Wells Fargo - Reinsurance Discussion

Company Participants

- Donald Watson, Executive Vice President, Financial Services
- Maamoun Rajeh, Chairman & Chief Executive Officer, Arch Worldwide Reinsurance Group

Other Participants

- Chad Stogel, Analyst
- Elyse Greenspan, Analyst
- Heather Takahashi, Analyst
- Steven Gavios, Analyst

Presentation

Elyse Greenspan {BIO 17263315 <GO>}

It's our pleasure today to have with us Arch Capital. We have Maamoun Rajeh, the Chairman and CEO of Arch's Reinsurance business; and we also have Don Watson, EVP, Financial Services and also Head of Investor Relations. I'm pretty sure most of you are familiar with them, but just to kind of get the high level introductions out of the way. This is being structured as a webinar, so you'll be able to see us visibly throughout the hour. You will, however, have the opportunity to ask your own question. You have a few different methods. First of all, you can use the raise the hand function at the bottom of your screen. You can also send in Q&A via the webinar function or you can email me directly, elyse.greenspan@wellsfargo.com. Just want to make sure that everyone gets a chance to have their questions answered.

I will kick things off with the first question. Probably most topical right now in the mood is just the upcoming January 1 reinsurance season. So could you just level set things for us? What are you thinking right now from a pricing perspective? And if we can get the view on both the reinsurance and as well as the retro side of the business? And how you think things might shake out from a pricing perspective?

Maamoun Rajeh {BIO 16155071 <GO>}

Sure. Thanks, Elyse, and thanks for having me. It's great to speak as always. Good afternoon, everyone.

In terms of 1/1, Elyse, this is for us as underwriters going to be the most interesting renewal season we've had in many, many years. We think about kind of the components that are driving this that get to the price changes. We have a level one certainty that's heightened. We have supply that's influx. And frankly, we have demand that's increasing.

I mean the interesting thing about our business as you know is when rates go up, even when units of exposure stay constant, rating agencies require more capital. And for reinsurers that's a great combination, when our capital is needed at the height or in an inflecting rate environment. So an interesting time to be solving problems and being -- having an underwriter ahead on.

But specifically to your question, if we think about property and retro, I think, first of all, it's important to keep in mind that property rates have been moving. They're coming into mid year '19. Our expectations is to rate movements around the -- mainly the Florida renewal was maybe plus 10 and the market ended up or at least our portfolio ended up closer to plus 20. And so that momentum, I think is going to carry through to 1/1, not in the same level, but I do believe 1/1/2020 will continue that rate move -- the rate rises that we've experienced beginning at 1/1/20.

Now let's keep in mind in 1st of January, the portfolio and the deals that we get to renew are global, right. And so we -- you get a smearing, you don't get just peak zone capacity and you don't get just loss impacted accounts, you get really a mix of a global U.S. and international book of business. But I do expect cap rates will continue to rise, probably in the U.S. low double digits, high single digits depending on the zone and the dynamics of the deal.

In retro will be orders of magnitude higher than that. I mean I think seeing what is already being discussed and some of the transactions that are on the desk, our handicapping of it is kind of where we expect it to be. I mean, we think about retro at Arch. We're not a large retro player. It's not the biggest thing that we do, but it is peaking our attention and has been for the last couple of years as the market is inflected. But we do expect to see something closer to twice the traditional reinsurance pricing, something in the order of 25 in our book getting up to 30 or north of 30 would be the area that would make retro a bit more interesting for us at Arch.

Elyse Greenspan {BIO 17263315 <GO>}

That's helpful. And then also at January 1, right, there is a good portion of European business that renews. And so I know right in past years, we've -- you know kind of when we get the holistic number renewals kind of seem more muted, right, because Europe hasn't moved. Do you think that European rates can move coming off of not just frequency of Cats, right, but also the COVID losses? Is there an environment where we think we can get some price in Europe, so the overall plan is something in good level positive direction?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. I mean you touched on a good point there, Elyse, in terms of COVID. COVID is manifesting a lot more in the Cat world outside of the U.S. than in the U.S.. That's a variable that's coming into play in Europe particularly, and they always seem to get the memo a little late over there. The market share dynamics are a little different with the top five reinsurers really commanding a whole lot of market share and not wanting to yield much. But I do expect, I mean, I think as our portfolio, if I think about 1/1/20, our international portfolio without any of these dynamics at play, we're up maybe, you know, let's call it flat to 3%. I do expect that it will increase. It probably won't increase to the same extent as the U.S. Demand plays a factor here, and the demand has been pretty static in Europe for a while. But we do expect that Europe will start to move, and for what it's worth, Elyse, at Arch we've been underweight Europe for the better part of the last decade. And frankly, we've been wrong. I mean the events just haven't been there. But in the long-term, I think will be a long-term, right. It's just not an area that the margins that you deploy capacity in Europe is just not where it should be.

Elyse Greenspan {BIO 17263315 <GO>}

And then thinking about alternative capital, right, we've heard about a good amount of trapped capital, primarily some from hurricane losses, and then some also from COVID. How are you thinking about the trapped capital? And is that factored in when you talk about retro rates being up 25% to 30%? Is that the catalyst that you see there?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah, I think, it's one-off. I mean, if we think about retro and the retro that's coming out of ILS capacity, I mean, it's been influx now for a while, right. Coming into 2020, it started to -- the first year, I think that we saw some stabilization of the growth and coming into 2021, I mean, anyone who has collateral at play by -- will by and large trap that collateral. That would be the wise and responsible thing to do. And frankly there is nothing sacrosanct about it. I mean that's just the way the product works. That's what makes that product relevant compared to a rated entity piece of paper.

And so I think the fact that a good chunk of the worldwide retro markets, particularly the aggregate products provided by these ILS shots, the fact that there is going to be trapped capacity, and frankly reloading with conditionality, I think capital providers and ILS managers together, they've gotten wiser. And claims have a way of teaching everyone a few things, right. And frankly, for the system -- for the entire system, it's better. It's healthier to have a wiser group of capital coming in through the ILS side of things.

So a demand for property cat, particularly in light of questions about views of risks and uncertainty around weather, all of that's coming together to just suggest that the ILS community won't be as -- at least won't be as prominent as they have been coming into 1/1. And the point that I always think about with ILS capital is that a lot of it's visible and a lot of it competes with us and it's the thing that everybody kind of keep stable. But where it really is effective when it's influx is where it sits behind traditional players. And we all know, over the years, there has been a lot of traditional players who've relied heavily on ILS capacity. And that's going to change their behavior in the market as well with that retro capacity going back.

Elyse Greenspan {BIO 17263315 <GO>}

That's helpful. And then as we think about the market on an overall basis, I think last year we were hearing about this U-shaped market, right, primary going up as well as retro and kind of reinsurance the bottom of the U. So as you kind of put these comments together is, do you think 2021 is -- and I know you're speaking more from the reinsurance side, but is 2021 still going to be a U-shaped market, where the U is higher? Or do you envision kind of that reinsurance working its way up, so the market doesn't really feel like a U-shaped when we think about next year?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. Yeah. Again I start from the premise that primary rates coming into the system is a healthy start. Our healthy clients, more demand for reinsurers is kind of just cascades that way in our favor.

Now I speak from an Arch Capital perspective, the fact that our primary operation is getting the rate rises that we're seeing there will deploy capital however it comes, wherever it's optimal. And from the reinsurance perspective, I do agree, right now, the 1/1 pulse that I sense in the reinsurance community is generally speaking for anything that's pro rata, the community is going to contend to take on the primary rate changes and not yield shares off programs. The rest of the -- and so I think that will be somewhat orderly coming through and net-net reinsurers are in a better place coming into 2021 than before.

Ceding commissions are and have had a trend of giving in favor of reinsurers a little bit, not wholesale. I mean, if we think about it, ceding commissions are that great variable between prior hard markets and this hard market. It's probably in the order of magnitude of about 5 percentage points that are not in our camp that traditionally have been, high 20s versus low 30s. But the rest of the market should, Elyse, I'd say the word should on the reinsurance side, improve and inflect, but we can't control that, right. We'll see how that comes through. I think, by and large, particularly if you think about cat and what's coming through cat, the community is probably graduating from low double-digit return on equity type numbers to maybe mid double-digit ROE numbers, which I believe are healthy.

And then on the retro side, if you're retro dependent, and you know you look at a lot of the Lloyd's capacity, if capital is a constraint, which is becoming increasingly so that is a bit of a squeeze of having to buy retro. But shops such as ours who can pick and choose, and frankly in the past we've been net buyers of retro. Today, we're probably going to be net sellers of retro. And so there is an opportunity for us to actually partake in the various segments here at the spectrum where prices are inflecting.

Elyse Greenspan {BIO 17263315 <GO>}

And then what about maybe the last part of kind of the January 1 dynamics? What about demand? Do you sense that insurers are potentially going to change their programs from raising their deductibles or perhaps lowering their deductibles? Do you think that there is going to be changes to programs that could potentially lead to more or less business coming to the reinsurance market?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah, I think, broadly speaking, Elyse, the sense I get from major clients is less change at 1/1. We don't want to change too much in our program, we don't want to change too much in our panel, which is exceptionally relevant to any newco starts and I'm sure might -- someone will have some question on that as well. But its consistency of panel, consistency of program seems to be the emerging theme.

Having said that, I think tolerance for volatility with our clients has gone down. So that bodes well for demand. And here, it's sort of holistic solution products around whole accounts and structured solutions. We're having some conversations generally, and I'm sure others are around this one. Now, it's early, it's funny, it's -- this will be a late renewal season. There are a lot of discussions, we're having a lot more discussions at this time last year in the last handful of years, but in terms of locking in deals and anyone sort of double lining pricing, we're still a ways off, and I think it's just going to be a late, late renewal season.

Elyse Greenspan {BIO 17263315 <GO>}

Okay. And then if we think beyond on January 1 rates, you kind of set the stage for thinking that we could see healthy rates in the U.S. and even perhaps some increases in Europe on the reinsurance side. As we think about the progression during the year, next year or so, 4/1 [ph], the Japanese renewals, and then 6 and 7/1 [ph] in Florida. Do you envision this as a market where we'll continue to see hardening during the year? And then even take us just as things sits today take us to 1/1/2022, like do you envision this being a market that has legs, where we could think about more than one year worth of firming?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah, sure. I mean, Japan, first of all in April is an easy one, because that's going to be an interesting one, because frankly there's a lot of you view -- views of risk in Japan are changing. And that will be an interesting renewal and a good one, I think for reinsurers.

But I think when you just step back and think about it, right, this market has been on the move for a number of quarters. And in fact, if we think about Q3, Q3 would mark sort of the third annual compounding of rate rises. And not just that, but it's at an increasing pace. And so just rough orders of magnitude, I think if we looked at the rate rises that we saw in Q3 '19 relative to '18, there were sort of two times that increase. And if we looked at the Q3 '20 versus '19, it was almost two times the increases, and that varies very widely depending on E&S and standard markets. But -- so the momentum coming in is really accelerating. That's one.

And I do think this notion that everybody is sort of -- sentiment matters and everybody is sort of converged on this notion that first of all, it's broad based rate rises, and the idea that they will continue for some time is baked in, I think. Now a lot of things can change in a year looking at 1/1/22, but I am optimistic that this market does have legs, primarily on the insurance side, on the policyholder level, which always invariably will be good for reinsurance.

And don't forget, a lot of what we do is pro rata business, right. We sit side by side with an insurer providing our capacity next in them on a select insurance. And as we build that business and as you have seen us on the reinsurance side in Arch, over the last couple of years, I mean we have grown and I'm pleased when I see that, we're never a top line shop a you know and we don't even have forecasts on telling our people what to do and what to expect. But, as I see that business piling in, that's a good quality business, and that has some time to earn through, and it's doing it at the right time in my opinion.

Elyse Greenspan {BIO 17263315 <GO>}

If you had to compare this market, and I know every market is different, it does bear us some similarities to post 2001 and also 2005. Would you pick one over the other or is it just -- there is just so many different variables today?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. I think you characterized it. I think it's got elements of both, right. If you think about COVID, COVID has that 9/11 sense to it in terms of the number of products that have been impacted. The difference is COVID geographically has been global, and isn't just limited to the U.S. Now ultimately, we'll find out how it all shakes out, and frankly, I feel a little bit better about COVID in terms of an industry loss today than I did six months ago. But nonetheless, that has a 9/11 feel to it, but the cat events and the frequency of cat events, and the expansion of just outside of the U.S. really has the 2005 feel to it. The key difference for me from 2001 is you haven't really had that exploding capacity. You haven't had destruction of capital per se. And we've got a lot of M&A activity that's been sort of the great sweeper of some of these field project, but haven't had that spectacular busts that we saw in 2001. And the existing community is healthier. It's there. The existing companies are probably best positioned to trade through this -- this cycle, this time around. So, a long way of saying, it's got a little bit of both, but it is unique in its own sense as well.

Elyse Greenspan {BIO 17263315 <GO>}

Great. And then a question that came in from an investor. I think we touched part on this earlier, but they just wanted to know if there were any change -- any major changes to terms and conditions for 1/1 or just 2021 in general. I know we kind of touched on the demand side of things. And then they also wanted to know how is Arch treating COVID claims in 2020 on XOL treaties with respect to (inaudible)?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. I'll hit the second first. Look our portfolio and the excess loss, particularly property portfolio, is constructed deliberately in a way to reduce or minimize uncertainty. We will never be perfect, but we spent a lot of time deploying capital in programs that model better than the average program. This means we stay away from tech lines in terms of property cat, seems we stay away from large commercial. And so that bodes well both for the predictability if I can say the credibility of the modeling, but it also bodes well for anything like COVID.

And so in the U.S., a large proportion of what we do on the cat is personal lines. And so we're not taking a blanket view of saying to our team go out and exclude communicable diseases on everything that you write. That's just not what we do and that's not constructive to clients. But we do think about it, and certainly our attention to it has been heightened. So we will underwrite the deals as we always have and we will make the changes that are appropriate to those.

Elyse Greenspan {BIO 17263315 <GO>}

Okay, that's helpful. And then in the past, you guys have spoken about return on allocated capital, right, to your P&C business.And you I think a few minutes ago made the point that you thought reinsurance, correct me if I'm wrong, is growing from a low double-digit ROE to a mid double-digit ROE. I'm not sure, I think that might have been just industry comment versus an Arch specific comment, but do you have a sense of -- correct me if I'm wrong on that, I mean do you have a sense of the return profile for reinsurance business that you would expect today if the pricing dynamics play out the way that you're expecting?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. I mean, do I have a sense? I have a very precise knowledge of it for sure. I mean I think as a general statement, you know first of all you know us well enough I think to know. We deploy capital across segments, even within the Reinsurance Group, and even when we talk about specialty lines within those specialty lines and within each line we go down to the sub-segment.

I mean I was thinking we are just having a discussion around our agri book, for example, is one of our specialty lines. Our agricultural book is unrecognizable today versus where it sat just thee years ago in the deployment of it. So there's a lot that goes into it. I don't want to dramatize it more than it is, but we do spend a lot of time down to a segment level of how -- where we kind of lean into and where we put exposures out there.

And so, yeah, I mean, I think so having said that, I think generally speaking, if this momentum that we see kind of continues for those that were in the low double-digit ROE area should end up in the mid double-digits. And then this interest rate environment, that's a phenomenal place to be I think. And frankly we haven't talked much about it right. The interest rates are a big driver of what's going on here, and on the sustainability of it and the need for it to continue, because it is exceptionally hard to make up for 150 basis point reduction in discount rate on long tail lines because you take a deal that's four-year durated, you just need -- you need 5, 6 points net of trend just to make up for that. And so that's another point that I think the market will slowly carve that back and ensure that underwriting margins kind of at least make up for that reduction that we are all experiencing in interest rates.

Elyse Greenspan {BIO 17263315 <GO>}

That's helpful. Before I go to the next question, just in FYI, I do see some other questions coming in, but if anyone on the line would like to ask their own question just use the raise your hand function and we will go around and make sure we will get the chance to ask their questions. But before we go to the Q&A, so you kind of hit on one of my next topics right. We spent so much time talking about what's going on with catastrophe rates that we haven't really hit on what's going on with the long tail lines. So on the casualty side, you make a valid point, right, with interest rates being so low, you're going to need to obviously push for our price on the longer tail lines as well. So can you just give us a sense of what you were seeing in casualty lines? And when you give us the pricing sense, can you give us the sense of which lines you view as much more attractive to Arch today from a growth perspective?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. I mean, once again, I think the story begins and ends on interest rates on anything long tail, we do -- I mean the market on the primary side is moving dramatically in the larger segment, in the large E&S sort of commercial space. And that's needed and that's required. And the fact -- as I mentioned the fact that we have those interest rates at the worst, the lowest they've been in, I don't know, forever 60 years, is a big impact on that segment of the market. And I think that's going to play out.

I mean, the bottom line for me is underwriters will have to make a decision. Do you lean into that market now with substandard returns and hope that you can write it out, or do you say to yourself, no, I'm going to hold out and wait another year until the tide carries it above mark. And everyone's grappling with that. All shops are going to have to make a decision around that element, because it's not -- it's fantastic on the insurance side, and it is becoming more interesting, at least in the last half dozen years, this is a chance to really make up for some of our absence of long tail lines.

And I should highlight that at least. I mean, the nice thing for us is we've been patient over the last five years. We haven't deployed overextended ourselves whether it's in property cat or in the reinsurance side on long tail. And the long tail segments that we did play in are very different than third-party GL or professional lines. And so it gives us a chance to kind of step into that a little bit going forward. And I don't think we'll go crazy, but we will do more as you would expect us to as the market improves, we'll do more.

Elyse Greenspan {BIO 17263315 <GO>}

Okay, great. I think there is a few questions that came in. But before I ask those on, we do have a question from Heather Takahashi with Thrivent. So Brian, if you want to just unmute her line?

Heather Takahashi {BIO 17304791 <GO>}

Hi, guys. Can you hear me?

Maamoun Rajeh {BIO 16155071 <GO>}

Hi, Heather.

Heather Takahashi {BIO 17304791 <GO>}

Hi. Thanks for doing the call. So, a question on property cat and model changes. So could you talk about how your models have changed for property cat since 2017? And what do you think the industry has done? For example, if you were to have given the return period on Irma back in 2017, and then you were asked the same question again in 2020, would that number have changed? And what's your view of what the industry has done if anything with respect to models and expectations?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. No, fair enough. And thanks for that Heather. And you know as well as I do right solving for one or two events sets, when you think about just the loss adjustment expenses, differences in Florida between one event and another could be 15 points on its own right. But the whole event set -- I mean look the nice thing about this business is, you have a baseline model and you do what you -- you get to overlay your view of risk onto that modeling. And every shop is going to do it differently and everyone's going to have a view by territory, by peril [ph], maybe just across the board.

And we've certainly -- we have our view. And our view certainly for us is that you can't ignore the frequency of the events that we've seen recently. Having said that, I recall 2004, 2005, as one of the things that we talked about earlier in the question is that in 2005 a lot of shops waived the white flag and said Florida is uninsurable. And for 10 years, you could have made a lot of money in Florida. And so it's -- you got to avoid being very, very specific about it, but we do -- Heather, the one thing you wouldn't be surprised to hear is it takes -- it's taken a lot more of our time talking about these topics and embedding it into our modeling. And for the first time, I'd say we actually have a meteorologist on staff. We haven't done that in the past. I think those insights are informative and helpful. We're never going to be that shop that builds an army of them and we're not going to be that reliant on modeling. But ultimately, you take a view and then the biggest lever that we have in terms of that is in times of uncertainty -- your ultimate lever is how much you deploy and in times of uncertainty you deploy less. And if you look at our capacity, I mean we've been sitting at the low-single digit percentage of our equity base in terms of -- globally at Arch in terms of P&L.

Donald Watson {BIO 19175196 <GO>}

Maybe one thing to add to that, Heather, just you get to it is a point that with this uncertainty that we have out there, you need more margin to cover the variability that you're having. And so, yeah, we've seen a lot of increased frequency this year. The last three, four years, if you think about it, we have -- there is increased uncertainty in terms of whether the models are moving and adapting quickly enough. And so you have to get more margin, and that's really a factor what's driving these rates.

Heather Takahashi {BIO 17304791 <GO>}

The other thing too I wonder about is the whole assignment of benefits issue. So I was talking to one of the Europeans last week and they were saying how excited they were about the price increases in Florida. And I asked what about that big, you know that slew -- although that huge amount of Hurricane Irma AOB claims that came in over the summer. What do you think about that? And the guys -- it's video conference call, so I could see the guy raises eyebrows like he had never heard this before. He was a strategy guy. He was the Head of Strategy. So you might be able to forgive him but still come on. So I'm wondering, are people factoring that stuff again in the industry, because I was surprised that he was surprised?

Donald Watson {BIO 19175196 <GO>}

Sounds like someone is going to be paying some surprised bills. What do you think?

Heather Takahashi {BIO 17304791 <GO>}

Yeah, I think so.

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. I mean Florida -- look Florida has always been laced with issues that one has to think about, right. It's -- the next big event when companies can't pay the reinstatement premium or have to take their claims out to a third -- and I'm being very -- I'm being provocative here intentionally, right. You have to outsource your claims payments and everyone's going to look back and say, well you know why don't you think about that. We do and you're limited by how much capacity you're willing to tolerate in any one zone and the clients that you -- everyone's got a view, right, every deal clears in Florida, everyone's got their best favorite clients. So we tried to have our own and we back test them and we audit them, et cetera, et cetera. And that's what you can do and then make the best bets that you can take.

Heather Takahashi {BIO 17304791 <GO>}

Got it. Thank you.

Elyse Greenspan {BIO 17263315 <GO>}

Now I will go back on, you know if anyone else would like to ask their own question, raise your hand or you can also use the Q&A function or send it into to me. I've got a good amount of questions sent in, so I'll just kind of go in the order that they were received. So one investor wants to know your views on the startups. Will they ruin the parade and put a dent in the hardening market?

Maamoun Rajeh {BIO 16155071 <GO>}

Broadly speaking, I mean I think it can, right. It can. But broadly speaking, I think the one interesting thing -- actually, first, taking a step back, right, let's look at the capital that's been raised. We think about the capital that's coming through by my count and Elyse and others will have a better one here. But we're north of $12 billion. And the vast majority of that capital has been raised for and by existing platforms. Yeah, some of that is newco and some of it is still sort of aspirational capital, and we saw the news on one of them, I think, yesterday and so on. So it suggests that maybe not everyone's going to clear through. But I think -- so that's one.

I mean, and two, I think the timing matters in setting up a de novo in this time and building a team and getting ready with licenses and platforms, I can make a lot of jokes around this, but I won't, but it takes time. And -- so you question the relevance or the impact that those new codes are going to have at 1/1.

And then broadly speaking, (inaudible) remember back, I was one of the early Archees here. I remember when we were five of us in the office at a time when we all knew each other and we all worked together, and still it was very challenging to get a company off the ground in a raging hard market. To assemble a team, disparate team in a COVID environment, putting your message out remotely and bringing a value proposition that doesn't exist with the likes of Arch and our peers, I think is more challenging this time around. I don't suggest that those companies that have a quality team won't be successful. But I'm sanguine about the impact in the short term.

And if I take the Arch Capital head off and I just put the reinsurer head on, and it present opportunities for us. Yeah, this newco is set up and by and large they would like to buy quota share capacity and they'd like to protect the unlucky events in the early days. And so, it works. It brings in business to the -- it brings in premium to the system.

But over time, yeah, it could have an impact. I also note that a lot of these companies that have started up have PE backing and we all know what PE's required returns are, and again, hopefully, that is a regulator as to how these companies deploy and how disciplined they're going to be. I think that's an important point to keep in mind. But net-net from what we're seeing in the market, what we're hearing from brokers, the dialog we have with our clients, and I'll say it, we already in dialog with our clients, right. It takes some time for others to do that. By and large clients want consistency and if the panel is there to trade, and a lot of the panel will be there to trade, it's going to be hard to break in from a reinsurer perspective.

Elyse Greenspan {BIO 17263315 <GO>}

Okay, great. We'll take a break from some of the sent in questions to go back to someone on the line, Steven Gavios at Jennison. Brian, if you could unmute his line please?

Steven Gavios {BIO 1490593 <GO>}

Thanks, Elyse, and thanks, Maamoun and Don for doing this for us. So two somewhat related questions. The easy one first. Maamoun, you had said earlier that you didn't think reinsurance programs and panels were going to change much. Do you think shares are going to change much within those panels?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. Well, do you know what, I'd like to think so, because I think by and large, whether it's a client, a broker or an ILS capital provider, there is a flight to quality. And I think there is going to be a reasonable chance that A plus rated quality organizations are going to have a chance to flex out in the programs at the expense of others.

Steven Gavios {BIO 1490593 <GO>}

Okay. And now my bigger question. So your boss seems to think that he is Phil Jackson and he is debating whether to pass the ball off to Jordan, Pippen or Kerr. So as you guys sit around the table, and of course you all know each other very well for a long time. How do you think about putting capital to work in the reinsurance business versus putting capital to work in the primary business, let alone the MI business?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. Well, yeah, being Michael Jordan I always want the ball, right. I always want to take the ball, I want to take the shot. And now look, do you know what, as you can see, I'm in the office, Marc is next door and Nicolas is over there, and we spend a lot of time in this organization collaborating and thinking about it. And we are just wired to put the capital where it makes sense to put it to work in. And there's a lot of insights and info flow, which again, when you think about it as an established organization with two global entities, insurance and reinsurance, is the advantage of getting decision making from these -- from those cross insights.

And so we are constantly going to deploy capital in the places that makes more sense. And we are also fortunate in our organization, our size and our prospects that we -- it's not an or discussion either. A lot of these discussions are and discussions that we can do here and here, and have some in reserve for if this story plays out, et cetera.

Steven Gavios {BIO 1490593 <GO>}

So, I guess, my question is a follow-up. As you think about your 2021 (Technical Difficulty) obviously there is a lot of uncertainties in that. Do you feel like you would have enough capital from daddy to write the business you want to write or is Nicolas is going to take it all from you?

Maamoun Rajeh {BIO 16155071 <GO>}

No, I have plenty of capital. Plenty of capital to write what we want to write and...

Donald Watson {BIO 19175196 <GO>}

Maamoun have sharp elbows by the way. So...

Steven Gavios {BIO 1490593 <GO>}

I sat next to him. I know.

Donald Watson {BIO 19175196 <GO>}

Yeah. Steven, let me just jump in on this. So a bid on it from the group perspective there. All of these guys are looking to get a return on that capital. And so, as they look at building their business plans, right now Reinsurance Group, what did you see through the nine months. These guys have really accelerated. They're absorbing capital right now. They're utilizing it and that's because they get good returns. I think we do get to, excuse me, a situation where the opportunities are so good in primary as well as reinsurance, as mortgage that we have to make a decision. Excuse me, on that. But I think the question is that would be a nice high class problem for us to outrun our capital as well as our capital generation that's going on right now. And I don't see it. We see really good opportunities in '21. We don't see us outrunning our ability to fund that internally.

Steven Gavios {BIO 1490593 <GO>}

It's helpful. Thanks, Don. Elyse back to you. Thank you.

Elyse Greenspan {BIO 17263315 <GO>}

Thanks. So going back to some of the questions that were emailed in. There were a couple on the return side to go back to those comments Maamoun. So one investor wanted to know when you said going from high single digits to mid double digit returns, did you mean mid teens or did you mean something like 20% to 30%?

Maamoun Rajeh {BIO 16155071 <GO>}

No. So look, I mean the question at the time was around cat versus retro. And I would differentiate the two. Again in our world, when you think about retro and when you think about how far removed you are from the original risk, you said yourself, yeah, look, I've got another plus whatever it's going to end up play being. And you start to monitor its classic fashion. I mean we've been monitoring retro, I'd say for about three years. I'm going to take the long -- long way to here answer.

But just, you know, the retro market to put in perspective is about $18 billion odd, you know, limits. And we -- three years ago, we'd seen probably a quarter of that. And in 2020 we saw two-thirds of that limit in terms of -- we reviewed and analyzed it. And it remains a small part of what we do. But our view of it is if you're going to do retro, you're going to want to do retro at north of 20 ROE. It was just -- don't hold me to this. But it's just -- it's kind of comparable if you're going to deploy capital between traditional treaty where you have a real good sense for what's going on. And retro the order of magnitude difference needs to be about a third more.

And so that's kind of how I think about it. And so the answer differs for the different segments that we might be in. But by and large, I mean, I think if you are writing property in the low teens, if I said single digits, I apologize, the low teens, you should be writing it -- with this momentum going, you should be getting a chance to do it at mid teens. And then retro, normally speaking should be taking -- again my rule of thumb maybe a third more than that to make a meaningful difference between or maybe we reallocate interesting and exposures from one to the other.

Elyse Greenspan {BIO 17263315 <GO>}

Okay. And then another question. I'm not sure how much detail you guys are going to want to get into this and Don if you want to add, because one investor was just wanting to know based off of your expectations for the 1/1 renewals, how would you generalize ROEs between your three business segments? And if you could just comment on your normalized ROEs that you expect between insurance, reinsurance and mortgage? So I'm not sure you kind of gave us kind of the reinsurance if there's anything you guys kind of want to add on the other two businesses?

Donald Watson {BIO 19175196 <GO>}

Well, I would say, yeah, it's -- one of the things that's making a different story today is what Maamoun referenced as investment yields. And your longer tail lines of business are suffering. And so we've talked about just like on the Insurance Group getting to better than a 95% on an ex-cat or on a normalized cat, I'll call it, basis. And we're operating at that, but guess what, the bars are being moved because of the investment yields.

And Maamoun just went through some of the numbers. It's pretty material on even medium tail business. And so we have to keep on improving. What I think a lot of what although Maamoun's group, it does a fair amount of casualty and longer tail lines. He also does a fair amount of the shorter tail where the investment yields have less of an impact. So we see better returns right now coming in in the reinsurance and that's why you see supporting a lot of growth there. We like the long-term stability of growth within the insurance group, but we're still probably talking of somewhere around that 10% to 12% expected returns on the business because of the drop in investment yields even as we see some improvement in the underlying loss ratios with improving rates.

Mortgage, which I don't want to pass up here is something that we still see as mid-teens ROEs. This is something that we still see as very good business. So all three of the businesses we think are double-digit ROE next year.

Elyse Greenspan {BIO 17263315 <GO>}

Okay, great. Before I go back to some of the questions that I have that came in Chad Stogel from Spectrum, I see you have your hand up and have a question. Brian, if we could unmute Chad's line please? Chad, you're live.

Chad Stogel {BIO 17489748 <GO>}

Hey, thanks, Elyse. Hey, guys, just we're doing all the talking about the renewals and the pricing, but also on that uncertainty point that you brought up earlier the losses COVID being one of them. Today we had a sort of surprise ruling out of Australia. Do you have any comments on that? The primary there were kind of banking on disease exclusions and then somehow or another the lawyers, as they normally do, they figure out a way to get around that and Australia ruled in favor of the plaintiff. So just curious, any thoughts you have there? And how big that market is because I can't imagine it comes close to the U.K. or definitely doesn't come close to the U.S. market, but they did something similar to the U.K. with the test case. So any comments there just on either your exposures or just more broadly?

Maamoun Rajeh {BIO 16155071 <GO>}

Well, I mean, I haven't seen that ruling. But as a general statement, I see Australia sort of the equivalent of California in being litigious, but the equivalent of Taiwan in their pricing. And so we're not a player in casualty in Australia. It is not an insignificant market for some, it's a fairly mature casualty market and professional market. But we don't by and large have exposure to it. And I haven't seen that ruling. But do you know what, it's just -- it's classic, right. It's why COVID is doing, what it's doing in this market, it's not because of COVID, it's just yet another bit of uncertainty that the industry has just realized. We don't have that buffer of safety to pick up these things. You look at Ogden rate changes in the U.K., if you look at COVID, and you said yourself this business on the long tail needs a buffer of uncertainty that the price in a long term shocks such as these.

Donald Watson {BIO 19175196 <GO>}

I think maybe just to add onto that Chad, that the reality is COVID is going to be with us for a while, and losses can continue to emerge for a period of time, right. Some of which we haven't seen and we don't know. There is the FCA in the U.K. as Supreme Court is going through this week, right. There could be some other conclusions there. We're going to continue to see test cases in the BI-ish language in the U.S. There is uncertainty and that's where we've got to monitor for it, we've got to look at our wording and we have to be very prudent about what we're doing. All of it's just -- and I like Maamoun's comment there, it's there has to be margin for uncertainty out there.

Chad Stogel {BIO 17489748 <GO>}

That makes a lot of sense. That's helpful. And just one clarification, Maamoun. Did you say for the decline in rates on long tail you need 5 points to 6 points? Was that the number that you kind of put out there?

Maamoun Rajeh {BIO 16155071 <GO>}

Pardon? Sorry, say that again.

Donald Watson {BIO 19175196 <GO>}

On investment yield -- with the drop in investment yields.

Chad Stogel {BIO 17489748 <GO>}

Yeah. With the decline in investment yield. Yeah.

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. I look at it. So it's just the back of the envelope, if you think about just the loss of -- again if you think we were discounting it 2% just a short while ago and we were discounting at 50 bps today. Just to stay even on a reasonable duration, you need probably, yeah, 5 points, 6 points of rate, just to make that equation. I mean it's pure math, right, just to make it work.

Chad Stogel {BIO 17489748 <GO>}

That makes sense. That's great. Thanks, guys. I appreciate your time today.

Elyse Greenspan {BIO 17263315 <GO>}

And so going back to questions that got sent into me, one that just got sent in. If cedents want stability on their panels, are you guys able to grow on most sought after panels? Either you're already on them or it's new business, or will growth come from getting on new opportunities to the market, when you kind of envision how you put together your portfolio next year?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. No, look good question. I think where we sit on panels, the discussions -- the conversations that we have with clients sound more like, hey guys, how can we get more of Arch on our program. What it is going to take to get you guys to do more? And so for us the ability to increase shares, I would say is easier to do than our average peer next to us who are already pretty much well entrenched and have big participations on programs.

And this goes for cat and some of the non-cat on the syndicated business. We will always be -- I mean I shouldn't say it that way, I mean, we are considered a first call type market for anything that's complex that's different that need speed of execution that needs a little bit of creativity. And those deals we will lean in and we'll do -- we'll take the whole thing or majority of it. We will have opportunities to do that in terms of, I think your words of new business, I think that area has a chance to present more opportunities for us. And on the syndicated side of the house the transactional business will get to inflect and do more.

And then frankly, in the last five years, if you really think about the components to the platform that we've put together, we haven't been deploying as much as our peer group as, but we haven't been sitting still either. And so we have various buckets whether you think of our prop fac team that's doing volumes that are sort of order of magnitude two times what they were doing just a short while ago, if you look at some of the various units that we put together, if you think about the ILS capabilities that we've built over just the last few years. We have tools that were coming into this kind of inflecting market that we didn't have just a handful of years ago on the reinsurance front. And so I think that's going to bode well. These are going to be timely for us.

And frankly, I mean, we have a lot of conversations with partners. We're always -- we're constantly speaking to fielding calls or reaching out to partners, capital providers that have been around Arch for many, many years, discussions around sidecars, discussion around other opportunities. These are constant. And I would say in the last number of years, it's been really our call not to do them because we just don't believe much in the returns and we won't slap the brand behind it. Going forward, frankly, we're going to be much more open-minded to that, so long as it adds value to our clients and makes sense and it is durable. And so that might be another source of things that we do that we haven't done historically.

Elyse Greenspan {BIO 17263315 <GO>}

That's great. And then another client wants to know given the rate momentum you're seeing and the growth you've seen this year in reinsurance, how much of an increase should we expect in net premiums in 2021?

Donald Watson {BIO 19175196 <GO>}

Get the crystal ball out there, Maamoun.

Elyse Greenspan {BIO 17263315 <GO>}

Yeah. I guess they want you to compare it 20% to 30% year-over-year or would you expect it to decelerate. So I'm not sure if you want to give a precise number, but maybe talk directionally?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. I mean, I think you should expect if the market improves, you would expect the shops such as ours to do more in that market. And if the market doesn't return or play out in the way we expected, we might do less. I mean we will constantly be looking to kind of maximize those returns and where we deploy it.

Donald Watson {BIO 19175196 <GO>}

I think the point is the momentum is good today. We like the market opportunity and we like our positioning. But it's really hard to say what kind of additional rate on rate do you get in '21. And that's really going to depend on our appetite. We don't have a particular desire to write more premium unless the returns are commensurate. The investment yields have continued to put pressure if we see more on the longer tail casualty lines. We still need a lot more because of the rate issue. So if your prediction is rates stay the same, are we're going to see enough, well, this is the other thing, how fast does the economic growth pickup up next year? Is the demand side going to pick up just from an economic activity? So a lot of unknowns out there. Where we are going into year end on property? I think it's a little clear, but beyond that it looks promising, but who knows, right.

Elyse Greenspan {BIO 17263315 <GO>}

Okay. And I wanted to take a break from some of the questions that I got sent into me. I think we do have a follow-up from Steven Gavios. Can you guys open Steven's line. Steven, are you there? He might have hopped off. Okay, we'll wait and see if he wants to -- Steven, are you there?

Steven Gavios {BIO 1490593 <GO>}

Here we go. Can you hear me?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah.

Elyse Greenspan {BIO 17263315 <GO>}

Yeah, sorry.

Steven Gavios {BIO 1490593 <GO>}

So, I believe the Watford Re saga is over hopefully. So maybe Maamoun from your perspective, you can just give us your thoughts on how you're going to integrate that and manage that going forward? Obviously you brought in some capital partners, but there's also more Arch skin in the game now going forward. And as I understand it, Watford was diversifying its own business a little bit. And now it will be only part of yours. So just talk to us about how you roll forward with that business from here?

Maamoun Rajeh {BIO 16155071 <GO>}

Yeah. Thank you. I mean using the word saga was probably pretty appropriate in this case. Not over yet, but clearly in the right place, in my opinion. Well, look, I mean, everything that we had in mind when we started Watford six years ago remains even more so -- more relevant today going into this hard market, hardening market, I should say, right. And so the idea of having a parallel balance sheet associated with Arch, the company is so intertwined with us in the first instance, makes a whole lot of sense.

And from our clients perspective, having the capacity to do more with them on the one hand for Arch to have a fee flow to continue is important. We've always talked about that element of what we look to do. So going forward, I think you, you know you look a Watford and you look at partners who know us very, very well, and Warburg and Kelso, as you know Kelso is a partner of ours in premium. And so we know them not personally and institutionally pretty well. And so they understand where we think we want to take Watford.

I think we'll probably talk a lot more about sort of Watford version 2.0 after the close, and just really kind of get into those details, but by and large holistically speaking, I think, where we counted on investment returns to be the majority of the total return in the past probably will lean more towards underwriting returns being more important component of the total return. Generally, yeah, there is a lot more to talk through but Steven hopefully that gives you enough to get a flavor for it. We don't mind. I mean this is a time when owning a bigger piece of Watford in this market, we're very happy to do so.

Steven Gavios {BIO 1490593 <GO>}

So, obviously, we'll talk more about this once you close the deal and can speak more fully, but just from the kind of a general view, as you were talking, it sounded to me like the renaissance da Vinci kind of relationship. Is that how we should think about it?

Maamoun Rajeh {BIO 16155071 <GO>}

Well, you know what, perhaps more so in the future than the past. But look Arch stands by the client relationships that are in Watford. Those are there because of Arch. And the transaction from an Arch shareholder perspective, we think is a compelling transaction, which is also an important component to this. So, in our minds, we did this for all the right reasons. I mean there are a lot of stakeholders here and we think all the stakeholders came out good here at the end of what -- how it played out. And strategically, we think Watford is very important to Arch and to our clients, and particularly in this time in the market.

Steven Gavios {BIO 1490593 <GO>}

Got it. Thanks.

Elyse Greenspan {BIO 17263315 <GO>}

And then a question that came in from an investor is the expected 10% to 12% ROE with all three businesses in the double digits, is that on allocated or reported equity?

Maamoun Rajeh {BIO 16155071 <GO>}

This is -- you're getting penalized for some good intentions there. So...

Donald Watson {BIO 19175196 <GO>}

This is what happened. So what we're talking about is allocated capital, guys. That's really what we're talking about. We're not trying to provide guidance on what our ROEs are going to be next year. We have capital allocated to all three operating units, we have capital allocated to our investments and we have our shareholders' equity as well. So you have all of these things factoring in at the group level.

The point that really with the returns that, I guess, we're guiding you is that it looks better going forward. And it's to the point that we are encouraged to write more business in each of our units. And what you've seen in the reinsurance group. I mean if Maamoun wanted to right the level of premium he wrote in 2020, he could have done that in 2017, 2018. It's available out there if you're willing to take the price. The difference is that more business is meeting a return threshold that we're willing to take today. And that's promising. There is a lot of uncertainty out there, whether it's coronavirus losses, whether it's natural cats, these are all things that we're in the business of paying losses out there, hopefully not too many of them, and hopefully we manage it well, but allocated capital, guys.

Elyse Greenspan {BIO 17263315 <GO>}

That's helpful. Well I think this does bring us to the top of the hour. But before we end things, first of all, I wanted to thank Maamoun and Don from Arch for joining us today. I was going to sum up the discussion, I would say if you guys are looking to a better market in 2021, January 1 double-digit rate increases, I think, you could see in the U.S. Europe will be up less, and you will see greater rates in retro and the momentum, you see it could continue on the reinsurance side during the remainder of the year, obviously with the caveat that there are some uncertainties, but you see this as a good environment, maybe a great environment to put capital to work in your reinsurance business and all businesses should be generating double-digit returns on allocated capital in 2021. I guess is there anything you would add to those is kind of being key takeaways from this discussion. And then in answering that question, Maamoun, is there anything you just want to point out to the investors that are on the line with us that we might not have addressed today?

Maamoun Rajeh {BIO 16155071 <GO>}

I think so this is just our sense for where things stand today. Optimistic, but things have to play out. And the nice thing about our platform is it's scalable on the reinsurance side for sure, very scalable and either way. And we've got a team that is excited going into this working hard. And we have a chance for more wins this time than we did in the past. But there's a lot in flux and we'll see ultimately how it plays out.

Elyse Greenspan {BIO 17263315 <GO>}

Don, would you like to add anything?

Donald Watson {BIO 19175196 <GO>}

No, I think we've covered this well. I think that we are more optimistic. There is always uncertainty out of there. And so these are our expectations today. Things will change. And part of a good management team is being able to adapt to those conditions as they happen. It's something that we spend a lot of time looking at, and you see the fruits of that in terms of recycle manage when the returns are less and we're writing more because the expected returns are better, and we hope to demonstrate that.

Elyse Greenspan {BIO 17263315 <GO>}

That's great. I want -- well, I would think this is a good place to end, but I would like to thank Maamoun/Michael Jordan, I guess, that's the new nickname and Don Watson from Arch for joining us today. If anyone has any follow-up questions just feel free to reach out to me. Thank you, guys, very much.

Donald Watson {BIO 19175196 <GO>}

Hey, Elyse, thank you.

Maamoun Rajeh {BIO 16155071 <GO>}

Thank you, Elyse. It's a pleasure.

Donald Watson {BIO 19175196 <GO>}

Thank you.

Maamoun Rajeh {BIO 16155071 <GO>}

Hope everyone has a good evening.

Elyse Greenspan {BIO 17263315 <GO>}

Thank you. You too.