Q2 2021 Earnings Call

Company Participants

- Francois Morin
- Marc Grandisson

Other Participants

- Brian Meredith, Analyst
- Elyse Greenspan
- Jimmy Bhullar, Analyst
- Josh Shanker, Analyst
- Meyer Shields, Analyst
- Phil Stefano, Analyst
- Ryan Tunis, Analyst

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Second Quarter 2021 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 gets 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>}

Thanks Liz. Good morning and thank you all for joining our Second Quarter 2021 Earnings Call. At Arch, our playbook remains simple yet effective. We protect our capital through soft markets and on lease, our underwriters during hard market. We believe that this time tested strategy gives us the best chance to generate superior risk adjusted returns over time. You should expect then from us at this stage of the cycle come straight from that playbook. As long as rate increases, support returns above our threshold, we will continue to grow our writings. We have seen this video before and the hard market of 2002 through 2005 when P&C results generated a sustainable stream of earnings for several years after market prices peaked and were fully earned. And so again this quarter, the power of Arch's diversified platform is evident in a strong underlying earnings in each of our operating segments. We delivered a 13% annualized operating ROE and aided by good investment returns and annualized net income ROE of 21% this quarter. One item that stands out this quarter was our strong P&C underwriting activity, Our P&C insurance results demonstrate significant improvement in underwriting performance. Better market conditions allowed our teams to expand their overall positioning and grow net written premiums substantially over the same quarter last year. We are now in the sixth consecutive quarter of rate increases at plus 10% this quarter, comfortably in excess of loss cost trend estimates. The higher level of premium earned from the post-2019 policy years is a primary driver of our improving underlying accident year combined ratio. About 2/3rd of the combined ratio improvement was due to lower loss ratios attributable to rate increases and underwriting actions we have taken over the past several years. The balance of the improvement was driven by a lower expense ratio. Production increased across most lines of business and geography areas as pricing improvements spread. While rate increases have tapered off from previous highs in some lines, we're seeing increases in lines that had been immune to meaningful changes and in lines where price increases are eased. We're still getting rate on rate increases and improving margins. We estimate that approximately 30% of our insurance premium growth reflects rate increases. About 50% is from higher net retention level and the remaining growth comes from new business and exposure growth with existing clients. Both our international and US insurance platforms continue to excel in the current market with substantial growth in professional lines, programs, property and travel and A&H writings. Our reinsurance group also had a quarter of strong growth while producing strong underwriting results. A large portion of this growth, results from our ability to leverage our expertise and historical experience as a writer of quota share business. When markets dislocate, our clients need capacity and capital as they seek to reshape their portfolio. That's why since 2019, we have been increasing our participation in side by side quota share arrangements. This has always been part of our reinsurance playbook and based on historical patterns, we believe a good place to deploy our capital for the next few years. As you may have heard, this market is notable as rate increases in traditional XOL reinsurance lag, the insurance rate increases. So our current preference is to be closer to the primary rate increases through a quota share with our clients. Property CAT excel is one of the few areas where we have reduced premium writings. They are down 26% as we are not finding enough opportunities that meet our return expectations. However, as you can see in our supplement, premium writings grew substantially in property, other than CAT and specialty segments. Casualty and Marine also produced excellent levels of growth. As with insurance, we expect the ongoing rate improvements to be reflected in our underwriting results over the next several quarters. The Arch arrangement story is want to providing creative capital solutions during hard markets that enables us to leverage our growth faster than in our primary insurance markets. We have considered this a core capability throughout our history. Our reaction to this market is no exception.

All in all, it was a very satisfactory job of seizing hard market opportunities by our team. [Inaudible] as they say. From a strategic standpoint, it's worth noting that we, along with our business partners, successfully completed the purchase of Watford at the beginning of the third quarter and are focused on working to build a sustainable reinsurance franchise. Allow me now to switching inflation fears, which continues to be a hot topic for our industry. I want to reiterate our perspective on how we view inflation at Arch. As underwriters, we study inflation on a line by line basis to price the business and established reserves and some lines like Workers' Comp, inflation remains low at this stage, I'd say 0% to 1%, however, in other lines like high excess general liability, we're estimating inflation to be in the 8% to 12% range. As a point of comparison, loss cost inflation from the ground up, has been in a 3% to 5% range for around 5 years, broadly across our portfolio. It's important to consider line of business specifics when we discuss claims inflation. Second, it's worth noting that in every line of business, the inflation rate increases as you move up attachment points. The key in pricing or reserving for an excess policy is to start with the proper ground uptrend and then applied the best curve to select a range for the trend in the upper layers. As is often the case in insurance, we are estimating and there is a lot of uncertainty around the correct number. Our philosophy is to keep this methodology consistent through the cycle. Third, we also supplement our analysis with some subjectivity. In the current environment and in certain lines, we add trend to try and account for the increased uncertainty, including the possibility of the so-called social inflation. We are typically more willing to adjust a trend above our indications, then we are to reduce it, all with creating a margin of safety in mind. This is not a new concept at Arch but a time tested philosophy that has allowed us to navigate both soft and hard markets through our opportunistic cycle management approach. Let's turn now to our mortgage group, which continues to operate as a well-oiled machine generating $250 million of operating earnings in the quarter.

Our insurance in force remains steady at roughly $278 billion for US primary MI. Refinance activity has slowed and we expect improving persistency throughout the remainder of the year and into 2022. Delinquency rates are decreasing across our portfolio and we still expect a large portion of delinquencies to cure based on many factors, including the strong equity position of our current inventory, where more than 95% of delinquent policies have over 10% of equity. New notices of default continues to decline and at 7400 in the second quarter are better than pre-COVID levels. Outside of the U.S., we increased our writings in Australia as a housing market remains strong. We like the long-term opportunity in Australia as demonstrated by our announcement to acquire Westpac's LMI business, which we now expect to close later this quarter. Pricing remains competitive but rational across the MI industry has rates now back to 2019 levels. However, the credit quality of borrowers remain strong similar to 2016, supporting our confidence in the continued earnings from our mortgage insurance portfolio. As I close my prepared remarks, this quarter I'll borrow from cricket which is top of mind because this weekend marks Cup Match here in Bermuda when the entire island goes cricket crazy for four-day holiday weekend. I think of the current P&C market like being the first team to bat during a cricket test match. Test cricket is one of the few sports that isn't governed by a clock. Unlike games that must be completed in 60 or 90 minutes, test cricket is about scoring as many runs as possible as long as you are getting favorable balls or pitches for baseball fans and for as long as it takes for all of your batsman to be out. The details are not critical but the idea is that similar to this market, we're waiting for the right ball and scoring as many runs as possible while we can rather than swinging aimlessly we'll do what we always do, play defensively when we have to but become aggressive and score as many runs as possible when the opportunity arises. We're not as worried about the clock running out, we'll just keep scoring runs. Now, I bowl it over to Francois to run through the financials.

Francois Morin {BIO 5980907 <GO>}

Thank you Marc and good morning to all on this first day of the Bermuda Cup Match Classic. Thanks for joining us today. Before I provide more color on our excellent second quarter results, I should remind you that consistent with prior practice, the following 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 filings, the term consolidated includes Watford. As you know, we closed earlier this month on the transaction we announced late last year to acquire Watford in partnership with Warburg Pincus and Kelso. Concurrent with the closing, we will be making changes going forward and how we report our equity interest in Watford results which I will share with you in a few minutes. As Marc shared earlier, we had an excellent quarter with each of the three legs of our stool performing very well in our investment portfolio also producing solid results. After-tax operating income for the quarter was $407.2 million or $1 per share, resulting in an annualized 13% operating return on average common equity. Book value per share increased to $32.02 at June 30, up 4.8% in the quarter. In the insurance segment, net written premium grew 43.3% over the same quarter one year ago, 38.5% if we exclude the growth due to the COVID related recovery in our travel accident and health unit from the same quarter one year ago. The insurance segment's accident quarter combined ratio, excluding cats was 91.4%, lower by 470 basis points from the same period one year ago. The improvement in the ex-cat accident quarter loss ratio reflects the benefits of rate increases achieved over the last 12 months and changes in our mix of business. In addition, the expense ratio was lower by approximately 180 basis points since the same quarter one year ago, primarily due to the growth in the premium base. As for our reinsurance operations, we had strong growth of 63.6% in net written premiums on a year-over-year basis. The growth was observed across most of our lines, but especially in our casualty and other specialty lines or strong rate increases and growth in new accounts health increased the top line. The segment's accident quarter combined ratio, excluding cats stood at 87.1% compared to 87.5% on the same basis one year ago.

As we have discussed in the past, we believe the underlying performance of our reinsurance segment is better analyzed on a rolling 12-month basis, which typically smooths out the impact of certain large transactions and-or claims that can have an impact on quarterly results. On that basis, the ex-cat accident year combined ratio stood at 84.3% over the last 12 months, lower by 660 basis points from the prior 12 months with the improvement almost entirely reflected on the loss side, as a result of the rate increases we have observed over the last 6 plus quarters. Losses from 2021 catastrophic events in the quarter, net of reinsurance recoverables and reinstatement premiums stood at $46.5 million or 2.4 combined ratio points compared to 13.5 combined ratio points in the second quarter of 2020. The activity in the quarter was the result of a series of small events across the globe and some late reported claim activity from the North American winter storms Uri and Viola in February. Following up on the trends we have seen in the last few quarters, the ultimate impact of COVID-19 on our mortgage segment remains very manageable. In particular, the delinquency rate, which came in at 3.11% at the end of the quarter is now close to 40% lower than it was when it reached its peak during the pandemic, at the end of the second quarter one year ago. We had another solid quarter in terms of production, and with refinance activity coming down from prior levels, we saw the insurance in force for our U.S. MI book remained relatively stable. Of note, this quarter was the exercise of calls features by the GSEs on certain vintage credit risk transfer contracts, reducing the insurance in force for a non-U.S. MI portfolio. The overall impact of these calls was an approximate one-time $31 million benefit to our underwriting income, approximately two-thirds of which came from the release of prior-year loss reserves, and the rest from the call premiums received. The combined ratio for this segment was 26.5% reflecting the lower level of new delinquencies reporting during the quarter. Income from operating affiliates was strong at $24.5 million, mostly driven by an excellent first quarter at Coface. As a reminder, we report our ownership interest in Coface's results on a quarter lag into our financial statements. As regards to Watford, the closing of the transaction on July 1, gave rise to a reconsideration event and as a result, we revisited our VIE analysis. Based on the new governing documents of the entity, we have concluded that while we will retain significant influence, we will not control the entity going forward. Accordingly, we will no longer consolidate the results of Watford in our financial results, starting with our third quarter financials and our 40% share of Watford results will be reported in the income from operating affiliates line along with our proportionate share of other operating affiliates such as Coface and (inaudible). As a result of the closing of the transaction, we also expect to report a one-time non-recurring gain of approximately $65 million in the third quarter. Total investment return for our investment portfolio was positive 150 basis points on a US dollar basis for the quarter. Net investment income was $89.4 million during the quarter, up $10.7 million on the sequential basis, driven by lower investment expenses and interest received on funds withheld transactions. The duration of our portfolio remains at one of its lowest levels in our history, 2.31 years at the end of the quarter, reflecting our internal view of the risk and return tradeoffs in the fixed income markets. Equity in net income of investment funds accounting for using the equity method returned approximately $122 million during the quarter, a key contributor to the growth in our book value. The effective tax rate on pretax operating income was 7.6% in the quarter, reflecting changes in the full year estimated tax rate that geographic mix of our pre-tax income and a benefit from discrete tax items in the quarter. Turning briefly to risk management, our natural cat PML on a net basis decreased to $676 million as of July 1, for the Northeast peak zone down to approximately 5.6% of tangible common equity and well below our internal limits at the single event one in 250-year return level. On the capital fund, we issued $500 million of 4.55% perpetual fixed rate preferred shares in June. We expect to use the proceeds to redeem all or a portion of our outstanding Series E non-cumulative preferred shares in September 2021 and to use any remaining amounts for general corporate purposes. Separately, we repurchased approximately $7.8 million shares at an aggregate cost of $306 million in the second quarter, bringing our year-to-date share repurchases to over $485 million or approximately 45% of our year-to-date net income, all while growing our book value and top line. As we have said since our formation 20 years ago, we are strong proponents of active cycle and capital management. We believe this quarter results demonstrates our ability to execute on this philosophy and leads us to invest in opportunities where we believe the returns are most attractive. At current prices and with the prospect of improving returns, we believe buying back our shares represent another compelling value proposition for our shareholders without compromising our capital flexibility. With these introductory comments, we are now prepared to take your questions.

Questions And Answers

Operator

Thank you. If you have a question at this time, (Operator Instructions) Our first question comes from Elyse Greenspan with Wells Fargo.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, thanks, good morning. My first question is on capital (inaudible). Francois, while you just said right, you bought back less than half of your earnings to start this year and I believe going into the year, you guys thought you had more than enough capital to support your growth, the growth that you thought you would see, so should we think about a pickup in potentially capital return if that statement is true in the back half of the year? And can you just update us, would you be willing to be active buying back their stock during wind season just given you know that it seems like you have a good level of excess capital.

A - Francois Morin {BIO 5980907 <GO>}

Sure. On the second question, Elyse, yeah, we're--while in our early days and I'd say pre-mortgage years, we were somewhat more careful with share buybacks during the wind season. We're not--we're now, as you know, a lot more diversified so I think that constraint or that reality is maybe less applicable than it used to be. But yeah certainly as we think about share repurchases or capital deployment throughout the second half of the year, we certainly think that we could be buying back more shares. I mean, our top priority is still to invest in the business and grow the business as best we can. But as you saw this quarter, I mean, we were able to do both and then some--and like to think that if things stay where they are or within reason, we would be doing the same in the second half of the year.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, and then in terms of your insurance segment, so you guys still seem pretty positive by 30% of the growth came from rate increases in the quarter, positive on pricing, a little bit concern of that inflation which we heard throughout the industry. So broadly, as you guys are thinking about the pricing environment as well as just what's going on with inflation, do you have a sense of for how long you think pricing should continue to exceed loss trend broadly across insurance recognizing obviously it's many different lines that come together?

A - Marc Grandisson {BIO 4369887 <GO>}

There is a question that will lead all of us, if you get the right answer to riches, Elyse. But I think it's fair to say that the market momentum is clearly there. I think you heard on other calls that that push for rate and increase the rate adequacy and getting to a better level is shared among most in the industry. I think there's a recognition between some of the losses that have occurred in the past and cat losses included some uncertainty and social inflation, cyber risk as well as no property cat events, obviously that have occurred. I think there's --and the interest rates being lower, I think there is a recognition that the prices need to go up. I think I will just give you a quick anecdote, some of our folks are doing file audits on the reinsurance side, that is, with some of our clients who are competitors of ours as well and the common threat of theme that seems to come through the audit is that the-- the underwriting community is recognizing that more needs to be done and you can see this evidenced in a discussion that they have with brokers. So we're very--we're very secure. I think there's going to be quite a bit more runway to this--to this pricing improvement.

Q - Elyse Greenspan {BIO 17263315 <GO>}

And then one last one on the reinsurance side, it sounds like Francois while from your comments that it's true duration in the quarter was more just kind of one-off. I guess, as we think about going forward, my question more is, as we've seen the shift to more of longer-tail lines within that book and away from property, would you expect the underlying loss ratio to deteriorate or is it just that there was just some one-off factors in the quarter? We could still see improvement in that on a go-forward basis?

A - Francois Morin {BIO 5980907 <GO>}

Yeah. In terms of modeling, I think it's going to go up and down right? And I would say the numbers we quoted in terms of the rolling 12 months is probably as good, it's a good starting point. The business mix, yeah, there'll be some fluctuations here and there. But yeah, we want more casualty but we wrote also a lot more other specialty which is maybe combined ratio is there a bit better. So it's hard to pinpoint exactly where everything, I mean what's going to happen obviously, in the next few quarters. But I'd steer you to the kind of the rolling 12-month number that I quoted to be - that should be a good starting point.

A - Marc Grandisson {BIO 4369887 <GO>}

Elyse, if I may add to that point and we also bear in mind at Arch, we tend to be prudent in reflecting all the margin improvement (inaudible) on. So we'll have to wait and see what it is, I just want to make sure we keep that in mind as we go forward.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, that's helpful, thanks for the call.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

A - Francois Morin {BIO 5980907 <GO>}

Thank you.

Operator

Our next question comes from Jimmy Bhullar with JP Morgan.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Hi, good morning. So first this is the question on pricing and obviously your comments are pretty positive, but can you sort of compare and contrast what you're seeing on the primary side versus what you're seeing in reinsurance broadly?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, so on the insurance side, there's a lot more activity, more price pickup on the insurance side and that's why on the quota share basis, even though the ceding commissions have not decreased as much as they would have otherwise in other hard markets, I think that if you're in a quota share basis, you essentially taken - you are participating alongside your clients in terms of rate increases. So whatever rate increase that would have included in my remarks on the insurance, you could ascribe to the quota share reinsurance participation. On the excess of loss, it tends to always lag a little bit behind the some benefit from the underlying rate because the excess of loss pricing typically, is a percentage of the underlying portfolio. So to the extent that some rate increase at the primary level, the excess of loss would get presumably a bigger percentage, but I think that it would be safe to say that the softer markets probably gave a bit less adequacy or it's probably more of a need for price pickup in the excess of loss, in general and would probably expecting this to start to happen soon. I think there will be some recognition that is sort of a second derivative of typically of a hardening market. Hope that helps.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

And are you equally optimistic or are there are signs - you mentioned property cat may be slowing down a little bit, but are you equally optimistic about the sustainability of the trend on pricing in both reinsurance and in insurance?

A - Marc Grandisson {BIO 4369887 <GO>}

Yes, on the excess of loss because like I said, I go back to 2002 to 2005 market. I think that the excess of loss market got probably a lot better, it took like 2004 to get there. So you need a couple of years of primary rate increases to start to find its way with their way onto the reinsurance excess pricing. It's a very normal hardening market. So I'm very encouraged actually.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Yeah. And then just lastly, you mentioned, credit quality on the MI side being strong. How are you -- and obviously, the labor market is very good as well. But how are you thinking about high property prices and just inflated values for homes and how that factors into your view of the business that you're writing now?

FINAL

Bloomberg Transcript

A - Marc Grandisson {BIO 4369887 <GO>}

If you were in a equilibrium in terms of supply and demand or the supply was plentiful, we'd be worried. That would take us back to the 2006 and 2007 period, but the supply and demand on the housing is such that it should help maintain the pricing for quite a while. We have 1.5 million to 2 million homes missing in the marketplace and it takes a while to find their way to the market. It is also under build as you know, as we all read in the press. So from our perspective, the house price appreciation, is there, we look at over or under evaluation. We also have these metrics from our economist and not seeing significant national over-valuations, so that's not another - yet another not a concern and the interest rates are still pretty low at 3%. The mortgage rates, i.e., at 3%. So the affordability is still pretty high compared to historical metrics. So all of these put together, it's never one dimension, right, you mean that you look at, I think overall if you crossed across everything it tends in the positive direction.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Okay, thank you.

Operator

Our next question comes from Josh Shanker with Bank of America.

Q - Josh Shanker {BIO 5292022 <GO>}

So I think I'm asking the same question from the last two conference calls, so I'm going ask it again. I look at the reserve releases in mortgage and I look at the reserves per new case in the 2Q '21 numbers and you are reserving more than ever for new defaults or delinquencies as you're releasing the reserves, yet the housing prices are appreciating. I'm trying to figure out what the math is about why the potential claim for loss keeps getting worse?

A - Francois Morin {BIO 5980907 <GO>}

While you're asking a very good question Josh, I think big picture as you know, we're still--there is still a lot that has to happen before we have more visibility into how the--in how the forbearance loans are going to--are going to pan out, how they're going to -- whether they're going to cure, whether they're going to turn to claim. And as you know those are, I mean, that's an 18-month process, so we--if we look at the peak months of April and May of last year, their 18 month period will expire unless things change should expire in the fourth quarter of this year. So that's one, we'll certainly have again more visibility and have a more definitive view on how to, I mean whether reserves were too high or not. And so that's where we sit on that at this point. We're reacting a little bit to the data but again, we still feel there is quite a need-- a lot that needs to be settled before we--we take, I'd say action on the current reserve levels. In terms of the new delinquencies, there's always tweaks that happen every quarter. You look at the average, the incidence rate and how severities and frequency assumptions that we put on the new delinquencies that get reported this quarter. Again, it's a smaller inventory of new delinquencies so I wouldn't--there is a bit more leverage and how those numbers play out but big picture, I think we're still very comfortable with our reserve levels. Yes, I think in implying maybe that we got too much, that's a possibility. But again, we'll know more in the second half of the year.

Q - Josh Shanker {BIO 5292022 <GO>}

So when I look at the reserves, I guess the $55 million reserves were current accidental year period put up in the fourth quarter. Is that a strengthening of average claim for the entire portfolio or is that a--is that a--we think the new claims being put on 2Q 2021, have the potential to be worse in terms of severity then the average claim currently on the book?

A - Francois Morin {BIO 5980907 <GO>}

Yeah, I think it's the latter. We didn't-we didn't really make any adjustments in terms of prior notices, so notices that were on the books before the quarter started. The thinking on the new notices is that the fact that they became delinquent kind of this late in the game, I'd say given that forbearance programs have been available for some time over a year. We think that there is a possibility that they could turn out worse than the ones that we got earlier. So there is a bit of mindset, there is philosophy that and time will tell but given that they might have gone through all their savings and they might have tried a lot of things and now they finally turn delinquent. So that's a little bit of the, I think the rationale behind these numbers.

Q - Josh Shanker {BIO 5292022 <GO>}

Okay, thank you very much for the update.

A - Francois Morin {BIO 5980907 <GO>}

Yeah. You're welcome.

Operator

Our next question comes from Ryan Tunis with Autonomous Research.

Q - Ryan Tunis {BIO 16502263 <GO>}

Hey, thanks, good afternoon guys. Marc, this is my first question. Can you hear me? Guys can you hear me?

A - Marc Grandisson {BIO 4369887 <GO>}

Yes, we can go ahead man.

Q - Ryan Tunis {BIO 16502263 <GO>}

Sorry about that. So, I had a cycle management question with property cat, yeah I'm not being critical. I'm just curious. So a year ago, it looks like you wrote $118 million of premium, in this year you wrote $88 million. So you wrote less. I get the property cat is not the best place to be but it feels like the rate environment was incrementally a little bit better. So I'm just - I guess a little bit curious like what goes into the decision to, as conditions improve actually decide 2Q of 2021, we don't want to write as much as we did in 2Q of 2020?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, its a really, really good question. So I think a couple of things happened, right. Number one, we probably, like everyone else have different perception of the riskiness of the cat book, right. We just had a windstorm in January. So, that will definitely make you take a different look at the non-model losses, right. There's a lot of non-model losses that seem to have percolated way more and we expect it over the last two, three years. So, there's an element of loss cost expectancy. And also as a result of that meeting a higher margin of safety for your return. That's clearly the number one consideration. And second one that is not to be forgotten is also, it's an allocation of capital. The same (inaudible) better use of capital is a risk adjusted of X in cap worth as much as a Y in other property, for instance, or in casualty. And those decisions are made on a quarterly basis, I would almost say almost daily. So as you get a broader range of opportunities on the reinsurance side, specifically, you are able to manage a portfolio and re-optimize the portfolio as you go at least maybe in a quarter or two quarters ahead. That's sort of the thinking behind stock of [ph] management with the view of optimizing your return, not necessarily bidding all out-all out, right. I mean that's sort of a one thing that (inaudible) told me way back one is that you don't want to be unlucky, property cat[ph] if you have all these great opportunities and not excluding outside of the cat realm, you probably (inaudible) a manager to taper it down a little bit also provided because it's not as juicy perhaps as the other lines are appearing at this point in time. So it's a bit of a window how we think.

Q - Ryan Tunis {BIO 16502263 <GO>}

Yeah, that makes sense. It's interesting. And then I guess just in mortgage insurance, in the attritional loss ratio, I mean, yeah, pretty much at pre-pandemic levels. I guess I was a little bit surprising just given there are some new notices. And I felt like back in '19 there almost none. So is this sustainable kind of 15% to 20% attritional or is it something this quarter that was an unusual tailwind?

A - Francois Morin {BIO 5980907 <GO>}

Well I mean attritional excluding BYD that's-that's how we think about, I mentioned it in prior quarters where 20% loss ratio was kind of plus or minus that should be what you should get over the cycle. And there is a bit of noise with the CRT transactions. So I mean there is moving parts within that, but yeah, 20% is absolutely sustainable.

Q - Ryan Tunis {BIO 16502263 <GO>}

Got it. And then just lastly, just had a curiosity, I was wondering if you guys would be willing to share like an internal view of what your excess capital position is?

A - Francois Morin {BIO 5980907 <GO>}

Well, that's something we've made public in the past and I think we are - because it's a daily, again a moving target, right? I mean there is, we don't know what the market is going to give us, so we could give you a number but then next tomorrow will be different. So it just - we rather, we want to keep the flexibility there and that's.

Q - Ryan Tunis {BIO 16502263 <GO>}

I agree, I thought I'd try.

Operator

Our next question comes from Meyer Shields with KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Two, I think basic questions. First, I know there's a lot of commentary at Arch and elsewhere about if that was prudent reserves because of current uncertainties with regard to in place. And is that - let me say differently, are you releasing reserves more slowly now than you would have in the past because of that issue, or is that an at current accident year, this issue?

A - Marc Grandisson {BIO 4369887 <GO>}

No, I think. Meyer, you and Arch [ph] I am. So you know that inflation impacts current accident year and prior accident issue, right. So clearly we are - it's part of the-it's part of the recipe, if you will, of establishing reserves. So we're trying to peg the historical trend as you know in triangles the best we can to the extent not captured within the loss development factors. So I think it's on both sides. Does that mean that we are releasing? Yes, I think that probably means that we historically have been a bit more careful in establishing our loss pick. If you look back at our history of combined ratio, the insurance grew specifically, you'll see that we were very much higher than most people were in the industry. So I think that tells you that we were reserving at that point with the view of the loss inflation that was one in 3% to 5% and we haven't changed (inaudible) at this point, except for, like I said in my comments certain lines where it's probably appropriate to do a bit more.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. No, that--I think that's right (inaudible) it makes lot of sense. Second question in reinsurance. How should we think about the catastrophe exposure in the non-property CAT property book?

A - Marc Grandisson {BIO 4369887 <GO>}

Well, it's part of this $76 million that Francois mentioned we're accounting for that but it's definitely less of the cat exposure. There is some in there. But it's definitely not the driver of the exposure at all. So, you know it depends on what kind of business you look at, the cat load on these premium is anywhere from 5% to 10%, sometimes a bit higher depending on the quota share you're writing. But in a lot of our other specialty for sure have some, but again much, much smaller. So I would say that, still the large--the larger contributor to our PML is through the cat XL portfolio.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, excellent. Thank you so much.

A - Marc Grandisson {BIO 4369887 <GO>}

You're welcome, Meyer. Thank you.

Operator

Our next question comes from Phil Stefano with Deutsche Bank.

Q - Phil Stefano {BIO 18965951 <GO>}

Yeah. Thanks and good morning. I wanted you to focus on the MI business. So of the $44 million in favorable development, it seems like just shy of half of that was due to the GSEs and the cancellation the CRT deal, the other $24 million give or take, can you give us a sense of the vintage years associated with that or--or what's driving that development?

A - Francois Morin {BIO 5980907 <GO>}

Well, I'll be--I'll give you a bit more specific. So yeah, you're right, just about half--just slightly under half of the total was from the GSE call deals and about a third I'd say is little tweaks again in, call it COVID assumptions that we kind of brought down a little bit and that--that's across - it's across all our book. So it's like a primary USMI, it's across some CRT deals that are still around that we've made some adjustments on those reserves and also on the international book so that gives you a perspective. And then there's just, call it, just under 20% of favorable development on run-off businesses or second lien and student loan businesses that have been in run-off for--for quite some time. So hopefully that gives you the split (inaudible) and answered your question.

Q - Phil Stefano {BIO 18965951 <GO>}

No. Yeah, that's great, that's great, Thanks. I think the--the PMIERs sufficiency ratio is pushing up near 200% and maybe you could talk to us about the ability to upstream capital when the GSEs might let you do that or do you go to the state regulators and contemplate getting special permission for a special of some sort?

A - Francois Morin {BIO 5980907 <GO>}

Yeah, that we discussed last quarter, that's in the works. Second half of the year, we are - we've begun the process already to upstream as you mentioned a dividend from our regulated entities to the holding company in the US. Some of it will have to be extraordinary, some of it is ordinary dividend. So there is -- we'll will have to have some discussions with the regulators on that, I'd like to think that we can get them comfortable that with our current levels of total capital and some of it, as you know, a lot of it being trapped and-or within the contingency reserves, I think we'll be able to get them comfortable that the level of dividends that we're talking about will be - will meet their needs and ours, so stay tuned. But I'd like to think that we'll be able to extract some dividends in the second half of the year.

A - Marc Grandisson {BIO 4369887 <GO>}

If I can address for one second Phil, the GSEs are allowing you to do dividend without any approval at 150 or above right now of (inaudible)

Q - Phil Stefano {BIO 18965951 <GO>}

Correct.

A - Marc Grandisson {BIO 4369887 <GO>}

So, and at the end of the year is going to go down to 115. So we think we have flexibility even from that perspective, you think you consider them as another gatekeeper of that dividend payout.

Q - Phil Stefano {BIO 18965951 <GO>}

Perfect, thank you.

A - Francois Morin {BIO 5980907 <GO>}

Sure.

Operator

Our next question comes from Brian Meredith with UBS.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes, thanks. Couple of quick questions here. First, the decline you saw in your property CAT reinsurance. I'm assuming that was just reduction in Florida exposure. And I guess on that question, what is your Southeastern kind of golf exposure look like today versus last year?

A - Marc Grandisson {BIO 4369887 <GO>}

It's down versus last year, but the first question of Florida, we had some decrease in flow. But if you look at premium, it's not as, it's not a one to one thing, Brian. I think that the reduction was also as a result of buying a few things too, if you will round of the portfolio. So it's not necessarily all like you know, if we get into this market trying to get our net exposure to a different level because the returns, we use also some reinsurance buying to (inaudible) So it's not only in Florida decrease.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you, got you. And then my second question is, now that the Watford deal is closed i t is in private hands, no longer public company, any material or any meaningful changes in strategy here that you're anticipating with Watford here going forward, different types of business they could write etc., etc.?

A - Francois Morin {BIO 5980907 <GO>}

Yeah, I'd say at a high level, I mean still early days, but at a high level, I think you should think more of Watford as a closer clone to Arch re-business or underwriting than what Watford was. Watford was - didn't necessarily do all the same classes of business, it was very much focused but more in the longer-tail stuff because of the additional pick up, the assumptions that were in terms of investment returns that we're going to get. So the, call it the 2.0 business model of Watford makes it more similar to what the Arch Re-portfolio or book looks like.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. So results should actually trend towards - ultimately trend towards what Arch Re looks like?

A - Francois Morin {BIO 5980907 <GO>}

Much more so, correct, yes.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. And then I'm just curious on Watford, is there ability or any contemplation of maybe taking on some of your mortgage insurance exposure going forward?

A - Marc Grandisson {BIO 4369887 <GO>}

We actually write some mortgage on Watford. Yes, there is some already existing, it's actually been one of the things they have done for quite a while. That's also something that Watford shareholders were very pleased with getting in the opportunity to have participated.

A - Francois Morin {BIO 5980907 <GO>}

The only - I mean it's an issue with ratings too Brian. So that's something that the ratings do matter for, in terms of getting GSE and regulators comfortable. So that's something that they're going to look into as well. Yeah.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you Brian, thank you.

Operator

I'm not showing any further questions. I'd now like to turn the conference over to Mr. Marc Grandisson for closing remarks.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks for everyone to be here and listen to our call and we're off to Cup Match and we'll talk to you next quarter. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference, this concludes the program. You may all disconnect.