Q3 2016 Earnings Call

Company Participants

- Albert A. Benchimol, President, CEO & Executive Director
- Joseph C. Henry, Chief Financial Officer
- Linda Ventresca, Corporate Development Officer

Other Participants

- Amit Kumar, Analyst
- Charles Joseph Sebaski, Analyst
- Elyse B. Greenspan, Analyst
- Ian J. Gutterman, Analyst
- Jay Arman Cohen, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst
- Michael Nannizzi, Analyst
- Ryan Byrnes, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Third Quarter 2016 AXIS Capital Earnings Conference Call and Webcast. All participants will be in a listen-only mode. After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference call over to Ms. Linda Ventresca, Investor Relations. Ms. Ventresca, the floor is yours ma'am.

Linda Ventresca {BIO 5930519 <GO>}

Thank you, Mike and good morning, ladies and gentlemen. I'm happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the third quarter ended September 30, 2016. Our earnings press release and financial supplement were issued yesterday evening after the market closed. If you would like copies, please visit the Investor Information section of our website, www.axiscapital.com.

We set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website. A replay of the teleconference will be available by dialing 877-344-7529 in the United States and the international number is 412-

317-0088. The conference code for both replay dial-in numbers is 10092851. With me on today's call are Albert Benchimol, our President and CEO and Joe Henry, our CFO.

Before I turn the call over to Albert, I will remind everyone the statements made during this call, including the question-and-answer session, which are not historical facts, may be forward-looking statements. Forward-looking statements involve risks, uncertainties and assumptions. Actual events or results may differ materially from those projected in the forward-looking statements due to a variety of factors, including the risk factors set forth in AXIS' most recent report on Form 10-K filed with the SEC on February 25, 2016. We undertake no obligation to update or revise publicly any forward-looking statements.

In addition, this presentation may contain non-GAAP financial measures. Reconciliations are included in our earnings press release and financial supplement, which can be found on the Investor Information section of our website.

With that, I'd like to turn the call over to Albert.

Albert A. Benchimol {BIO 2023727 <GO>}

Thank you, Linda and good morning, ladies and gentlemen. Thank you for joining us today. Last night, AXIS reported third quarter operating income of $161 million or $1.78 per diluted share with annualized operating ROE of 12% for the quarter. The continuous improvement that we're seeing in our results reflects strength in both our underwriting and investments. Adjusted for dividends, diluted book value per share grew 4% in the quarter, and 14% over the past 12 months. During the quarter, we returned over $157 million in capital to our shareholders through share repurchases and common share dividends, repurchasing 2.5% of our shares outstanding at the end of last quarter.

Through nine months, we've returned to shareholders $490 million or 158% of year to date operating income in the form of dividends and share repurchases, reducing our share count by 8.8%. Overall, we reported a consolidated combined ratio of 92.6%, a four-point improvement relative to the same period last year, benefiting from light cat activity and continued favorable prior year reserve development. Each of our three major businesses, insurance, reinsurance and accident and health reported solid underwriting profits and year over year improvements.

We are highly encouraged that the various metrics that we are monitoring to measure our progress reaffirm that AXIS is on a strong path forward. This quarter demonstrates tangible results of progress in our key strategic initiatives. With a more focused business model, improving sourcing and underwriting operations, a solid balance sheet, and strengthened market presence, we are well-positioned to find attractive business, even in a challenging environment and to drive superior shareholder returns in a transforming insurance marketplace.

With that, I will turn the call over to Joe, who will walk us through the results. Joe?

Joseph C. Henry {BIO 13390626 <GO>}

Thank you, Albert and good morning, everyone. During the quarter, we generated strong results, featuring net income of $177 million and an annualized ROE of 13.2%. Our operating income for the quarter was $161 million and annualized operating ROE of 12%. Both our net income and operating income this quarter benefited from continued good underwriting performance, a low level of catastrophe and weather-related losses, continued favorable prior year reserve development and excellent performance from our investment portfolio.

The strong growth in book value per share in the quarter to $59.77 was driven by net income and an increase in unrealized gains on our available for sale investment portfolio, which primarily reflected the tightening of credit spreads, partially offset by strengthening of the U.S. dollar against the pound sterling.

Moving into details of the income statement, our third quarter gross premiums written increased by 2%, with growth in our insurance segment offset by a decrease in our reinsurance segment. Our insurance segment reported an increase in gross premiums return of $69 million or 11% in the third quarter compared to the same period in 2015. Increased premiums were largely driven by new business written in our property and A&H lines. The increase in our property lines was driven by growth in our London book, including MGA program business. The increase in accident and health was due to new health business written in North America and in the Middle East.

Our reinsurance segment reported a decrease of $45 million or 14% in gross written premiums in the third quarter of 2016 compared to the same period of 2015. The decrease was largely due to timing differences which impacted premium growth in our professional, liability and property lines with a restructuring of three large quota share treaties affected the timing of premium recognition. Adjusting for timing differences of $51 million, reinsurance gross premiums grew 2%.

Net premiums written decreased by 12% in the third quarter of 2016, compared to the same period in 2015 with an increase in our insurance segment offset by a decrease in our reinsurance segment. Insurance net premiums written were up 14%, driven by growth in premiums written and a decrease in the ceded ratio. The ceded ratio decrease was due to changes in our accident and health programs, partially offset by increased quota share premiums ceded in our liability and professional lines.

Reinsurance net premiums written decreased by 45%, reflecting the decrease in gross premiums written in the quarter as well as the impact of new retrocessional cover entered into with Harrington Re, which increased premiums ceded in our liability and professional lines. On a year-to-date basis, reinsurance net premiums were up 7% compared to 2015. As discussed in Q2, we have been ceding more of our reinsurance premiums to strategic capital partners in recent quarters. Our expectation has been that on balance our reinsurance net premiums written would show mid-single-digit growth and our year-to-date figures are consistent with this.

Net premiums earned increased by 2% in the third quarter of 2016, compared to the same period of 2015. The increase in net premiums earned reported by our reinsurance segment was largely driven by strong premium growth in our liability, marine and other, as well as our catastrophe lines in recent periods, together with the favorable impact of premium adjustments in our credit and surety lines recorded in the quarter. The growth was partially offset by increased premiums ceded in our catastrophe and property lines as well as the impact on our liability and professional lines of the new retrocession to Harrington Re.

Net premiums earned reported by our insurance segment in the third quarter were comparable to the third quarter of 2015. Growth in premiums written in recent periods, primarily in our accident and health lines was largely offset by an increase in our professional lines ceded reinsurance programs.

Our third quarter consolidated current accident year loss ratio decreased by 0.8 points to 65.1% compared to the same period of 2015. During the quarter, we incurred $22 million or 2.3 points in pre-tax catastrophe and weather-related losses net of reinstatement premiums, primarily attributable to U.S. weather-related events. Comparatively, we incurred $43 million or 4.7 points, primarily attributable to the Tianjin explosion and U.S. weather-related events during the same period in 2015. Our ex-cat and weather current accident year loss ratios increased by 1.6 points to 62.8%, with increases in both segments.

The insurance segment current accident year loss ratio, ex-cat and weather, increased by 2.8 points from 60% to 62.8%. The increase was largely attributable to growth and change in mix of business within our A&H line of business where we responded to opportunities in international markets and wrote more business that carries a higher loss ratio, but a lower acquisition expense ratio. We consider this to be attractive business, and we are pleased to report that our A&H business reported a positive contribution to our underwriting results for the quarter.

In addition, the insurance segment's loss ratio was impacted by adverse rate and trend, largely offset by a decrease in the mid-size loss experience, particularly in our marine lines. Our reinsurance segment current accident year loss ratio, ex-cat and weather, increased slightly by 0.4 points from 62.3% to 62.7%, due to the ongoing adverse impact of rate and trend, partly offset by the recognition of better than expected recent attritional loss experience across our long-tail lines of business.

Year-to-date, our current accident year loss ratio increased by 2 points to 67.8% compared to the same period in 2015, driven by a 2 point increase in the cat loss ratio. During the year, we incurred $145 million of cat and weather-related losses compared to $90 million in the same period of 2015. After adjusting for these events, our current accident year loss ratio was 62.5% in both years. The adverse impact of rate and trend, together with business mix changes, were offset by a decrease in the mid-size loss experience in our insurance, marine and property lines.

Turning to loss reserves established in prior years, our results continue to benefit from net favorable loss reserve development, which amounted to $76 million during the quarter. Prior year releases came from all lines of business in both segments and predominantly recent accident years for short-tail lines and older accident years for medium and longer-tail lines. Our year-to-date favorable loss reserve development was $224 million, compared to $166 million recognized during the first nine months of 2015. During the three months ended September 30, 2016, our acquisition cost ratio increased modestly by 0.4 point, compared to the same period in 2015.

Our reinsurance segment's ratio increased to 26.1% due to the impact of retrocessional contracts, an increase in the amount of business being written on a proportional basis, together with slightly higher acquisition costs associated with certain lines of business. In addition, the 2015 ratio included the benefits of fees from strategic capital partners, which are now included in other income or offset against G&A expenses in 2016. Decreased acquisition costs in our insurance segment were driven by the higher ceding commissions following the expansion of our professional lines reinsurance programs and lower acquisition costs for the A&H business, which had a higher loss ratio.

Our G&A ratio for the third quarter was 15.3%, compared to 15.7% in the same period in 2015. While foreign exchange and higher earned premium contributed to that improvement, we continue to see the benefits of expense initiatives that we put in place. That combined with the benefits of strategic capital partner arrangements and lower performance-based compensation have resulted in reduced expenses in the quarter and year-to-date.

Overall, we reported underwriting income of $104 million and a combined ratio of 92.6% for the third quarter. On a year-to-date basis, our underwriting income was $213 million, with a combined ratio of 95.7%. Net investment income was $117 million for the quarter, an increase of $71 million from the third quarter of 2015. The increase was attributable to our alternative investment portfolio and is primarily due to the strong performance of the equity markets, which positively impacted both hedge fund and credit fund performance. We view the nine month results as meeting our expectation for the period.

In aggregate, the total return on our cash and investment portfolio for the quarter was 1.1%, including and excluding the impact of foreign exchange. The total return in the current quarter benefited from the downward shift in the sovereign yield curves and tightening of credit spreads on investment grade and high yield corporate debt. During the quarter, we repurchased an additional $126 million worth of our common shares, comprised of $125 million purchase pursuant to our board authorized share repurchase program and $1 million relating to shares purchased in connection with divesting restricted stock awards. At October 26, 2016, the remaining authorization under the repurchase program approved by the board of directors was $375 million.

Some final comments on our results, I'd like to reiterate our strong underwriting performance this quarter, including continued strong performance by our reinsurance segment and improved performance by our insurance and A&H businesses. In addition, we continue to make progress towards achieving and realizing the benefits of strategic goals that we have discussed with you in prior quarters. In this regard, I would like to direct you to the additional disclosure we have provided in our financial supplement relating to our activities with our strategic capital partners, including details of premiums ceded to Harrington Re by our reinsurance segment as well as details of fee income generated.

Finally, we would like to take this opportunity to provide you with an update on Hurricane Matthew. While it is still early days, we currently expect our after-tax net losses in the range of $45 million $60 million related to Hurricane Matthew. Industry losses for the event range from $3 billion to $7 billion. The wide range is indicative of the recent nature of the events and the significant flood element, which is not considered in all industry estimates.

We have exposure in both our insurance and reinsurance segments. Our estimate of insurance losses are heavily influenced by expectations of loss from commercial flood coverages, primarily in the Carolinas. Our estimate of loss from our reinsurance segment primarily derived from cedings in Florida, where losses may arise from lower layers of reinsurance programs. Overall, accessory is underweight, the sources of loss expected for the reinsurance market and our estimates are indicative of this.

And with that, I will turn the call back over to Albert.

Albert A. Benchimol {BIO 2023727 <GO>}

Thank you, Joe. Turning to market conditions, they remain very competitive and challenging, but we also believe we are seeing signs that corrective action is starting in some lines that needed and the pace of rate reductions is generally declining. We're not predicting an immediate recovery, but more of an approaching stabilization. For example, our insurance rates on average were down 3% overall for the quarter as compared to down 4% in both the second quarter of this year and the third quarter of 2015. Casualty lines in the U.S. were the strongest, particularly in wholesale markets with positive rate change in the mid-single digits. Professional lines are flat to down modestly and property related lines down in the mid- to high-single-digit range. While international specialty lines remained weakest with reductions often in the double-digit category.

Overall, market conditions were best for us in our U.S. division with rates flat on average in the quarter, as positives in casualty lines were offset by reductions in property. This compares to market rates that were down 2% in the second quarter this year and down 4% in the third quarter of 2015. We are managing our insurance activities to optimize outcomes under these conditions, emphasizing service, responsiveness and claims management as our key differentiators. We're targeting risks that remain attractive, pushing for greater balance in our portfolio and shrinking of those areas where we are not satisfied with the risk-adjusted returns.

Our insurance segment gross premiums written in the quarter were up 12% over the prior year on a constant currency basis. Over half of that increase came from our accident and health operations, where we consider to build the scale that will allow us to deliver consistent profitability. The remaining insurance business was up 5% as growth in property, professional and liability lines more than offset reductions in marine and energy, terrorism and aviation as well as our last year's exit from the Australian retail markets. Our risk appetite, which continues to be increasingly data driven, continues to deliver a portfolio comprised of more small to mid-size business, lower net lines, lower volatility and improving profitability metrics.

Moving onto reinsurance, the major themes in the market remain the same as in recent periods, as we consider to see competition across most lines and geographies. However, as we've discussed with you in recent calls, we're observing a number of positive indicators. We've begun to see pockets of resistance to further softening in rates and terms. In particular, recent quarter share renewals has difficulty increasing ceding commissions and we are seeing with slowing rate reductions and excessive loss placements driven by abundant market capacity and generally good underlying experience.

Nevertheless, we also see some large seasons becoming more opportunistic in their buying behavior, which will require our underwriters to continue to demonstrate smart and disciplined underwriting. The talk at Monte Carlo, CIAB and currently in Baden Baden indicate that reinsurers are more intent on holding the line. The next few weeks will be telling.

We continue to enhance our position in the reinsurance markets, getting closer to our cedings, providing a broad set of solutions to help them succeed. We're managing macro cycles across portfolios, while expanding our products and opportunity set, including mortgage insurance, where we're off to a good start and expect to see positive contribution in 2017. We are observing a number of our clients continue to view reinsurance as a vehicle to strengthen their capital position via risk transfer. This is especially true with certain insurers subject to Solvency II.

Our team is working to provide unique and tailored solutions for each client. There also continues to be a trend across reinsurance buyers to consolidate programs across lines of business and geographies and often smaller panels. We believe these trends will bode well for our client centric approach, delivering a full spectrum of reinsurance solutions.

Overall, we are pleased with the progress we're making and the cornerstones of our accessory strategy. Getting closer to the customer, utilizing analytics to improve the portfolio and accessing multiple sources of capital and distribution. As announced earlier this year, we established Harrington Re, a new Bermuda-based reinsurance company sponsored by AXIS in partnership with the Blackstone Group. We've begun to place risk with Harrington Re, which represents the latest installment in our strategic capital partnering activities. Harrington is a vehicle through which we match a longer duration asset portfolio with medium to long-tail business.

This transaction is an integral part of our larger alternative capital strategy, which is designed to match the right risk with the right capital. In this context, we view Harrington as a great opportunity to share premium where the asset portfolio can be better aligned with the underlying risk. It represents a win for all stakeholders involved. For us, Harrington Re provides first a broader platform to underwrite risks, support key clients and grow relationships with our clients and distribution partners; second, capital flexibility through a permanent and growing capital base; and third, additional fee income through over rise in (23:02) profit commission. It's an important part of our strategy to assemble a broad portfolio of third-party capital partnerships, and over time, we will look to increase the portion of our business that we share with our partners.

In conclusion, we're pleased to see the continued improvements in our operations and results, demonstrating our progress and further strengthening AXIS' position as a leader in specialty insurance and reinsurance. Our path forward remains organized around delivering a differentiated value proposition, characterized by underwriting expertise, responsiveness, creativity and outstanding claims service, a risk appetite and portfolio construction informed by disciplined application of data and analytics, a solid balance sheet, complemented by a broad team of high-quality capital partners and an effective platform staff for professionals who are among the best in our business. We are encouraged by recent metrics and committed to execute the strategy to position AXIS as a stronger, more profitable company, providing outstanding products and services to our clients, rewarding careers to our employees and superior returns to our shareholders.

With that, let's open the call for questions. Operator, please open the lines.

Q&A

Operator

The first question we have will come from Jay Cohen, Bank of America. Please go ahead.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

Yes. Thank you. Two questions. I guess first on Harrington Re, with Harrington, you mentioned one of the benefits is capital flexibility and not just Harrington I guess, but your other capital partners, third-party capital partners, should we expect because of that flexibility, buybacks to remain above earnings as we've seen over the past year or so?

A - Albert A. Benchimol {BIO 2023727 <GO>}

I think in that area, we are always responsive to the opportunities that we have and so if there is an opportunity to grow for and utilize more capital than is released by third-party capital partners, then we won't do that. If we find that there is less opportunity, then certainly we would. To that effect, Jay, our track record with regard to capital management I think is among the best in the industry, we've been increasing the efficiency of our capital through lowering the volatility, which as you know is very capital heavy through the growth of third-party capital partnerships and through the way that we have changed our portfolio and we will continue to do that. But I think our view is obviously there is an opportunity to grow capital at a strong return for our shareholders. That would be our preference, and if not, we will reduce the equity that we have if we can't use it, but we will continue to grow third-party capital as a percentage of our overall capital that is utilized to support the risk that we produce.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

That's helpful, Albert. And then I guess also on Harrington, the fees that you generated, really two step question. How do you determine what percent of those fees come in the form of fees and what come in the form of offsets to expenses? And then the second part of that question is, can you give us some advice on how to model those fees going forward?

A - Albert A. Benchimol {BIO 2023727 <GO>}

I could try. So, the way we look at it is that those revenues that are overwrite specifically tied to the premium that we are generating, we view those as appropriate to offset against our G&A expense. Those components that are more volatile and responsive to profitability, profit shares and so on, we think belong in other income, and that's generally the way we look at it and this is something that we're doing, not just for Harrington, but for the totality of third-party capital. And in fact we are unlikely to provide any details about those because they are a portfolio of third-party capital partnerships, so you will get a consolidated number. Historically, I think it's going to be approximately two-thirds of the fees are going to be considered offsets to G&A and a third are going to be considered in other income, but again the other income number is likely to be more volatile, because it really depends on profit commissions and performance, which by definition, will move around up or down based on actual activity.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

Got it. That's very helpful. Thanks, Albert.

A - Albert A. Benchimol {BIO 2023727 <GO>}

You're welcome.

Operator

Next we have Elyse Greenspam of Wells Fargo.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Hi, good morning. First on Harrington Re as well, there was about $100 million sourced for them in the quarter, I believe you guys said that they were going to be writing about a 0.25% to 0.3% premium for surplus. Was there an element that we saw higher premiums this quarter since this vehicle was launched later in the year? I guess how do we just think about the premium reduction for that vehicle as we go into 2017?

A - Albert A. Benchimol {BIO 2023727 <GO>}

That's fair. I think it's particular to our own accounting standards in which we recognize all of the written premium upfront. I know that on quota shares, there are some companies that choose to recognize the quarterly amount in each quarter. We recognize the production on day one and then setup a UPR and then earn it over the period, which is by the way why our accounting for multi-year treaties has generated a perceived increase in our gross written premiums compared to some others, because others are not recognized in other premiums upfront and we are. So what you're seeing is the totality of the written premiums that are expected to be earned over the next 12 months in the quarter. So it's not a quarterly number. It's the upfront number. We continue to anticipate that on an annual basis, we will cede to Harrington somewhere in the area of a quarter to a third of their capital. So that has not changed.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay, thank you. And then in terms of the reinsurance premiums also, you guys mentioned about $51 million due to timing in the quarter, when should we see, was that renewal shifted to another quarter, how should we think about that for modeling purposes?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Well, we kind of explained that in the first half of the year, we still view that the growth that we were showing was accelerated by some timing factors by the end of the year, it would balance out. And so what you're seeing here is really the other side of the growth that we showed in the first half of the year. So we always indicate that our growth for reinsurance for the full year would not be at the level indicated in the first half and this is what you're seeing.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay, great. And then just kind of more high-level margin question, year to date, your underlying margins have been about flat overall with last year, some improvement in insurance and reinsurance, what about a year into the margin improvement plan that you guys laid out at this time last year I guess. Are you where you kind of thought you would be on an overall basis and by segment, and then given the still competitive insurance and also reinsurance market, and I know you are making still some shift in your business mix, but how do you think about the level of margin improvement you can see between now and the end of 2017?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Actually, we are very pleased with the progress that we have, and as I said, the measures that we are following are giving us the right details. So I know that Joe will provide some additional details with regards to mix of business, but let me tell you the way I look at it. Each of our three businesses is doing better year-over-year than we had, and I know that the insurance numbers have been affected by a mix of business with regard to A&H, but let me give you some additional color. The combined ratio for A&H is down 4 points in the third quarter, versus the third quarter of last year, down 5 points year-to-date versus '15. However, the mix of business in A&H changed, and therefore, there is a higher loss ratio there. And overall, by the way, the A&H loss combined ratio is higher than the insurance combined ratio. And since A&H is now a bigger part of the premium base of insurance, it's had a mix impact. So A&H is doing better.

If you look at insurance, excluding A&H, the loss ratio ex-cat for the current calendar year is flat. The combined ratio ex-cat for the current calendar year is flat for the quarter and on a year-to-date basis, it improved by 2 points. So, we're comfortable with the fact that insurance is also improving on a going forward basis. Reinsurance is optimizing the portfolio in a difficult market, it's doing all the right moves with regard to the shift in the portfolio, with regard to the use of third-party capital, and here again, we're comfortable with the improvements that we've seen in A&H. So each of those three numbers as far as we are concerned show very good progress. The mix of business is what's causing some of these ratios to look at different and, of course, as we are also growing more fee business, which is improving the results, that contribution from the fee business is not making its way in the combined ratio. So, the combined ratio is also not reflecting the full improvement that we're doing in our operations as reflected in the fees.

A - Joseph C. Henry {BIO 13390626 <GO>}

Elyse, it's Joe. The only thing I would add to that is that, if you wanted to get into specifics of the insurance current accident year loss ratio, ex-cat and weather, it was 62.8% in the quarter, it was 60% a year ago. Of that 2.8 point increase, 2.5 points relates to the mix issue that Albert just talked about for A&H. If you want to look at rate and trend within the insurance segment, it's about 1.8 points of a headwind this year. On reinsurance, it's about 0.7 point and the fact that we've held our ex-cat and weather loss ratios on a year-to-date basis where they are (34:06) even with what I just referred to with respect to A&H is reflective of the progress that Albert was just referring to.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay, that's great. And then just one last question, we've seen a little bit of heightened M&A activity in the space of late. If you can just give us a little bit of an updated view on what type of transactions you might consider for AXIS?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Well, first and foremost, our strategy is based on organic growth, organic development, new business generation and continued improvement in our mix of business, and that has to be our core strategy. And I'm pleased with the way we're executing on that. Obviously, every company receives business from bankers with big books with every single possibility around, we, of course, listen, but beyond that, I am not sure it's appropriate to discuss the conversations that we're having.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. That's great. Thank you very much.

Operator

Charles Sebaski of BMO Capital Markets.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

Good morning.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Good morning.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

I guess the first question on just some clarity to understand the fee income, why is the offset to G&A as opposed to sort of as a ceding commission overwrite, which would come through the acquisition expense ratio, why isn't that being captured in the reinsurance division as all other reinsurance would be?

A - Joseph C. Henry {BIO 13390626 <GO>}

Yes. Charles, it's Joe. So last year, as you know, we offset those types of fees against our acquisition costs. This year, when we implemented Harrington Re, we took a hard look at how we were accounting for the costs and just said it would be a better representation to offset them against the actual expense that we were incurring. So, we have underwriting fees. We've got overwrite fees. We've got management fees. We've got profit commissions, performance fees. There are lot of different type of fees and frankly, we just went through all of them and determined that part of them would be better off shown as other income. So it really is just reflective of a new view and, in fact, a more accurate view of where the original expense is incurred. So we reflect, if you will, the offset against those specific line items. And as Albert said before, about two-thirds of those, we would expect to be offset against G&A going forward and about one-third of them would be other income in our income statement.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

All right. Next is on the accident and health, Albert, I think you mentioned that you kind of said in our three businesses and I think highlighting that accident and health is kind of a third business, yet it's incorporated into the operating results of the insurance business and you kind of gave some detail that was helpful on the performance there and what insurance would look ex-A&H. If it's a third business and you want us to look at it ex-A&H, why wouldn't that just be stripped out, like why don't we have a third operating reporting line that we can just see and track actual A&H business and then insurance as insurance?

A - Albert A. Benchimol {BIO 2023727 <GO>}

That's a good point. It's a materiality issue and certainly always was expected that once it reached a certain amount of materiality, it would be appropriate to split it out. So, I think it's simply a question of time and scale.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

All right. I guess finally on currently what you guys are doing, I guess in the quarter and what you're seeing here in the fourth quarter, what would you say that the current accident year, what are you writing business at in current accident year ROE perspective, I guess maybe on an allocated capital basis? Obviously, the operating ROE and ROE were really strong in the quarter, but there is a lot of things that went on favorable development. I guess, what the current writing, where are you thinking or would you ballpark the current underwriting?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Yes. I think we've given that indication before and we believe that the current year is generally written in the mid-to-high single-digit ROEs, which is where we continue to see the 2016 business being written.

Q - Charles Joseph Sebaski {BIO 17349221 <GO>}

Okay. Thank you very much for the answers.

Operator

Next, we have Meyer Shields of KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Good morning. Albert, one big picture question. I think you're clearly doing the right thing with Harrington Re, but I'm wondering in your view, how vulnerable is medium or long-tail pricing, medium or long-tail lines pricing to the introduction of alternative forms of capital compared to what happened to property cat rates?

A - Albert A. Benchimol {BIO 2023727 <GO>}

I think that there are two components to it, one is supply and demand and the other is the – of capital pursuing any kind of business and the other is the ultimately is the right price because whoever provides the capital at some point is still going need to be paid for their fees and their expenses and the claims that go forward. And whether that capital is alternative or industry capital, interest rates always have a significant impact because long-tail losses are obviously generate over time more investment income. And so, we've always had this allegation of or this connection between available investment returns and available – and the pricing on casualties. So, I think those things don't change.

My view on this is that whether we like it or not, there is going to be a growing amount of third-party capital in the industry and the successful companies are going to be the ones that make money in whatever market conditions result, as a result of the capital conditions and optimize their sourcing opportunities and their portfolios in the best way possible. I tend to believe that because of the capital that there is out there, we're going to have less of the old cycles of up and down. And so people who just wait for the pricing to improve to make money may wait a long time. I think we need to make money under the current market conditions, and at AXIS, that's what we're doing. We are organizing ourselves, we are selecting the right risks and we're building portfolios that will make money in the current market conditions.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, thanks. That's really very helpful. The second question just with regards to the insurance segment makeshift, does that have any implications for either trend or capital requirements?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Well, A&H, as you know, requires a lot less capital than the insurance, the rest of the insurance line, the property casualty insurance line, which is why it delivers a very acceptable ROE or even better – a very attractive ROE even with a higher combined ratio than you would have in the normal P&C business. And again that's why sometimes it's difficult when we think of an ROE perspective from an outside perspective to look at a higher combined ratio, the initial reaction to a higher combined ratio might be that this is negative. But if that higher combined ratio is attached to a lower capital requirement, you can actually achieve a very ROE, which is why we are very pleased with the development that we've seen in the quarter and the year-to-date notwithstanding the fact that it had at a modest negative impact from the insurance combined ratio.

Q - Meyer Shields {BIO 4281064 <GO>}

And on the loss trends?

A - Albert A. Benchimol {BIO 2023727 <GO>}

I think the loss trends are going to be dependent on the individual line, I think we follow those for the moment. We don't see any significant difference in the loss trends that we see across most of our lines.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Fantastic. Thank you so much.

Operator

Next, we have Amit Kumar of Macquarie. Please go ahead.

Q - Amit Kumar {BIO 16979665 <GO>}

Thanks, and good morning. And congrats on a good quarter. Just a few follow-up questions. The first question I have is on the level of reserve releases. I was wondering if there was any release which came from a prior large loss or large cat.

A - Albert A. Benchimol {BIO 2023727 <GO>}

No, Amit, for the most part, this is normal releases from '14 and '15 accident years and shot-tail lines property and marine and older actions years 2015, I'm sorry 2010 and prior on the longer-tail lines, nothing unusual in the release themselves. As I mentioned in the script, it really came from all lines of business in both segments and for the most part from our all accident years. So there is no unusual item in the reserve release itself.

Q - Amit Kumar {BIO 16979665 <GO>}

Got it. That's helpful. The second question I had was again going back to the discussion on Harrington. I think the capital was 600 million at that time, you had said that you look at adding to the capital down the road and maybe do other things. Has that thought process changed or are we just looking at the 600 million for now and any other additions in 2017? Can you just update on that front.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Currently, the capital of Harrington is 600 million which we consider very satisfactory for what we need right there right now. My response from the Harrington and frankly on all of third-party capital is, we'll file these things over time as they are necessary. We will continue to increase the amount of capital that we partner with but not necessarily with Harrington.

Q - Amit Kumar {BIO 16979665 <GO>}

Got it. That's helpful. The third and final question and maybe this ties Harrington to Elyse's question on size. Earlier today, we were discussing the same thought process on other conference call as to what level of size makes a difference. I recall at Monte Carlo you had made a statement that you would look at anything into 3 billion to 5 billion range in terms of partners. Has that thought process changed with sort of Harrington picking up speed or is that the same thought process as we head into 2017?

A - Albert A. Benchimol {BIO 2023727 <GO>}

I think that that caused the – that interview and article I think we're taking things out of context. I went back and re-read the article, and again, it was very clear that what I said was that our strategy is focused on organic growth and that continues to be what we want to do.

The question was what kind of size would a company like AXIS, what kind of size or an acquisition that on a theoretical basis, I said well given our size, given our capital, these are the things that we theoretically could do and that was not an indication that we were planning to do an acquisition of that type and other than a theoretical question that if AXIS were to make an acquisition what kind of size acquisition would be comfortable for AXIS? But I repeat the core statement that I made in that interview which is that our strategy is based on all kind of growth, recruiting new teams, developing our staff, opening up new markets and lines of business. We are of course going to review the various options that are available in the market, but our strategy is an organic one.

Q - Amit Kumar {BIO 16979665 <GO>}

Got it. That's actually very helpful. That's all I had. Thanks for the answers and good luck for the future.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Thank you.

A - Joseph C. Henry {BIO 13390626 <GO>}

Thank you.

Operator

Next we have Ryan Byrnes of Janney.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Great. Thanks, Good morning. Most of mine have already been taken, but I just had one. When you guys were talking about focusing on organic growth going forward, we can't really dig into it, but I just want to get your thoughts on your launch of your Lloyd's platform. Obviously, it's been a pretty tricky market over there the last couple of years, but just wanted to see why that is and where do you think that can get to in maybe the next, I guess, three years to five years.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Thank you for that. And as you know, we started the Lloyd's platform about two and a half years and the reason for that fundamentally is that we wanted to be able to leverage the licenses that Lloyd had all over the world and to also see some business that we were not necessarily seeing. We don't think of Lloyd's as a separate business. We've always had a large international business out of London. And in fact, a lot of the growth that we saw at Lloyd's was really our transferring our own business to the Lloyd's platform and we also have seen some new business opportunities.

So when we think about what we're doing internationally, we are not going to be reporting or talking about Lloyd's as a separate business, but simply talking about it in the context of our international specialty lines, which use a number of distribution channels including branches and balance sheets in Ireland, in Singapore and elsewhere in the world. Lloyd's should be really viewed as a very efficient use of regulatory licenses.

A - Joseph C. Henry {BIO 13390626 <GO>}

Ryan, the only thing I'll add to that is just for the record here. We've written about $120 million in business through nine months in Lloyd's. And as Albert said, we've seen some new business. Approximately $20 million of that 120 is business we haven't seen before.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Got it. Great, I appreciate that.

Operator

The next question we have comes from Kai Pan of Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning. Just a follow up on the question on the reserve, we have seen some slowing reserve releases or some taking reserves charges on the primary care side. I just wondered how closely are you with your cedents, and because you have very strong reserve leases in the past and I just wonder do you see any sign that it would cause any concerns?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Short answer is no. We obviously spend – and you're referring here to the reinsurance, I believe, since you're talking about our cedents.

Q - Kai Pan {BIO 18669701 <GO>}

Yes.

A - Albert A. Benchimol {BIO 2023727 <GO>}

We do, as part of a normal monitoring of our business as part of our every renewals, we go back, we evaluate the conditions, the underwriting, the book of business, we're very satisfied that we have the right understanding or the right reserving for the books of business that we write. You can rest assured that when we see individual companies either reduce their reserve releases or take a charge, the first thing we do is go and identify if something that we had already booked for or if not are we on the account. I can tell you that its part of our normal process and, to-date, we are very comfortable with the way we are staying on top of our business.

Q - Kai Pan {BIO 18669701 <GO>}

That's great. Thank you so much.

Operator

Ian Gutterman of Balyasny.

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

Hi. Thanks. Just wanted to follow-up a little bit on some of the insurance growth and just get a little more context. The growth in the property business, I think you said it was London, can you just talk a little bit more about what that is and, I guess, I would've thought London property would be pretty tough business right now.

A - Joseph C. Henry {BIO 13390626 <GO>}

So, Ian, two things. One, we have a MDA operation basically in London. It started up a couple of years ago with Lloyd's and we've added resources in that area and, frankly, we've just seen better opportunity. So this is just natural growth of an initiative really started up two years or three years ago.

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

Okay.

A - Albert A. Benchimol {BIO 2023727 <GO>}

I would add Ian that this is very consistent with going after smaller insureds and smaller accounts. And so, in fact, your absolutely correct in expecting that for the large accounts that are most at risk to the rate pressures, we've seen reductions in that area. But you've also heard that we were shifting our book of business to smaller accounts that were less prone to the competition that were less volatile and we're seeing that and we're pleased with the progress that we're making in the transition of our property book to smaller insureds, smaller lines and less volatility.

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

(51:42). And then on A&H growth, did you – maybe I missed it. Did you say how – was that sort of the core insurance clients growing or was there was a big reinsurance component to that?

A - Joseph C. Henry {BIO 13390626 <GO>}

It's actually mostly reinsurance in both our international operation and our US operation, Ian.

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

Okay.

A - Joseph C. Henry {BIO 13390626 <GO>}

We've done some additional business in the Middle East and, frankly, we've written some new business in the U.S. on the reinsurance side, most of it is coming on the reinsurance side.

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

Got it. And then on Harrington, I'm looking at, I guess, its page eight of the supplement where I think that's a newer slide about strategic capital partners and it looks like essentially everything your ceding out of the reinsurance segment either shows Harrington or other strategic partners. Can you sort of explain first what does other strategic partners mean? Is that other third-party capital and am I right adding this all up that basically you're not buying any retro, I guess, if you will from any traditional company that is all either a partner or Harrington?

A - Albert A. Benchimol {BIO 2023727 <GO>}

That's very observant of you. What you see on that slide is only people with whom we have an underwriting relationship and we share our risk with them. We do have other retro that we purchased, but that is not reported on that page. It's reported in the sessions, I believe.

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

Okay. I just want to add it up. I think the net premium you showed here were equal to the net premiums for the reinsurance segment, so it looked like it was 100% of it.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Okay I'm sorry, but that's my mistake.

A - Joseph C. Henry {BIO 13390626 <GO>}

It's not a large piece of it though, the other normal retro business that we do.

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

Got it. Okay. And then just to clarify Elyse's question earlier, obviously, you said you booked the quarter's share upfront, so we shouldn't expect it to spread out for this quarter, but was there sort of upfront, bigger than normal quota share session this quarter because you're getting started and we shouldn't expect $100 million going forward the next two (53:47) quarters, because of their capacity. I'm trying to guess how much bigger than normal this was with just sort of an upfront load to it?

A - Albert A. Benchimol {BIO 2023727 <GO>}

My recollection is that there's both a small amount of retro but not much to it. I think the way to look at it is on an annualized basis. When you think about the annual premium that we're ceding to Harrington to be about 25 to 30% of their capital and what you're seeing here is what we've got for the six months reflecting what we're going to need to do for the year. You should not expect that there would be a similar amount in the fourth quarter because most of those contracts were written upfront. These are quota share contracts so they tend to be recognized upfront. There may be a small amount in the fourth quarter, but you'll see those - the written numbers being very front-loaded and then those written premiums being earned over a period of time.

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

And maybe let me word it a little bit better. I worded that poorly. If I think about what I think the annual session to Harrington will be, should it be about that divided by four each quarter or is it going to be biased towards Q3 and Q1 when the book of normal renewals are? Just wanted to model it better.

A - Albert A. Benchimol {BIO 2023727 <GO>}

No, I would suggest that if we're saying that 30% of $600 million, you're thinking about an annualized number of $200 million of written premium. And depending on when the contracts are written, it might differ by quarter, but they should add up at the four quarters on a 12-month basis to be around that number. It will be less than that, of course, for 2016 since we only launched Harrington half year.

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

Yeah, of course. Yeah, I just wanted to make sure it wasn't - in that $200 million example it wouldn't be $50 million per quarter if we should think of sort of normal seasonality of reinsurance ceding and do more in Q1 and Q3 and less in Q2 and Q4. It's okay. I can follow up off-line.

A - Albert A. Benchimol {BIO 2023727 <GO>}

No, that makes sense.

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

Okay. Perfect. Thank you.

Operator

Next we have Michael Nannizzi with Goldman Sachs.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Thanks so much. Most of my question's been answered. I guess I had one maybe part industry part AXIS question on reserving, if I could. So, if I look at more of your underwriting income is reserve development this year versus last year and, overall, development is up in notional terms as well for a lot of folks as someone comments had indicated on the call, we've seen development trends slower – favorable development trends slow.

I would look at the more recent accident year for the industry, they don't look as good as the older years did a few years out and there haven't been that many property losses at least in the last few years, which has been good for accident year results. And then, when I look at your results for the last few quarters, generally, at least relative to my estimates, they've come in a bit light, pricing is not improving, which would seem to imply that future earnings altogether are becoming more reliant on development at a time when these industry trends don't look great. So, I'm just trying to square all that together and maybe there are something about your book that's a little different or something that I'm missing there just in terms of how you're repositioning. So if you could help me sort of square those things that would be really helpful.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Mike, if you don't mind, I'll ask you to kind of restate your question. There was a lot in what you said and I'm not sure how much of that was an observation versus question. If you would reframe a question, I would be happy to answer it.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Sure. So, if reserving trends are becoming less favorable and your earnings are more reliant on reserve development, can you give us some indication of your comfort that those reserving trends are going to continue to come through and, if so, I guess from where, given that that would sort of imply that would be sort of different than the industry overall?

A - Albert A. Benchimol {BIO 2023727 <GO>}

Okay. I guess I would take exception to the fact that our earnings are dependent on reserve development. I think that what you're saving with regards to AXIS, I can't speak for anybody else, is our reserving philosophy. We've always said that no matter what the estimate is in any one year we will book a higher number than that because we think it's the prudent thing to do.

And the reserve release - and we've also said that we would take bad news early and that we would be slow in releasing good news. That is our philosophy. It's been consistently applied for a long time. One of the results of the strategy is that if you only compare current year results and by definition we are going to book a higher number than the industry, that's not that we're less profitable, it's that we choose to book a higher number than the rest of the industry in the current year results. We will be consistent.

The second issue is that as far as we're concerned, reserve releases are simply a question of timing of profits. It doesn't create profit. The profits are created on the day that you underwrite the policy. And what we choose to do is to simply recognize some of that profitability in the current year and wait until we are more sure of the result to recognize the balance of it. And so our strategy and our approach to reserving by definition will mean that if we do it consistently, there should be reserve releases going forward.

Now, there are two components to reserve releases. The first is what is the midpoint of the actuarial estimate and the second is what are you booking above the midpoint of the actuarial estimate. In the absence of change in the actuarial estimate and then whatever you book above the midpoint of the actuarial estimate should come down over time as the reserve releases. The change in the actuarial estimate up or down is another component of the change. And I would say that for most of the industry, most of which you have seen in reserve releases, is that change in the midpoint.

There may be other companies that book more than the midpoint. I can't speak to that. But I will tell you is we have two components to our reserve releases. One is the change in the midpoint and the second is the release of that additional number that we chose not to take on day one. Our strategy should result in a more consistent pattern of releases, but, of course, there is no guarantee of that.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Okay. Thank you so much.

Operator

Well, at this time, we're showing no further questions. We'll go ahead and conclude today's question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

A - Albert A. Benchimol {BIO 2023727 <GO>}

Thank you very much for participating in our quarter. We're obviously very pleased of the improvement in our performance. We're especially pleased of the large growth in our book value in the quarter and year-to-date. And we look forward to reporting to you further progress as we move forward. Thank you.

Operator

And we thank you, sir, also and to the rest of the management team for your time off today. The conference call has now concluded. At this time you may disconnect your lines. Thank you, take care and have a great day everyone.