin your conference.

Peter Hill {BIO 15385944 <GO>}

Good morning. And thank you for joining this first quarter 2016 financial results conference call. Yesterday, after the market close, we issued our quarterly release. If you didn't receive 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 May 27th. The replay can be accessed by dialing 855-859-2056 U.S. toll free or +1-404-537-3406 internationally. The passcode you will need for both numbers is 84474528. Today's call is available through the Investor Information section of www.renre.com and will be archived on RenaissanceRe's website through midnight on July 6th.

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 Jeff Kelly, 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 good morning, everyone. I'll open the call with a brief overview, then I'll turn the call over to Jeff to go over our financial results, then I'll come back on and speak in more detail about our business and the market.

Last night, we released our first quarter earnings, where we reported an ROE of 11.8% and an operating ROE of 6.1%. We had positive results in our Catastrophe segment, which benefited from low loss activity, and our Lloyd's segment, which had an especially strong quarter. Our investments portfolio also performed relatively well. And while our casualty and specialty business experienced some unusually large loss activity resulting in a breakeven quarter, they delivered strong growth and otherwise performed within expectations.

As discussed on the last call, the market remains difficult, and we continue to see reductions to rates. While we cannot change this environment, we can define our strategy and execute it well. And I promise that we will continue to exercise the same levels of discipline, as we have in the past. This disciplined approach to capital and risk management is why we continue to be the preferred partner for a wide range of companies on both sides of the risk transfer equation.

As others are becoming more risk-tolerant, we are becoming less so. For example, we shrank the size of our property cat book by eliminating underpriced business. In addition, we managed our risk profile by increasing our ceded purchase in all three of our segments, most notably, in specialty.

We've also diversified our risk and improved our overall return profile by building our casualty and specialty business. The breakeven results for this quarter do not alter our perception of this business or the correctness of our overall strategy. Several event-specific losses affected our results, which Jeff will explain in greater detail.

These low-frequency, high-severity loss events were not a surprise but a characteristic of the portfolios from which they emanated. Assuming our customers' volatility is what we do and from time-to-time, will result in a bad quarter or even a bad year. The losses we experienced over the quarter are idiosyncratic and not something I expect to continue. Over the long-term, our record of profitability speaks for itself.

This year, we will focus our attention more than ever on building and enhancing our client relationships, recognizing the changing market dynamics where a number of our clients are centralizing their purchases of reinsurance. While our team has been disciplined and pulled back from business that did not meet our hurdles, we have also demonstrated market leadership by bringing unique and value-added services to our clients.

And with that, I'll turn the call over to Jeff.

Jeffrey D. Kelly {BIO 1390834 <GO>}

Thanks, Kevin. And good morning, everyone. I'll cover our results for the first quarter, and then, as always, update you on our top line forecast for the remainder of 2016.

While, the first quarter was again a relatively quiet in terms of Catastrophe losses, we did experience higher claims incidence in our Specialty Reinsurance segment. Alternative asset results from our private equity portfolio were also depressed during the quarter. However, the decline in interest rates and credit spreads resulted in strong mark-to-market investment performance that helped our reported net income and book value growth. Year-over-year top line growth comparisons are skewed by the inclusion of Platinum's results only after the close of the acquisition on March 2nd in the year-ago period.

Moving on to the financial results. We reported net income of $128 million or $2.95 per diluted share and operating income of $66 million or $1.51 per share for the first quarter. The annualized operating ROE for the quarter was 6.1%; and our tangible book value per share growth, including change in accumulated dividends was 2.6%.

Let me shift to our segment results, beginning with our Lloyd's segment, followed by Specialty Reinsurance – or by – the Cat segment, then followed by Specialty Reinsurance, and Lloyd's. In our Cat segment, managed cat gross premiums written in the first quarter declined by 9% from the year-ago period, driven by price reductions and our decision to pull back from risk that no longer met our thresholds.

Recall last quarter, we had highlighted our decision to cut back significantly our participation in the assumed retro business at the January 1 renewals. As a reminder, managed cat includes the premiums written on our wholly-owned balance sheets, as well as cat premium written by joint ventures DaVinci, Top Layer Re and Upsilon.

Net premiums written for the Cat segment decreased 15% from the prior-year period, reflecting increased purchases of retro reinsurance relative to a year ago. The first quarter combined ratio for the Cat unit was 27.5%. Catastrophe losses were benign, and net favorable reserve development totaled $6 million in the quarter.

In our Specialty segment, gross premiums written increased by $245 million, relative to the year-ago period. There were two main drivers of this growth. First, as I mentioned earlier, there was a timing difference between the year ago-period, only reflecting business written by Platinum during the month of March. The other driver was significant growth in our credit book, primarily reflecting increased mortgage reinsurance opportunities that we had also highlighted on last quarter's call.

Our top line in the quarter included $139 million of credit-related premiums, principally reflecting a few large mortgage reinsurance deals. While we booked premiums written for the mortgage reinsurance deals at inception, they have a long duration, and consequently, are often earned over a period of approximately 10 years.

As we've grown our specialty book, we have also increased the use of ceded purchases to enhance overall returns. Consequently, we are actively managing the net retained risk across our casualty and specialty book, and particularly, in the newer credit lines, where we've been growing.

The Specialty Reinsurance combined ratio for the first quarter came in at 100%, which was essentially breakeven. Attritional loss trends have remained generally benign. This segment reported net adverse development of $3.5 million in the quarter. Continued favorable reserve development on attritional losses of $17 million was more than offset in the quarter by approximately $21 million of net unfavorable development on six event-driven specialty claims. Those events included a bankruptcy surety claim, two train derailments, a dam failure and an energy loss.

Our practice for Specialty events, which have low-frequency, but high-severity loss profiles like these is to put up additional case reserves against the loss. Thus, of the total event-driven reserve strengthening this quarter, $19 million related to ACRs, which is well above the reported loss level for these events. The expense ratio of 40.9% in Specialty Reinsurance was five points higher than in the year-ago quarter, principally due to higher acquisition costs related to the credit lines.

In our Lloyd's segment, we generated $133 million of premiums in the first quarter, an increase of 2% compared with the year-ago period. Our growth rate is lower than we had indicated in our guidance for the year and is reflective of a generally competitive marketplace. Net premiums written at our Lloyd's unit are down 19% for the quarter. Recall, we have meaningfully increased our sessions at Lloyd's to manage the risk profile of the business, as we have grown in recent years.

The Lloyd's unit came in at a profitable combined ratio of 90.4% for the first quarter, reflecting generally benign loss experience. The unit reported $1 million of net adverse reserve development in the quarter. The expense ratio at 46.3% was slightly higher than a year ago but better than in the fourth quarter. The expense ratio continues to be impacted by the use of ceded purchases relative to our top line growth.

Turning to investments. We reported net investment income of $29 million in the first quarter. Recurring investment income from fixed maturity securities totaled $36 million for the first quarter. Our alternative investment portfolio generated a loss of $6 million in the first quarter, reflecting $9 million of negative marks on our private equity investments, which were slightly offset by positive performance on other investments.

Performance in our private equity portfolio was weaker than anticipated, with a few funds posting mark-to-market losses during the quarter. The annualized total return on the overall investment portfolio was a solid 4% in the quarter. A decline in treasury yields and credit spreads for many investment classes resulted in strong unrealized gains on investments.

Our investment portfolio remains conservatively positioned, primarily in fixed maturity investments with a high degree of liquidity and modest credit exposure. The duration of our investment portfolio remained relatively short at 2.2 years and is stable to where it has been in recent quarters. The yield to maturity on fixed income and short-term investments was slightly lower at 2%. Our capital and holding company liquidity positions remained very strong. During the first quarter, we bought back 769,000 shares for a total of $85 million. We have not repurchased shares since the end of the quarter. As we look forward, any decision relating to share repurchases will, as always, depend on our view of business opportunities, the profile of our risk portfolio and evaluation of the stock.

Finally, let me provide you with an update to our top line forecast for 2016. At this time, we are maintaining our prior top line guidance for each of the segments. I'd remind everyone, as always, that premium estimates of this nature are subject to considerable risk and uncertainty, and our goal in providing them is to give you our best estimates at this point in time.

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

Kevin J. O'Donnell

Thanks, Jeff. As Jeff just mentioned, our property Cat segment performed well with the combined ratio of 27.5% for the quarter. Like everyone, we are facing a very competitive rate environment in the cat market. So, while we cannot control rates, we can control the amount of risk we take. As I discussed earlier, that risk is down year-on-year.

The major renewal for the quarter was Japan, which was, again, competitive. But despite another round of price reductions, pricing for Japanese earthquake risk remains higher than prior to the Tohoku 2011 earthquake.

So, we are quite pleased with the portfolio that we constructed and even found a few opportunities to grow with good customers in adequately priced layers. As we approach the June 1 renewals in Florida, many of the major trends from prior years continue to resonate. Overall, while there are many moving parts, demand in Florida looks like it will be roughly flat. However, we continue to expect pricing pressure of this renewal due to ongoing abundant supply, although we anticipate that price decreases will be more muted than in prior years. We believe, however, that we can continue to construct a market-leading portfolio. As always, we will exercise discipline and ensure that we are paid adequately for the risk that we are assuming.

For primary companies operating in the Florida homeowners' insurance market, premiums are down and loss ratios are up. Florida insurance companies are still profitable for the most part, but this is not a positive trend. These deteriorating conditions have implications for both the health of our clients and the post-loss social inflation environment, so we're watching them closely.

Turning to our casualty and specialty book. As I discussed at the beginning of the call, we recognized some losses within the casualty and specialty portfolio in the first quarter. As Jeff mentioned, these are event-specific losses and, we believe, are not indicative of any underlying trend. While it's not customary to speak of events in casualty and specialty, perhaps because of our property cat roots, we sometimes discuss the book in these terms.

In looking through some of our reinsurance treaties, we identified a few events that we believe needed additional ACR. What this means is that we increased our loss reserves in excess of what the clients reported, as we have thought these events were subject to greater uncertainty than generally appreciated. This is strictly a retroactive adjustment and does not inform our current book or any expectations for our reserves more broadly.

Overall, the reserves for the affected classes have developed in line with our expectations of loss emergence. The unusual aspect of this quarter is that the loss emergence appears in somewhat of a cluster. There have been other quarters where we have been fortunate to be on the other side of this volatility of loss emergence. But gauged over a longer timeframe, these portfolios are performing as expected.

Even though the marketplace remains competitive, there were signs that ceding commissions may have topped out, which is welcome news after several years of increasing generosity to cedents. Unfortunately, there were also signs of increased rate competition on the insurance books that we are protecting. And with that, we expect to see higher loss ratios and less margin in this business over time.

We continue to see select growth opportunities in casualty and specialty. Although these are primarily in the financial and credit lines, we renewed strongly in the mortgage reinsurance space. Mortgage reinsurance has the type of business profile that we like, one in which the market needs our capacity and is looking to transact with only a select number of well-rated and highly respected reinsurance counterparties.

In general, we always look to grow our business with core clients in areas in which we are able to generate the best returns. The characteristics of this market match well with our three competitive advantages of customer relationships, risk selection and capital management. And we are optimistic there will be more opportunities to deploy capital in this area.

Moving to our Lloyd's business now. Our Lloyd's unit had a profitable quarter, delivering a 90% combined ratio. We are seeing steady progress in the growth of this business, which continues to develop as a winning franchise with great potential. We believe that we are building an efficient portfolio in Lloyd's and look to that segment to be a meaningful contributor to our profitability over time.

Results for the quarter were substantially better than for the previous quarter. While we are very pleased with Syndicate 1458's performance, we should remain mindful that results for this business will average out over the long term. And as discussed last quarter, one should not be overly focused on a good quarter or a bad quarter. On the gross to net side, we've constructed an attractive gross portfolio, and the capital efficiency of the book was improved by virtue of our ceded strategy.

Finally, I'd like to briefly discuss a few of the losses that occurred after the close of the quarter. Let me start with the earthquakes in Japan and Ecuador. While it's too early to actually estimate the losses from either of these earthquakes, our initial expectation is that due to the way in which the personal and commercial risk is covered, and also the types of business our exposure emanates from, our losses will be limited.

In Japan, the excess of loss covers purchased by Japanese companies are not likely to be materially impacted, and therefore, by extension, should not affect the retro market. While the Japanese proportional covers may result in losses to reinsurers, we are not a significant writer of this business.

In Ecuador, we anticipate that our loss will be low, given the level of insurance penetration in the country. Similar to Japan, we don't see Ecuador impacting our retro book. And as you will remember, we reduced our exposure to this area significantly at the January renewal. I

In addition to the earthquakes, Texas is experiencing volatile weather, including significant hailstorm losses. As with any large U.S property cat event, we will likely have some exposure. While we're in the preliminary stages of evaluating the losses, we think that the hail activity will likely result in some losses to the lower end of regional covers but will be retained by the national primary carriers. With that, while we expect some loss – and to flow to us in the reinsurance market generally, but for the most part, losses will be retained by cedents.

And with that, I'll turn it over for questions. Operator?

Q&A

Operator

And your first question comes from Kai Pan with Morgan Stanley. Please go ahead.

Q - Kai Pan {BIO 18669701 <GO>}

Good morning. Thank you. And just first question is, want to get a more detail on the reserve addition in the Specialty line. What were these - like, those clients, was it region offshore or region in the U.S.? And also, what's the reason behind - you have to add it to - (22:03) late reporting, or you have additional information you added to it? And I just wonder, will that change your reserving process and practice going forward?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Thanks, Kai. So, I think, in - I think, maybe anticipating a couple of questions around this. Maybe, it'd be useful to provide a - maybe expand on Kevin's description a little bit of the - on the numbers, the process, and then any conclusions that we draw from these developments. So, as we said in the prepared remarks, the segment only had about $3.5 million of adverse development. And it's important to bear in mind that, that's relative to $1.8 billion in casualty reserve. So, it's relatively small. It does mask the fact that there was $17 million of favorable development on attritional losses. And then as, I think, I mentioned in my remarks, there's $21 million related to the specific events.

To answer your first question in terms of the geography for the events, somewhere in the U.S., somewhere in - somewhere elsewhere in the world, so I wouldn't describe them as concentrated in any one geography. Given our process - maybe talking about our process, just a minute, as Kevin said, historically, I - and I suppose it's - given our cat roots, we tend to look at these kinds of large industry losses as - more as events, almost similar to a cat event. And this is consistently how we've looked at events in the specialty book over time, that include the subprime crisis, the Madoff fraud, LIBOR rigging, scandal, the VW situation, and more recently the Tianjin explosion in China.

So, we look at these events, and our underwriters working with our finance team, and actuary make a judgment about whether or not the - we have more information that makes us want to - or indicates that we - perhaps this event is larger than we anticipated, it would be. And I think that's the case in these six particular events, that we got new information that caused us to revaluate the size of the event overall. So, lots of times, we have to make an assessment of the size of the event, our potential exposure before we have reported losses from clients. And to some degree or another, that's the case in this instance.

And then I think in terms of what conclusions do we draw from anything that happened in the quarter, I think, as Kevin said, given that these six events aren't related to one another in almost any way that we can think of, geography, peril, line of business, we don't take away any trend in these, and thus, don't see any need to change our process. And our process this quarter was no different than in any previous quarter.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Just add-on to that - a follow-on to that. In the past, if you look at these events, more like a cat event, but your track record is showing that in your property cat business, you tend to be more conservative, initially booking the losses, and then gradually, it can be released through years. What's different here?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

I wouldn't characterize the – I think, to your point, I think we have a very strong track record of reserving across all of our businesses, and that's certainly the case in cat. We don't look at these any differently and thinking about the industry loss than we would, as if it were a cat event.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Then...

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

So, I try not to talk in terms of conservative or anything other than that. It's – we try and make our best judgment at the time we put up reserves against any loss. And I think, overtime, we've evidenced a pretty good track record in that regard.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's fair. If we – stepping back, if you take out this $200 million considered one-off reserve addition, and then if you normalize your private equity fund return to like another $20 million, and this quarter, the ROE would've been probably around 10%. I just wonder, is this the new normal in the low cat quarter, like a low double-digit rate charge.

A - Kevin J. O'Donnell

I think that's a great question. And I think you're taking a couple of things out of what's actually a pretty complicated quarter. So, I think if we talk about what's in the quarter, we can get a sense as to the moving parts that we're experiencing.

I'd say, other than the fact that we are several years into a soft market and returns are down, I'm not sure there's a lot of signals than what I'm seeing in the quarterly report that we've put out. Looking at cat, we've talked about it being a competitive market. And as you'd expect, we are writing a good portfolio, and we are de-risking it, as rates are down and our risk tolerance is up.

Looking at Specialty, I think, I would really try to determine whether the book – at the highest level, the information that we have with the losses is whether the book is adequately priced or whether the book is adequately reserved. Our view is that we've written a good book and that we're continuing to position it to where the rates are best, hence the growth in the financial lines and, specifically, the mortgage.

I think the pressure on ceding commissions and the fact that, that's beginning to abate is good news. On the other side of it, we're beginning to see some rate tension and some rate competition in the primary books that we're protecting. Our underwriters are trained to monitor that and to evaluate that and something that we're working – we're watching closely. I think with – and so thinking about it, I'm not sure there's a ton of signal in the way to think about our returns only and the fact that there's a lot of moving pieces within the cat book and the specialty book.

Additionally, we had the investment performance this quarter, which had both mark-to-market loss - gains on the fixed income portfolio and then some marks on the private equity. And again, our strategy on that book is the same. And our perception of the ability - or the earning capability of that book is what it has been. So, I feel like what we're doing is the right things in recognition of a soft market. And there's a lot of moving pieces around. It's hard to isolate, and then try to extrapolate forward.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's good. That's very helpful. If I may, last question is that - on the buybacks. It looks like buybacks is a little bit smaller than your net income for the quarter. Are you still committed to return more than your earnings through the year?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Thanks, Kai. Yeah. As I think I said on last quarter's call that we anticipated the volume more than we earned in the year. And that's - that our point - at this point in the year, we don't see any reason to alter that guidance to you.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. And I just want to make sure. The earning you're referring to, because there is big delta this quarter, is the net income or operating income?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Yeah. Try not to focus on any - it's more than we earned, however, you measure that, yes.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Thanks.

Operator

Your next question comes from Vinay Misquith with Sterne Agee. Please, go ahead.

Q - Vinay Misquith {BIO 6989856 <GO>}

Hi. Good morning. So, I just wanted to follow up on the adverse development. So, would it be fair to assume that the underlying business really hasn't changed, that's the reserving on the underlying business, and that still is trending in the right direction? You said, $17 million?

A - Kevin J. O'Donnell

Yeah. That's - on both accounts, that's correct. I think, Jeff, what we're trying to do here is provide a ton of transparency. And in thinking about the $17 million with attritional loss development on our curve and then thinking about the fact that we added additional reserve to some specific events is really just us trying to put more transparency around the loss that we have in the quarter, which ultimately, is $3.5 million. We've not changed our view of our risk. And we think that if you're looking at signals coming out of the reserves, a stronger signal comes from whether you have – the frequency of your loss emergence is changing, not whether you have, what I'll call, as an unlucky quarter with a cluster of larger events coming in.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure. And also just curious about whether this adverse development tells you anything about the book of business that you wrote. So, first of all, it would be helpful to understand whether this came from the Platinum business, number one; number two, RenaissanceRe is growing pretty significantly in Specialty, and so curious as to whether this reserve addition adds color to the growth that you've had before?

A - Kevin J. O'Donnell

So, again, good questions. I think, the – traditionally the way that I think the quarter would be reported, from an actuarial standpoint, would be that we had $3.5 million of adverse development against $1.8 billion of total reserves. We are bringing in the other information to get some transparency. And the reason we want to give that transparency is we believe there's not a signal in the reserve development we've had for the quarter.

So, we do have a slightly different process than many, and that we think about things in an event, from an event mentality, which allows us to put the loss up when we hear about it similarly to what we did in Madoff. And then over time, we'll determine whether it was the appropriate reserve as the rest of the curve runs out.

I think the other question I have is between whether it's the Platinum book or the Renaissance book. We're a fully integrated organization, and we don't think of us, as having a legacy Platinum book or a legacy Renaissance book. I would say, the books of business that are most affected by this, really come in to the excess casualty. We have some surety in financial lines and a little bit of a general casualty stock that comes in. So, it's reasonably spread, it's written across multiple platforms, and it's coming in from different types of loss into different types of lines. So, it's hard to categorize it as one or the other.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

The only thing I would add, Vinay, is that – related to that is that our reserving process is across both the legacy Platinum organization prior to – or what would have been prior to close. And RenRe have been synced up since the day of the close. So, we've been operating our reserving processes, and they've been synced up since the close, so – and then the only other thing that you touched on, I don't know whether Kevin mentioned, just to close it off, we don't think this reserve additions, at all, inform any view of the profitability of the in-force book, or the areas in which we've grown over the last year or two years.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay, that's helpful. The second question is on the profitability, actually, the reported profitability within Specialty and Lloyd's. The accident-year loss ratio actually was significantly better than the prior three quarters. Was it something special this quarter, or should we expect this level of profitability for the future?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

No, I think, from an accident-year perspective is just relatively benign loss experience.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. And then one last one, if I may. The ceded reinsurance increased significantly both in Specialty and Lloyd's. Should we be thinking about that moving forward too, or was it just a one-quarter issue?

A - Kevin J. O'Donnell

I think looking at the Lloyd's, we had a bigger increase, and we talked more about it probably in the fourth quarter than we did in the first quarter for the Lloyd's increase in Specialty. The ceded Specialty is one where - we're doing that to enhance the returns of the portfolio. So, for instance, one of the places that we're continuing to see a lot of opportunity to grow is in the financial lines and credit lines, most specifically, in the mortgage. So we're buying more ceded in that area, because it allows us to construct a better portfolio, as we continue to grow it.

It allows others to leverage off our expertise and access the business because of our strong ratings. So we're exchanging risk premium for fee income. So, the opportunity - we will continue to increase our sessions in that, matched up against the opportunity we have to write that business. To give you some sense of scale at this point, we're ceding and representing other capital for about 50% of the business that we're writing right now.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. That's helpful. Thank you.

Operator

Your next question comes from Michael Nannizzi with Goldman Sachs. Please, go ahead.

Q - Michael Nannizzi {BIO 15198493 <GO>}

A couple of quick numbers. First, the guidance then based on 1Q results would seem to imply that you would expect Specialty to shrink for the rest of the year, and Lloyd's to grow to sort of make up for 1Q. So somewhere in the neighborhood of like 30% a year. I mean, is that directionally, effectively, what you're saying?

A - Kevin J. O'Donnell

So, starting on the Cat, I think our guidance of down 10% seems reasonable. On the Lloyd's, some of the things that we anticipated growing were lightly represented in the first quarter. So I think we will see - or we hope and anticipate that we'll see better growth as we go through the year.

With Specialty, I think, Specialty still continues to be on the lumpier side. I think we are seeing better opportunity, and there's a very good pipeline of mortgage deals, particularly from the GSEs, coming down the pipe. So, we won't stop accepting Specialty business, because we have guidance out. If our ability to write profitable business is greater than our guidance, we'll revise it over time.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. Got it. And then the items - sort of loss items you mentioned in the quarter, did that impact Tower Hill in the quarter as well?

A - Kevin J. O'Donnell

The Tower Hill - from the reinsurance that we write for Tower Hill, that's predominantly property cat stuff. The type of AOB loss that is coming in is not something that would affect those reinsurances. The piece that it would affect is that we're an owner of Tower Hill, and Tower Hill's profitability has been affected by the assignment of benefits claims in Florida. I think they are increasingly sophisticated in the way that they're handling those claims. And I hope that over time, it'll become a lesser story than it is right now.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. Got it. And then just one other quick one. On the Specialty then, the expense ratio that ticked up in the first quarter, is that - just given the mix of the business and how you're growing, is that where we should think about that? And then on the operating expense side, should we be thinking about that in terms of notional dollars or a percentage?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Yeah. I think on the specialty expenses, the operational expenses and the acquisition expense, the expense ratio overall - for the operational expenses, I think what you're seeing there is really three full months in this quarter versus last quarter, and the increased head count in that segment. It is the largest part of the Platinum integration that got integrated, moved into the Specialty platform. So that's not surprising.

I think on the acquisition expense, that's a function of both the increase in the level of premium and the change in business mix from a little more proportional business and the increase in the mortgage business, which carries higher acquisition costs. So, to the extent that that business mix is roughly consistent going forward, I think that's a fair assessment.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. And then just one last one if I could sneak it in. I mean, sort of picking up on Kai's question. I guess, looking at your historical results, in light cat quarters like this one, ROEs were - those are your best ROEs, just because, even though with soft pricing, a lack of activities the two sort of move together and those are the years where book value grew the most, and margins were your best, and ROEs were the best.

I mean, I guess, in this market, is it right to compare what we got today to your average historical, or is it right to compare this to, again - and this is adjusting for investment the shortfall in investment income. I get to about that same sort of 10% ROE number if we sort of normalize those out. Is it better to compare this to your average historical or to kind of those peak years when you've benefited from a lack of cats?

A - Kevin J. O'Donnell

It's a good question, and it's a hard one to answer. I think looking at the book of business, I think our cat portfolio performed well. I also think we're a different company today than we were before, where we do have the diversity coming in, in most quarters from the Specialty business. I think the other thing to think about is just - or what I'd like to convey is the way that we think about the business, which is we're not trying to build the best portfolio in a low-cat quarter, we're trying to build the best portfolio against all outcomes.

If we wanted to optimize our returns in a no cat quarter, we would just write more, we'd expose more capital, we'd buy less. And everything that we're doing is trying to come up with the most efficient portfolio. So, we've got guidance out of down 10%, we're writing less. We're reducing risk and exposing less capital, and we're buying more ceded. So, I think it is hard to compare exactly what we've done in the past, but it's 100% rationale to think that rates are down significantly after several years of the soft market. So, it's a little bit of a mix bag as I would think about it, I'd say.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Yeah. The only thing I'd add to what Kevin said is, I think, it is difficult to compare, because the facts and circumstances in prior years don't compare well with these. And the way we run the business, in any point in time, might not compare with that in terms of the level - is it a risk-on, risk-off year? As Kevin mentioned, we've been buying a lot of ceded protection and reduced risk in, really, all three of our segments. And then, there's the interest rate environment, which is historically low by any comparison.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Correct.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

And then there's our capital position, and I think we're probably in one of the stronger capital positions I can certainly remember since I've been here.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it, got it. Okay. Thank you so much.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Yep.

Operator

Your next question comes from Sarah DeWitt with JPMorgan. Please, go ahead.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Hi. Good morning.

A - Kevin J. O'Donnell

Good morning, Sarah.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Following-up on the capital position, your premium to equity of 35% is near all-time lows, even though your book is less cat-dependent. So, is it correct to think that you could probably double your operating leverage, and you have nearly $2 billion of excess capital? And if, so why hold so much capital?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

I don't think premium to equity in our business is probably a terribly useful metric, just because it – there's a lot of different ways that we take on economic risk. And so, I wouldn't necessarily use that term. That said, even based on what I said, I think we have a very strong capital position. And as I think we've tried to say in previous calls, we always look to return what we don't think we can use after we've looked at the risk in the book. And admittedly, I think the risk in the book, relatively speaking, is lower.

But we also look at potential opportunities and other ways to deploy the capital and hold some amount of capital for that. That said, as I noted earlier, I think we're in an extremely strong capital position. We look at the share price in terms of a consideration as well as to when and how much we buy back shares. But, yeah, I think as we said at the beginning of the call, it's – we intend to buy back more stock this year than we earned.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Okay. Great. And then just on the net investment income, what's the right run rate to be thinking about there, and have the private equity investments rebounded so far in the second quarter?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Well, putting a pause on the second part of the question, I mean, I think if you look at the recurring net investment income in the quarter of about $36 million, that's actually pretty consistent through time. We've been earning roughly that on the fixed income portfolio. That's reflective of the duration, the yield on the book at its current size. So, I think, that run rate is likely to hold for some time.

We've had a rather sharp rebound in the equity markets since the end of the – or during the last couple of months. I'm certainly hopeful that private equity returns are higher, but that's one that we don't get a lot of inter-quarter information about, so we make our best estimate of the value of those funds on a real-time basis at the end of the quarter. We'll see how it develops. But I'm optimistic based on where public equity markets are, that those are in for a better quarter, this quarter.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Okay. Thank you.

Operator

Your next question comes from Brian Meredith with UBS. Please, go ahead.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Hi. A couple of quick questions. Jeff, I just want to clarify. So, the guidance in Specialty, that is on an apples-to-apples basis, or does that include the extra two months that you're going to get this year from Platinum?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

It includes the extra two months that we'll get from Platinum. So ...

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Okay.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

...I think, as I said in my...

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Yeah.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

...prepared remarks, there's two parts of it. It's big growth on a dollar basis. It's two parts. It's the credit-related deals that we've been doing and the Platinum growth.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Got you. Makes sense. And then, just another quick – just accounting. Where does the fee income hit that you get on those mortgage insurance deals? Is that going to be a credit to your acquisition costs or be somewhere else?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

It'll be a credit to the acquisition costs.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Okay. So, that should offset some of the higher acquisition costs associated with that business?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

To some degree.

A - Kevin J. O'Donnell

Yeah. I think it'll take some time, because it'll be based, in some degree, on the profitability of the portfolios.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Got you. Okay. Great. And then last question, just – Kevin, you mentioned, and looking at the Specialty business, that you said, competition increasing some of the primary lines that you're seeing, and you expected maybe some margin compression going forward. Just curious, could you be more specific on what lines are you seeing the increased competition?

A - Kevin J. O'Donnell

Yeah. I think, if we were looking at, I'd say, it's probably more in the Specialty lines than in some of the more traditional casualty lines. Like an extreme example would be, like, we have a very small airline account. There's been a lot of aviation competition. On the positive side, we're seeing good opportunities in the mortgage, as we discussed. I think the general casualty is more of a mixed bag, where we're seeing some – it's more of an account specific. I think it's hard to draw that conclusion for the market at this point, but when you see some price deterioration in some accounts, it's not crazy to begin to think that the whole market will begin to become more competitive.

I would – it's more specialty than in the traditional causality lines. And within the casualty lines, it's more on specific accounts, which, again, we're watching closely to see if it becomes more of a market level competition. I actually don't want to point out some of the professional lines. We're seeing increased competition, I'd say, more broadly as well.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Excellent. Great. Thank you.

Operator

Your next question comes from Josh Shanker with Deutsche Bank. Please, go ahead.

Q - Joshua Shanker {BIO 5292022 <GO>}

Yeah. Thank you. Repeating some of the points earlier, but just trying to clarify, the loss events seen this quarter higher frequency than normal, are these widely distributed throughout the industry? And we've only had a few reporters, but it doesn't seem like those companies that have reported so far have the same amount of concern that you guys do. Do you think that these were one-offs that you took a large piece of, or do you think that as more reporters report their numbers, we'll see that this is a bigger issue for the industry, in general?

A - Kevin J. O'Donnell

So, I think that's a good way to think about it. These – we are a very small percent of the insured loss on this. And it's coming through a lot of very different books of business. The – so, I think these are industry events. I think most of these events have been on the cover of the paper, when they occur. So, I do believe it's affecting people more broadly.

I think the unique thing about us is just the way that we talk about these losses, where going back to the previous comment, I think, net, I think, someone may – a traditional way to talk about this is you have $3.5 million of adverse development, and wouldn't get into the specifics of the moving parts. We're trying to give you a little bit of more clarity as to how we're thinking about it. And then secondly, I think our cat-biased background naturally pushes us to think of these in terms of events with the rest of the market. We'll think of them as already in current reserves.

Q - Joshua Shanker {BIO 5292022 <GO>}

Okay. That's a perfect answer. And one thing which was probably been asked six ways from Sunday for years, following upon what Sarah had asked about capital, is there a way to think about how much less risk your balance sheet might be bearing for catastrophe, than it might have been doing so four years ago?

A - Kevin J. O'Donnell

Again, I think that's a great question. And it's one that – it's different by region, and it's different by loss level, which always makes it complicated. I know we've talked about that before. I would say – I would look potentially at what our session is and look at our growth cat premium to our net cat premium. And you'll see that there's a lot of premium that we're representing on behalf of other capital.

The most specific example I can give on that is thinking of the FACF (52:26) line that we put out last year. At the end of the day, we brought 19 sources of capital to that. So, it's hard to be really specific as to how risk is represented on our balance sheet today as compared to how it is represented years ago. But I'd say that we are being very thoughtful and aggressive in thinking about constructing our net portfolios, using traditional and non-traditional sources.

Q - Joshua Shanker {BIO 5292022 <GO>}

All right. Well, I mean, if you ever decide you want to give – if you have better understanding how to think about that, I would – I'll be first in line to listen.

A - Kevin J. O'Donnell

Appreciate that. I think it's one of those that the way we think about it is in such an interrogated way across the risks that we're taking, that it's difficult for us to come up with a simple metric that represents the risk in a material way.

Q - Joshua Shanker {BIO 5292022 <GO>}

And it makes complete sense. It's just hard for yokels like me, as you probably imagined.

A - Kevin J. O'Donnell

I don't think you're a yokel and I know it's difficult. And I wish we had a better way to communicate about it that didn't push out too much information to our competitors.

Q - Joshua Shanker {BIO 5292022 <GO>}

No. I completely understand. Thank you very much.

A - Kevin J. O'Donnell

Yeah.

Operator

Your next question comes from Jay Cohen with Bank of America Merrill Lynch. Please, go ahead.

Q - Jay Cohen {BIO 1498813 <GO>}

Yes. Thank you. I just had a couple of other questions. Outside of the main thing we've been talking about, your corporate expenses, those obviously have jumped around as you had some integration expenses in there. Are they still inflated because of the integration with Platinum, and where would that settle out, do you think?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Thanks, Jay. It's - so we had corporate expenses in the quarter of about $8.2 million. Of that amount, roughly, $1 million related to the severance for one of our employees, and then we had an additional $1.6 million related to continued integration expense in the quarter. So, if you think of the $8.2 million, less those two amounts, that would have been about $5.6 million. We're going to incur about $1.3 million, I think, in integration expenses over the remainder of 2016, and then only about $300,000 in 2017. So, net-net, I - the way I think about corporate expenses kind of landing in a range is probably somewhere between $5 million and $5.5 million on a quarterly basis.

Q - Jay Cohen {BIO 1498813 <GO>}

That's really helpful, Jeff. Thank you. The second question on the Lloyd's business. I think, Kevin, you said that, your increase in ceded premiums there impacted your expense ratio, but you really didn't describe exactly how it's impacted it. Can you talk about that?

A - Kevin J. O'Donnell

Yeah. That's was lower earned premium from the sessions that we had coming through.

Q - Jay Cohen {BIO 1498813 <GO>}

So, it inflated it?

A - Kevin J. O'Donnell

Yeah, inflated the expense ratio. Yes.

Q - Jay Cohen {BIO 1498813 <GO>}

As you do know if it was a ceding commission that might have even offset it more, but now I get it. That's helpful.

A - Kevin J. O'Donnell

Yeah.

Q - Jay Cohen {BIO 1498813 <GO>}

Thanks a lot.

A - Kevin J. O'Donnell

Okay, yep.

Operator

Your next question comes from Meyer Shields with KBW. Please, go ahead.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. I know this is unanswerable, but you mentioned in the Specialty Reinsurance, that there was sort of attritional reserve development that was favorable, and I'm wondering why we're not seeing that sort of trend in the Lloyd's segment as well?

A - Kevin J. O'Donnell

So, I guess, your first part of the question was operative; it's unanswerable. I think, the way I think about it, they're different businesses that we're building up. It's a smaller book within Lloyd's, and it's a book that includes both property and specialty. So, I think there's a couple of pieces to it. But we do have a traditional – within the casualty that we write, and within the specialty that we write, in particularly the casualty and specialty that's on more than one of our platforms, they reserve the same way.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Understood. With regard to the – and again, here in Specialty Reinsurance, with regard to the mortgage insurance, I understand that the acquisition expense ratio is heightened because of the expenses associated with that. Are there any start-up expenses that are associated with building up this book of business, or is this a good run rate, assuming that this mix of earned premium and DAC asset amortization continues?

A - Kevin J. O'Donnell

I don't think there's a material start-up cost associated with us moving into that business. It's a few underwriters writing on behalf of our existing balance sheets, so it's not a material aspect.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thanks very much.

A - Kevin J. O'Donnell

Yep.

Operator

Your next question comes from Bill Wilt with Gordon Haskett. Please, go ahead.

Q - William Wilt {BIO 5683199 <GO>}

Hi. Good morning. Thanks for taking my call. My question, do you anticipate the changes to A.M. Best, BCAR, best capital adequacy ratio, to that methodology? Do you think that those changes will drive an increased demand for property catastrophe reinsurance?

A - Kevin J. O'Donnell

Yeah. I think - looking back, the last time A.M. Best changed the model, it created a big opportunity for us to sell additional cover. I think, this time, the conversations we've had with A.M. Best are much more measured in that their analysis of the change in the model, it doesn't materially change people's capital requirements. My guess is there'll be some exceptions to that. But at this point in time, we don't have enough information to have real clarity as to what it means to our portfolio. But if what we're hearing is accurate, it shouldn't be - unfortunately, it probably won't create much of an opportunity for us, but fortunately, it won't change our capital requirements.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thanks very much.

A - Kevin J. O'Donnell

Sure.

Operator

Your next question comes from the line of Ian Gutterman with Balyasny. Your line is open.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Hi. Thank you. I guess my first question is on these Texas events. I'm guessing, with the spread of aggregate covers over the past few years, a number of these local, regionals and mutuals by aggregates, is there risk between the Q1 and Q2 events that we're going to see aggregates max out, maybe even blow out in the top to these companies?

A - Kevin J. O'Donnell

Yeah. I think that's a great question, and it's something that we're looking at now. They're definitely going to be impacted. So now, the question is by how much? So, even if the aggregates are only eroded, it changes the profile of your risk exposure going into wind season, so it's something we're looking at now. The other thing is it's been volatile. There was activity last night, actually. So, I think we're kind of in the – it's almost like a live cat right now. But the point you're raising is really important point to focus on, not only as to whether we'll have losses from these events, but how it changes your exposure profile that the aggregates are materially eroded.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Got it. That's what I was wondering. Okay. Great. And then not to beat a dead horse by I thought I'd ask things I don't think have come up yet on the specialty losses. First, given there are 15 events, where these all Q4 events that you just didn't have enough information on, or were they spread out throughout 2015?

A - Kevin J. O'Donnell

It's a mix of things, actually. It's actually six events. We've thrown so many numbers at you it's hard to keep track, but it's a mix of things. I'll give you a specific. One of which is the Amtrak loss that happened between New York and Philadelphia. And one of the things that we've seen is the cap that was applied has been increased. So, we're adjusting our reserve based on the fact that there's a retroactive increase in the liability cap associated with that event. So we can't be that specific on this sort of stuff. Other stuff is more difficult to assess, but we're making an assessment that is materially more volatile than what the market is assuming.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Okay. And then the other aspect, I think going through the list, most of them, if not all of them, were non-property. I think there's a number of casualties mentioned assurity. Does that suggest any – I guess, I think what's surprising to people, right, is we're kind of used to you guys always having the small events be releasing down the road. But those are all properties, there's something that suggest casualties is a little bit harder – as you go into it casualty we might see more of this sort of – the volatility might go both directions as opposed to usually going just one direction, because casualty is different than property reserving?

A - Kevin J. O'Donnell

I wouldn't read into it being more volatile. Certainly, that not my expectation. I think, some of these losses have a property component to it. So there's a property element, but we think there's liability associated with either the companies involved. An example of a combined event like that could be something like people are going to (01:02:10). It's not of one of the ones we're talking about today.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay.

A - Kevin J. O'Donnell

But, in general, we're writing an excess casualty book. I think excess casualty, in particular, is exposed to large events and some volatility. I think the real question then comes back to how one reserves for it. We have more of that cat mentality. We think of it as an event. For many others, say, I've got an expected loss ratio against this book, and what I'm seeing as - even though it might be a shock loss, it's contained within the normal reserves. So, it could be simply just a fundamental difference in the way people think about the same losses. None of these losses we're the only one exposed to.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

No. Of course, because I was just wondering if there was something where - I mean, I think you mentioned most of this is ACR. If I think of, say, a tornado event, or a hail event, or whatever, you guys are actually pretty - have such robust data that you kind of, I think, probably know what the right ACR should be before the cedent does, right? And I just didn't know if it's just a little harder to get that right, and that - maybe what I'm trying to ask you is - it feels like maybe I'm interpreting this wrong, but that these increases sort of surprised you, right, that whatever you thought the initial exposure was turned out to be more. And we're on prop, I guess, it seems you guys seemed to have an information edge on most and not get caught off-guard. Is that fair, or am I interpreting what you're saying, wrong?

A - Kevin J. O'Donnell

It's an interesting way to think about it. What we - let me explain what we do on property. In property, we do a top-down, bottom-up analysis. Top-down, we take a very -- we take a view on the industry, we run data, and then take a view on individual accounts based on market share and some other non-specific elements. Then we look at the individual account and run it from the bottom up and determine what that loss is, and then we can factor it to the right number using those inputs.

Within casualty, I think, the loss is different, where over time, you learn more. And the loss can spread among seasons, and it can spread to new lines. So, we can go from a property loss to a D&O loss and kind of across different categories. So, I think, there are differences in the way we think about it. We can't bring a market share approach to it, so we do take a more traditional actuarial view, which I think is a healthy way to think about it. And then, we take more of an event view, which is more unique to us and probably, again, an extension of our cat roots. So, I don't think, I would point to it as being more volatile. But I think, I would point to it is as, us just having a different process and how to think about it.

If we go back - like we put up an event loss for LIBOR, again, we're certainly not the only one exposed to LIBOR, but I would imagine that others are looking to see how that develops over time and determining whether it's in attrition. We looked at it and said, we think, this is more of an event, we'll put it up, and over time, hopefully, come to the same place.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Got it, makes sense. I'll cut it off there, because I know we're running long. So, thank you.

A - Kevin J. O'Donnell

That's okay. Thank you.

Operator

There are no further questions at this time. I'd like to turn the call back over to Mr. O'Donnell.

A - Kevin J. O'Donnell

Thank you, everybody. I know, there's a lot of moving pieces this quarter. We tried to give you as much transparency as we can, and we hope that it was helpful. Thanks again for tuning in, and looking forward to talking to you next quarter. Bye.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.