Q4 2019 Earnings Call

Company Participants

- Francois Morin, Executive Vice President, Chief Financial Officer and Treasurer
- Marc Grandisson, President and Chief Executive Officer

Other Participants

- Brian Meredith
- Elyse Greenspan
- Jimmy Bhullar
- Meyer Shields
- Michael Zaremski
- Ryan Tunis
- Yaron Kinar

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2019 Arch Capital Group Earnings Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session, and instructions will follow at that time. (Operator Instructions) As a reminder, this conference call is being recorded.

Before the company get started with its update, management wants to first remind everyone that certain statements in today's press release and discussed on this call may constitute forward-looking statements under the federal securities laws. These statements are based upon management's current assessments and assumptions, and are subject to a number of risks and uncertainties.

Consequently, actual results may differ materially from those expressed or implied. For more information on the risks and other factors that may affect future performance, investors should review periodic reports that are filed by the company with the SEC from time to time. Additionally, certain statements contained in the call that are not based on historical facts, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

The company intends the forward-looking statements in the call to be subject to the Safe Harbor created thereby. Management also will make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP and definition of operating income can be found in the company's current report on Form 8-K furnished to the SEC yesterday, which contains the company's earnings press release, and is available on the company's website.

I would now like to introduce your host for today's conference, Mr.Marc Grandisson, and Mr.Francois Morin. Sirs, you may begin.

Marc Grandisson {BIO 4369887 <GO>}

Thank you, Crystal, and good morning to you. Arch completed 2019 on strong footing, as the mortgage insurance market remains healthy, and our property and casualty operations are well positioned for the pricing improvements taking place in many areas of the market.

Our operating income produced an annualized return on common equity of 11.7% for the fourth quarter, and 12% for the full-year, while book value per share grew 3.2% for the quarter, and nearly 23% for the year. While property and casualty rates are increasing in several lines of business, we believe the market remains in a transitioning phase between soft and harder conditions.

Given the uncertainty of current claim trends, we believe our industry needs further rate increases to provide a more clear risk-reward proposition. In this transitional environment, risk selection and thoughtful capital allocation remain critical, to generating superior returns.

As we discussed last quarter, strengthening market conditions are evident to us from both the rise in our submission activity and our ability to achieve significant rate increases. Dislocation is ongoing as some industry participants de-risk by tightening underwriting standards, and by actively managing down their exposures. We believe that these conditions are likely to continue in the foreseeable future, due to the continuing uncertainty regarding losses from the recent soft policy years.

While there are some lines of business where the rise in loss costs can be tied to social inflation. In our view, a large component of the stress on the P&C industry's performance is due to prolonged soft market conditions and optimistic loss picks over the last three to four policy years.

While reported capital levels are still high, combined ratios are still below 100. Therefore the duration of the transition or hardening market is unpredictable. Within our insurance segment, conditions for growth improved throughout the year, as indicated by 29% growth in our fourth quarter 2019 net written premiums.

About one quarter of our premium growth came from recent acquisitions, while 50% was created organically through new opportunities, and the rest coming from rate improvement. Following three years of elevated property losses in both the U.S and internationally, property rate increases particularly E&S risks in cat exposed area in the U.S, are up more than 25%.

We have also seen rate increases ranging from 10% to 20% in large commercial general liability and public company D&O policies. But as we discussed previously, rates are not rising in all lines, and in some areas, rates are not rising enough. Switching now to our reinsurance business. Pricing in that segment tends to follow primary insurance, and we have observed some signs of discipline returning to the reinsurance market.

In our facultative reinsurance business, we are seeing increasing submission levels, and much improved pricing. Fac reinsurance has been a leading indicator of treaty market conditions historically, and we like the positive signal fac is giving us at this point. On the treaty side, we are beginning to seem to see modest improvements in terms and conditions, including declines in ceding commissions ranging from 1 to 3 percentage points.

Ceding commissions remain elevated however, and are 500 bps above the level seen in the last hard market. Focusing on the January 1 reinsurance renewals for a minute, rate increases in what is primarily a property cat reinsurance renewal period, created a few opportunities for our reinsurance group, but we remain under weight cat risk. As a reminder, our self-imposed internal risk limitation is 25% of equity capital. At this point, our 1 in 250-year PML stands at only 6% of equity capital.

Turning now to our mortgage insurance segment. Arch MI continued to perform well. As I mentioned earlier, the operating environment is characterized by strong credit quality, and a healthy housing environment. In addition, lower interest rates led to strong new mortgage originations in the quarter. Accordingly, our new insurance written at Arch MI U.S was strong at roughly $24 billion in the quarter.

Overall, our U.S insurance in force was $287 billion at quarter end, and the underwriting quality of recent originations remained very high. On a macro basis, lower interest rates and high employment have made housing more affordable. At the same time, demographic forces in the U.S are creating a tailwind, as millennials move into their prime household formation years.

Lower interest rates also led to greater refinancing activity in the quarter, which explains the decline in our persistency rate in the fourth quarter down to 76%. From a historical perspective, this level remains high and along with good mortgage origination activity, supported growth in our insurance in force in the quarter.

With respect to our investment operations, interest rates have returned to historically low levels. As in our underwriting approach, we have maintained our focus on risk-adjusted total return, which contributed to our growth in book value per share in this quarter and the year.

In summary, Arch's position following years of de-emphasizing the most commoditized and soft business lines in property casualty market is favorable. We have the human and financial capital to grow, should the market continue its favorable trajectory into 2020.

And with that, I'll hand over the call to Francois.

Francois Morin {BIO 17410715 <GO>}

Thank you, Marc, and good morning to all. Before I give you some comments and observations on our results for the fourth quarter, I wanted to remind you that consistent with prior practice, these comments are on a core basis, which corresponds to Arch's financial results, excluding the other segment i.e, the operations of Watford Holdings Limited. In our filing, the term consolidated includes Watford.

After-tax operating income for the quarter was $308.4 million, which translates to an annualized 11.7% operating return on average common equity, and $0.74 per share. Book value per share grew to $26.42 at December 31, a 3.2% increase from last quarter and a 22.8% increase from one year ago. This result reflects the effect of strong contributions from both our underwriting and investment operations.

Starting with underwriting results. Losses from 2019 catastrophic events in the quarter, net of reinsurance recoverables and reinstatement premiums stood at $30.4 million or 2.2 combined ratio points, compared to 9.70 combined ratio points in the fourth quarter of 2018. These losses impacted both our insurance and rein segments and were primarily due to Typhoon Hagibis, and a series of smaller events.

As for prior period net loss reserve development, we recognized $54.7 million of favorable development in the fourth quarter, net of related adjustments, or 4.0 combined ratio points compared to 6.1 combined ratio points in the fourth quarter of 2018. All three of our segments experienced favorable development at $2.8 million, $19.1 million and $32.8 million for the insurance, reinsurance and mortgage segments respectively.

We had solid net written premium growth in the insurance segment of 28.7% over the same quarter one year ago. The insurance segment's accident quarter combined ratio, excluding cats was 101.6%, higher by 330 basis points from the same period one year ago. Approximately 220 basis points of the difference is due to an elevated level of large attritional claims in the quarter, primarily from our surety unit, which can experience some volatility from quarter-to-quarter.

The balance is primarily due to a higher expense ratio, driven by investments we are making in the business and the integration of our UK regional book, and other smaller acquisitions. Now moving on to our reinsurance operations, where we had a relatively stable quarter.

Net premium growth was at 4.3% from the same quarter one year ago. And the accident quarter combined ratio, excluding cats, stood at 92.3%, compared to 96.2% on the same basis one year ago.

The difference is mostly attributable to the presence of a large attritional casualty loss arising from the California wildfires in the same quarter, one year ago. Our expense ratio remained essentially unchanged at 26.9%. The mortgage segment's accident quarter combined ratio improved by 200 basis points from the fourth quarter of last year, as a result of the continued strong underlying performance of the book, particularly within our U.S primary MI operations.

The calendar quarter loss ratio of 0.9% is lower by 120 basis points, than the result recorded in the same quarter one year ago, mostly as a result of better-than-expected claim experience. The benefits to the loss ratio from current year favorable development was 510 basis points, in addition to the 940 basis points related to prior years.

The expense ratio was 20.7%, consistent with the result from same period one year ago. Total investment return for the quarter was a positive 107 basis points on a U.S dollar basis, as our high quality portfolio continued to perform well. For the 12-month period, our portfolio returned 7.3%, an excellent result driven by particularly strong returns across our fixed income and equity investments.

The duration of our investment portfolio at December 31, was down slightly to 3.40 years from 3.64 years at September 30, and was overweight relative to our target allocation, as we continue to expect a lower for longer global interest rate environment. The corporate effective tax rate in the quarter on pre-tax operating income, which was 6.9%, and reflects the geographic mix of our pre-tax income, and a 30 basis point benefit from discrete tax items in the quarter.

The 2019 fourth quarter effective tax rate on operating income includes an adjustment to interim period taxes recorded at an annualized rate. This adjustment increased the company's after-tax results on pre-tax operating income available to Arch common shareholders by $12.4 million or $0.03 cents per share. As always, the effective tax rate could vary depending on the level and location of loss or income, and varying tax rates in each jurisdiction.

Turning briefly to risk management. With the recent improvements in catastrophe pricing, we have increased our natural cat PML to $612 million as of January 1, which at slightly more than 6% of tangible common equity on a net basis, remains well below our internal limits at this single event, 1 and 250 year return level.

This change demonstrates our ability to deploy incrementally more capital in an improving market to opportunities that offer adequate returns on an expected basis. In our mortgage segment, as mentioned on our prior earnings call, we completed or 10th Bellemeade transaction in the fourth quarter, with coverage of 577 million. As of year-end 2019, the in-force Bellemeade structures provide aggregate reinsurance coverage of approximately $3.3 billion.

With respect to capital management, we did not repurchase shares this quarter. Our remaining authorization which expires in December 2021, stood at $1 billion at December 31. Our debt to total capital ratio stood at 13.1% at quarter-end, and debt plus preferred to total capital ratio was 19%, down 350 basis points from year-end 2018.

Finally, as you know, we closed on the Barbican acquisition in November of last year. The integration of their platform is well underway. For the 2020 calendar year, we expect to incur approximately $65 million of intangible amortization across all acquisitions we have made prior to December 31, 2019.

With these introductory comments, we are now prepared to take your questions. Thank you.

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions). And our first question comes from Yaron Kinar from Goldman Sachs. Your line is open.

Q - Yaron Kinar {BIO 17146197 <GO>}

Hi, good morning. So my first question just goes to growth in the insurance segment. If I heard your comments correctly, sounds like you're so lukewarm in terms of the market opportunities and the rate environment and rate adequacy. And yet, I think even excluding the acquisitions you grew at a good 20% clip or so, I guess where are you seeing the opportunities? And if you were to become more constructive on market conditions? Where do you see that growth of capping?

A - Francois Morin {BIO 17410715 <GO>}

The first part is -- thanks for the question -- the first part is I think, we're lukewarm in the sense of saying it is a full-on hard market. We just want to impress upon everyone that we're in the early stages of rate changes and we don't know how long that's going to last. And I also made comments about the fact that the industry has an all-time capital high and still printing very reasonable combined ratio numbers.

So I just wanted to make the point that it's not across all lines of business. Having said this, the growth that you see us experience or go through for the year-and certainly in the fourth quarter is our is in the areas where market are coming back to our pricing level and return expectation. So we had deemphasized those lines of business for quite a while actually as softer years were eating into our on production and I think of late we've seen in a resurgence of submissions and we're able to hit and get up pricing and return.

So in the areas where we're growing, I would say that it is definitely an improving market and improving such that we believe we're clearing some of the loss trend -- or loss cost trend concerns that one may have. So I also want to remind that we had not grown as much as a market would have probably could have indicated with last year. So this is hyper -- No, this is good growth on the lower number. For instance only on the D&O side, we -- our premium written was about half of what it was last year versus five years ago. So you don't need much of an increase to really make a dent, in the overall price increase. And the second question is we can grow a lot. And as we saw, we know you asked Yaron whether we can grow based on the conditions. If conditions continue on and we're seeing right now, still getting something very, very good. I think we could still grow a fair amount. I think we have been our guys, our people have been very busy even in those softer years, but I do believe that we have extra capacity and appetite to write more quite a bit more if it happens. How much will depend and be dictated by overall rate level in 2020.

Q - Yaron Kinar {BIO 17146197 <GO>}

It sounds like that premium growth could accelerate in the right market conditions.

A - Francois Morin {BIO 17410715 <GO>}

That is the a fair statement.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. And do you have any sense where your booking to current is the new business coming on relative to the overall portfolio and insurance like what the adequacy of returns there is?

A - Francois Morin {BIO 17410715 <GO>}

Yes. So, we haven't changed much of a loss picks and I want to put things in perspective as well is that the rate changes that have taken place that we're talking about really started to be we believe enough above the lost cost trend since the middle of 2019. So it's a bit early and premature to make any changes to your booking your loss ratio, you look at it on an accident year basis, plus, things could develop on historic -- history all the accident years prior to 2019. So it's premature to make any comment onto loss pick as we speak. Frankly, loss pick if they are to improve and we believe everything else being equal. They should improve over the next couple of years. They'll take know six to seven quarters to really see the good traction and see some movement there.

Q - Yaron Kinar {BIO 17146197 <GO>}

Understood. Thank you. And best of luck on the year ahead.

A - Francois Morin {BIO 17410715 <GO>}

Thanks, Yaron.

Operator

Thank you. And our next question comes from Jimmy Bhullar from JP Morgan. Your line is open.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Hi. Good morning. First, I just had a question on the tax rate. It improved a lot '18 to '19. And I think it was lower than what you'd expect it as well. What's driven that is it the geographic makeup of income? Or and what's your expectation or sort of likely range for 2020.

A - Francois Morin {BIO 17410715 <GO>}

Well, yes couple of points here. I think the -- it was a bit lower than what we had given us a range earlier in 2019. There is a couple of discrete items that played out throughout the year, which helped out in terms of publishing the final tax rate. So when I just I took some notes I look back and without these adjustments which is really how we think about when we give you a range the 2018 tax rate was 11.2, this year was 10.9, so very close. Ultimately we had some additional benefits that brought it down to 10.4 for the year. So yes, as you know, as tax rate is very much a -- it's hard to have a lot of precision on the tax rate because we just don't know where the losses are going to be before they happen. So whether there's a cat or favorable or unfavorable development on prior years et cetera.

So looking at 2020, I'd say we're very comfortable saying that we're going to probably be in the same range, maybe if you want to expand it may be try to make sure we're in the range of maybe 10 to 14, like years past we seen a last we said 11% to 14, so maybe there's potentially it could be a bit lower. But I think it's a bit early again. We're in the early days of 2020 and hopefully that's enough for you to update the models.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Okay. And then on the MI business, obviously, your overall margins have been very strong and same goes for peers as well. And a lot of that the strong results on the legacy block. But if you look at new business our ROEs are those in the sort of double-digit range or is it more sort of single digit ROE type business in terms of new sales. And it -- I realized it will take a while for your overall business to shift towards new business ROE.

A - Francois Morin {BIO 17410715 <GO>}

I almost choked up now, we're solidly well in the double-digit return still in the market it's still very good quality. I would even argue the risk of the later last half of the year, actually improved somewhat for the industry not only for us. And I think that have to do with Fannie and Freddie sort of putting a bit more constraints on that the risk layering in the business. So no still very, very healthy returns, very healthy.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

And then just lastly on any comments on one-one renewals and specifically were they better or worse than your expectations? And anything -- any sort of views on the sort of upcoming 4/1 renewals in mid years?

A - Francois Morin {BIO 17410715 <GO>}

The 1/1 renewals were in continuation might we had some rate increase in third quarter broadly in the industry, fourth quarter was a bit better. The first quarter lined up to be yet better yet. So yes, better rate environment at one-one clearly for the first quarter. We don't know what it means for 4/1. I am done prognosticating what the future will hold. It's the law of supply and demand of and perception of relative risk is a market-based thing. So sometimes I think market should go up, and it doesn't, and sometimes it goes down and it's all over the place, so it's too early to tell where 4/1 and 7/1 will end up but clearly the momentum at 1/1 continues, it's going to be -- it's an improving market, clearly.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Elyse Greenspan from Wells Fargo. Your line is open.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi. Thanks. Good morning.

A - Francois Morin {BIO 17410715 <GO>}

Hello.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, my first question is I guess on 1:1 a little bit, -- we've heard about the retrocessional market being pretty strong this year. Was -- has Arch written on more of that business. And just how did you observe what went on in the retro market at 1:1 and is that a sign of potentially better things to come or would you think it would be for some of the 4/1 and 6/1 renewals.

A - Marc Grandisson {BIO 4369887 <GO>}

Yes. I mean certainly, on the I mean you see that a little bit in our cap PML, they went up in some large portion because of additional retro business that we wrote that I would say was very much opportunistic. So whether that sticks, and whether that means tells us something about 4/1 or 6/1, we just don't know. But for sure, we saw some definite, some good opportunities in the specifically in the retro space at 1:1 that we were happy to have the capital to be able to deploy, and take advantage of the opportunities.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. And then with the insurance book, I know you guys in the past have talking about that expense ratio being elevated just due to the accounting and the earn-in from some of the more recent deals you guys have done. I'm assuming that there was still somewhat of an impact on that in the fourth quarter. And can you just kind of give us a sense to think about if you have Barbican coming on, how we should think about the expense ratio within the insurance book in 2020?

A - Francois Morin {BIO 17410715 <GO>}

Yes. So as I said in my remarks, I think the expense ratio was roughly call it 130 bps or so was in this quarter was the result of the effectively bringing on online the UK regional book. So we're now a year into it. So everything else being equal 2020, we should see the premium being earned out and the expense ratio coming down. The new twist is Barbican and as you know the Lloyd's market in particular has a slightly higher elevated expense ratio, which we think is there's an offsetting benefits on the loss ratio. But I mean, to give you a bit of directionally a bit where we think the 2020 expense ratio is going to be for insurance, we think it should be right around where it was for 2019. Yes, it's not going to improve materially. I don't think it's going to get worse because we're going to see some benefits but I think it should be about at the same level.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. That's helpful. And then lastly on the insurance pricing. Marc, you seem to be pretty positive especially relative to where -- your comments have been for most of 2019 and it's a developing market and I guess every market seems to be different and no capital obviously, a lot more robust than if we want back to past upturns, is there any market like if you think back through Arch's history? Does this -- compared to the early 2000s, does this compare to kind of 2013, is there a market that this feel similar to when we can kind of think about pricing improvement or does it feel because of the social inflation issue maybe different than any of these past markets?

A - Francois Morin {BIO 17410715 <GO>}

Well, it's different in terms of the health of the industry and the combined ratios as I mentioned that's for sure, so that makes it a very unique opportunity. But I do believe, we have major players pulling capacity out. So even though it's printed capacity, effectively used capacity is definitely lower when the overall market specifically in the large risk, some of the players that we've talked about them, Lloyd's being clearly one of them. I think I would tend to think it looks -- it feels a bit more as 2005 after Katrina, Rita and Wilma because capital was still plenty, people paid their claims.

A couple of companies had some issues but by and large the pricing went up and it was larger as a result of perceived risk. And I think this is what's going on, I think people as an industry this uncertainty about around social inflation is creating a lot of uneasiness and pushes us to want to charge more to make sure we cover as much of the eventuality as we can. So that's sort of what I would say the perceived -- the heightened risk perceived is higher, it's not a bankruptcy driven, reinsurance driven necessarily market turn. So it's a blend of a few of those. It's hard. Every market -- I guess you live and learn and experience new things as you go, but yes, that's what I would summarize it to be.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you so much. I appreciate the color.

A - Francois Morin {BIO 17410715 <GO>}

Thanks, Elyse.

Operator

Thank you. And our next question comes from Mike Zaremski from Credit Suisse. Your line is open.

Q - Michael Zaremski {BIO 20606248 <GO>}

Hey, good morning. First question on US MI. One of your competitors this morning spoke to decline and expected decline in premium yields in 2020. Any color there whether you expect some more dynamic given -- pricing on new business might be a little tighter versus using risk-based pricing.

A - Francois Morin {BIO 17410715 <GO>}

I think that we the phenomenon that's going on as a result of refinancing clearly, points you to a lower price, a lower premium rate and that's because the risk is lessened, right? A lot of the refinancing we saw in last two quarters and accelerated in the third in the fourth quarter is people sort of refinancing because the interest rates are just that much better, and it's a makes sense for them to refinance. By doing so the LTV that was originally put on our book of business two, three years ago is actually lower, which is lowering the risk and everything else being equal. It also has a knock-on effect on the DTI, on the debt to service to income servicing, it improves them as well.

So that risk that you, as the same people, same house, same environment, but in this hope there was also some house price appreciation. So you get all these things going on, this is a not as risky a proposition now as it was two or three years ago. So we lend itself to say that the pricing should be now indicator lower pricing because of all these various moving parts but it doesn't mean that returns has changed and that's really the key that we want to share with you guys is, top-line and MI is really, really hard to pin down, they are singles, it's cancellations and it's very hard to see how it all evolved, but in the end what we care about and what we've seen is that the return characteristics of the things that were refinance which one could say is underlying is somewhat decrease in price -- in premium rate is actually the top-line, phenomenon. It's not a return phenomenon, the returns are still very healthy and that's what we're actually focusing on.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay. That's helpful. Next, I'm just kind of broad question about the reinsurance segments. If I kind of look at the combined ratio of the last couple of years. It's been in the mid-90s, I think that translates into a single digit ROE, but you can please correct me if that's not right. And I guess catastrophe levels don't appear to have been maturely higher than expected either. So just kind of thinking about the future is that largely reflective of just simply that competitive operating environment, and I guess hopefully there's continued momentum in 2022 to improve the ROE profile of the segment.

A - Francois Morin {BIO 17410715 <GO>}

So, first you're wrong, It's not in a single digit. So let's make sure we're clear here.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay.

A - Francois Morin {BIO 17410715 <GO>}

Yes, I think it's much better than this. I think that the re -- our reinsurance portfolio is not a different one and then there's been mix shift over the last two or three years. We were a lot more, we are a lot more property cap of probably 10 to 12 years ago. So there's always moving parts in the reinsurance platform and I would say that our play for instance in motor in Europe will generally -- will by definition lead us to a higher combined ratio but the returns are still pretty very well in excess or well in the range of where we would want them to be -- to write that business. So I think the combined ratio in reinsurance is just a reflection of this constant calling, pulling, pushing through realigning capital within the various lines of business. And I think what you're seeing is a combined ratio that is just reflective of what we see in terms of opportunities in terms of returns, and I can tell you for certain that our reinsurance group has a very ambitious return on equity expectation when we write the business and that's what every underwriting decision is based on not on combined ratio.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay got it. So I was wrong that there's your portfolio that holds probably less capital than I was assuming that are versus some peers. Thank you.

A - Francois Morin {BIO 17410715 <GO>}

The one thing I would like to add Mike, just quickly on the returns I mean and that really is all about our cycle management where our premium volumes went down quite a lot over the last number of years on the reinsurance segment. If the market gets healthier which it's showing some signs of that. I think I don't think our returns will necessarily get that much better, but I think we'll be able to have a bit more growth on the top-line expand the platform and see more opportunities.

Q - Michael Zaremski {BIO 20606248 <GO>}

Thank you.

Operator

Thank you. And our next question comes from Brian Meredith from UBS. Your line is open.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes. Thanks. Couple questions here. First just on the insurance segment. You talked about how Barbican is going to impact your expense ratio. Will it have any impact underlying loss ratio? And I guess just to add on to that. Is it going to prevent you from maybe achieving an underlying combined ratio below a hundred in that insurance area in 2020.

A - Marc Grandisson {BIO 4369887 <GO>}

Well, Barbican is in the big picture doesn't really move the needle. It brings a lot of nice traits with it. It has some fee businesses that we like it has also gives us that, makes us more relevant than London. But the one thing that you should be aware of is a lot of the capacity that Barbican is deploying is actually third-party capital. So that doesn't stick to our ribs in terms of the combined ratio. Yes, we'll have some benefits on the fees and et cetera. But big picture, Barbican on a net basis wrote about $125 million a premium last year in 2019, split roughly 50/50 between insurance and reinsurance whether that business, we're certainly going to shut down some lines. We're going to do some re underwriting along the way.

So once you do a bit of math on it, you'll quickly hopefully appreciate that. For the insurance segment on its own. I mean Barbican is not going to be a big factor and how 2020 plays out. In arms of the combined ratio, so on that note that the Francois point realistically Brian, we need to focus on as we are right now growing and seizing the opportunities that are presented into our insurance segment. And if anything that will bring us to the combined ratio that will lead us to 12-ish returns on equity, I think it's going to come through the current opportunities that we see and our ability to seize upon it which is plenty.

Q - Brian Meredith {BIO 3108204 <GO>}

So, I guess what you're saying is that it could be the underlying combined ratio kind of dropping below 100, and getting to those to return. We not, may not see it here in 2020, but it's 2021 or whatever is the opportunities continue to come in.

A - Marc Grandisson {BIO 4369887 <GO>}

That's right. If you look, Brian, the rates really moved, starting middle of last year and a lot of stuff is being renewed still on the -- in the new "rate environment". So we have to write the business first, you have to earn it. So 2020 and '21 exactly what you're exactly where we are. Yes that's why it takes a while to see the good deeds being reflected, the same way it takes a long time for bad deeds to get reflective of may I add.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. And then under the reinsurance, Marc, I'm just curious, I know a lot of the businesses you write is quota share type business. How much of your reinsurance business is called exposed to areas where you're seeing a significant amount of price increase BDNS, certain property lines? And then you might see a good benefit from the subject premium pricing coming through.

A - Marc Grandisson {BIO 4369887 <GO>}

I think, the beautiful thing about our friends at the reinsurance group is that they are a go anywhere kind a company they can do anything, go anywhere, do anything. So in general, they have access and are able to see the deals that are ENS casualty property whatever so they we have a -- we've been around for 18 years, we've written a lot of reinsurance, we still 1.5 billion plus we're not a small where smaller in the grand scheme of things but we still have a lot of selling points in London and Zurich in the U.S. and Bermuda, so no we're able to grow if the growth opportunities are there. There's no issue there whatsoever.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. But what about your subject premium basis already on the books. Are you seeing kind of growth there?

A - Marc Grandisson {BIO 4369887 <GO>}

I think that by virtue of the improvement you need for 2020. We don't give guidance obviously as you know, nice by -- nice try. If rates keep on increasing and keep at the level they are, as there is healthy no positive rate. And if it keeps into 2021, we will have a more premium clearly. I'm not sure that's what you're asking. I'm trying not to answer the right question. So I'm trying to get the right picture by, so help me out.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay. Yes. Well, I think I've used to -- what I'm trying to get at is that, I get the premium growth situation, right? And then it's more to the underlying obviously business is actually seeing improved price too, right? Just like you're seeing in your own business, and just would impact that could potentially have on your reinsurance margins.

A - Marc Grandisson {BIO 4369887 <GO>}

Oh, yes, of course, yes. You're right. We're seeing it through the quota share. And your right in the newer phenomenon. It's anecdotal, it seems to be starting even the excess of loss pricing now is picking up and in speed, so that's also encouraging. So we may have some -- to your point. You're right. We're not a huge excess of loss at least in the traditional general liability lines and professional lines, you're right. Yes. We're benefiting from our quarter share participants and companies. Yes, we are.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you, Brian.

Operator

Thank you. And our next question comes from Meyer Shields from KBW. Your line is open.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. There is a couple of small questions to start off with. First, are there any plans to change the amount of mortgage insurance that's retained on U.S. paper versus seated to Bermuda in 2020 versus 2019?

A - Marc Grandisson {BIO 4369887 <GO>}

No plans at this point. I mean as you know, what all about we try to have as much capital as we can in offshore just because it's a better domicile gives us more flexibility. But at this point and as you know there's tax implications, we don't want to trip the BTAX issue. So at this point no plans to change anything.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, perfect. Second. I know in the past you talked about capital deployment opportunities that ended up as Barbican and in the U.K. And as long as you give us a sense as to, what you're seeing now in the pipeline in terms of other potential opportunities?

A - Marc Grandisson {BIO 4369887 <GO>}

I think we're -- we're seeing a bit less. So I think people are busy more looking at their stuff and trying to improve their book of business. I think that's really and more of an inward focus. I think, M&A we have -- we see all of them or we believe we see most of a transaction that are been talked about. I think, we were a bit more open and we're able to strike some transactions over the last year, because the pricing was right and the opportunities were there. but yes, now we don't see acceleration or somewhat of a decreased activity, but I think just serves as a result of the this current marketplace being a bit more dislocated that's really what I would say.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. And then that brings me to third question. I'm wondering whether -- you talked about how combined ratios are still being reported as profitable, but there's also the soft market impact, which at least I would interpret are suggesting that maybe the real command ratios aren't as good. Does that delta look any different now than it did before past hard or hardening market?

A - Marc Grandisson {BIO 4369887 <GO>}

That's a really good question Meyer. I don't know the answer, just haven't looked at the numbers at the end of 99-2000. It doesn't seem -- I'll tell you my gut feeling right now. It doesn't feel to be as much of a delta, and also in terms of what impact it could have on a capital market if we were more levered as an industry 99, 2000. We were writing a 1.3 to 1.4 premium to surplus now, we're 0.7 to 0.65, 0.8 whatever. So, lot less lever. So probably more absorbable, but at the same time there's less investment income. So if you look at, if you think that the market changes as a result of being that cash flow negative or having to not having recurring income. Then, I think that it's -- we're probably in a similar position meaning that the loss -- the losses or if you combine the underwriting income with the negative at the end of 99 with the investment income which was very positive. I think we're probably a combination in a similar place, but we have higher capital. So, more cushion to absorb it.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's very helpful. Thank you so much.

A - Marc Grandisson {BIO 4369887 <GO>}

Okay. Good. Thanks Meyer.

Operator

Thank you. Our next question comes from Ryan Tunis from Autonomous Research. Your line is open. your line is open.

Q - Ryan Tunis {BIO 16502263 <GO>}

Hey, thanks. I just had a couple. I guess first one, thinking about 2020 is a potential year, given what's happening from a pricing standpoint from margin improvement for the industry. I understand why that could be a challenging? Where it could be challenging for some? But I think when I look at Arch relative to competitors, there's more of a short tail mix whether it's in primary insurance also facultative re. So, I guess Marc if you could just comment on why isn't there a more constructive near-term outlook for margin improvement, giving you're clearly getting rates? And in some cases rate on rate and some of these property lines where there does seem to be kind of a lay up argument for margin expansion?

A - Marc Grandisson {BIO 4369887 <GO>}

So let me correct you quickly Ryan on the insurance side, we are 70%, 75% liability has a premium written. So that would sort of dampen, if you will the acceleration or the recognition of the improvement in terms and conditions. So make this a bit more cautious. So that's something you need to bear in mind. This is on the insurance segment. And again, on the on the insurance segment even speaking to the short tail. It still does take a while to get through again like I said significant improvement in rates; we took place starting middle of middle-ish of 2019. So it does still take a while to recognize and know and really see the earning coming through, the earned premium is a combination of -- as you know for other underwriting years.

On the reinsurance side. I'm trying to think of it. I think it's also -- there's a fair amount of liability as well in there, right? First one is also a fair amount of property, although property as you -- as we mentioned is also deleverage on the property cap, we did increase the other property. We're running a lot more on the non-cat XL, this is more opportunistic and that you're right. We should probably see whether we were, what margin expansion there was and we believe it's there. We should see it. But again, it was written, last third-fourth quarter. So we'll come again over the next 12 months. So it takes a while, it takes a while. You have to be patient. Patience is a virtue in our industry.

Q - Ryan Tunis {BIO 16502263 <GO>}

Understood. And then my second one is just around. I think we -- it seems like we've heard less from the reinsure's about the casualty environment and losses coming in. Here, maybe you could just talk about the extent to which your -- what do you see on the reinsurance book in terms of claims activity on the casualty side versus primary like is there a real lag? Have the claim started to happen or is that probably still in the commonly [ph] ? Any theory as to when and how we might see more paid losses, I guess on the reinsurance side.

A - Marc Grandisson {BIO 4369887 <GO>}

It's a very good question. I think, when we do have a tail of two cities here, I think that our insurance are seeing the claims. Of course we have the advantage or the luxuries to have an insurance company that's on top of claims and know and participate in the marketplace, when we look at what information our reinsurance folks are getting, there is clearly a lag. I'm not saying it's misinformed or what not but there was clearly a lag and it's been there forever. This is not a new phenomenon Ryan. This has been going on for years or for as long as we've been -- as I've been in the business. It's been there and it was there before my time. So there's always information asymmetry and a information delay.

By the time it gets to the insurance company, they have to look at this evaluate, book the reserve or not book the reserve and then in turn inform their reinsurance partners. On the quarter share, little bit easier because you're able to do more claims review and be on top and a be side by side with them. You can also compare whether we have other of our clients and similar risks and what not. On excess of loss, as you could expect. It's a little bit more difficult there's further lag on that one as well. So we clearly have a lag in recognition in our reinsurance company has been really, really adamant and proactive and try to recognize some of the losses that may not be enough reported. And that's also what made us bit more careful in our current writings or lack thereof in the liability space, but it's clearly a lag on the reinsurance side.

Q - Ryan Tunis {BIO 16502263 <GO>}

That's helpful. Thanks.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks, Ryan.

Operator

Thank you. And I am showing no further questions from our phone lines. I'd now like to turn the conference back over to Marc Grandisson for any closing remarks.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you, everyone. Happy Valentine's Day. Make it a Happy Valentine's weekend, if you have a chance. Talk to you next quarter.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a wonderful day.