Q2 2018 Earnings Call

Company Participants

- Craig Howie, Executive Vice President, Chief Financial Officer
- Dominic Addesso, President, Chief Executive Officer
- John Doucette, President, Chief Executive Officer, Reinsurance Division
- Jonathan Zaffino, President, Chief Executive Officer, Insurance Operations

Other Participants

- Amit Kumar, Analyst
- Elyse Greenspan, Analyst
- Josh Shanker, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst
- Yaron Kinar, Analyst

Presentation

Operator

Good morning, and welcome to Everest Re Group's Second Quarter 2018 Earnings Conference Call. On the call today are Dom Addesso, the company's President and Chief Executive Officer; Craig Howie, Chief Financial Officer; John Doucette, President and CEO of Reinsurance Operations; and Jon Zaffino, President and CEO of Insurance Operations.

Before we begin, please note that the company's SEC filings include extensive disclosures with respect to forward-looking statements. In that regard, statements made during today's call, which are forward-looking in nature, such as statements about projections, estimates, expectations and the like, are subject to various risks. Actual results could differ materially from current projections or expectations. The SEC filings have a full listing of the risks that investors should consider in connection with such statements.

Now, let me turn the call over to Dom Addesso.

Dominic Addesso {BIO 1428096 <GO>}

Thank you. Good morning, and thanks for joining our call this morning. The second quarter of 2018 was a decidedly mixed quarter for Everest. Surely the bottom line results were not where we wanted them to be, driven by the reserve charge we pre-announced. Nonetheless, it was another quarter of a successful execution of our strategy.

We had a lot of success executing on the opportunities that have been presented to us in the market. We are seeing strong premium growth both in our insurance and reinsurance business. Plus, in both segments, our underwriting and re-underwriting actions have driven improvements in the attritional loss ratio and the profit margins embedded in our portfolio. Of course, the progress towards our strategic objective is masked by the reserve charge. No doubt, this adjustment was disappointing. And while it reflects some broader underlying trends going on in the market, in reality, we know it will require us to improve and make changes to recognize these trends.

The underlying cause of the reserve shortfall can be attributed to two factors, which were not apparent to us at year-end. First, our clients are seeing a large number of reopened claims, largely stemming from the AOB threat in Florida. Ceding companies were trying to settle claims quickly, conceivably to mitigate the AOB issue.

The loss reports we received from clients showed a high percentage of closed claims very clearly and we were encouraged by these reports. Settling claims quickly was initially a sound strategy, but what we now know is that, this approach left our clients vulnerable when the actual repair bills came in higher than what they originally closed in their claim. To a lesser extent but for the same reasons, the claims reopening has impacted Puerto Rico after Maria as well, driving up losses which crystallized in the second quarter. The reality was that these closed claims statistics we were seeing were a false [ph] positive.

The second factor was the extraordinary rise relative to past events in loss adjustment expenses. The expense numbers we're seeing are significantly above our historical data. In fact, we saw some treaties experience high-30's and even 40% expense loss. Again, these numbers are only began to emerge in the second quarter of claims reports. Both of these factors reopened claims in a much higher than expected LAE with the overwhelming reasons for the increases we saw.

Our reserves at year-end for our core reinsurance cat portfolio contemplated demand surge but these developments were beyond anything seen before. In addition, when coupled with the California wildfires, it had a leveraged impact on our aggregate retro book. I would refer to this as the cliff [ph] factor. In other words, our previous analysis at many of our clients' retro accounts, not attaching. Now, some are very much in the money.

So while these are the observations, it demands that we respond to what may be the new normal. Going forward, cat pricing will need to reflect the higher level of loss adjustment expenses, particularly for those accounts they rely heavily on third-party adjustment services. While some of the LAE level was driven by scarcity of resources due to multiple, almost simultaneous events, for example, citizens doubled their standard adjusted fees due to the shortage created by Hurricane Harvey. Our pricing needs to better consider this new reality. Plus, our reserving process going forward needs to be refined to consider these factors in multiple events, as seen in 2017.

This commentary have just gone through or hopefully clarified the circumstances and our recognition that we need to respond appropriately to changing market conditions. However, while we did temporarily get the score-keeping wrong, make no mistake that we are playing the game at a high level and we'll continue to do so. Our profits from our cat portfolio were 3.5 billion over the last five years. This business comes with volatility but the appropriate reward for the risk is evident.

Finally, given the extraordinary circumstances of the 2017 cats and the separate process we use in setting cat reserves versus non-cat reserves, our review of our current reserves finds no read-across on the adequacy of our non-cat reserves. We are very comfortable that our track record of conservatively setting our non-cat reserves continues.

While these catastrophes obviously the conversation, I would reiterate that other key parts of the organization are doing excellent and the attritional results are reflective of that. It is critical, the continued improvement is adding profitable diversification to our portfolio. The reinsurance portfolio has seen continued growth in mortgage and other credit-related business, as well as a revival of our casualty book where pricing has improved considerably, allowing us to entertain more deals.

Overall, reinsurance premiums earned have risen almost 30% in the first half of the year to $2.5 billion with an attritional combined ratio of 81.7%. This is an encouraging result as we move into the second half. The improvements in the attritional results reflect the trend we noted in the first quarter.

The insurance business continues its growth trajectory, were premiums earned in the first half have increased by 17%. This growth numbers understated due to the cancellation and re-underwriting of certain legacy parts of that portfolio. In fact, the new business initiatives along with the existing go forward portfolios have grown almost 30% or 300 million. As a result of re-underwriting and new growth areas, the book is now demonstrating more consistent profitability. The improving trend in the attritional is illustrated in the investor deck. Our new products are now earning in as you will note by comparing earned premium to written, which should continue to improve our margins. We are well positioned to produce a good second half.

Thank you. And my colleagues will elaborate further, and of course, welcome your questions at the end. Craig?

Craig Howie {BIO 17579923 <GO>}

Thank you, Dom, and good morning, everyone. Everest had net income of $70 million in the second quarter of 2018. This compares to net income of $246 million for the second quarter of 2017. On a year-to-date basis, net income was $280 million compared to $537 million for the first half of 2017. The quarter and year-to-date results were impacted by current and prior year catastrophe losses. Net income included $9 million of net after-tax realized capital losses compared to $50 million of capital gains in the first half of 2017. The 2018 capital losses were primarily attributable to fair value adjustments on the public equity portfolio.

After-tax operating income for the second quarter was $40 million compared to $234 million in 2017. Operating income year-to-date was $260 million compared to $501 million for the first six months of 2017. The overall, underwriting gain for the Group was $20 million for the first half compared to an underwriting gain of $313 million in the same period last year. The year-to-date combined ratio for the Group was 99.4% compared to 88.3% reported in the first half of 2017, impacted by the higher catastrophe losses in 2018.

In the second quarter of 2018, the company reported a $400 million pre-tax increase in its estimates for prior year catastrophe events, net of reinsurance and reinstatement premium. The increase was primarily related to the 2017 storm events which is about one-third of the change related to reopened claims reported in the second quarter, about one-third coming from higher loss adjustment expenses, and the other one-third coming from the impact on retro aggregate covers.

The Group also saw $65 million of current year catastrophe losses net of reinsurance. Of the total, $50 million related to Cyclone Mekunu in Oman, and Yemen, and 15 million related to the late winter storms in the United States . This compares to $54 million of catastrophes during the second quarter of 2017.

On a year-to-date basis, the results reflected catastrophe losses of $565 million compared to $74 million during the first half of 2017. Partially offsetting the catastrophe development was $97 million of favorable prior year reserve development related to non-catastrophe reserves. The prior year favorable development was primarily identified for reserve studies completed in the second quarter of 2018. These reserves related to the casualty and property reinsurance business, both in the United States and internationally.

The redundancy determined from the reserve studies was recognized in the second quarter given the magnitude of the overall indications. These redundancies have developed over time, but we don't react until the position becomes more mature. We continue to maintain our loss reserve estimates for the more recent years unchanged. Excluding the catastrophe losses and favorable prior year reserve development, the underlying book continues to perform well. The overall attritional combined ratio for the first six months was 85.3% compared to 85.6% in the first half of 2017. With the improvements in the attritional combined ratio and the 25% growth in earned premium, the underwriting profit has improved by more than $100 million on an attritional basis for the first six months of 2018 compared to the same period in 2017.

Our expense ratio remains low at 5.7% for the first two quarters of 2018, down slightly from 5.8% for the same period last year. For our investments, pre-tax investment income was $141 million for the quarter and $280 million year-to-date on our $18 billion investment portfolio. Investment income was up $23 million or 9% from one year ago. This result continues to be driven by the increase in limited partnership income, which was up $14 million from the first half of 2017 and the fixed income portfolio. The pre-tax yield on the overall portfolio was 3.1% compared to 2.9% one year ago as both the investment grade and alternative fixed income portfolios are up year-over-year . The duration of the portfolio remains at just over three years.

On income taxes, the tax benefit was the result of the amount and geographic region of the losses associated with the catastrophes and the income associated with the loss reserve releases in the quarter. The effective tax rate is an annualized calculation that includes planned catastrophe losses for the remainder of the year. The expected range for the full year as now 0% to 6%. Lower than expected catastrophe losses would cost the tax rate to trend towards the higher end of this range.

Positive cash flow continues with operating cash flows of $133 million for the first half of 2018 compared to $634 million in 2017. The decline reflects a higher level of paid catastrophe losses in 2018 compared to 2017.

Shareholders' equity for the Group was $8.2 billion at the end of the second quarter compared to $8.4 billion at year-end 2017. The decline in shareholders' equity in the first half of 2018 is primarily attributable to the $232 million mark-to-market impact on the investment portfolio and capital return through $106 million of dividends paid, as well as $25 million of share buybacks, offset by $280 million of net income. The company returned 47% of net income to shareholders. Our capital position remains very strong.

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

John Doucette {BIO 7178336 <GO>}

Thank you, Craig. Good morning. Q2 was the first renewal season following the catastrophes in 2017 for some loss affected areas. Notably, Puerto Rico and some of the Caribbean at April 1, as well as Florida at June 1. Overall , the markets were mixed. And from a rate perspective, they varied based on loss activity, as well as macro and local supply demand factors. However, these and other renewals in Q2 provided our underwriters with an opportunity to reshape our portfolio by capturing higher risk adjusted rewards. We improved our portfolio by achieving rate increases, particularly on loss affected Puerto Rico and Caribbean accounts growing share with some key Florida clients, reallocating capacity to different attachment points and better priced layers. We also saw more turnover in the book as we decrease shares or declined poorly priced deals and scaled up capacity on more attractively priced opportunities.

Shifting capacity from excess of loss layers and proportional treaties on programs to where we have paid the best risk adjusted price using our leading reinsurer position in the market to get preferred signings and utilizing both alternative capital and our equity capital to most efficiently match risk to capital, all position us for better than market results. These advantages benefit us even for flat renewals, and helped drive some of this year's premium growth.

Our reinsurance gross written premium for Q2 was $1.4 billion, and $2.8 billion year-to-date , which is a 29% growth in premium over year-to-date 2017, driven by growth in all of our reinsurance segments. Some of our growth in reinsurance was due to increased excess of loss and quota share participations on existing treaties and also new quota share treaties with improved profitability following the 2017 cat losses.

In addition, we achieved some impactful reinsurance successes with several key global clients who want to trade more broadly with leading global reinsurers such as Everest Re across multiple lines of business around the world . Over the last several years, we have deployed significant resources to understand and be responsive to the risk transfer and risk financing needs of our global clients. Consequently, we continually expand our strategic relationships with several of these global clients, and thus meaningfully have increased our in force profitability and future opportunities with them. We also benefited from rate improvement in certain lines, especially loss affected property lines and select casualty and professional lines.

We believe our current portfolio overall is stronger and more resilient than it has been for a long time. As Dom stated, our results did suffer from development on the 2017 events predominantly from Irma and Maria. The confluence of three significant catastrophe losses within five weeks caused a surge in demand for loss adjusters inflating loss adjustment expenses to exceptional level. In addition, claim reopening frequency in both Florida and Puerto Rico were higher than expected. As noted earlier, the combination of increasing loss estimates due to reopens and loss adjustment expenses, coupled with the losses on the California wildfires had a more severe impact to aggregate covers which we wrote.

Including the 2017 loss emergence, reinsurance produced 107% combined ratio for the quarter . However, our attritional combined ratio was 79.8% for the quarter and 81.7% year-to-date, compared to 84.2% and 82.1% respectively in the prior year period. This quarter's loss ratio benefited almost 2 points from lower non-cat weather losses and a better expected loss ratio. The improved attritional combined ratios are noteworthy given the increased share of proportional business and additional casualty writings, which both typically run to a higher attritional combined ratio than a more property dominated excess of loss portfolio.

In our US reinsurance segment, gross written premium of $1.3 billion year-to-date grew 23% versus the same period last year. Growth was broad based across property and casualty lines. We saw new opportunities for excess of loss and pro-rata deal, which included some new commercial and personal pro-rata business, additional mortgage writings, reinstatement premiums and increased facultative writings. The Q2 year-to-date combined ratio was 116.8%. The corresponding loss ratio was elevated by 43 points of cat losses, mainly from the development on hurricanes Irma and Maria, and the combined impact that these losses had with other 2017 events on aggregate covers. However the year-to-date attritional loss ratio decreased 2 points to 54%.

The international segment with gross written premium of $766 million grew by 31% in this year-to-date period. This included growth in Latin America on new opportunities and larger post loss treaty participations increased pro-rata writings and additional capacity deployed on international fact of deal in an improved post loss rate environment, as well as, growth in new lines of business around the world, such as Indian crop reinsurance out of our Singapore office and new products out of our Canadian operations. The combined ratio for the first six months was 88.2%. The six month loss ratio was impacted by 14 points of catastrophe losses, which included about $50 million from Cyclone Mekunu in

Oman with the rest predominantly from Hurricane Maria. The attritional loss ratio is running about flat year-to-date at 51%.

The Bermuda segment had gross written premium of $785 million or 41% growth during the first half with contributions from writings covering various territories and lines of business. This included growth in London, Zurich and Bermuda operations in various lines in both excess and pro-rata business and included some large opportunities with multinational insurers and continued expansion of our trade credit, surety and political risk capabilities and writings. The segment achieved an 83.6% combined ratio in the first half with the attritional loss ratio up less than a point to 58.6%. The loss ratio was affected by business mix including additional premium.

Now turning to the 6/1 and 7/1 renewal. Overall the market offered modest rate increases for both property and casualty. Accordingly, we did not just follow the market but proactively structured our global property portfolio in a competitive post-loss rate environment to maximize our return by allocating larger lines are more attractive deals and reducing or declining underpriced deals. Through this process, we improved our portfolio for this renewal season representing a better risk adjusted return as we head into this wind season, with less exposed limit, less PML, more premium and more expected profit than last year. While some competition on the property side start to increase market share, we start with accretive deals from our core clients that recognize the Everest long-term value proposition. In the end, particularly with the increased deployment of capacity to capped pro-rata treaties, we materially increased our premium while our cat exposure is flat or down depending on the territory and return period.

With respect to our casualty portfolio, we achieved some rate increases and lower ceding commissions. Modest improvement in reinsurance terms continued as the casualty reinsurance market has stabilized considerably from recent years. In addition, we added new profitable casualty business which was not offered to much of the reinsurance market whether due to our long-term client and broker relationships, superior ratings, balance sheet strength or the ability to lead reinsurance programs for clients in all P&C lines around the world. We are often included in a select group of reinsurers invited to play on unique market opportunities.

In the mortgage reinsurance market, we remain a leader with a robust in-force mortgage book and significant future opportunities. With improved loan underwriting practices by lenders since the financial crisis, loss expectations remain muted in the near term. However, we remain watchful of potentially destabilizing macroeconomic forces and/or heightened competition, and we'll manage our portfolio accordingly. We are pleased with our progress at building a better positioned, meaningfully larger and more diversified global reinsurance portfolio. We remain confident that we can execute in a market that is transforming at an accelerated rate, whether it be from third-party capital, M&A consolidation, evolving distribution channels or rapid technology change and disruption.

With that backdrop of fast-paced change, Everest Re will continue to differentiate itself with global breadth of capabilities across all P&C lines, meaningful and relevant capacity supported by alternative capital through Mount Logan, cat bonds, traditional and nontraditional hedges, evolving and innovative capital structures, all allowing us to maximize the value proposition to our customers, while enhancing returns to Everest shareholders.

Creative product structuring to deliver customized risk transfer and risk financing solutions for our clients, and expense efficiency and nimble execution via our flat and lean organization allowing us to capture more dollars of margin for each dollar of premium than most of our competitors.

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

Jonathan Zaffino {BIO 16652236 <GO>}

Thanks, John, and good morning. Our global specialty insurance operations delivered a solid quarter of performance. We are encouraged by our steady improvement and the progress we are making toward our key goals. Prominent among these goals are diversified and profitable growth and increased resilience across our in-force portfolios and operating platforms. Our team has done an outstanding job executing on the plan and building upon the many foundational pieces we have put in place over the past three years.

The second quarter brought some notable performance highlights beginning with the highest level of quarterly gross written premium, net written premium and net earned premium realized in our insurance operations history. This further marks the 14th consecutive quarter of year-over-year growth in our business. This achievement is the result of highly diversified growth across our property and casualty, and accident and health operations, our growing geographic reach and our consistently evolving product capabilities. It also speaks to our increasing relevance within the specialty insurance market. This quarter's results are also encouraging, considering our two largest underwriting divisions by gross written premium in the quarter, Everest Underwriting Partners and our US Property Group experience notable declines in their premium production due to various deliberate underwriting actions. Importantly, this quarter build upon the underwriting profitability achieved in the first quarter of this year and brings our year-to-date underwriting profit to $22 million, more than two-fold increase over prior year first half.

Our second quarter underwriting profit is $9.5 million, a three times increase over 2017 second quarter and 37 [ph] million more than our 2016 2Q performance. Further, five of the last six quarters have produced an underwriting profit below the exception being the third quarter of 2017 where we along with the rest of the industry felt the impact of unprecedented cat activity. We are encouraged but not surprised to see our profitability increasing as we expand our specialty product premium writings along with our top line results.

An area of continued focus for the insurance operation is the attraction of industry-leading talent across our expanding global platform. Everest insurance remains a highly desirable home for talented professionals across a range of disciplines. In fact, more than 500 colleagues have chosen to join Everest over the past three years. These talent acquisition efforts continue to fuel our growth, while ensuring we have the right people in place to support our expanding books of business. Notable hires this year include a new CEO of our Canadian Insurance Operation, the Everest Insurance Company of Canada. A new leader of the Specialty Insurance Group, our dedicated platform in the sports, entertainment and leisure space, and a new Head of our E&S Casualty operations. Each of these leaders, strengthened our already deep bench of talent and our representative of the top five professionals joining our organization. The evolution of Everest Insurance is a long-term effort and there is room for further improvement, but there is no denying. The many strategic actions we have taken some 2015 are beginning to take hold and evidence themselves in our underlying results.

Turning to the financial results for the second quarter of 2018, the global insurance operations produced 646 million in gross written premium, an increase of 77 million or 13% over second quarter 2017. Adjusting for its second quarter 2017 renewal rights deal that enhance our wholesale property platform gross written premium growth improves to 17%. Year-to-date, gross written premium rose to $1.2 billion, $147 million or 15% increase over the same period of 2017.

Adjusting for the renewal rights deal first half gross written premium growth also comes in at 17%. Again, a gross written premium for the second quarter represents the single largest quarter of production in our history and shows a 96% increase over 2Q 2015, nearly doubling our production from when we started this transformation Just three short years ago. The significant addition of new products which continue to gain scale, coupled with strong performance from our many existing product areas contributed to this excellent result. Nine of our 11 major business segments showed year-over-year growth in the first half while our line of business mix remain generally stable with roughly 40% of our premium written in Short Tail classes and the remainder in our specialty and casualty lines.

Our net written premium growth while still a healthy 6% year-to-date over the comparable period of 2017, it was impacted by two notable items. First was the previously discussed 2Q '17 renewal rights deal which included a one time transfer of underwritten premium in that quarter. If we exclude this one-time item, net written premium growth improves to 8% for the first half, further impacting net written premium growth or additional hedges we have implemented for our wholesale and retail property portfolios which included a one-time session related to a new quota share placement incepted on April of this year.

Net earned premium in the quarter was 408 million, an increase of 45 million or 12%. Year-to-date, net earned premiums increased by 114 million or 17% over the prior year period to 802 million. The growth in earned premium has been anticipated as various new business ventures incepted over the past three years begins to earn through the P&L at a greater rate.

Turning to the combined ratio for the quarter, the GAAP combined ratio was 97.7%, a 140 basis point improvement from the second quarter of 2017. Year-to-date, the GAAP combined ratio was 97.3%, 150 basis point improvement over the comparable prior year period. Our attritional combined ratio for the quarter in year-to-date period are 95.4% and 96.6% respectively. This represents a 1.8% increase over 2017 second quarter of 93.6% and a 90 basis point increase over 2017 year-to-date results of 95.7%.

Last year's second quarter attritional combined ratio had the one-time benefit from an adjustment to our A&H portfolio which accounts for the majority of the 90 basis points increase in the year-to-date attritional combined ratio. This quarter's loss and loss adjustment expense ratio improved 1.6% from the prior year period to 68.7% from 70.3%. This includes 2.6 points of cat activity in the current quarter related to late winter storms in the US. This compares favorably to the 3.6 points of cat activity in 2Q '17. The second quarter '18 attritional loss ratio increased 1.5% to 66.3% from 64.8% in 2Q '17. However, on a year-to-date basis, the 2018 attritional loss ratio of 66.2% remains very stable and in fact it's flat compared to the first half '17.

Our expense ratio was stable in the quarter as we take advantage of our improved scale to continue our investments in people and technology. Our expense ratio in the second quarter was 29% down from the first quarter results of 31.9%, and essentially flat from 2Q 2017. For the year-to-date period, the expense ratio was 30.5%, up a 100 basis points from the 29.5% in the comparable period of 2017. Again, we anticipate the expense ratio to stabilize as we continue on our growth path and as earned premium continues to come through in the second half of the year. As we've stated in prior calls, an expense ratio of roughly 30% remains very competitive in the specialty insurance segment.

I want to spend a few minutes on the rate environment and share some observations with regard to pricing. Overall, I would break this down into three areas. First, we see some encouraging trends in parts of our US property and commercial auto books, for example. Second we are encouraged by some gradually improving lines of business such as primary general liability and various professional lines. And third, there remains some areas under a higher degree of rate pressure mainly US workers compensation, which we will continue to closely monitor.

Overall, excluding workers' compensation, Everest Insurance produced an aggregate rate change of plus 5.8% in the second quarter, which is the strongest rate change we have seen since the second quarter of 2012, a six year high. Further this continues an upward trend in non-workers' compensation rate change that began in the beginning of 2017. As for the encouraging areas, commercial auto was up 14% for the quarter and 13.1% year to date. Property rates increased 13.1% for the quarter and 12.6% year-to-date. Commercial auto has been on an upward trend over many quarters. And for property, the second quarter was the fourth in a row of growing rate increases. As for line showing steady rate improvement, primary general liability is gaining momentum and the quarter's plus 3.2% change is more than double the rate increase we experienced in the first quarter of this year. Further, the second quarter marks the sixth quarter of the last seven in positive rate change territory of this line. As with respect to various professional lines, they continue to experience moderate rate pressure, although overall rates appear to be bottoming out, coming in near flat for the quarter.

Workers compensation despite coming under persistent rate pressure continues to perform well and in line with our view of loss experience across our portfolio. As stated previously, we remain encouraged by the profitability of this line of business and we'll carefully monitor rate and loss cost trends in the coming quarters.

Some concluding comments. Stated simply, the momentum across our global specialty insurance operation continues, strong premium growth and increasing profitability are being achieved alongside continued investments in talent, technology and operating platforms. We have built an adaptive, resilient and relevant specialty insurance organization that we continue to grow, guided by our number one priority of profitable, sustainable growth. We look forward to continuing our momentum and reporting back to you next quarter.

Now I'll turn the call back over to Todd for Q&A.

Questions And Answers

Operator

Thank you. (Operator Instruction). Our first question comes from Josh Shanker with Deutsche Bank.

Q - Josh Shanker {BIO 5292022 <GO>}

Thank you. In your prepared remarks, you spoke about what you got wrong on the cat losses last year, and suggesting you've under priced loss adjustment expenses. So is the book of business you have in cat to-date under-priced relative to what you should have priced to that on January 1.

A - John Doucette {BIO 7178336 <GO>}

Good morning , Josh. It's John. Thanks for the question. I would not characterize it that way and we always are continuing to evaluate loss trends and factors that go into our pricing, and really it was a function of the loss adjustment expenses that happened in totality when the multiple events happened. But we do look at and have modified our loss adjustment expenses going forward and we did going into this renewal season at 6/1.

Q - Josh Shanker {BIO 5292022 <GO>}

Did that changed the competitiveness about how you could participate? Did you find that your bids are better except at 1/1 than at 6/1.

A - John Doucette {BIO 7178336 <GO>}

I think, there's a lot of countervailing occurrence that are happening and at 1/1, that's more of a different market -- 6/1 is Florida and there's a lot more Territories at 1/1. So I think there were a lot of moving parts, including some of the capital. I think, there was a more macro overarching supply demand as we headed into 6/1 but there's a lot of moving parts that are there.

We did, as I mentioned in my prepared remarks -- we did write more on deals that we liked and wrote declines several deals or reduced the share of deals that we didn't like and some of that was pricing, some of that was what we was at the right kind of -- either an agreement or disagreement, on what the price equilibrium should be for losses that happened or losses to particular layer. So, either by region or to client or to a layer and what we thought the price equilibrium should be for that. So it was more than usual churn in the portfolio this Florida season than we had seen, but we were -- in the end, pleased with our ability to deploy the capital, supporting the clients that we wanted to support. We also wrote more proportional business as we indicated both in casualty and in property.

A - Dominic Addesso {BIO 1428096 <GO>}

Josh, these multiple events also had -- because there were multiple events, had a disproportionate impact on our retro ag book. And as a result of pricing demands that we had back in January -- one, we actually have less exposure there, we did in the previous year.

Q - Josh Shanker {BIO 5292022 <GO>}

So if you think about --

A - John Doucette {BIO 7178336 <GO>}

Go ahead.

Q - Josh Shanker {BIO 5292022 <GO>}

If you think about your outwards reinsurance book, I think that in retrospect, you wish you had certain kinds of protection, particularly around LAE that you didn't have coming into this year. Do you feel well protected on your outwards reinsurance book this year or does it carry with the same risks that befell you in 2017?

A - John Doucette {BIO 7178336 <GO>}

First of all, a big portion of our outwards book is through Mount Logan, which is proportional, as well as some facultative or specific deals which again are for the most part proportional. So those are not affected.

Our cat bonds, which frankly make up the bulk of our protections beyond Mount Logan are really intended to be protected against capital events, not earnings events. So we still feel very comfortable with our cat load that we profess to be under 9% and (inaudible) protections are the same or better.

Q - Josh Shanker {BIO 5292022 <GO>}

All right. Well, I'll cede this floor to other questions.

A - John Doucette {BIO 7178336 <GO>}

Thank you.

A - Dominic Addesso {BIO 1428096 <GO>}

Thanks, Josh.

Operator

Thank you. Our next question comes from Elyse Greenspan with Wells Fargo.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, good morning. So my first question just trying to get a bit more color on the increase to losses for 2017. So, you guys mentioned, part of it was related to the AOB issue in Florida. We've seen that going on in the State with a bunch of the homeowner insurers for some times. So in retrospect, I mean -- maybe are you a little bit less surprised that this happened, just a little bit more color there.

And then my second question would be, I don't know with IBNR that you can disclose in relation to how you're carrying for these events or some other metric, I guess. So we would expect -- we can kind of look to a number and say, this has been fully addressed and we don't expect any additional movement from here?

A - Dominic Addesso {BIO 1428096 <GO>}

I will ask Craig to address the IBNR question. But relative to the AOB, the AOB issue was not the AOB per se, it was the threat of AOB that we think was driving the number of reopens. So, again, to be clear, what we were seeing is increases were due to reopens, not as it relates specifically to AOB.

Craig, on the IBNR question?

A - Craig Howie {BIO 17579923 <GO>}

On the IBNR, we believe that we put up the adequate IBNIR going through these calculations for these catastrophe events. Our goal was to put this issue behind us. And so, we believe that the IBNR that we hold for all our cat events and that's separate from our non-catastrophe reserves is adequate to cover any and all prior year cat.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. And then my second question, maybe this ties back to a little bit of what Josh was asking. But if we look at your losses, following on this quarter is increase as a percent of equity. Really you do stand above your peers following this increase . So in retrospect, as you think back, where you carrying too much risk to the three storms . And I guess you know as you've -- you did mention writing less aggregate retro this year. So do you think , given that the increase happened kind of right around the mid-year renewals that were taking place, do you think that you were able to kind of see it in time to make enough adjustments to the book you're carrying into this year's wind season.

A - Dominic Addesso {BIO 1428096 <GO>}

So in response to your first question, take a little bit of -- slightly disagree with characterizing and it as above our peers. It frankly more in line. We manage our cat exposure as you know on an after-tax basis. As do many others, but most others are being in Bermuda don't have some of the same advantages from our tax structure that we do. So frankly, we consider it on that basis.

And again given our capital position, given what I mentioned in my script, it was that -- again over the last five years our, overall cat portfolio has been extremely profitable at generating over $3.5 billion of profits in that five-year time period. As well as, I think, if you look at our operating ROE compared to our peers, I think you'll find that we lead the group there as well.

So the answer to your question relative to tax [ph] is, we manage our cat exposure at less than 9 points of combined ratio points on an annual expected basis. And frankly, over the last five years or 10 years has actually proven to come in right in around that number. So, we think we've kind of optimized our portfolio. The fact that we write a lot more retro and retro ag than most other participants again because of our size and our scale can lead to a little bit more volatility. But again, we think that that's come with the appropriate returns. I don't know if that answers your question, but --

Q - Elyse Greenspan {BIO 17263315 <GO>}

Yeah, that does. And then one last question, moving away from the cat increase, the current accident year results were pretty strong in reinsurance in the quarter. In the prepared remarks, I believe you said 2 points was from non-cat weather and you showed about a 5 point improvement in your accident year loss ratio in reinsurance in the quarter, which did standout as you commented just given the shift of pro-rata and casualty business. Now, is that -- as you think going forward, is that a level of improvement that can be sustained or were there some other one-timers in the quarter or should we just look to the half year number as representative of the underlying margin improvement we could see?

A - Dominic Addesso {BIO 1428096 <GO>}

I always prefer to look at the half year number, because any one quarter can have a fair bit of volatility in it. But I think the half year numbers fairly reflective of what we expect going forward, recognizing of course that it was positively impacted by the non-cat -- the scarcity of non-cat, cat events, which has frankly had not occurred for a number of years.

And I recall, last year it was for both primary companies and reinsurers, there was a lot of storm activity in the first half of the year that didn't reach the level of -- in our case, $10 million per event. So we call them non-cat, cat. But recognizing that difference depending on how you would like to account for that in your models, the six month numbers would be more reflective of how we see the portfolio.

A - John Doucette {BIO 7178336 <GO>}

And Elyse, good morning. It's John. I would just add a little more color on the portfolio. So we did see rate increases at different points in time this renewal season post the events. Again, we talked about it at 1/1, was it as much as we are hoping for now but we did see rate increases at 1/1, 4/1, 6/1 and 7/1 and that is going to have some impact in the numbers you're looking at. We also -- as we continue to build out our mortgage and credit portfolio, that has run into an attractive combined ratio. And there's a lot of other things, I talked about the global clients and the strategic relationship we're building with some of those also has run favorably.

So there's a lot of moving parts, but again just to reiterate from the prepared comments, we really believe that our overall portfolio -- our US, international, casualty, professional, property, mortgage, structured is better positioned today that we've been able to get rate in some places, but also position the portfolio and build some stronger portfolio overall. That will impact -- that has impacted the attritional combined ratio.

A - Dominic Addesso {BIO 1428096 <GO>}

To further add to that, John mentioned in his prepared comments about -- as well, a low combined ratio line, expansion in -- or growth in trade, credit, political risk and surety. Again we have over a number of quarters now (Technical Difficulty) as far as you diversify our portfolio not only by product and class of business, but also geographically. And I think, if you look at the underlying metrics, you'll find that we've achieved a lot of that success and that's in part which driving down what historically had been a much higher annual expected cat load driving that down below 9% notwithstanding the fact that, yes, we have these events in '17. But again, given the fact that we have a retro book that -- in retrospect was not -- it's not a surprising outcome.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you very much for all the color.

A - Dominic Addesso {BIO 1428096 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Yaron Kinar with Goldman Sachs.

Q - Yaron Kinar {BIO 17146197 <GO>}

Good morning, everybody. My first question on the insurance -- reinsurance front. So Everest, I'd say, it's probably a little bit of an outlier in terms of the strong growth in net premiums written, that we've seen and that growth has accelerated this quarter. John, I know you said that this growth was broad. But I'm just curious, are there any particular notable deals that drove this particularly strong growth this quarter? And are you seeing the ceding commissions or the ceding rates relatively stable?

A - John Doucette {BIO 7178336 <GO>}

Good morning, Yaron. Thanks for the question. So we are -- so a couple of things. So, I mentioned the global clients. And so the large, the top 15 or so multinational insurers, we see them coming back -- I would say the pendulum when we've talked about this over the last several earnings calls or years, where they were retaining more, centralizing their ceided -- globalizing their treaties and sometimes that work for them on a pro forma basis and sometimes it didn't, maybe it didn't work as well on some of the cost of the business with some of the volatility they wanted. And we do see that there is seems to be as a pendulum seems to be moving a little bit in the other direction, they are potentially ceding more. And that is a disproportionate advantage to Everest, because they have very strong, tight reinsurance security committees. They want to trade with people and basically all lines of business, not just property, they want trade with reinsurers and all lines of business and they want to trade with them around the world.

And given our broad portfolio and experienced underwriters that are situated in all the major markets, hubs around the world, we have that ability to trade with the global reinsurers locally, as well as holistically at a corporate level, and that is driving not all but it's driving some of it. We're also seeing continued opportunities in the mortgage space. And Frankly we are seeing other clients coming to the market with casualty and professional reinsurance treaties in a way that we haven't seen in the last couple of years. So we had been bearish on the casualty space for many years and ahead of our peers on decreasing as the ceding commissions went up and we didn't like the trade as much or the strategic positioning of that, and we're directionally moving -- Increasing our capacity to that space as we do see more favorable dynamics for us to allow us to support casualty and professional treaties. And again, we do have some strategic relationships there, not just with the global clients that are resulting in some meaningful premium opportunities.

And you asked about the ceding commissions. We are seeing in some cases the ceding commissions coming down. There has been a lot of talk about that, that maybe a property can't subsidize other lines of business, that other lines of business will have to stand more on their own. So at 1/1, we were pleased with that and we continue to see some favorable movement on ceding commissions across our long tail book of business.

Q - Yaron Kinar {BIO 17146197 <GO>}

That's helpful. And just to clarify, the increased use of your services in your balance sheet by the global clients that's coming -- that's broad-based or is it coming from a concentrated number of clients?

A - John Doucette {BIO 7178336 <GO>}

So, we trade with all of them. The top 14, 15, 16 of them, but it varies. With some of them we trade a lot more and part of that's there. Session strategy, the reinsurance strategy on how -- where they are in that thought process. Part of it is long-term relationships that we've developed with them, part of it is where they're situated. So there's a lot of moving parts, but we do trade with all of them. But what we are seeing is our ability that, when they come to the market, they would come and talk to Everest. They'll come and talk to a few other large global reinsurers but they won't necessarily talk to a broad reinsurance panel. And again that is disproportionally impacting favorably our ability to grow the book and diversify the book.

A - Dominic Addesso {BIO 1428096 <GO>}

Our growth with these global clients for most of those relationships, we believe, the total volume is growing. Not all, but -- so we can, if you're trying to get to as there a small handful, it's across the spectrum.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay, that's helpful. And then on the insurance side. I guess given that net premiums earned are up over 15% in the first half of the year, why would the expense ratio deteriorate year-over-year?

A - Jonathan Zaffino {BIO 16652236 <GO>}

Good morning. This is Jon. I think you're going to see some movement in any discrete quarter based on the timing of our hiring efforts and timing of various investments in technology, I think what we're aiming for is, again as I said in my prepared remarks, that 30% level is quite competitive. But there's a lot of moving parts as we continue to expand geographically in various lines of business and make various investments. So that's part of it. We look at the -- on a trailing 12 month basis, it's trending in the right way and we also look at it compared to first quarter which obviously was a nice improvement. So we're pretty comfortable about where that's been.

Q - Yaron Kinar {BIO 17146197 <GO>}

Great. Thank you very much.

A - Dominic Addesso {BIO 1428096 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Amit Kumar with the Buckingham Research Group.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks, and good morning. And thanks for the color. I have three follow-up questions to the loss development discussion. Number one, just going back, I guess in your opening remarks, you outlined two reasons for the loss development. Two other companies in our universe talked about the same reasons, yet they actually release reserves from 2017 events. How can we as outsiders reconcile these two things in which Everest in an outlier?

A - Dominic Addesso {BIO 1428096 <GO>}

Well. I can't speak to what their process is and I think I've already suggested that we have to make some changes in the way we look at these things. And I'll point back to -- and I can't speak to what the circumstances were in these two companies. Some of which by the way -- we may have supported on the retro side and didn't see losses from them until the second quarter. So that's kind of an interesting sidebar. But we were disproportionately impacted by retro ag book which by definition is going to be a late report.

And I think overall, I can't speak to what they've done versus what we've done, but we know we have to make changes to how we address these multiple events going forward. I will also point to the fact that, you might recall that in the weeks following, in the months following these events that widespread press reports of claims being closed, the events were not as large as -- was expected. So there was some market chatter, if you will, that wasn't selling off any alarm bells for us, and clearly in retrospect that was a mistake, but -- and we had literally admit that.

But for sure, the loss itself is certainly contained within our capabilities, within our earnings. Our long-term track record is still intact and when you go back and push this event back into '17, I still submit to you that our operating returns were better than one of our peers.

Q - Amit Kumar {BIO 15025799 <GO>}

Fair point. I guess, just relating to that answer, can we have some comfort or how much limit is left in this cover which you were referring to? And how will this respond if there is any additional development?

A - Dominic Addesso {BIO 1428096 <GO>}

I will ask Craig or John to --

A - John Doucette {BIO 7178336 <GO>}

So, I mean as we went through this from a ground up, we did look at the aggregate covers that had losses submitted on them. And we know what those limits are and that remain on those covers. But what we really did from a modeling standpoint and going to the underlying -- underwriters was trying to find out what other aggregate covers have we written where we haven't seen a loss selection yet, and we are trying to extrapolate that across our portfolio.

So that was included in our additional loss estimate for these events.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. The third and final question, it's been a few years since we've discussed models and their efficacy. I know, in the past, I think you've mentioned using an AIR model. Any thoughts on AIR versus RMS and even any thoughts of changing the models that we use? Thank you.

A - John Doucette {BIO 7178336 <GO>}

So look, we are all aware of limitations of the models and that these are tools, and one of the things that go into how we underwrite, how we price and how we reserve. And there were many examples during -- not just the 2017 events, but events prior to that, that showed model misses from the major vendors and that happened multiple times including -- during the 2017 events with quarters of magnitude missed.

So we agree with you that the models are a tool and it need to be thought that way, and so we rely -- we look at the models, but we rely on, first principles as well as underwriting who the clients are we want to support, what do we think of their underwriting? What do we think of our positioning with them. How they trade forward, how they treat reinsurance and/or retro writers? And we think that allows us to both build a profitable book of business as well as build a sustainable competitive franchise with clients that we have around the world.

Q - Amit Kumar {BIO 15025799 <GO>}

(Multiple Speakers) the AIR model, right?

A - Jonathan Zaffino {BIO 16652236 <GO>}

Yeah.

A - Dominic Addesso {BIO 1428096 <GO>}

We use AIR, we also look at RMS, we look at other -- a lot of AIR and RMS haven't developed in some of the more developed -- developing countries and we look at local models -- we try to look at all data sources, all modeling, all vendor models that we can to determine what we think is Everest's fewer risk.

Q - Amit Kumar {BIO 15025799 <GO>}

Thank you.

A - Dominic Addesso {BIO 1428096 <GO>}

Thank you, Amit. (inaudible). And we running over and we're more than happy to stay on because we've got a number of other people in queue. So next, move to the next caller.

Operator

Thank you. Our next question comes from Kai Pan with Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

Good morning. Thank you for fitting me in. My first question is on the current quarter's, second quarter catastrophe losses, $65 million seems higher than your pre-announcement two weeks ago, just want to clarify that.

A - Craig Howie {BIO 17579923 <GO>}

So Kai, this is Craig. We pre-announced a net after-tax number and that number was net of other current year weather related losses. So, as you heard us talk about, we were able to lower our loss selection on the reinsurance side for non-cat losses if you will. Anything below $10 million, we were able to lower that loss selection, because we didn't have many events during the first half of the year that were indicating reinsurance exposure.

So that's that was offsetting that 65 and the rest is after-tax to get us to 25 million, and that was in the pre-release.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. So that portion benefits your underlying core loss ratio in your reinsurance operations.

A - Craig Howie {BIO 17579923 <GO>}

That's correct. It was not a cat event, it was the underlying reinsurance attritional loss ratio.

Q - Kai Pan {BIO 18669701 <GO>}

Okay, great. My second question on the insurance side. It looks like, if you would take out adjustments year ago, it's pretty flat in terms of combined ratio -- underlying combined ration. Given the business growing and still probably not upto the goal for mid-90s combined ratio yet. So, do you think, if there is room for further improvements towards that goal? And how quickly you can get there?

A - Jonathan Zaffino {BIO 16652236 <GO>}

Hi, Kai. It's Jon. Good morning. Yes, let me remember this, there is few things going on in the second quarter comparative. First as I mentioned was the renewal rate still which moves some things around. Secondly was the one-time adjustment for our A&H book. So, achieving the flat both loss and combined on the attritional basis -- that feels like we are directionally moving in the right way, considering come of the deliberate underwriting actions we took throughout the first half of the year and actually, candidly we have for the prior couple of years. We expect that momentum to continue. For instance, some of our newer businesses which we think had very favorable risk return characteristics were about one-third of our premium writings in the quarter as an all time high from the inception of each of these.

So, as that continues to earn through, we do expect further improvement. Again, you might get some movement at any discrete quarter based on various movements across the book. But overall, we still think there is room for improvement.

A - Dominic Addesso {BIO 1428096 <GO>}

To add to that Kai, we have some of our newer lines of business of longer earning periods, whether it is surety, trade credit, political risk, transaction risks and those portfolios are beginning to build and the earned premium is going proportionately there and those are very low combined ratio classes.

Q - Kai Pan {BIO 18669701 <GO>}

Okay, great. Last one if I may on the buybacks. And it looks like you resume buyback $25 million in the quarter. I assume, that's before -- this loss revision 2017 events. I just wonder what's your thought process behind it. And now your stock is trading below 1.1 times book, will you be more aggressive in buying back you own shares even during the wind season?

A - Dominic Addesso {BIO 1428096 <GO>}

It is a very attractive price.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you.

A - Dominic Addesso {BIO 1428096 <GO>}

Thank you, Kai.

Operator

Thank you. We will take our last question from Meyer Shields with KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Two quick ones, I think. First of all, in reinsurance, was there any change in the accident year loss pick for casualty and specialty lines from the first quarter to the second quarter?

A - Dominic Addesso {BIO 1428096 <GO>}

There was -- there's always movement, Meyer, with respect to loss picks throughout the quarter. We constantly look at -- we hope reserve committees at the end of each quarter -- as part of process, we do that both on the reinsurance side and the insurance side. But as we go through that process, we look at everything. We look at rate change, upward down. We look at loss cost trend, upward down. But there is constant movement in those expected loss ratios in any given quarter. Were there movements this quarter? The answer is, yes, slight movements always.

A - John Doucette {BIO 7178336 <GO>}

But nothing material and some of that has to reflect the fact that, we've had some newer business coming into that line. So it has to be reflective of the business that we are now putting on the books. But generally, it's been pretty stable.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, that's very helpful. So in the past few years, you've had phenomenal aggregate reserve development and generally concentrated in the fourth quarter. I know this is sort of unrealistic question, in which should we assume that some of the second quarter reserve releases came out of what we would normally see in the fourth quarter as a function of conservative reserving?

A - Dominic Addesso {BIO 1428096 <GO>}

Well, part of the answer to that question -- it's not a ridiculous question. The reserve studies that we have done this time are the same reserve studies that we do every time -- this time of the year. Typically those reserve studies, because they're smaller lines of businesses don't produce these kinds of results, which -- and therefore, they are not material. And therefore , sometimes if the material that get booked is the non-material then we wait for the fourth quarter.

So this time around, we have some relatively smaller lines of business or class of a business that produce pretty favorable number obviously. And so it's obviously -- I don't know the answer to your question because we haven't done the year-end reserve studies yet. But typically, we wouldn't expect this level of releases from the lines of businesses that we're under review. And therefore, you wouldn't expect these lines of business to have contributed that much to the year-end reserve releases. Is that helpful at all?

Q - Meyer Shields {BIO 4281064 <GO>}

It is, yes, very much so. And I guess just final follow-up, is there any sense of the change in or any quantification of losses here to Mount Logan because of the reserve shift?

A - Craig Howie {BIO 17579923 <GO>}

Could you say that again? What exactly --

Q - Meyer Shields {BIO 4281064 <GO>}

Yeah, I'm sorry. The magnitude of the change in 2017 catastrophe losses that were ceded to Mount Logan.

A - John Doucette {BIO 7178336 <GO>}

Yeah. So, this is John. So the short answer is yes. As indicated previously, Mount Logan participates on -- basically quota shares of layers and portfolio of business that Everest rides. And consequently the session to Mount Logan grew particularly -- grew accordingly with the increase in the loss picks that Everest put forth.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay , perfect. Thank you so much.

A - Dominic Addesso {BIO 1428096 <GO>}

Welcome

Operator

Thank you, ladies and gentlemen. And (Multiple Speakers) end our questions for today.

A - Dominic Addesso {BIO 1428096 <GO>}

Thank you, Todd and thanks to all for your questions today. I hope you came away with a better understanding of the circumstances regarding our reserve change. But nevertheless, as we look back at the portfolio and our business model, we remain very confident that our underwriting strategy is solid. As I mentioned, it's evidenced by our five year average operating ROE through 2017 which after adjustment for the cat losses was 11.8%. This is better than each of the companies in our peer group. I think, it's worth emphasizing.

Cat business is volatile. But as I pointed out, it's profitable through the cycle. And again as I mentioned previously, it is less than 9 combined ratio points an average through those same five years. But what I really -- I think the message we want to leave you with is the understanding of the breadth of our entire business model. And over the last couple of years, we've succeeded in lessening our cat exposure by diversifying our reinsurance portfolio into credit, other specialty classes. Along with this, as John talked about the resurgence in our casualty lines of business.

As a consequence, the attritional results continue to improve. Furthermore, the organic build of our insurance operation has been noteworthy. We now have profitable, specialty insurance operation expected to exceed over $2 billion in premium, that's double from three years ago. I recognize in the short term that it maybe very natural to look at those in this business that can be sometimes misleading. And if you more closely examine the underlying metrics, I think you'll find and get a better sense of what the future holds for Everest. So we believe it's a bright one.

Thank you very much for your interest this morning.

Operator

Thank you, ladies and gentlemen. This concludes today's conference . You may now disconnect your phone lines, and have a great rest of the day.